annual report 2012

www.bodycote.com | Stock code: BOY

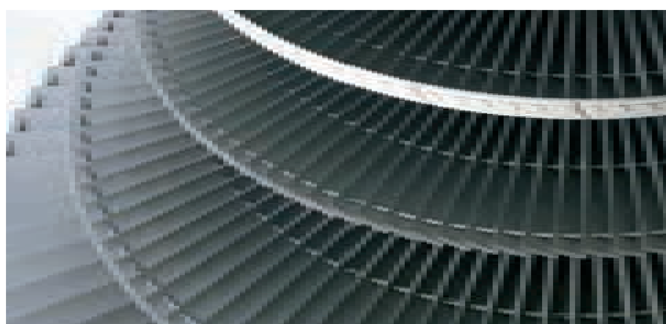
At a glance

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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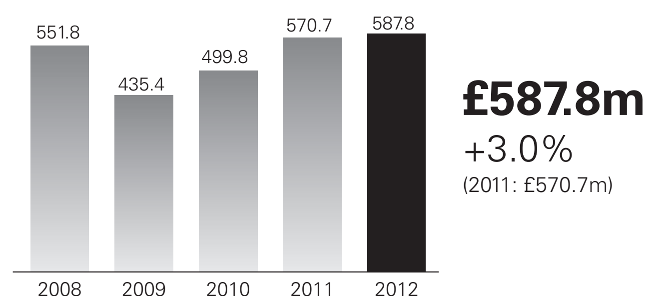
Cover image
This photo-microstructure shows a typical untreated carbon chromium bearing steel with the presence of alloy carbides (carbon compounds). In this case, the presence of alloy carbides can be undesirable as they are difficult to machine (due to their high hardness) but this can be rectified by a normalising or annealing heat treatment, which will break down the alloy carbides into a form which has less effect on machineability and a better response to subsequent heat treatment. Credit: Klaus-Peter Rezsni, Bodycote.

Financial highlights

	2012	2011
Revenue	£587.8m	£570.7m
Headline operating profit[1]	£97.9m	£85.5m
Operating profit	£93.4m	£80.4m
Headline profit before taxation[1]	£94.3m	£80.9m
Profit before taxation	£89.8m	£75.8m
Headline operating cash flow[2]	£110.8m	£96.0m
Operating cash flow[3]	£103.0m	£90.3m
Net debt / (cash)	£34.2m	£(0.1)m
Basic headline earnings per share[4]	37.4p	32.7p
Basic earnings per share	35.8p	30.0p
Dividend per share[5]	12.3p	10.9p
Return on capital employed[6]	19.5%	16.9%

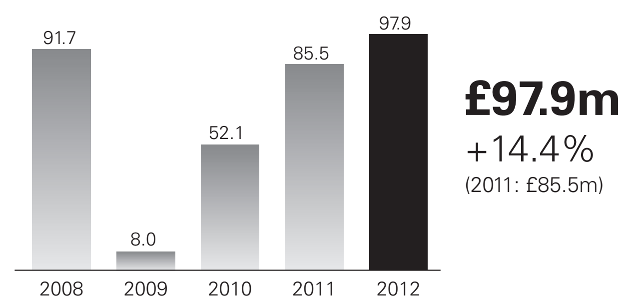
1 Headline operating profit and headline profit before taxation exclude acquisition costs of £2.5m (2011: £nil), reorganisation costs of £2.4m (2011: £nil), profit on disposal of investment of £2.4m (2011: £nil), amortisation of acquired intangibles of £2.0m (2011: £0.9m) and impairment charges of £nil (2011: £4.2m).
2 Headline operating cash flow is defined as operating cash flow stated before cash flow relating to restructuring of £5.3m (2011: £5.7m) and cash flow relating to acquisition costs of £2.5m (2011: £nil).
3 Operating cash flow is defined as cash generated by operations of £150.7m (2011: £134.8m) less net capital expenditure of £47.7m (2011: £44.5m).
4 A detailed reconciliation is provided in note 9 on page 74.
5 See note 8 on page 73.
6 Return on capital employed is defined as headline operating profit of £97.9m (2011: £85.5m) divided by the monthly average capital employed of £501.1m (2011: £505.2m). Capital employed is defined as net assets adjusted for net debt / (cash).

Revenue - continuing operations
£m



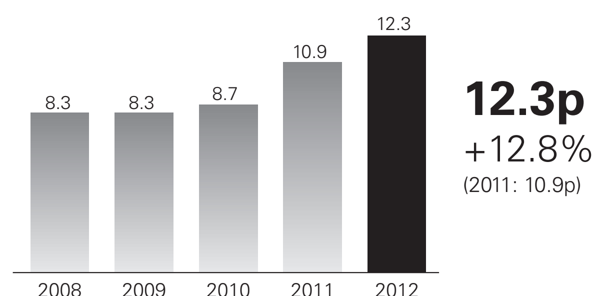
£587.8m
+3.0%
(2011: £570.7m)

Headline operating profit
£m



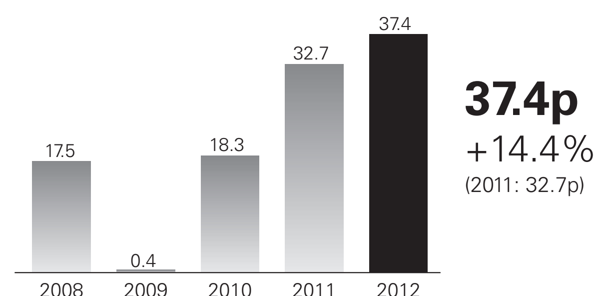
£97.9m
+14.4%
(2011: £85.5m)

Dividend per share[5]
Pence



12.3p
+12.8%
(2011: 10.9p)

Headline earnings per share[4]
Pence



37.4p
+14.4%
(2011: 32.7p)

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

Customer focus

- Bodycote is focused on continual improvement of our quality of service and takes an active role in finding solutions to technical issues and promoting mutual business development with our customers.
- Bodycote seeks to secure long-term agreements and strategic partnerships with our customers which are often exclusive in nature and embody protection and relative freedom from risk, allowing both companies to concentrate capital and other resources on core competencies.

Global network

- Bodycote's global network of over 190 market-focused[6,7] facilities in 26 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[31] and enhances our competitive position in the sub-contract market.
- 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 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.
- Bodycote's scale enables continuous but focused investment, both in the latest processes and in the most efficient and environmentally friendly equipment.

The partner of choice

Service

- Bodycote has become the partner of choice[3] 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.

Creating value

For 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

For Bodycote

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

For investors

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

Superscript numbers indicate references to other pages in the report where further information can be found.

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.

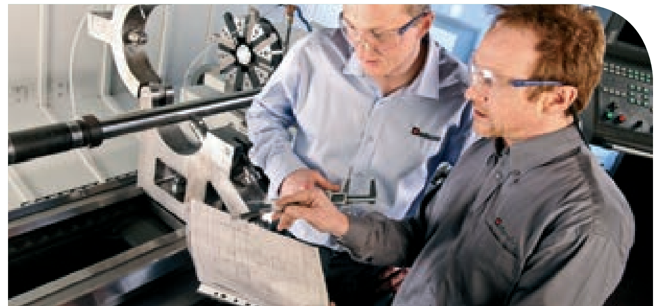
With the largest operational capacity in the world and a wide variety of sizes of equipment, Bodycote HIP is able to accommodate large volumes of small product as economically as large individual components.

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 and sharing knowledge where appropriate. 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.

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, giving full regard to a safe working environment for our employees and minimal environmental impact.

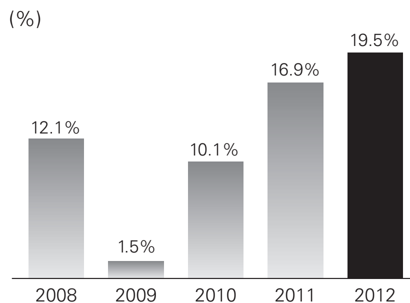
Our strategy is based on the following fundamentals:

- 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 selected 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.
- Expanding with our customers to emerging markets with an emphasis on Eastern Europe, Brazil and China.

Measuring our progress

Return on Capital Employed (ROCE)

(%)



Performance

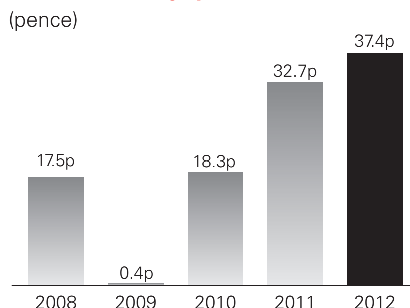
Return on capital employed increased by 2.6 percentage points during the year, from 16.9% to 19.5%. Headline operating profit increased by 14.4% from £85.5m to £97.9m, while average capital employed reduced by 0.8% to £501.1m.

Definition

Headline operating profit as a percentage of the monthly average capital employed. Capital employed is defined as net assets adjusted for net debt/(cash).

Headline earnings per share

(pence)



Performance

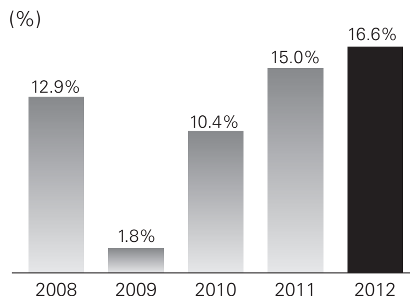
Headline earnings per share increased by 4.7 pence during the year, from 32.7 pence to 37.4 pence. Headline earnings increased by 15% from £60.8m to £70.0m, while the average number of shares in issue remained static.

Definition

Headline earnings per share is defined in note 9 to the Group financial statements.

Return on Sales (ROS)

(%)



Performance

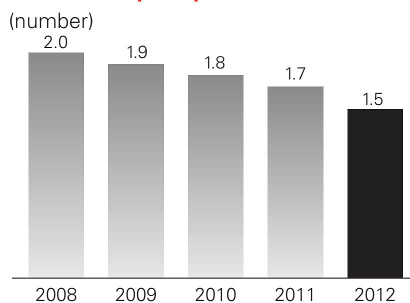
Return on sales increased by 1.6 percentage points during the year, from 15.0% to 16.6%. Headline operating profit increased by 14.4% from £85.5m to £97.9m, while revenue increased by 3.0% from £570.7m to £587.8m.

Definition

Headline operating profit as a percentage of revenue.

Accident frequency

(number)



Performance

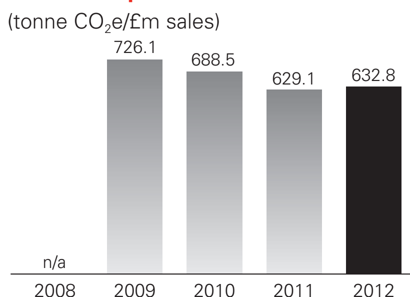
Bodycote works tirelessly to reduce workplace accidents and is committed to providing a safe environment for everyone who works at or visits our locations. The accident frequency rate was reduced to 1.5 (2011: 1.7).

Definition

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

Carbon footprint

(tonne CO_2e/£m sales)



Performance

Excluding acquisitions the carbon footprint decreased by 3.5% from 629.1 tonnes per £m sales to 606.9 tonnes per £m sales. Including acquisitions the carbon footprint increased by 0.6% to 632.8 tonnes per £m sales.

Definition

Carbon footprint is defined as tonnes of CO_2 equivalent emissions, divided by £m revenue. CO_2 equivalent emissions are calculated by taking electricity and gas usage in kilowatt hours and multiplying by country specific conversion factors provided by DEFRA (Department for Environment, Food & Rural Affairs).

Global network

Bodycote is experienced in all major market sectors and is able to combine the capability and expertise of a network of over 190 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 190 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.

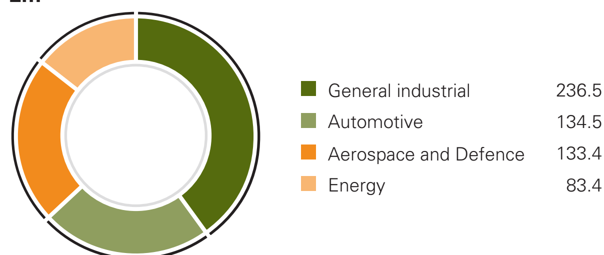
Although Bodycote is headquartered in the UK, 89% of the Group's revenue is derived outside the UK. With facilities in 26 countries, Bodycote is truly global.

North America

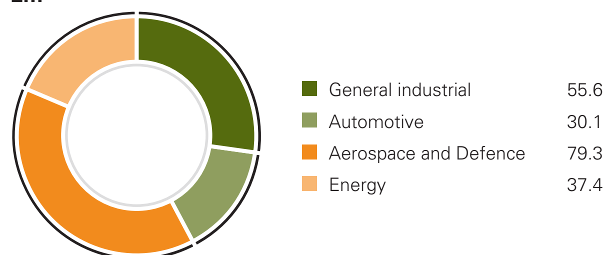
Bodycote is the largest provider of thermal processing services in North America by a significant margin, with a comprehensive network coverage. This network offers locations convenient to customers in all areas where manufacturing and technical industries are concentrated.

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
£m



Revenue by market sector – North America
£m



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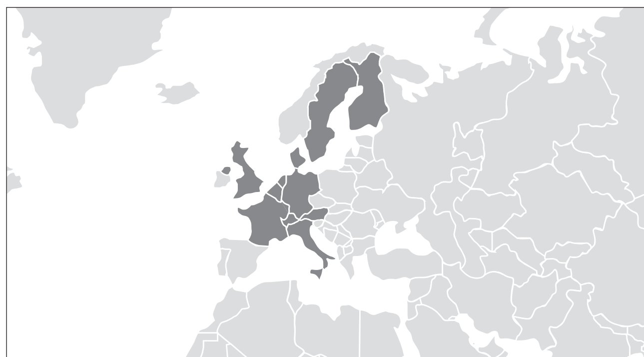
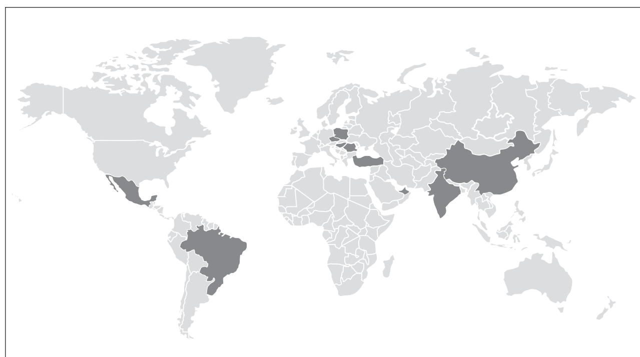
Western Europe



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 range 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.

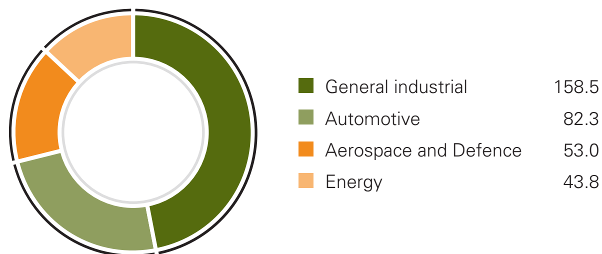
Emerging markets



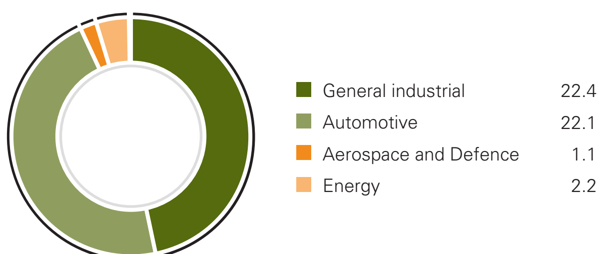
Bodycote has 28 facilities in emerging geographies covering Eastern Europe, China, Brazil, India, Singapore and Dubai.

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.

Revenue by market sector – Western Europe
£m



Revenue by market sector – Emerging markets
£m

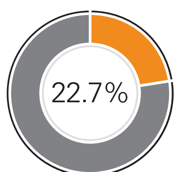


Markets we serve –
Aerospace, Defence & Energy

Aerospace, Defence & Energy

Within the Aerospace, Defence & Energy (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 64 facilities in total.

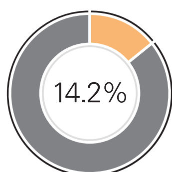
Aerospace & Defence



£133.4m
(2011: £113.6m)

Contribution to Group turnover

Energy



£83.4m
(2011: £72.0m)

Contribution to Group turnover

For further information about the markets we serve go to **www.bodycote.com/markets**

Markets we serve –

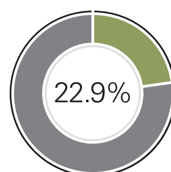
Automotive & General Industrial

Automotive & General Industrial

Whilst the Automotive & General Industrial (AGI) marketplace has many multinational customers which tend to operate on a regionally-focused 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 129 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.

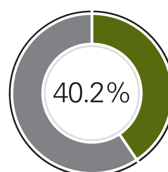
Automotive



£134.5m
(2011: £147.4m)

Contribution to Group turnover

General industrial



£236.5m
(2011: £237.6m)

Contribution to Group turnover

For further information about the markets we serve go to **www.bodycote.com/markets**

Chairman's statement

"I believe that the Group will continue to deliver positive returns in the years ahead. Underpinned by our continued focus upon excellent customer service, strong cash management and the quality of our global workforce, I look forward to the future with confidence."

Alan Thomson | Chairman

Overview

Against the backdrop of a weak economic environment, particularly in Europe, I am pleased to report that Bodycote made further progress in 2012. In line with our strategy to provide thermal processing services on a global scale, we made a number of acquisitions in the USA at a cost of £84.7m. These represent the first portfolio additions the Group has made since 2008. Going forward we will continue to seek out opportunities to expand the Group through a combination of organic growth initiatives in new markets and technologies while seeking to build new plants and acquire new businesses.

Despite the adverse movement in exchange rates, headline earnings per share at 37.4p grew by 14.4%, headline operating margins exceeded 16% and operating profits were fully backed by positive cash generation. The return on capital employed increased to an impressive 19.5%.

Dividend

The Board is proposing a final dividend of 8.3p, an increase of 13.7%, which will be paid to shareholders on 7 May 2013 subject to approval at the AGM. This brings the total dividend for 2012 to 12.3p (2011: 10.9p) costing £23.4m, which is a year on year increase of 12.8%.

Governance

As Chairman, one of my primary responsibilities is to ensure that the Group operates to the highest standards in all aspects of governance and risk management. Our aim within Bodycote is to manage a growing business effectively, while ensuring that proper operating procedures are maintained at all times in each of the 26 countries where we operate. Transparency is central to this objective and you will find more detail about our approach and progress over the last year in the Corporate Governance section starting on page 38. This year's Corporate Governance report now fully reflects the changes introduced in the UK Governance Code (The Code) in June 2010.

A feature of the Board's agenda this year was the commissioning of an externally facilitated review of the Board's performance. While the outcome was favourable, it did provide useful insight enabling the Board to continue its development.

During the year I met a number of Bodycote's major shareholders and received positive feedback from them on their views of the Group. Going forward I will maintain this regular dialogue with our shareholders and look forward to meeting increasing numbers of you at this year's AGM, when there will be an opportunity to discuss the Group's business and achievements.

Board Changes

On behalf of the Board, I would like to thank Hans Vogelsang for his substantial contribution to Bodycote over the last 10 years, particularly as Senior Independent Director and Chairman of the Remuneration Committee. Hans will be retiring from the Board on 24 April 2013 at the end of our AGM. Hans was an invaluable supporter when in 2007 the Board took the strategic decision to dispose of the Testing division which enabled us to focus on revitalising the Thermal Processing business. His wise counsel will be missed.

Following an international search led by external consultants we welcomed Eva Lindqvist, our first female member, to the Board in June 2012. A Swedish national and a qualified engineer, Eva brings a wealth of skills and international experience, particularly of operating in Asia and North America. In addition to serving on the Nomination and Audit Committees she has agreed to chair the Remuneration Committee.

People

Over the past year I have continued to visit our operations around the Group. Following our first business acquisitions for some years in North America, I was delighted by the welcome extended to the Bodycote team by our new colleagues. I continue to be impressed by the commitment and professionalism of our employees and their ongoing desire for the Group to grow and prosper. Our people are undoubtedly our key asset and I am certain that the long-term opportunities for growth mean that our employees will continue to find Bodycote a place where they can enjoy rewarding careers. On behalf of the Board I congratulate them all for delivering another year of successful trading and financial performance.

Summary

As you will read in this Annual Report Bodycote is in very good shape and has once again delivered value in terms of total shareholder return and the Board's recommendation is for a 12.8% dividend increase.

I believe that the Group will continue to deliver positive returns in the years ahead. Underpinned by our continued focus upon excellent customer service, strong cash management and the quality of our global workforce, I look forward to the future with confidence.

A.M. Thomson
Chairman
27 February 2013

Chief Executive's review

"2012 has been another year of good progress. Improving business mix and the part-year benefit of acquisitions have enabled further improvements in performance and enhanced the Group's geographic balance."

Stephen Harris | Group Chief Executive

Trading overview

Bodycote delivered another strong performance in what was a difficult economic environment. Sales growth of £17.1m included a contribution of £22.4m from acquisitions but was impacted by £19.6m of foreign exchange translation headwind. Notwithstanding the difficult trading environment Bodycote continued to demonstrate its pricing power and ability to improve the mix of business, resulting in headline margins[1] increasing to 16.6%.

The Aerospace, Defence and Energy business took full advantage of the strong markets and delivered sales growth of 11.5%, of which 4.2% came from acquisitions, with margins expanding to 26.7% (2011: 21.9%). Progress was particularly pleasing in the Automotive and General Industrial segments. Even though revenues declined by 2.9%, notwithstanding adding 3.8% from acquisitions, margins remained constant at 13.3%, providing continued evidence of the improved resilience of Bodycote's profitability.

Return on capital employed increased to 19.5% (2011: 16.9%) on the back of the higher level of profits and carefully managed net capital expenditure of £47.7m, which was 0.9 times depreciation (2011: 0.9 times). Capital expenditure was lower than expected due primarily to longer than anticipated approval and regulatory processes. Capital expenditure was targeted at expansion of aerospace capacity and greenfield sites in emerging economies together with a focus on specific technologies such as Specialty Stainless Steel Processes (S^3P), HIP Product Fabrication, Corr-i-Dur® and Low Pressure Carburising.

Headline operating cash conversion was once again very strong at 113% demonstrating the Group's commitment to cash generation as a primary focus. Net debt finished the year at £34.2m after spending £84.7m on acquisitions during the year. On 18 February 2013, the Group's €125m revolving credit facility was refinanced to 1 March 2018.

Strategic Progress

2012 marked a year of excellent strategic progress for Bodycote. Our initiatives aimed at improving market focus and increasing efficiencies through deployment of enhanced business processes all worked together to help drive profitable growth. Indeed the expansion of Group margins and growth in ROCE underscores the quality of earnings and resilience of the business.

While there are many examples of the successful deployment of Bodycote's strategy, activities in Brazil and in Eastern Europe disappointed in 2012. In Brazil the currency rose strongly, disrupting Brazil's position in the global supply chain. In Eastern Europe sales dropped, mainly due to manufacturers choosing to sustain their facilities in France and Germany, bearing the brunt of cutbacks in parallel plants in Eastern Europe.

In contrast, the growth in S^3P was very pleasing, overcoming many of the capacity constraints that had hampered this business following its strong growth in 2011. Late in the year capacity was increased in the HIP Product Fabrication business and the benefits should be seen in 2013.

A number of businesses were acquired in 2012. North America has been under-represented in Bodycote, with the business heavily weighted towards Western Europe. Acquisitions in North America were high on the priority list as a result.

In April the heat treatment division of Curtiss-Wright was acquired, adding eight sites to the Group's footprint in North America. One major attraction of this business is its high degree of aerospace and energy work. Three of the acquired sites are located in the Wichita, Kansas aerospace hub, an important centre that previously did not have a Bodycote presence. The remaining sites dovetail very well into the pre-existing North American network.

[1] Headline margin is defined as headline operating profit as a proportion of revenue. Headline operating profit is reconciled on page 15.

In October seven sites were acquired from Bluewater Thermal Processing LLC. Six of these sites constituted the business formerly known as Carolina Commercial Heat Treating, which has a strong competitive position in the so called 'right to work' states of the South Eastern USA. This region, spanning from North Carolina down to Georgia and across to Tennessee, has enjoyed higher than average growth in the USA having been the target for significant inward investment for some time. It is not only benefiting from the arrival of many new foreign companies, but also from businesses that are relocating away from the union dominated north. The fledgling aerospace supply chain that is being established in the region provides a further attraction for Bodycote.

Other acquisitions included a small business comprising three sites in Michigan and Indiana, which was acquired from a private owner on 31 December 2012. They bring to the Group some of the best practitioners of Low Pressure Carburising and sophisticated vacuum heat treating technology in the world and are a welcome addition to the Group.

As we enter 2013 all of the businesses acquired are performing in line with expectations.

Summary and outlook

2012 has been another year of good progress. Growth in our global Aerospace and Energy business outweighed the decline in Automotive and General Industrial markets in Europe. Improving business mix and the part-year benefit of acquisitions have enabled further improvements in performance and enhanced the Group's geographic balance.

2013 has started slowly and we are mindful of the near term macroeconomic environment. Nevertheless, at this early stage in the year the Board expects modest progress in 2013.

Looking further ahead, the improvements made to the business in recent years give the Board confidence that Bodycote will continue to deliver good profits and cash through the business cycle.

S.C. Harris
Group Chief Executive
27 February 2013

Bottle it – a component journey

DOSING DEVICE

There are several important factors influencing the productivity of machines used in the food and beverage industry. Of the utmost importance is cleanliness, not only from microbes but also from external pollutants from machine degradation.

For machines which operate 24/7 with production rates of several thousands of bottles per minute, equipment must perform faultlessly and be able to withstand aggressive wear and cleaning chemicals – Bodycote's Specialty Stainless Steel Processes (S³P) provide the ultimate protection.

The device begins its journey as steel billet. Quality and purity of the steel is critical – it must be free from inclusions to generate a defect free surface.

The device is machined to tight tolerances for shape and surface perfection to ensure no leaks in the equipment.

The device is vacuum annealed to eliminate machining stresses and to impart corrosion resistant properties.

The part is polished to a mirror finish to eliminate any remaining surface defects.

Bodycote's S³P processing is applied to ensure the material can withstand the harsh conditions of high speed production, wear from food and drink, and attack from cleaning chemicals.

End application – food and beverage production

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

	2012 £m	2011 £m
Revenue	**587.8**	570.7
Operating profit	**93.4**	80.4
Add back / (subtract):		
Impairment of goodwill and acquired intangible fixed assets	**–**	4.2
Acquisition costs	**2.5**	–
Reorganisation costs	**2.4**	–
Profit on disposal of investment	**(2.4)**	–
Amortisation of acquired intangible fixed assets	**2.0**	0.9
Headline operating profit	**97.9**	85.5

Group revenue was £587.8m, an increase of 3.0%, of which acquisitions accounted for 3.9%, organic growth contributed 2.5% and foreign exchange rate movements had a negative impact of 3.4%.

Headline operating profit was £97.9m, an increase of 14.4%, of which acquisitions accounted for 6.0%, organic growth contributed 11.0% and foreign exchange rate movements had a negative impact of 2.6%. Headline operating margin increased from 15.0% to 16.6%.

Cash flow is analysed as follows:

	2012 £m	2011 £m
Headline operating profit	**97.9**	85.5
Add back non-cash items:		
Depreciation and amortisation	**50.5**	50.2
Impairment of fixed assets	**0.7**	0.5
Share-based payments	**3.9**	5.4
Loss on disposal of property, plant and equipment	**0.1**	0.7
Headline EBITDA[1]	**153.1**	142.3
Net capital expenditure	**(47.7)**	(44.5)
Net working capital movement	**5.4**	(1.8)
Headline operating cash flow	**110.8**	96.0
Cash cost of restructuring	**(5.3)**	(5.7)
Acquisition costs	**(2.5)**	–
Operating cash flow	**103.0**	90.3
Interest	**(2.5)**	(4.5)
Taxation	**(19.3)**	(15.3)
Free cash flow	**81.2**	70.5

Strong profit growth, disciplined capital spending and working capital control have resulted in excellent operating cash flow of £103.0m (2011: £90.3m). This has allowed £84.7m of acquisitions to be funded, while Group net debt at 31 December 2012 remains modest at £34.2m (2011: net cash £0.1m).

Capital expenditure has continued to be managed carefully. Capital spend (net of asset sales) in 2012 was £47.7m, being 0.9 times depreciation (2011: 0.9 times). There has been a continued focus on cash collection and receivable days at 31 December 2012 are 58 days (31 December 2011: 59 days). Receivables are little changed in the year and a modest increase in inventories (£1.8m) has been more than offset by an increase in payables of £6.4m.

Definitions:

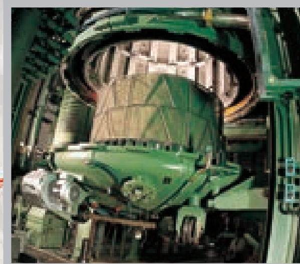
[1] Earnings before interest, tax, depreciation, amortisation, share-based payments, impairment of fixed assets, loss on disposal of property, plant and equipment and exceptional items.

Touch down – a component journey

AIRCRAFT LANDING GEAR

Safety critical landing gear must perform without fault every time the aircraft flies. A combination of thermal processing techniques is used to ensure the steel's material properties are optimised and to protect it during its working life. Traditionally, landing gear has been surface treated using hard chrome plate, but this is now being superseded by more environmentally friendly thermal spray processes, which provide extreme wear and corrosion resistance.

Alloy steel billet is forged to shape.



The part is heat treated to harden and temper the steel.

A thermally sprayed surface treatment is applied to replace hard chrome plate for improved wear and corrosion resistance.

The component is surface machined using diamond tools due to the extreme hardness of the surface finish.

End application – aircraft

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

Markets

Aerospace, Defence & Energy markets

Aerospace and defence revenues improved in 2012 by 17.5% (18.7% at constant exchange rates, of which 13.5% was organic and 5.2% from acquisitions), due to a combination of new contract gains, market share improvement and market demand.

Original equipment sales improved as both Boeing and Airbus continued to increase production rates. Available seat kilometres grew by 3.9% indicating an increase in aircraft flying hours, which in turn drove an increase in demand for aftermarket parts. Sales growth in North America covered most sectors of the aerospace industry but in Europe was primarily due to the supply chain for narrow body aircraft. Sales for engines for wide body aircraft have, as yet, been more muted.

Sales into the defence sector, which account for around 5% of Group sales, were robust with little or no evidence of the downturn reported in the industry finding its way to the platforms that Bodycote serves. Most of the Group's revenues come from the installed equipment base, with a heavy emphasis on applications for US homeland defence.

Power generation sales increased by 3.5% in 2012 (6.3% at constant exchange rates, of which 3.3% was organic and 3.0% from acquisitions) compared to 2011 and would have been higher but for capacity constraints in our US HIP business. Additional capability is due on-stream towards the end of 2013. Once again demand was stronger in North America than in Europe.

Sales to oil & gas customers increased by 21.8% (22.3% at constant exchange rates, of which 15.4% was organic and 6.9% from acquisitions). Much of this growth came from gains in subsea applications and market share wins. Requirements for gas fracking in North America have subsided as the year progressed and this has been exacerbated by inventory correction at the oilfield services companies. The switch from gas fracking to oil provided some mitigation as rigs were made ready for production in a new location.

Automotive & General Industrial markets

In automotive, in the face of reduced demand in all geographies except North America, the Group built on the gains achieved in 2010 and 2011 by offering the broad range of new and traditional processes the sector requires, along with the reliability of service and supply that the extensive network of facilities can offer. Sales to the car and light truck sector declined by 7.1% and to heavy truck by 15.1%.

General industrial revenue performance was mixed by sector and geography. Sales decreased in the year by 0.5%.

In North America automotive revenues improved strongly and for the year as a whole were ahead of 2011 by 25.9% (25.0% at constant exchange rates, of which 5.8% was organic and 19.2% from acquisitions). Car and light truck related sales increased by 23.1% and heavy truck increased by 40.1%. General industrial sales also advanced well and revenues were ahead 25.0% compared to 2011 (23.9% at constant currencies of which 6.5% was organic and 17.4% from acquisitions).

In Western Europe sales were significantly impacted both by reduced demand and currency translation effects due to the weakness of the Euro versus Sterling. Automotive revenues were down 14.5% in 2012 (9.5% in constant currencies, there were no acquisitions). Car and light truck fared better (down 11.8%, 6.0% in constant currencies) than heavy truck, which was lower by 22.6% (19.9% in constant currencies). General industrial sales were much less affected but were, nevertheless, down compared to 2011 by 6.3% (but only 0.6% in constant currencies, there were no acquisitions).

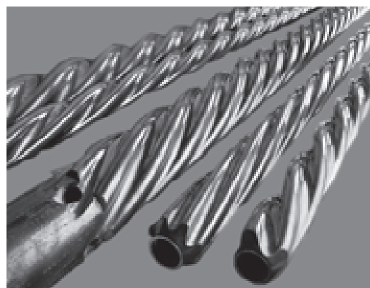
The Group's business in emerging markets had a disappointing year, with sales lower year on year by 13.1% (6.5% at constant currencies, there were no acquisitions). In Eastern Europe weak demand from Germany and France saw our customers reducing their output in Poland and the Czech Republic rather than cut back in their home countries. Asia, notably China for Bodycote, witnessed a short term slow-down in manufacturing activity and Bodycote's business in Brazil was impacted by a significant reduction in industrial activity in 2012.

Extending productivity

Subsea components

Components operating in the harsh environments of the oil & gas industry must withstand extreme material demands and resist attack from a variety of aggressive mediums. Corrosion and wear can lead to expensive downtime in exploration, where equipment is in continual use. The application of thermally sprayed coatings and the use of powder metal HIPed Near Net Shape (PM - NNS) components offer optimised material solutions allowing these components to operate reliably for extended periods of time, reducing cost and downtime.

For further information about our services go to **www.bodycote.com/services**



Results

Revenues for the Aerospace, Defence & Energy (ADE) business were £260.4m in 2012 compared to £233.5m in 2011, an increase of 11.5% (12.6% in constant currencies made up of 8.4% organic growth and 4.2% from acquisitions). Organic revenue growth in the year reflects further strong demand from aerospace customers in all geographies and market share gains, particularly for subsea oil & gas requirements. Revenues for onshore oil & gas began the year strongly but slowed in the second half, as gas fracking requirements fell.

Headline operating profit[1] for ADE was £69.6m (2011: £51.1m). The headline operating profit margin improved from 21.9% to 26.7% as a result of improved mix of business and higher capacity utilisation.

In 2012, the Group has added capacity in a number of aerospace focused facilities, notably in California to ensure customer demand is met. The acquisition of three aerospace facilities in Wichita, Kansas at the end of the first quarter also added capacity to the Group's network. In the coming year it is expected that capital expenditure will again be slightly above depreciation as further capacity and capability are added to support continuing growth in aerospace demand.

Net capital expenditure in 2012 was £21.1m (2011: £15.2m) which represents 1.1 times depreciation (2011: 0.8 times).

Capital employed in ADE in 2012 was £233.6m (2011: £219.2m). The small increase is primarily due to investment in new capacity to meet continued sales growth in the aerospace markets. Return on capital employed in 2012 was 29.8% (2011: 23.3%).

Achievements in 2012

ADE made considerable progress during the year in gaining new agreements with a range of customers and for a variety of end uses. In heat treatment this included additional business with aero engine OEMs both for new build and repair and with the supply chain for aircraft structural components. The Group's unrivalled capabilities across heat treatment, metal joining and hot isostatic pressing are a key selling point. Bodycote's new presence in the Wichita, Kansas market has seen Bodycote gain new business with several customers there, while the greenfield site in Empalme, Mexico has entered into a number of new contracts. In HIP, new customers, who are key suppliers to the oil majors in the subsea oil & gas market, have been serviced for the first time in 2012.

Organisation and people

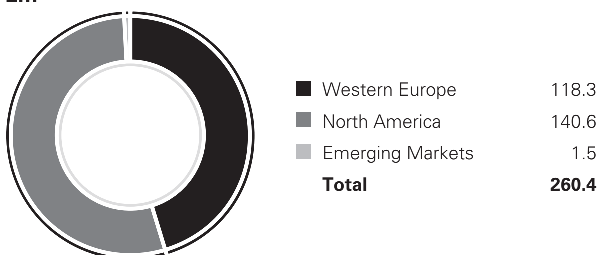
Overall full time equivalent headcount at 31 December 2012 was 2,123 (2011: 1,983), an increase of 7% compared to revenue growth in ADE of 11.5%. At 31 December 2012 the headcount included 132 full time equivalents from the acquisition completed in 2012.

Looking ahead

Order books for commercial aerospace OEMs remain strong, although the increase in aircraft build rates in the higher volume platforms is now slowing and there is some short term softness in oil & gas demand. Notwithstanding the slower pace of market growth that is anticipated in the near term, Bodycote expects to be able to capitalise on its world leading position and once again outperform the market.

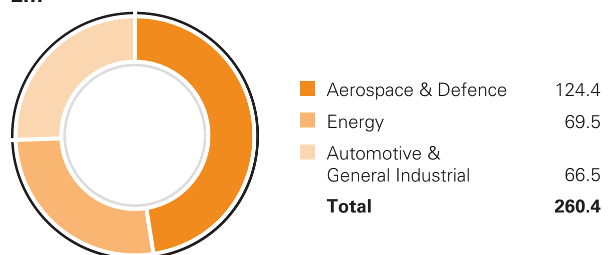
[1] Headline operating profit is reconciled to operating profit in note 2 to the consolidated financial statements.

ADE revenue by geography
£m



Western Europe	118.3
North America	140.6
Emerging Markets	1.5
Total	**260.4**

ADE revenue by market sector
£m



Aerospace & Defence	124.4
Energy	69.5
Automotive & General Industrial	66.5
Total	**260.4**

Reliable performance

Drivetrain components

The automotive industry faces numerous challenges, ranging from consumer driven price and reliability expectations to enhanced environmental and efficiency requirements. Drivetrain components are subjected to high operational loads and can be exposed to extreme environments. The manufacturer's choice of material combined with Bodycote's various processes ensure that every component in the drivetrain operates to design specifications. Many parts are hardened to attain the required strength, whilst others are hardened in local areas prone to wear. Additional procedures can be carried out to provide resistance to corrosion.

For further information about our services go to **www.bodycote.com/services**

Results

Automotive & General Industrial (AGI) business revenues were £327.4m in 2012, compared to £337.2m in 2011, a decrease of 2.9% (but an increase of 2.2% in constant currencies, made up of an organic decline of 1.6% and an increase from acquisitions of 3.8%).

In 2012 there was a clear difference in demand for the Group's services across the different geographies. North America followed a strong 2011 with a robust 2012 in both automotive and general industrial markets and revenues continued to be enhanced by market share gains. North American revenues grew by 10.5% excluding acquisitions and in constant currencies. In Europe and the emerging markets Group revenues declined by 3.4% (in constant currencies) driven by the weaker macroeconomic conditions particularly in the Eurozone.

Headline operating profit[1] in AGI was £43.6m compared to £44.7m in 2011. Despite the reduction in revenues, headline margins remained stable at 13.3% reflecting an improved mix in the business and a prompt reaction in managing costs in geographies where demand levels weakened.

Net capital expenditure in 2012 was £23.0m (2011: £27.0m), which represents 0.8 times depreciation (2011: 0.9 times). In 2013 we expect that capital expenditure will be just above depreciation as we add capacity in China, Mexico and for selected technologies such as S^{3}P, Corr-i-Dur® and Low Pressure Carburising. Return on capital employed in 2012 was 16.3% (2011: 15.6%). The increase reflects continuing focus on improving capital returns by increasingly targeting higher added-value activities. On average, capital employed in 2012 was £267.5m (2011: £286.2m).

Achievements in 2012

The Group has continued to win business across all geographies. In North America our ability to support automotive manufacturers as they move to newer technologies in pursuit of better fuel efficiency has provided Bodycote with market share growth. New outsourcing contracts in Europe and contributions from differentiated technologies such as S^{3}P meant that the revenue declines stemming from the weak economic environment were moderated and margins held up well.

AGI continued to see the benefits of restructuring and market focus. The emphasis on improved efficiency has been a key factor in the achievement of 20% margins in North America and the maintenance of margins in the low teens in Europe in the face of declining revenues.

Organisation and people

At December 2012, the number of full time equivalent employees in AGI was 3,595 (including 415 from acquisitions completed in 2012) compared to 3,423 at the end of 2011 and 1,606 less than its peak in July 2008. AGI revenues of £327.4m compare to £352.7m in 2008 (at 2012 exchange rates) a decrease of 7.2%.

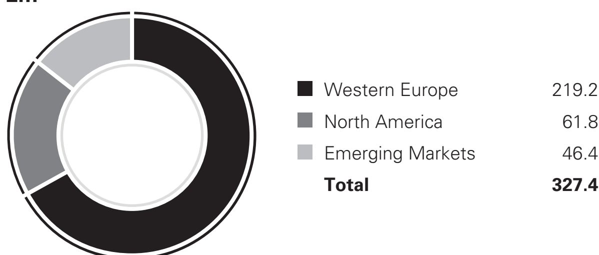
Looking ahead

The AGI divisions will continue to build on their success of enhancing their margins through capturing high value work. The focus on improving customer service helps drive this effort while the prioritisation of existing capacity in favour of higher value work and investing in selected technologies such as S^{3}P, Corr-i-Dur® and Low Pressure Carburising provides additional momentum. In addition the Group will continue with its strategy of adding to its existing footprint in emerging markets, with an emphasis on China and Mexico in the near term.

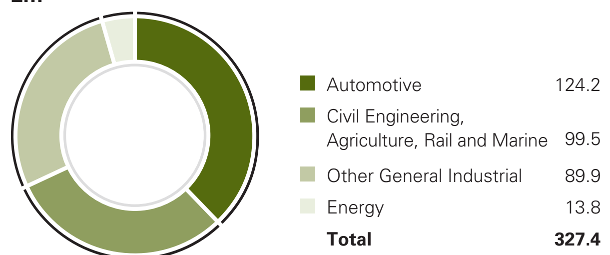
For the online version of this report go to **bodycote.annualreport2012.com**

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

AGI revenue by geography
£m



AGI revenue by market sector
£m



Finance Director's report

David Landless | Group Finance Director

Financial overview

	2012 £m	2011 £m
Revenue	**587.8**	570.7
Headline operating profit	**97.9**	85.5
Amortisation of acquired intangible fixed assets	**(2.0)**	(0.9)
Acquisition costs	**(2.5)**	–
Reorganisation costs	**(2.4)**	–
Profit on disposal of investment	**2.4**	–
Impairment charge	**–**	(4.2)
Operating profit	**93.4**	80.4
Net finance charge	**(3.6)**	(4.6)
Profit before taxation	**89.8**	75.8
Taxation	**(22.8)**	(19.8)
Profit for the year	**67.0**	56.0

Group revenue was £587.8m, an increase of 3.0%, of which acquisitions accounted for 3.9%, organic growth contributed 2.5% and foreign exchange rate movements had a negative impact of 3.4%.

Headline operating profit for the year increased by 14.4% from £85.5m to £97.9m, and headline operating margin was 16.6% (2011: 15.0%). Acquisitions in the year increased headline operating profit by £5.1m. The impact of foreign currency movements in the year was a reduction in headline operating profit of £2.2m. Operating profit was £93.4m (2011: £80.4m) after charging £2.0m (2011: £0.9m) in respect of the amortisation of acquired intangible assets, £2.5m of acquisition costs (2011: £nil) and £nil (2011: £4.2m) in respect of the impairment of goodwill and other intangible assets. A profit on disposal of the Group's investment in Ionbond of £2.4m (2011: £nil) and reorganisation costs of £2.4m (2011: £nil) were also recognised.

Headline operating cash flow[1] for the Group was £110.8m (2011: £96.0m). This was 113.2% of headline operating profit (2011: 112.3%). Net capital expenditure was again below depreciation at 0.9 times (2011: 0.9 times) as the Group continued to focus on increasing the utilisation of existing equipment. Working capital reduced in the year, with increases in the level of inventory more than offset by an increase in the level of payables.

After deducting interest and tax, the Group recorded positive free cash flow[2] of £81.2m (2011: £70.5m).

Exceptional costs

Total exceptional costs charged to the income statement amounted to £4.5m (2011: £5.1m). The amortisation of acquired intangible assets arises from acquisitions in both the current and prior years and the level of the charge has increased to £2.0m (2011: £0.9m). £2.5m of acquisition costs were expensed in the year (2011: £nil). A profit on disposal of investment of £2.4m (2011: £nil) has been recognised and reorganisation and redundancy costs of £2.4m (2011: £nil) have been incurred in relation to the establishment of an accounting Shared Service Centre in Prague.

The 2011 charge of £4.2m for impairment of goodwill and other intangible assets related to the Group's South American operations. No goodwill remains on the Group's balance sheet in respect of this business. The Board has concluded that no impairment charge is required in 2012.

Restructuring provisions outstanding at 31 December 2012 total £11.5m. Of the remaining costs, £6.2m is expected to be spent in 2013 and £5.3m in 2014 and later. All expenditure after the end of 2013 will relate to ongoing environmental remediation, primarily in the USA.

[1] Headline operating cash flow is reconciled on page 15.

[2] Free cash flow is reconciled on page 15.

Profit before tax

Headline profit before tax was £94.3m (2011: £80.9m). Profit before tax was £89.8m (2011: £75.8m), and these amounts are reconciled as follows:

	2012 £m	2011 £m
Headline operating profit	**97.9**	85.5
Net finance charge	**(3.6)**	(4.6)
Headline profit before tax	**94.3**	80.9
Amortisation of acquired intangible fixed assets	**(2.0)**	(0.9)
Acquisition costs	**(2.5)**	–
Reorganisation costs	**(2.4)**	–
Profit on disposal of investment	**2.4**	–
Impairment charge	**–**	(4.2)
Profit before tax	**89.8**	75.8

Finance charge

The net finance charge was £3.6m compared to £4.6m in 2011 (see details below) resulting from lower net interest rates (£0.1m) and lower average net debt (£0.6m). Facility fees (£0.3m) and financing costs (£0.6m) were lower than last year. Bank charges were similar, but pension and other finance charges were higher by £0.6m.

	2012 £m	2011 £m
Net interest payable	**0.5**	1.2
Financing costs	**1.1**	2.0
Bank and other charges	**0.8**	0.7
Pension finance charge	**1.2**	0.7
Net finance charge	**3.6**	4.6

Taxation

The tax charge was £22.8m for the year (2011: £19.8m).

The effective tax rate of 25.4% (2011: 26.1%) resulted from the blending of differing tax rates in each of the countries in which the Group operates.

The headline tax rate for 2012 was 25.7% (2011: 24.6%), being stated before accounting exceptionals, including amortisation of goodwill and acquired intangibles (which are generally not allowable for tax purposes).

Subject to any future tax legislation changes, due to the Group making most of its profits in countries other than the UK, the headline tax rate is expected to remain around current levels which is higher than the current UK statutory tax rate of 24%, and which is due to fall to 21% from 2014.

Earnings per share

Basic headline earnings per share (as defined in note 9) increased to 37.4p from 32.7p. Basic earnings per share for the year increased to 35.8p from 30.0p.

Dividend

The Board has recommended a final dividend of 8.3p (2011: 7.3p) bringing the total dividend to 12.3p per share (2011: 10.9p). If approved by shareholders, the final dividend of 8.3p per share for 2012 will be paid on 7 May 2013 to all shareholders on the register on 12 April 2013.

Capital structure

The Group's balance sheet at 31 December 2012 is summarised below:

	Assets £m	Liabilities £m	Net Assets £m
Property, plant and equipment	448.7	–	448.7
Goodwill and intangible assets	166.8	–	166.8
Current assets and liabilities	130.6	(155.6)	(25.0)
Other non-current assets and liabilities	3.2	(13.5)	(10.3)
Retirement benefit obligations	–	(18.5)	(18.5)
Deferred tax	33.3	(56.4)	(23.1)
Total before net debt	782.6	(244.0)	538.6
Net debt	10.0	(44.2)	(34.2)
Net assets as at 31 December 2012	**792.6**	**(288.2)**	**504.4**
Net assets as at 31 December 2011	758.7	(276.1)	482.6

Net assets increased by £21.8m (4.5%) to £504.4m (2011: £482.6m). In constant currencies, net assets increased by £45.3m (9.4%). The major movements compared to 31 December 2011 were an increase in goodwill and intangible assets of £55.3m primarily as a result of acquisitions completed during the year, an increase in net debt of £34.3m, an increase in retirement benefit obligations of £5.0m, an increase in property, plant and equipment of £4.8m, together with an increase in other net current liabilities of £6.2m and a decrease in net deferred tax liabilities of £4.1m.

The increase in property, plant and equipment was due to net capital expenditure of £47.7m, depreciation of £48.7m, and additions through the acquisition of businesses of £22.0m, offset by the effect of disposals and foreign exchange variances.

Net deferred tax liabilities decreased by £4.1m due to an increase in deferred tax assets resulting from a charge to equity in respect of share-based payments and retirement benefit obligations, an adverse movement in foreign exchange rates and a net reduction in liabilities due to corporate tax rate changes in various jurisdictions. Restructuring provisions were reduced by £4.0m, as Group restructuring activities proceeded as planned.

Retirement benefit obligations increased by £5.0m during the year, largely as a result of a fall in corporate bond yields reducing the discount rate from 4.75% to 4.50% in the UK, which is the most significant liability.

Finance Director’s report continued

Net debt/(cash)

Group net debt at 31 December 2012 was £34.2m (2011: net cash £0.1m). During the year, additional loans of £27.5m were drawn under committed facilities after funding £84.7m of acquisitions. The Group continues to be able to borrow at competitive rates and therefore currently deems this to be the most effective means of funding.

Cash flow

The net decrease in cash and cash equivalents was £7.6m (2011: £7.7m), made up of net cash from operating activities of £131.2m (2011: £119.8m), less investing activities of £130.6m (2011: £45.9m) and less cash used in financing activities of £8.2m (2011: £81.6m).

The increase in net cash flow from operating activities from £119.8m to £131.2m is driven primarily by the increase in headline EBITDA[1] from £142.3m to £153.1m. Working capital decreased as tight control of working capital led to a small increase in the level of inventory being offset by an increase in trade payables. Net current tax liabilities also increased by £4.1m in line with the profitability of the Group. The continuing utilisation of environmental and restructuring provisions offset the working capital reduction by £2.8m. The net effect was a decrease in the level of working capital of £2.1m (2011: increase of £6.3m).

Net cash outflows from investing activities increased from £45.9m to £130.6m, primarily due to acquisitions in the year as disclosed in note 24. The level of net capital expenditure in 2012 at £47.7m (2011: £44.5m), although higher than in the prior year, remained below historical levels, reflecting continued tight management control.

Net cash outflows used in financing activities decreased from £81.6m to £8.2m. 2012 saw the repayment of loans of £2.3m (2011: £59.3m) and new bank loans raised of £28.8m (2011: £0.4m), together with payment of dividends totalling £21.3m (2011: £17.4m).

There has been a continued focus on cash collection with receivable days at 31 December 2012 reducing to 58 days (2011: 59 days).

Net interest payments for the year were £2.5m (2011: £4.5m). Tax payments were £19.3m (2011: £15.3m) reflecting the increase in Group profits.

Capital expenditure

Net capital expenditure (capital expenditure less proceeds from asset disposals) for the year was £47.7m (2011: £44.5m). The multiple of net capital expenditure to depreciation was 0.9 times (2011: 0.9 times), which reflects the Group’s continued careful management of its capital expenditure programme. As at 31 December 2012 the Group had capital expenditure creditors of £13.9m (2011: £13.1m). Major capital projects that were in progress during 2012 include continued investment in our HIP and S^{3}P processes and additions to heat treatment capacity to support the aerospace sector.

Borrowing facilities

Total funding available to Bodycote under its committed facilities at 31 December 2012 was £232.6m (2011: £236.4m), expiring between July 2013 and August 2016.

There have been no new committed facilities arranged during 2012, although the €125m revolving credit facility, due to mature on 31 July 2013, has been refinanced during February 2013. The replacement facility is for the same amount and is available from 1 March 2013 maturing 1 March 2018. The new facility has a higher margin than the 2006 arranged facility it replaced.

At 31 December 2012, 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	101.4	33.5	**67.9**
£125m Revolving Credit	31 August 2016	125.0	–	**125.0**
		226.4	33.5	**192.9**
$10m Letter of Credit	31 August 2016	6.2	4.9	**1.3**
		232.6	38.4	**194.2**

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. 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 2012 has increased to 7% (2011: 0%).

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:

	2012 £m	2011 £m
Funded		
UK	**4.2**	1.8
Other Western Europe	**0.5**	0.7
North America	**0.9**	0.9
	5.6	3.4
Unfunded		
Western Europe	**12.6**	9.9
Emerging Markets	**0.3**	0.2
	12.9	10.1
Total deficit	**18.5**	13.5

The UK plan is closed to new entrants but the 98 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.

UK scheme liabilities have increased from £82.2m to £85.5m over the year. A fall in corporate bond yields has reduced the discount rate from 4.75% in 2011 to 4.50% in 2012, which increases

[1] Headline EBITDA is reconciled on page 15.

the present value of the liabilities. Changes in other actuarial assumptions have had minimal impact.

Assets have increased over the period from £80.4m to £81.3m leading to a deficit of £4.2m as at 31 December 2012.

The liability for unfunded Western European schemes increased by £2.8m, primarily in France. As with the UK, the key reason for the increase in the deficit in the Western European schemes is a reduction in the corporate bond yields.

For the year ended 31 December 2013 the Group is required to adopt IAS 19 (revised) Employee Benefits.

	2012 Current £m	2012 Revised £m
Operating costs	**1.1**	1.5
Net finance charge	**1.2**	0.6
Total IAS 19 charge	**2.3**	2.1

The impact is summarised in the table above and the reasons for changes are:

- A £0.4m increase in operating costs as a result of the requirement to reclassify pension scheme administration costs from net finance charge to operating costs. Such costs include the PPF levy and actuary, audit, legal and trustee charges which, under the current IAS 19, are allowed to be included within the net finance charge.
- A £0.6m reduction in the net finance charge, being the sum of a £0.2m reduced charge due to the new requirement for the expected return on assets to be calculated by applying the corporate bond yield based discount rate to the balance sheet pension-related assets, and a £0.4m decrease as a result of the reclassification of the pension scheme administration costs to operating costs identified above. The Group expects the 2012 pension deficit (as restated) to increase by £0.5m due to the removal of the option for the Group to adopt the corridor method of accounting for the recognition of actuarial gains and losses.

The Group expects the 2012 pension deficit to increase by £0.5m due to the removal of the option to amortise past service costs over the vesting period. Any outstanding past service costs will be recognised in full at the start of the year.

Post balance sheet events

The €125m Revolving Credit Facility was refinanced on 18 February 2013 and further details are noted opposite. There have been no other post balance sheet events.

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. This includes an overview of the Group's financial position, 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.

Committed facilities as at 31 December 2012 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

On 18 February 2013, the €125m Revolving Credit Facility maturing on 31 July 2013 was refinanced for the same amount, extending the maturity to 1 March 2018, increasing the weighted average life of the committed facilities at that date to 4.2 years.

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.

Cautionary statement

The Group Review, as defined in the Directors' Report, contains certain forward-looking statements. These statements are made by the Directors in good faith based on the information available to them up to the time of their approval of this report and such statements should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying any such forward-looking information.

D.F. Landless
Group Finance Director
27 February 2013

Principal risks and uncertainties

Effective management of risks is essential to the delivery of the Group's objective of creating superior shareholder returns. The Board is responsible for the Group's risk management and the review of risk activities has been delegated to the Audit Committee. Under the leadership of the Vice President of Risk, Bodycote has developed the risk management framework to identify, report and manage its business critical risks. During the year a Risk Committee was established, represented by senior managers from each of the operating divisions. The role of the Risk Committee is to embed risk management and facilitate the implementation of risk management measures at a divisional level.

A variety of approaches is used to identify and report risks, which are aggregated first at a sub-divisional level and then at Group level. For each business critical risk, assurance activities have been documented in risk assurance maps and this is used to direct assurance activity.

The Vice President of Risk provides an update to the Audit Committee on the Group's risk activities at every meeting and a comprehensive review of the Group's business critical risks is presented in December. In addition, the Board examines a specific risk topic at each Board meeting.

The table below highlights the major risks that may affect Bodycote's ability to deliver the strategy, as laid out in page 4. Details of the Group's financial risks (funding, foreign exchange, interest rate and counterparty risks), which are managed by the Group's treasury function, are provided in note 18 to the financial statements. The mitigating activities described below will help to reduce the impact or likelihood of the major risk occurring, although the Board recognises that it will not be possible to eliminate these risks entirely. Furthermore, there could be risks that may be unknown or that may be judged to be insignificant at present, but may later prove to be significant. For this reason more effort has been directed at measures to recover from a situation where a significant risk does crystallise. These include a comprehensive review of the Group's business continuity planning measures and the development of crisis management planning.

Risk Description and Impact	Mitigation
Market and Customer Risks	
Markets Bodycote's exposure to macroeconomic performance means that it suffers from a high level of sales volatility. A substantial proportion of Bodycote's sales are closely linked to the economic cycle: Sales in the markets served by the AGI businesses (63% of the total Group) tend to develop in line with or ahead of the economic cycle, whereas aerospace and defence sales (23%) tend to track behind the economic cycle. Sales to the energy sectors (14%) are closely linked to energy prices, which in turn can be affected by general economic activity. The high proportion of fixed costs in the business means that a drop in sales will have a significant impact on profitability. However, Bodycote's presence in 26 countries in a wide variety of end-markets acts as a natural hedge to neutralise localised economic volatility. Nevertheless, the Board is mindful of the potential impact on demand for the Group's services while uncertainty around the Eurozone debt and the US fiscal problems continues.	■ Implement strategic plan with medium term objective of "above-market" sales growth, a focus on targeted "growth-premia" business segments and a more balanced geographic spread. ■ 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. ■ Wide geographical and market sector spread of Group sales.
Loss of key customers Bodycote benefits from many long-term relationships with key customers. Damage to, or loss of, any of these relationships would be detrimental to Group results and could affect the viability of one or more of Bodycote's facilities. However, the Board believes this is unlikely as Bodycote strives to provide a high level of customer service 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 14% of sales and the balance made up by many thousands of customers.	■ Continue focus on customer service and quality processes to maintain excellent relationships with major customers. Use key account management to monitor customer satisfaction with the Group's service levels. ■ Ensure there is no significant customer dependency.
Corporate and Community Risks	
Human resources Bodycote is reliant on its ability to attract, develop and retain staff of the right calibre to support its growth strategy. Competition for capable resources is high and there is a risk that Bodycote may not be able to attract or retain skilled individuals. As a 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.	■ Continue the 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.

Risk Description and Impact	Mitigation

Corporate and Community Risks

Safety and health
Bodycote is committed to providing a safe work environment for its employees. The nature of Bodycote's activities presents safety and health risks which can have a significant impact on individual employees. Furthermore poor safety and health practices could lead to disruption of business, financial penalties and loss of reputation.

- Group-wide health and safety policies set by the Group Chief Executive.
- ISO 18000 compliant SHE management systems being implemented by Group Head of Safety, Health and Environment with the support of divisional safety and health teams.
- Programme in place to focus on reduction of incidents which could have a high impact.
- Safety compliance audits at all plants at least once a year.
- Oversight of safety and health framework provided by the Group SHE Committee.

Environment
Bodycote is committed to providing the highest level of protection to the environment. Environmental contamination could lead to health risks, disruption of business, financial costs and loss of reputation.

Historical use of solvents and other hazardous chemicals by plants operated by Bodycote or by plants acquired by Bodycote could have led to ground contamination. The environmental regulations in many of the jurisdictions that Bodycote operates in impose actual or potential obligations on Bodycote to remediate contaminated sites. Bodycote incurs costs annually (2012: £1.5m) in meeting its obligations and maintains a provision of £13.9m. If the provision is insufficient to meet the cost of remediation, then this could have an impact on the Group's results. Some of the Group's heat treatment plants continue to use solvents and hazardous chemicals in small quantities.

- Remediation of contaminated sites as required by local legislation.
- Reduction in the use of hazardous substances, such as chlorinated solvents.
- Environmental procedures and measures in place conforming to ISO 14001 (2012: 78% of plants).
- Environmental due diligence of businesses for acquisitions.

Operational Risks

Service quality
The Bodycote brand is reliant on the repeatable delivery of parts to agreed specification to an agreed timescale. Deterioration in quality or service levels can cause serious long-term damage to Bodycote's reputation with financial consequences such as the loss of a customer and the cost of damages or litigation. 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.

- Maintain industry relevant accreditations.
- Quality systems and processes operated at plant level with oversight by divisional quality teams.
- All plants subjected to internal and external quality audits and inspections at least once a year.

Major disruption at a facility
Bodycote's business processes are inherently risky and there is a possibility that a major fire or utility outage could lead to closure of a facility's operation. In addition a number of sites are exposed to natural hazards, such as earthquakes, flooding and storms. As a result there is a possibility that service to Bodycote's customers from the affected site could be disrupted. However Bodycote's global network of 186 plants creates a framework to provide back-up capability for any affected facility.

- ISO 18000 compliant SHE management systems are being implemented by Group Head of Safety, Health and Environment with support of divisional safety and health teams.
- Programmed equipment maintenance and inspections.
- Independent insurer inspections to assess hazard and business interruption risks.
- Overhaul of business continuity and crisis management plans.

Information technology projects
The efficient operation of the Group will rely increasingly on the proper development and operation of its IT systems. Bodycote is currently undergoing a group-wide implementation of a new ERP system. The impact of the re-engineered business processes will have significant long-term benefits on Bodycote's operational effectiveness. However, failure to manage the implementation programme successfully could result in cost overruns and, potentially, disruption to the business.

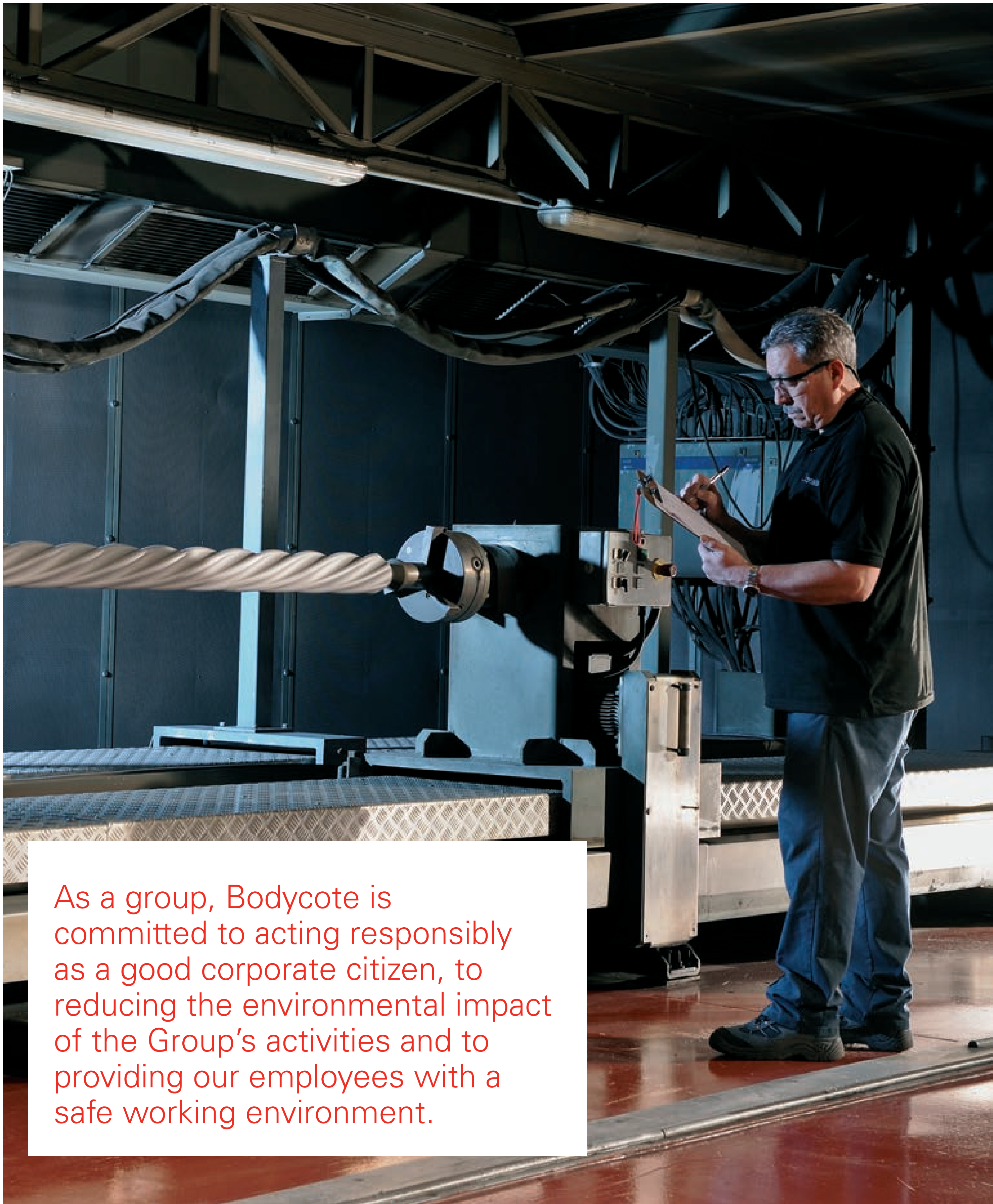
- Project approval and progress subject to Board review.
- Project teams made up of skilled subject matter experts supplemented with third party advisors.
- Best practice project management processes in place with assurance provided by third parties.

Regulatory Risks

Regulatory and legislative compliance
The global nature of Bodycote's operations means that the Group has to comply with a wide range of local and international legislative requirements, including anti-bribery and anti-competition legislation, taxation legislation, employment law and import and export controls. Failure to comply with legislation could lead to substantial financial penalties, disruption to business, diversion of management time, personal and corporate liability and loss of reputation.

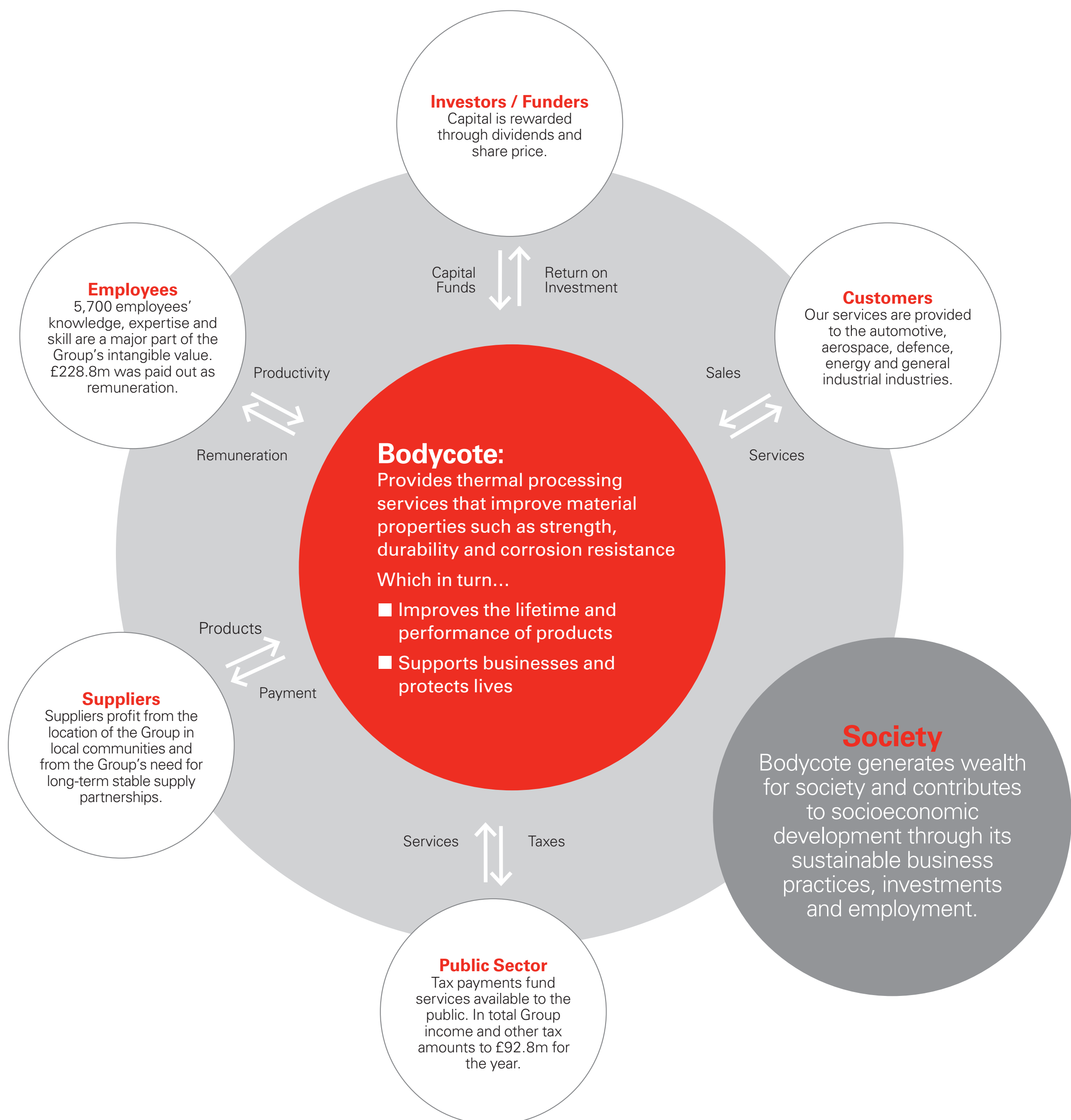
- Establish business processes supported by HR policies and the Group Code of Conduct.
- Implement whistleblower facility managed by a third party: the Open Door Line.
- Training and awareness programmes.
- Engage local specialists to support Bodycote at local, divisional and Group level.
- Regular audit of the effectiveness of implemented procedures.

Corporate responsibility and sustainability



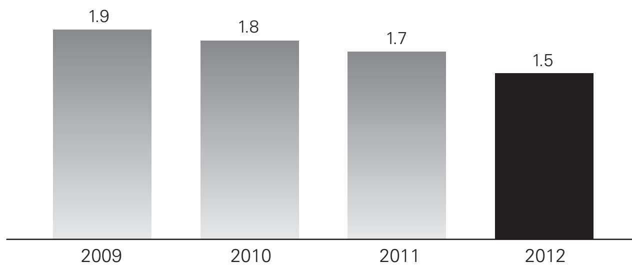
As a group, Bodycote is committed to acting responsibly as a good corporate citizen, to reducing the environmental impact of the Group's activities and to providing our employees with a safe working environment.

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 the wider society.



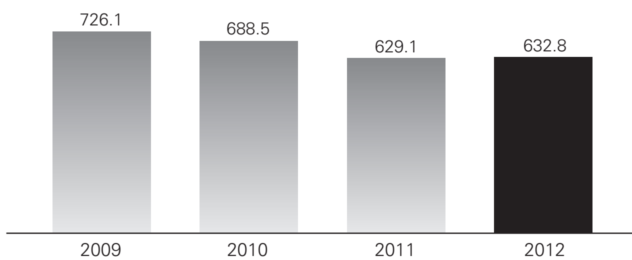
Corporate responsibility and sustainability continued

Accident frequency[1]



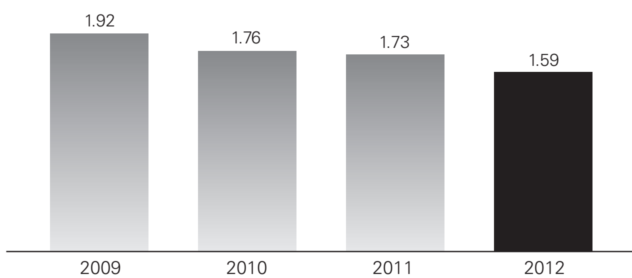
Carbon footprint[2]

(tonne CO_2e/£m sales)



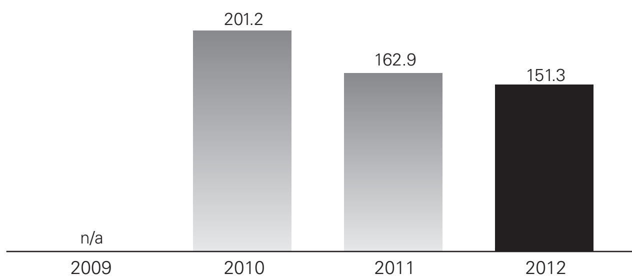
Water consumption

(thousand m³/£m sales)



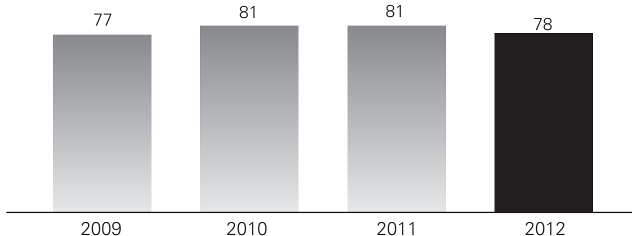
Chlorinated solvents

(kg/£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.

Bodycote invests in the training and development of its people both at local and Group level. At a 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.

A tool to develop further understanding and skill in the area of performance management has been built and has been cascaded globally through the management population. Through communication of clear messages coupled with skills development, the organisation aims to raise the capability of its management population in driving performance. This initiative is backed by a 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.

Human rights

Bodycote's human rights policy is consistent with the Universal Declaration of Human Rights and the UN Global Compact's ten principles.

We prohibit forced, compulsory and underage labour and any form of discrimination based on race, gender, religion, age, disability or political affiliation. Appropriate mechanisms are in place to support any contraventions of these rules.

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.

Bodycote seeks to play a positive role in the local communities in which it operates by providing employment opportunities, building goodwill and developing a reputation as a good neighbour and employer.

[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.
[2] CO_2 e is carbon dioxide equivalent, which represents the CO_2 released due to our energy usage.

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. Furthermore, 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 of Risk, who then passes the matter to the appropriate individual in the business to address.

Bribery and Competition Law online training courses have been put in place, translated into the major languages used throughout the Group, and relevant employees have completed the interactive courses.

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 potentially 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.

Although Bodycote has reduced its lost-time accident rate by 35% over the past five years, it recognises the need to improve further. Starting in 2012, a three-year global improvement strategy has been initiated, which focuses 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, but recognising that all employees have responsibilities for their own safety and the safety of others. In keeping with this, a group-wide employee 'safety climate' survey was undertaken in 2012, to which 41% of all employees responded. A number of specific improvement actions have been taken to address some of the concerns raised by the survey.

KPI – accident frequency (lost-time injury rate)

Accident frequency is defined as the number of lost time accidents per 200,000 hours worked.

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.

At every stage where Bodycote is involved in the manufacturing cycle, our operational aim is to reduce 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 by 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.

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 2012, the Group had 193 locations and 78% of our operating facilities had achieved ISO 14001 accreditation. The decrease in the percentage compared to prior years is due to facilities acquired which have not yet obtained accreditation. Excluding acquisitions, 86% of our facilities had achieved ISO 14001 accreditation.

KPI – Carbon footprint and water consumption

As a consequence of the increase in sales, and the acquisition of a number of new operational sites, the absolute electricity usage increased by 2% whilst gas usage increased by 14.4% - together accounting for an increase in energy usage of 8.8%. The total Group energy use excluding these acquisitions remained constant compared with 2011.

Excluding acquisitions the carbon footprint decreased by 3.5% from 629.1 tonnes per £m sales to 606.9 tonnes per £m sales. Including acquisitions the carbon footprint increased by 0.6% to 632.8 tonnes per £m of sales.

Water usage per £m sales decreased by 8%. 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 equipment has been introduced. In 2012 the overall solvent use decreased by 7% compared with the previous year.

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 in 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 highlighted 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

Executive Directors

S.C. Harris, 54 | Group Chief Executive (middle)

Appointed: November 2008
Committees: Nomination and Executive (Chairman)
Qualifications: Chartered Engineer, graduated from Cambridge University, Masters degree in business administration from the University of Chicago, Booth School of Business.
Experience: Started his career in engineering with Courtaulds plc then moved to the USA to join APV Inc from 1984 until 1995, where he held several senior management positions. He was appointed to the Board of Powell Duffryn plc as an executive director in 1995 and then went on to join Spectris plc as an executive director from 2003 to 2008. He was also a Non-Executive Director of Brixton plc from 2006 to 2009.
External appointments: Non-Executive Director of Mondi plc

D.F. Landless, 53 | Group Finance Director (right)

Appointed: March 1999
Committees: Executive
Qualifications: Chartered Management Accountant, graduated from the University of Manchester Institute of Science and Technology.
Experience: Started his career with Bowater and Carrington Viyella and joined Courtaulds plc in 1984. Appointed a Finance Director in UK and US divisions of Courtaulds plc from 1989 to 1997 and Finance Director of Courtaulds Coatings (Holdings) Limited from 1997 to 1999.
External appointments: None.

Non-Executive Directors

A.M. Thomson, 66 | Chairman (left)

Appointed: December 2007
Committees: Nomination (Chairman) and Remuneration
Qualifications: Chartered Accountant, graduated from Glasgow University with a Masters degree.
Experience: Worked on a variety of audits for Arthur Andersen and Price Waterhouse, followed by senior management positions with Rockwell International plc, Raychem Ltd and Courtaulds plc. Joined Rugby Group plc as a Finance Director from 1992 to 1995 followed by Smiths Group plc from 1995 to 2006. He was also a Non-Executive Director of Johnson Matthey from 2002 to 2011. Past President of the Institute of Chartered Accountants of Scotland.
External appointments: Chairman of Hays PLC and Hamsard 3054 Ltd (Polypipe) and Non-Executive Director of Alstom SA.

Board of Directors

(pictured left to right)

J.A. Biles, 65 | Senior Independent Director (appointed as SID on 1 May 2012)

Appointed: August 2007
Committees: Audit (Chairman), Remuneration and Nomination
Qualifications: Chartered Accountant, graduated from Exeter University in Chemistry and Physics. Fellow of the Institute of Chartered Accountants, having qualified with Price Waterhouse in London.
Experience: Worked on a variety of audits and M&A activities at Price Waterhouse in his early career, followed by 5 years at EMI plc. In 1981 he joined Racal Electronics plc and held three successive financial director roles in defence and energy electronics. Appointed Group Finance Director of Chubb Security PLC in 1991 in its demerger from Racal. He then joined FKI plc, the engineering group, as Finance Director in 1998 where he remained until 2004. From 2004 until 2008 he joined ArmorGroup International plc as Non-Executive Director and from 2005 to 2012 Charter International plc, from 2005 to 2011 Hermes Fund Managers Limited and Northern Ireland Electricity plc (Previously Viridian Group plc) from 2005 to 2011.
External appointments: Non-Executive Director of Sutton & East Surrey Water plc since 2006.

E. Lindqvist, 55 | Non-Executive Director

Appointed: June 2012
Committees: Remuneration (Chair appointed 14 December 2012), Audit and Nomination
Qualifications: Engineer, graduated with a Masters from Linköping Institute of Technology, Diploma in Marketing from IHM Business School and MBA Financial Analysis from University of Melbourne.
Experience: Began her career in various positions with Ericsson working in Continental Europe, North America and Asia from 1981 to 1990 followed by Director roles with Ericsson from 1993 to 1999. Joined Teliasonera in 2000 as Senior Vice President moving to Xelerated as Chief Executive from 2007 to 2011.
External appointments: Appointed as Non-Executive Director of Assa Abloy AB in 2008, Tieto Corporation from 2010, Transmode Holdings AB as of 2007, Innovationsbron since 2007, Blekinge Institute of Technology from 2010 and Episerver in 2011.

K. Rajagopal, 59 | Non-Executive Director

Appointed: September 2008
Committees: Audit, Remuneration and Nomination
Qualifications: A Chartered Mechanical Engineer, graduated with a B Tech (Mechanical Engineering) from IIT, Madras, India, followed by an MSc and PhD in Mechanical Engineering from the University of Manchester and was awarded an honorary doctor of science degree by Cranfield University. A Fellow of the Royal Academy of Engineering, the Institution of Engineering and Technology (IET) and the Institution of Mechanical Engineers.
Experience: Joined BOC Edwards after obtaining his PhD and worked in various positions in operations management including Operations Director. Promoted to Managing Director of Edwards in 1993 and Chief Executive of BOC Edwards in 1996. Appointed Executive Director of BOC Group plc in 2000 until 2006. Past member of UK Council for Science and Technology and the Audit Commission. He was Non-Executive Director of Foseco plc from 2005 until 2008 and FSI International (a NASDAQ company) 2000 to 2005.
External appointments: Chairman of UMC3 since 2010 and of HHV Pumps Ltd since 2009. Non-Executive Director of W.S. Atkins plc since 2008, Spirax-Sarco Engineering plc from 2009 and E2V Technologies PLC from 2010.

J. Vogelsang, 70 | Senior Independent Director (resigned as SID on 30 April 2012)

Appointed: January 2003
Committees: Remuneration (Chairman until 31 December 2012)
Qualifications: Chemical Engineer, graduated from the Technical University of Delft, Netherlands, with a Masters degree.
Experience: Commenced his career as Royal (Dutch) Air Force Reserve Officer from 1966 to 1968. From 1968 to 1984 he worked in various manufacturing, sales, marketing and business positions for Shell Companies in the Benelux, appointed General Manager for Shell Chemicals in Norden in 1984. Promoted in 1988 to Vice President of Shell Chemicals International Trading Company and Head of Speciality Chemicals of Shell International Chemicals Company, based in London, assuming the responsibility of Chief Executive for the Shell Companies in Sweden in 1992 before becoming Vice-President Shell Chemical Europe and Africa in 1994. President of Montell Polyolefins Europe from 1999 and President of Technology at Basell Polyolefins from 2001 to 2002.
External appointments: Non-Executive Director of Metex SA.

U.S. Ball | Group Company Secretary

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.

Directors' report

The Directors are pleased to submit their report and the audited financial statements for the year ended 31 December 2012.

The Chairman's statement, the Chief Executive's review, the Finance Director's report, and all the information contained on pages 4 to 51 together comprise the Directors' report for the year ended 31 December 2012.

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 105 and 106.

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
- 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 2012, 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 8.3p per ordinary share making a total for the year of 12.3p per share (2011: 10.9p). The final dividend, if approved, will be paid on 7 May 2013 to shareholders on the register at the close of business on 12 April 2013.

Share capital

The Company's issued ordinary share capital as at 31 December 2012 was £33.1m and during the year was increased by the issue of 160,421 ordinary shares between 8 March and 26 November 2012 for a total consideration of £252,458.79, in connection with the Company's executive share incentive schemes. At the Annual General Meeting on 25 April 2012 the shareholders authorised the Company to purchase up to 19,126,367 of its own shares. This authority expires at the conclusion of the forthcoming Annual General Meeting to be held on 24 April 2013, at which time a further authority will be sought from shareholders.

Capital structure

Details of the issued share capital are shown in note 23. The Company has one class of ordinary shares, which carry no right to fixed income. Each share carries the right to one vote at general meetings of the Company. There are no specific restrictions on the size of a holding nor on the transfer of shares, both of which are governed by the general provisions of the Articles of Association and prevailing legislation. The Directors are not aware of any agreements between holders of the Company's shares that may result in restrictions on the transfer of securities or on voting rights. Details of employee share schemes are set out in note 27 and shares held by the Bodycote Employee Benefit Trust abstain from voting and waive dividend rights. No person has any special rights of control over the Company's share capital and all issued shares are fully paid. The appointment and replacement of Directors is governed by the Company's Articles of Association, the UK Corporate Governance Code, the Companies Act and related legislation. The Articles of Association may be amended by a special resolution of shareholders. The powers of the Directors are described in the Corporate governance statement on page 38. Under the Articles of Association the Company has authority to issue ordinary shares with a nominal value of £11,021,387.

There are also a number of other agreements that take effect, alter, crystallise or terminate upon a change of control of the Company following a takeover bid such as commercial contracts, bank loan agreements, property lease agreements, employment contracts and employee share plans. None of these are considered to be significant in terms of their likely impact on the business of the Group as a whole, and the Directors are not aware of any agreements between the Company and themselves or employees that provide for compensation for loss of office or employment that occurs because of a takeover bid except where specifically mentioned in this report.

Directors

The current Directors and their biographical details are listed on pages 33 and 34 and all served throughout the year with the exception of Eva Lindqvist, who was appointed on 1 June 2012. 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 2012 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 shareholders, if they wish to continue to serve as Directors of the Company. Accordingly, those Directors retiring and offering themselves for re-election at the 2013 Annual General Meeting are Messrs A.M. Thomson, S.C. Harris, D.F. Landless, J.A. Biles, Dr K. Rajagopal and E.Lindqvist. After 10 years of service J.Vogelsang will retire at the 2013 Annual General Meeting and will not stand for re-election. 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 46 to 51. No Director has had any dealings in any shares or options in the Company since 31 December 2012. 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 2012 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 or her. The Board reviewed the declarations and approved the existence of each declared Situational Conflict until September 2013 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. Under the Group's Open Door Line, employees' concerns can be voiced over the phone on an anonymous basis in the local language. Approximately 3,700 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 £2,000 (2011: £9,000). There were no political contributions in 2011 or 2012.

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 45 days (2011: 47 days).

Shareholders

An analysis of the Company's shareholders and the shares in issue at 14 February 2013 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 107.

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/she ought to have taken as a Director to make himself/herself 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 2013 Annual General Meeting will be held on 24 April 2013 in accordance with the notice being sent to shareholders with this report.
By order of the Board:

U.S. Ball
Secretary
27 February 2013

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 supporting the governance agenda and upholding good principles of corporate behaviour at Bodycote recognising that good governance serves to ensure that the business is run to achieve growth on a controlled and ongoing basis. What I believe are the important governance developments at Bodycote over the last year are detailed in Governance reporting below.

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

Key actions in 2012

- Ensure key recommendations from the 2011 strategy review are being implemented
- Board visits to meet the Dutch and Danish teams
- New Non-Executive Director appointed
- External Board training on current topics

Priorities for 2013

- Implement actions from the 2012 external board evaluation
- Continued focus on management development and succession planning
- New Remuneration Committee Chairman appointed and smooth transition and handover commenced
- Continued emphasis on external Board training

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 26 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. We have made progress in addressing the issue of gender and diversity, with the appointment of Eva Lindqvist to the Board as a Non Executive Director on 1 June 2012. As and when we are recruiting new members we would expect to continue to address the issue of gender and ethnicity. Due to the small size of our Board, comprising two Executive Directors and four non-Executive Directors and a non-Executive Chairman, we believe it difficult to set targets or timescales for the percentage of women, or any other group, on our Board and do not propose to set targets for the percentage of women on our Board in future years.

Female representation on our Board is currently 14% and at manager level it is 23%. We will increase female representation on the Board if appropriate candidates are available when Board vacancies arise. Females represent 16% of our total workforce.

Board evaluation

The Board has undertaken its first external Board Evaluation during 2012. Following a review of proposals from five external facilitators, the Board appointed ICSA Board Evaluation to facilitate a review of its performance.

The facilitator Mr Geoffrey Shepheard met with each director on an individual basis to obtain their views on seven aspects of the Board's performance and to ascertain whether their needs and expectations were being met. The evaluator ensured that pre-defined constituent elements of each topic were covered in the discussions and a qualitative score was assigned by each director. The seven topics were as follows:

- Board responsibilities
- Oversight
- Board meetings
- Support for the board
- Board composition
- Working together
- Outcome and achievements

The results of the evaluation were considered by the Board at its meeting in October 2012 and the directors discussed the recommendations which are now in the process of being implemented. Additional emphasis will be placed on risk management and certain operational matters. The approach to Board Evaluation included relevant questions to cover the activities of each Board committee.

The report concluded that the Board was performing well and high governance standards had been adopted. Strong evidence of cohesion and genuine support for colleagues was noted and it was apparent that the Executive is strongly challenged when appropriate.

Arising from the exercise, the Board has concluded that its focus should remain on divisional growth strategies, technology development, risk and sustainability as well as continued training.

The Executive Directors Messrs S.C. Harris and D.F. Landless were appraised internally in January and February 2013.

Led by the Senior Independent Non-Executive Director, the Directors have carried out an evaluation of the Chairman's performance in December 2012. The performance of the other individual Non-Executive Directors was appraised internally by the Chairman.

Training

All new directors receive initial induction training on a diverse range of topics including trading, investor relations, organisational and legal matters. The Board receives training via ad hoc presentations and papers from advisers and the Company Secretary. External periodic training on important topics takes place through the Deloitte Academy and during the year the directors received training on trends in financial reporting, corporate governance and risk management.

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.

The road map for Non-Executive refreshment continued to be developed in 2012.

Compliance reporting

In respect of the financial year 2012 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 'Code').

In respect of the year ended 31 December 2012 Bodycote has complied with the provisions of the 2010 Code and has voluntarily adopted most of The UK Corporate Governance Code issued in September 2012 (as reflected in the Report of the Audit Committee), with the exception of provision E1.1. The Board has taken the view that generally it is the responsibility of the Group Chief Executive and the Group 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 2012.

Operation of the code

Taken together with the Report of the Audit Committee, the Report of the Nomination Committee and the Board report on remuneration presented on pages 38 to 51, this statement explains how Bodycote has applied the principles of good corporate governance set out in the 2010 Code.

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 2012, including a specific meeting to review and update the Company's long-term strategy. The Board of Directors comprises seven members, of whom five 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 Group Chief Executive is Mr S.C. Harris and the Senior Independent Non-Executive Director ('SID') was Mr J. Vogelsang, who chaired the Remuneration Committee until 14 December 2012 and who stepped down as SID at the conclusion of our AGM in 2012. The Audit Committee is chaired by Mr J.A. Biles, who was appointed SID after the conclusion of our AGM in 2012. Ms E. Lindqvist was appointed a Non-Executive Director on 1 June 2012 and was appointed Chairman of the Remuneration Committee as of 14 December 2012. After 10 years of service, Mr J Vogelsang will not stand for re-election at the 2013 AGM. Mr J. Vogelsang stepped down as a member of the Audit and Nomination Committee on 31 December 2011. Brief biographical details of all Directors are given on pages 33 and 34. The Board makes visits to UK sites and overseas facilities during the year. Certain defined powers and issues are reserved for the Board to decide, inter alia:

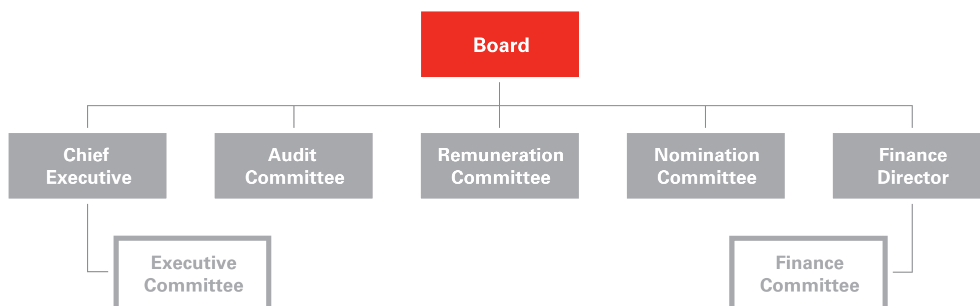
- Strategy;
- Approval of financial statements and circulars;
- Capital projects, acquisitions and disposals;
- Annual budgets;
- Directors' appointments, service agreements, remuneration and succession planning;
- Policies for financial statements, treasury, safety, health and environment, donations;
- 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 regarding 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 52. The Board also operates three committees. These are the Nomination Committee, the Remuneration Committee and the Audit Committee.

In accordance with the recommendations of the Code, Board members serve for a period of six years which will only be extended in exceptional circumstances.

So that the necessary actions can be taken promptly, a Finance Sub-Committee, comprising the Chairman (or failing him any other Non-Executive Director), the Group Chief Executive and the Group 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, Dr K. Rajagopal and Ms E. Lindqvist are all independent for the purposes of the Code. During 2013 J. Vogelsang will have served as a Board Director for 10 years and the Board recognises that his tenure has reached a threshold at which his independence could be called into question. However, given the importance of the experience and skills required to perform the role of Chair of the Remuneration Committee, J. Vogelsang remained as Chair of the Remuneration Committee until 14 December 2012, when E. Lindqvist took over as Chair. J. Vogelsang will be a Board Director until the 2013 AGM, at which time he will not stand for re-election.

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	–	–	7	7	4	4
S.C. Harris	9	9	–	–	–	–	4	4
J. Vogelsang	9	9	–	–	7	7	–	–
J.A. Biles	9	9	4	4	7	7	4	4
K. Rajagopal	9	9	4	4	7	7	4	4
E. Lindqvist*	6	5	2	2	4	4	2	2
D.F. Landless	9	9	–	–	–	–	–	–

* Appointed on 1 June 2012

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 with the exception of E. Lindqvist, who did not attend the September meeting due to commitments in place prior to her appointment. In addition, where not a member, Messrs Thomson, Harris, Vogelsang and Landless attended by invitation the whole or part of some of the meetings of the Audit, Nomination and Remuneration Committees.

Proposals for re-election

The Board decided, in line with the 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.A. Biles and Dr K. Rajagopal will stand for re-election, and Ms E. Lindqvist having been appointed by the Board on 1 June 2012 will stand for election. After 10 years of service, Mr J. Vogelsang will not stand for re-election at the 2013 AGM. The Board recommends to shareholders that they re-elect or elect all the Directors. In accordance with the recommendations of the Code, Board members will serve for a period of six years which may be extended in exceptional circumstances.

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 or her 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.

Every Bodycote site provides assurance on specified financial and non-financial controls through a control self assessment process. The results are validated by Internal Audit through spot checks and are reported to the Audit Committee. In addition the President and the Vice President of Finance of each Division sign a letter of Representation annually.

During 2012, 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 the Group's key strategic and operational risks, which is summarised from work performed by VP of Risk and the Group's Risk Committee to identify risks (by means of workshops, interviews, investigations and by reviewing departmental or divisional risk registers). The risks identified were assessed using conventional impact and likelihood scoring (both before and after mitigating actions), and further assessment, monitoring and review work was carried out in 2012. The Group's risk management framework is progressively being embedded throughout the Group. The principal risks and uncertainties affecting the Group are shown on pages 26 and 27. 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 Group Chief Executive and Group 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. Makinson Cowell undertook an investor audit and presented the views of shareholders to the November Board. During the year the Chairman met separately with three of the five largest shareholders to discuss governance matters. 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 Group Chief Executive and Group Finance Director. The Chairman and Senior Independent Non-Executive Director are available to discuss any issues not resolved by the Group Chief Executive and Group 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
27 February 2013

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 principal purpose is to advise on the appointment and, if necessary, dismissal of Executive and Non-Executive Directors. The Committee's terms of reference, which are listed on the company's website, include all matters required by the UK Corporate Governance Code. Further information on "The Code" can be found on the Financial Reporting Council's website www.frc.org.uk. The terms of reference are reviewed periodically by the Company Secretary and any changes are then referred to the Board for approval. No changes were made to the terms of reference during the year.

Composition of the Nomination Committee

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

As recommended by the Code the Chairman acts as the Chairman of the Committee which also comprises Messrs J. A. Biles, S.C. Harris, Dr. K. Rajagopal and Ms. E. Lindqvist (appointed 1 June 2012). J. Vogelsang, after 9 years of service, retired from the Committee on 31 December 2011. 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. 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

In 2012 the Committee formally met four times and reviewed the skills of the Board, with a view to considering the current and future skills and experience which the Board might require.

The Committee discussed succession planning, board diversity and reviewed the performance of the Group Chief Executive and other senior executives. In particular, the need to broaden the Board membership with respect to gender, ethnicity and age was discussed. The Chairman led the ensuing recruitment project and Egon Zehnder, an international search firm, was engaged to identify suitable candidates with relevant experience. Egon Zehnder produced a shortlist of candidates and a sub-group of the Committee met with the shortlisted candidates. All members of the Committee and the Executive Directors met with the preferred candidate prior to confirmation of her appointment. Eva Lindqvist, a Swedish national and qualified engineer, was appointed to the Board in June 2012. She has lived and worked at senior management level in Europe, North America and Asia over the last 30 years. The Committee also considered and approved the appointment of J. Biles as Senior Independent Director (SID) with effect from 1 April 2012 in succession to J. Vogelsang.

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 concluded that no inappropriate conflicts of interest exist. The Committee also assigned the Chairman to review and agree with the Group Chief Executive the Group's objectives for the forthcoming year.

In December 2012 the Nomination Committee reviewed the Board's size and composition, the frequency of the process for Board and Committee meetings, best practice for the handling of a number of Board issues including defining the Committee's terms of reference and drawing up a training programme for Directors. In anticipation of the retirement of J. Vogelsang at the 2013 Annual General Meeting, the succession of the Remuneration Committee Chairman was addressed and E. Lindqvist was appointed Chairman of that Committee with effect from 14 December 2012.

In line with the UK Corporate Governance Code the Committee carried out its first external Board Evaluation during 2012. The project was undertaken by Geoffrey Shepheard of ICSA Board Evaluation, who presented the report to the October Nomination Committee meeting, with both Executive and Non-Executive Directors in attendance. Further details of the review can be found in the Corporate Governance section of the Annual Report. Recommendations arising from the 2012 Board Evaluation are in the process of being addressed.

As Chairman of the Committee I will be available at the 2013 Annual General Meeting to answer questions relating to the work of the Committee.

On behalf of the Committee:

A.M. Thomson
Chairman of the Nomination Committee
27 February 2013

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 J.A. Biles, Dr K. Rajagopal and E. Lindqvist (appointed 1 June 2012) who are all independent Non-Executive Directors. J. Vogelsang, who was a member of the Audit Committee resigned as a member of the Committee on 31 December 2011. Their biographical details are set out on pages 33 and 34 and their remuneration is shown on page 50. 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 (2005-2012). The Company Secretary is secretary to the Audit Committee. The Chairman, Group Chief Executive, Group Finance Director, J Vogelsang, Group Financial Controller, Vice President of Risk, Group Treasurer, Head of Tax, other senior finance personnel, external auditor and internal auditors attend Audit Committee meetings as appropriate by invitation.

Fair, balanced and understandable Overview of Annual Report and Accounts

In light of discussions undertaken by the Directors during Board and Audit Committee meetings, the Directors were satisfied that the Annual Report and Accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

Main activities of the Audit Committee

The Audit Committee met four times during 2012, and in February 2013, 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 of Risk, internal auditors 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, internal auditors 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:

- Significant issues, judgements and estimates in relation to the financial statements were considered and addressed by the Committee by discussing and challenging these during meetings. The Committee considered the following key estimates and judgements ensuring that appropriate rigour had been applied as part of the year end process:
  - The accounting for the acquisitions in the year, in particular the assumptions adopted in determining the fair value of assets and liabilities including goodwill and intangible assets
  - The appropriateness of the Company's tax provisions were reviewed on a country by country basis taking account of acquisitions completed in 2012 to ensure that tax provisions were adequately stated
  - 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
  - Validity of the going concern assumption used in preparation of the Annual Report and Accounts was reviewed in considerable depth. Appropriate downside sensitivity analysis has been performed on net debt profile, committed facility headroom, financial covenants and Euro based sales. There is a reasonable expectation that the Group has adequate resources to continue in operational existence even if the situation outlined in the sensitivity analysis occurred
  - Actuarial assumptions relating to retirement benefit schemes
- A quarterly report on internal audit from the Vice President of Risk was presented at each meeting and the findings discussed. During the year the plan for the ensuing year's work was considered.
- The external auditor also presented, for the year end statutory audit and interim review engagements respectively, their audit plans at the December and April meetings covering scope of work to be done and during the year there was a detailed review of their management letter covering the auditor's findings in respect of 2011.

Report of the Audit Committee continued

- The external auditor presents their audit plan and procedures, and in particular the identification of significant risks, to the Audit Committee every year before the interim and the final audit. Following completion of the audit, the external auditor confirmed that no additional matters had arisen during the audit which would have required them to alter their planned procedures. The Audit Committee also requested feedback from both management and audit teams as well as operating companies' financial management about the effectiveness of the audit carried out in the various locations around the world where the Company operates.
- The Audit Committee is also presented with an update on any material litigation in which the Group may be involved.
- At each meeting an update is presented on any new accounting developments and requirements and any changes in corporate governance arrangements that may affect the Group.
- On a regular basis, the Committee reviewed papers on liquidity, banking arrangements and the appropriateness of the going concern assumption for preparation of the financial statements. The Committee's activities supported the Directors in their assessment of the going concern position of the Group, which is set out on page 25.
- The Audit Committee met with the external auditor without management.
- The Audit Committee reviewed the effectiveness of the external audit process and reported to the Board.

The Vice President of Risk has responsibility for developing the Group's risk management framework, including internal audit, and enhancing the Group's risk assessment and mitigation activities. This appointment demonstrates the Board's continued commitment to maintain sound risk management and internal control systems.

During 2012 the Audit Committee also:

- assessed and confirmed the independence of the external auditor;
- having reviewed the effectiveness of the audit, the performance and capabilities of the external auditor and having taken into account their tenure of office from 2002 and whether the position should be formally tendered, recommended to the Board that the auditor be reappointed and agreed their fees;
- discussed putting the audit out to tender after the conclusion of the audit of the accounts for the year ending 31 December 2019, five years after the current audit partner rotates off the assignment;
- approved the Group's accounting policies;
- approved the management representations to the external auditor;
- reviewed arrangements for reporting and investigating fraud and employee concerns; normal internal audit activity and operation of the Group's 'Open Door' policy uncovered a small number of potentially fraudulent incidents which were all fully investigated. None had any material financial impact on the Group and, where necessary, systems and procedures were amended to minimise the risk of recurrence;
- reviewed the effectiveness of internal controls and risk management processes and recommended certain changes;
- reviewed the terms of reference for the Audit Committee; and
- assessed the Committee's own effectiveness.

Training

The Committee receives regular technical updates as part of the agenda of each Committee meeting as well as specific or personal training as required. A training session was held during November 2012, where Deloitte updated the Committee on a number of relevant accounting matters and discussed trends in corporate reporting.

Independence of external auditor

The Audit Committee has put in place safeguards to ensure that the independence of the audit is not compromised. In this respect, the Audit Committee reviewed:

- the external auditor's plan for the current year, noting the role of the senior statutory auditor, who signs the audit report and who, in accordance with the professional rules, has not held office for more than five years, and any changes in the key audit staff;
- the arrangements for day-to-day management of the audit relationship; and
- the overall extent of non-audit services provided by the external auditor as specified below.

Non-audit fees paid to the auditor are available in note 3 on page 71. There has been no significant non-audit engagement.

The policy in respect of services provided by the external auditor is as follows:

- Audit-related services: The external auditor is invited to provide services where their position as auditor renders them best placed to undertake the work. This includes reporting and certification connected with borrowings, shareholders and circulars, regulatory requirements and work in respect of acquisitions and disposals.
- Other services: No contracts in excess of £20,000 in value can be awarded to the external auditor without prior approval from the Chairman of the Audit Committee.
- Tax and general consulting work: In general and where conflict could arise, the work is not awarded to the external auditor and is put out to tender.
- There are no contractual restrictions on who the Audit Committee can choose as external auditor.

Internal audit

Following a review of the Group's internal audit processes and capabilities a decision was taken by the Committee to outsource the major part of the internal audit provision. The Group went out to tender to three major accounting firms and after receiving presentations from them, the contract for services was awarded to Ernst & Young LLP, who commenced their work in April 2012.

Internal Audit independently reviews the risk and control processes operated by management. It carries out independent audits in accordance with an internal audit plan which is agreed with the Audit Committee before the start of the financial year. This plan takes account of the risk management framework surrounding major business risks in each operation and provides the required degree of coverage. The Audit Committee requires that all accounting centres are visited at least once every two years and that all plants are visited at least once every five years. From 2013 onwards additional assurance will be obtained through control self assessments, when all plants and accounting centres will be required to self certify annually the effective operation of their controls. The accuracy of these returns will be checked by Internal Audit. Internal Audit reports include recommendations to improve internal controls together with agreed managerial action plans to resolve issues raised. Internal audit follows up the implementation of recommendations and reports progress to senior management and the Audit Committee. The Committee noted that the 2012 Internal Audit programme was successfully completed. The effectiveness of the Internal Audit function is reviewed and discussed on an annual basis with the Vice President of Risk and the Engagement Partner of Ernst & Young LLP.

Overview

As a result of its work during the year, the Audit Committee has concluded that it has acted in accordance with its terms of reference and has ensured the independence and objectivity of the external auditor.

On behalf of the Audit Committee:

J.A. Biles
Audit Committee Chairman
27 February 2013

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 2012 were:

J. Vogelsang (Chairman, until 14 December 2012)

J.A. Biles

A.M. Thomson

Dr K. Rajagopal

E. Lindqvist (from date of appointment of 1 June 2012 and Chairman as of 14 December 2012)

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

The Committee met seven times during 2012, and again in February 2013, to consider amongst other matters:

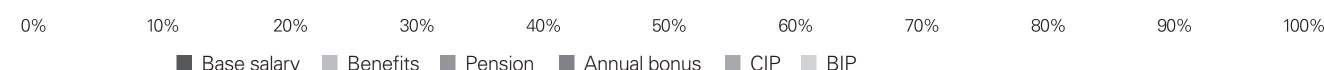
Theme	Agenda items
Best practice	■ The Company's remuneration policy in light of discussions during the Bodycote AGM and newly published best practice guidelines ■ Review of the current UK corporate governance environment and the implications for the Company, including the Government's reforms and draft regulations to replace Schedule 8 of the Act ■ Implementation of a clawback policy in respect of Executive Directors' performance based remuneration
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 2012 ■ The annual bonus structure and performance targets for the financial year ended 31 December 2013 ■ The vesting of Bodycote Incentive Plan (BIP) awards and those made under the Bodycote Share Match Plan (now operating as the Co Investment Plan (CIP)) made in 2009 which had a performance period ending during the year ■ The vesting of the joining award made to Mr Harris under the Bodycote Share Match Plan (as mentioned, now operating as the CIP) ■ The conditional awards made under the BIP and CIP during the year ■ Pension arrangements for senior executives
Reporting	■ Consideration and approval of the remuneration report for 2012

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.

S.C. Harris

D.F. Landless



■ Base salary ■ Benefits ■ Pension ■ Annual bonus ■ CIP ■ BIP

When the package is reviewed this is done in the context of individual and Company performance, internal relativities, criticality of the individual to the business, experience and the scarcity or otherwise of talent with the relevant skill set. Currently reward for the Executive Directors is structured as shown opposite:

Element of pay	Component	Purpose/details
Fixed	■ Base salary	■ To ensure competitiveness, attracting and retaining talent ■ To reflect individual skills and experience
	■ Benefits	■ In line with market practice ■ Provision of Company car (or allowance in lieu of), private medical insurance and long-term disability insurance
	■ Pension	■ In line with market practice ■ To ensure competitiveness, attracting and retaining talent
Variable	■ Annual bonus	■ To incentivise delivery of corporate objectives and strategy ■ To provide opportunity for enhanced reward in return for challenging performance targets
	■ Bodycote Incentive Plan	■ To incentivise delivery of long-term shareholder value and provide opportunity for enhanced reward for superior performance
	■ Bodycote Co-Investment Plan	■ To align Executive Directors with shareholders, demonstrate individual commitment and satisfy minimum shareholding requirements

Each of the above components is discussed in greater detail in the following sections of this report. The sections dealing with Directors' emoluments paid, pensions and incentives have been audited.

Fixed elements of pay

Base salary

The Committee reviews base salaries for each Executive Director and senior executives annually taking into account the responsibilities and performance of the individual, current market practice, pay in similar engineering businesses and companies of a comparable size and scale of operations. The Committee was also mindful of pay levels amongst the employee population.

The Executive Directors received inflationary salary increases for 2012 and 2013. The salaries of the Executive Directors are as follows:

Name	Position	Salary from 1 January 2012	Salary from 1 January 2013
S.C. Harris	Group Chief Executive	£457,800	£470,200
D.F. Landless	Group Finance Director	£292,400	£300,300

Pension

The Committee reviews the pension arrangements for the Executive Directors to ensure that the benefits provided are consistent with those provided by other similar companies.

Mr Harris is entitled to a salary supplement in lieu of pension at a rate of 22% of basic salary, of which £82,000 was waived during the year. In addition, in the event of death, a death in service benefit of eight times basic salary will become payable.

From April 2012 Mr Landless ceased to participate in the Group's UK contributory defined benefit pension scheme due to him prospectively reaching the lifetime limit. Instead Mr Landless receives a salary supplement of 22% of basic salary up to the defined benefit scheme cap and 16% of base salary above the cap, of which £35,000 was waived during the year.

The defined benefit scheme is closed to new members and provides increases in pensionable salary capped at 3% per annum. The scheme also provides lump sum death-in-service benefits and pension benefits based on final pensionable salary. For Mr Landless death in service under the defined benefit scheme changed when he ceased to be a contributory member of the defined benefit scheme from four times basic salary with spousal pension to eight time's basic salary without spousal pension.

An analysis of the accrued pension entitlements for Mr Landless under the defined benefit pension scheme during 2012 is given on page 51.

Variable elements of pay

Clawback policy

During the year the Committee introduced a formal clawback policy for Executive Directors in respect of annual bonuses and long-term incentive awards. This clawback policy is to come into effect from 1 January 2013 and has been introduced to provide the Committee with discretionary powers to clawback performance based remuneration should exceptional circumstances occur. Such circumstances would include:

- Fraud;
- Misconduct;
- Significant misstatement of financial results; or
- Miscalculation of performance conditions.

Should the Committee, in its opinion, consider such circumstances to have occurred during a performance period from 2013 onwards then the clawback policy will provide the Committee discretion to determine that any amounts paid or awards vested by reference to the relevant

period shall be clawed back. Clawback will start to apply to awards made from 2013 and the Committee expects that the mechanism to clawback any such amounts will be to reduce future annual bonus payments, reduce the value of subsisting awards that have, at the relevant time, not yet vested or by reducing the level of award to be made at the following grant date.

Annual bonuses

The annual bonus provides the Executive Directors and other senior executives with the opportunity to receive an annual bonus wholly payable in cash based on achievement of certain performance targets. Recognising that despite an increase, the Group Chief Executive remained behind many of his peers in terms of base salary in 2011, the maximum annual bonus opportunity for the Group Chief Executive was increased to 130% of base salary to ensure comparability in terms of total reward on achievement of superior performance. The structure of the annual bonus scheme in 2012 for Executive Directors was as follows:

	Maximum	Profit		Cash flow		Personal objectives		Actual
	% salary	% weight	% achieved	% weight	% achieved	% weight	% achieved	% salary
S.C. Harris	130	70	48	10	10	20	15	95
D.F. Landless	100	70	48	10	10	20	15	73

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

For 2013 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. The target is based on budget exchange rates and acquisitions are excluded. In addition, future annual bonus payments will be subject to the Committee's clawback policy as outlined previously.

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. The Committee, in determining the performance targets attached to awards, takes into account the current and forecasted performance for the business and its sector along with broker consensus to ensure stretch targets are set.

	ROCE		EPS	
Award year	Threshold performance	Maximum performance	Threshold performance	Maximum performance
2010	11.1%	16%	19.8p	31.0p
2011	14.6%	20%	28.3p	39.8p
2012	18.7%	23%	36.2p	62.15p
2013	18.7%	23%	42.0[1]p	61.3[1]p

1 The 2012 EPS targets restated at exchange rates on 31 December 2012 correspond to 33.8p at threshold and 58.08p at maximum performance with the result that 2013 targets in real terms are ahead of those for 2012.

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 2010 and 2011, below 31.1p for awards made in 2012 and below 42p for awards made in 2013, then no award shall vest. Awards commence vesting progressively from zero on achievement of threshold performance with maximum performance resulting in awards vesting in full. In addition, the 2013 and future BIP awards will be subject to the Committee's clawback policy as outlined previously.

The Committee has decided that the ROCE figure of 23% is a good aspiration for the Group and are cognisant of the fact that overdriving incentives on capital employed can lead to unintended consequences in terms of short term capital starvation for the business.

The Committee intends to use the ROCE and EPS measures in combination for BIP Awards made in 2013. Details of the awards made under the BIP are provided on page 50. Following completion of the performance period the Remuneration Committee has determined that 175% of the BIP awards made in 2010 shall vest (2009: 175%) as the level of ROCE and EPS performance was 87.5% and 87.5% respectively. In reaching this conclusion, the Remuneration Committee took into account certain review procedures carried out by the external auditor.

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. In addition, the 2013 and future CIP awards will be subject to the Committee's clawback policy as outlined previously.

As the performance period for the 2010 CIP award commenced on 1 May 2010 and ends on 30 April 2013, the outcome will be reported in next year's report.

Advisors

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 £70,000, which included amongst other things, benchmarking of executive salaries, advice relating to the vesting of awards made under the Bodycote Incentive Plan both in the UK and overseas and advice regarding the proposed changes to the reporting of remuneration by the Department for Business Innovation & Skills. Ernst & Young LLP also advises the Company on tax matters and provides the internal audit service. Other fees included £2,000 paid to Eversheds in respect of Remuneration Committee advice.

Total Shareholder Return

The graph on page 51 illustrates the Company's TSR performance since 2007 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 31 December 2012. In line with market practice the calculation for TSR assumes reinvestment of dividends and is based on data provided by Datastream.

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. One year's remuneration does not include any BIP or CIP payments (which would be subject to the normal leaver provisions) or, by default, payment of any projected bonuses, instead any bonus payment due will be calculated by reference to the average of the previous three years. 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.

Long-term savings vehicle

During the financial year the Company made discretionary contributions into the Bodycote Investment Incentive Plan. The plan is entirely cash based to provide an alternative long-term savings vehicle for senior executives. The Committee considers the plan an essential tool to aid retention while recognising the need for executives to have flexibility in long-term financial planning. Company contributions are discretionary and vary year on year and are made in lieu of other elements of pay and therefore the Company remains cost neutral and any risk in relation to the value of investments made in the plan is borne entirely by participants. Contributions for the Executive Directors are shown on page 51.

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 2012, the Committee is satisfied that 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 £77,765.

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 their 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 2011 the 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:

E. Lindqvist
Chairman of the Remuneration Committee
27 February 2013

Board report on remuneration continued

Emoluments during the year – audited

	Basic salary and fees £000	Benefits £000	Annual bonus £000	Total 2012 £000	Total 2011 £000
Executive Directors					
S.C. Harris	458	29	435	**922**	1,000
D.F. Landless	292	29	214	**535**	566
	750	58	649	**1,457**	1,566
Non-Executive Directors					
A.M. Thomson	150	–	–	**150**	140
J. Vogelsang	57	–	–	**57**	51
J.A. Biles	58	–	–	**58**	51
K. Rajagopal	46	–	–	**46**	43
E. Lindqvist *	27	–	–	**27**	n/a
	1,088	58	649	**1,795**	1,851

* Appointed on 1 June 2012

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 2012 Number of Ordinary Shares	31 December 2011 Number of Ordinary Shares
Executive Directors		
S.C. Harris	**542,983**	160,730
D.F. Landless	**377,986**	136,284
Non-Executive Directors		
A.M. Thomson	**42,719**	41,841
J. Vogelsang	**–**	–
J.A. Biles	**23,798**	23,157
K. Rajagopal	**22,368**	22,368
E. Lindqvist	**–**	n/a

None of the Directors has 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 2012	Awarded in year	Lapsed in year	Vested in year	Interests as at 31 December 2012	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
	–	193,653	–	–	**193,653**	£3.94	February 2015
D.F. Landless	344,215	–	–	344,215	**–**	£1.56	February 2012
	262,004	–	–	–	**262,004**	£1.79	February 2013
	157,176	–	–	–	**157,176**	£2.98	February 2014
	–	123,698	–	–	**123,698**	£3.94	February 2015

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

	Interests as at 1 January 2012	Awarded in year*	Vested in year	As at 31 December 2012	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
	–	–	–	**–**	–	May 2015
D.F. Landless	4,480	–	4,480	**–**	£1.87	March 2012
	8,010	–	–	**8,010**	£1.89	May 2013
	2,783	–	–	**2,783**	£3.75	May 2014
	–	8,187	–	**8,187**	£3.79	May 2015

* 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.

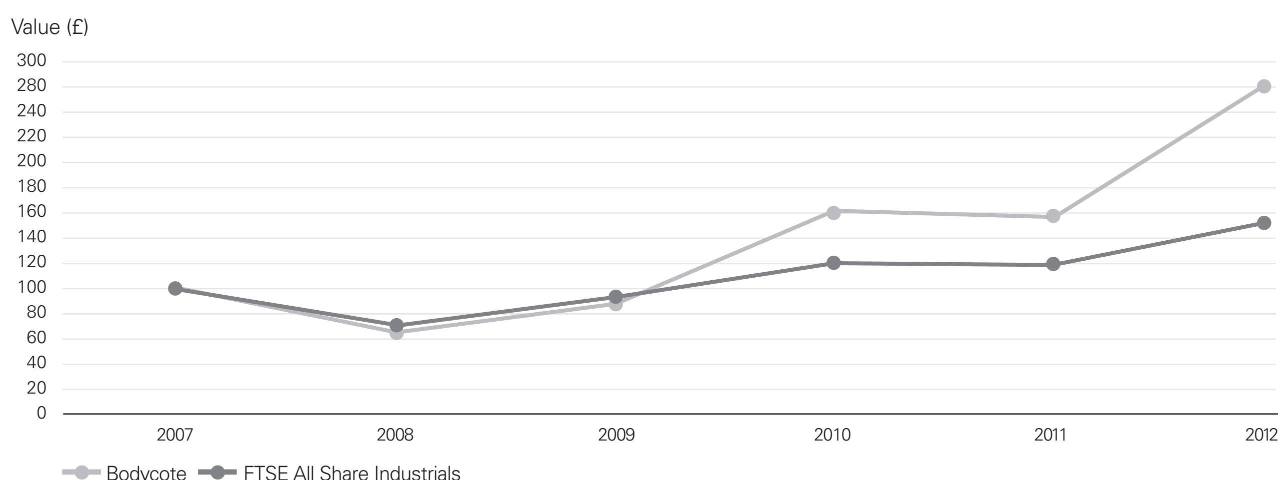
Directors' Pensions – audited

Director	Accrued annual pension at 01/01/12 £000	Transfer value at 01/01/12 £000	Real increase in accrued annual pension £000	Inflation £000	Increase in accrued annual pension £000	Transfer value of real increase in accrued annual pension (less members' contributions) £000	Real increase in transfer value (less members' contributions) £000	Members' contributions £000	Accrued annual pension* at 31/12/12 £000	Transfer value at 31/12/12 £000
D.F. Landless	45	933	–	1	1	(6)	39	4	**46**	**997**

* Calculated as at 31 December 2012 but only covers up to 5 April 2012 when D.F. Landless left the pension scheme.

Total Shareholder Return

This graph looks at the value, by 31 December 2012, of £100 invested in Bodycote plc on 31 December 2007 compared with that of £100 invested in the FTSE All Share Industries. The points plotted are the values at financial year ends.



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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 51 together comprise the Directors' report for the year ended 31 December 2012. 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 27 February 2013 and is signed on its behalf by:

S.C. Harris
Group Chief Executive
27 February 2013

D.F. Landless
Group Finance Director
27 February 2013

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 2012, 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 Group Accounting Policies and the related notes 1 to 29.

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 2012 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 matters 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 is 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 2012.

Nicola Mitchell (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Manchester, UK
27 February 2013

Consolidated income statement

For the year ended 31 December 2012

	Note	**2012 £m**	2011 £m
Revenue	1	**587.8**	570.7
Cost of sales and overheads		**(489.9)**	(485.2)
Operating profit prior to exceptional items		**97.9**	85.5
Amortisation of acquired intangible fixed assets		**(2.0)**	(0.9)
Impairment charge		**–**	(4.2)
Profit on disposal of investment		**2.4**	–
Acquisition costs		**(2.5)**	–
Reorganisation costs		**(2.4)**	–
Operating profit	3	**93.4**	80.4
Investment revenue	5	**0.2**	0.2
Finance costs	6	**(3.8)**	(4.8)
Profit before taxation		**89.8**	75.8
Taxation	7	**(22.8)**	(19.8)
Profit for the year		**67.0**	56.0
Attributable to:			
Equity holders of the parent		**66.9**	55.8
Non-controlling interests		**0.1**	0.2
		67.0	56.0

	Note		
Earnings per share	9		
		Pence	Pence
Basic		**35.8**	30.0
Diluted		**35.8**	29.4

All activities have arisen from continuing operations.

Consolidated statement of comprehensive income

For the year ended 31 December 2012

	2012 £m	2011 £m
Profit for the year	**67.0**	56.0
Exchange losses on translation of foreign operations	**(14.2)**	(12.3)
Movement on hedges of net investments	**–**	0.4
Actuarial losses on defined benefit pension schemes	**(5.3)**	(2.0)
Tax on items taken directly to equity	**1.4**	0.5
Other comprehensive expense for the year	**(18.1)**	(13.4)
Total comprehensive income for the year	**48.9**	42.6
Attributable to:		
Equity holders of the parent	**48.8**	42.8
Non-controlling interests	**0.1**	(0.2)
	48.9	42.6

Consolidated balance sheet

At 31 December 2012

	Note	**2012 £m**	2011 £m
Non-current assets			
Goodwill	10	**131.8**	102.6
Other intangible assets	11	**35.0**	8.9
Property, plant and equipment	12	**448.7**	443.9
Other investments	13	**1.6**	0.8
Deferred tax assets	19	**33.3**	52.3
Trade and other receivables	15	**1.6**	1.9
		652.0	610.4
Current assets			
Inventories	14	**18.4**	16.7
Current tax assets		**0.6**	2.4
Trade and other receivables	15	**109.5**	105.8
Cash and bank balances	15	**10.0**	18.1
Assets held for sale	16	**2.1**	5.3
		140.6	148.3
Total assets		**792.6**	758.7
Current liabilities			
Trade and other payables	21	**132.9**	126.9
Current tax liabilities		**13.7**	11.4
Obligations under finance leases	20	**0.2**	0.2
Borrowings	17	**43.4**	10.8
Derivative financial instruments	18	**0.1**	0.1
Provisions	22	**8.9**	10.6
		199.2	160.0
Net current liabilities		**(58.6)**	(11.7)
Non-current liabilities			
Borrowings	17	**0.3**	6.5
Retirement benefit obligations	29	**18.5**	13.5
Deferred tax liabilities	19	**56.4**	79.5
Obligations under finance leases	20	**0.3**	0.5
Derivative financial instruments	18	**–**	0.2
Provisions	22	**9.4**	11.4
Other payables	21	**4.1**	4.5
		89.0	116.1
Total liabilities		**288.2**	276.1
Net assets		**504.4**	482.6
Equity			
Share capital	23	**33.1**	33.0
Share premium account		**177.1**	176.9
Own shares		**(11.3)**	(6.7)
Other reserves		**141.6**	143.1
Hedging and translation reserves		**10.5**	24.7
Retained earnings		**152.0**	110.3
Equity attributable to equity holders of the parent		**503.0**	481.3
Non-controlling interests		**1.4**	1.3
Total equity		**504.4**	482.6

The financial statements of Bodycote plc, registered number 519057, were approved by the Board of Directors and authorised for issue on 27 February 2013.

They were signed on its behalf by:

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

Consolidated cash flow statement

For the year ended 31 December 2012

	Note	**2012 £m**	2011 £m
Net cash from operating activities	25	**131.2**	119.8
Investing activities			
Purchases of property, plant and equipment		**(48.8)**	(43.6)
Proceeds on disposal of property, plant and equipment and intangible assets		**4.7**	1.5
Purchases of intangible fixed assets		**(3.6)**	(2.4)
Acquisition of businesses		**(84.7)**	(0.5)
Purchase of sundry investments		**(0.9)**	(0.9)
Disposal of subsidiary		**2.7**	–
Net cash used in investing activities		**(130.6)**	(45.9)
Financing activities			
Interest received		**0.3**	0.6
Interest paid		**(2.8)**	(5.1)
Dividends paid		**(21.3)**	(17.4)
Dividends paid to a non-controlling shareholder		**–**	(0.1)
Repayments of bank loans		**(2.3)**	(59.3)
Payments of obligations under finance leases		**(0.2)**	(0.4)
New bank loans raised		**28.8**	0.4
Proceeds on issue of ordinary share capital		**0.3**	0.8
Own shares purchased / settlement of share options		**(11.0)**	(1.1)
Net cash used in financing activities		**(8.2)**	(81.6)
Net decrease in cash and cash equivalents		**(7.6)**	(7.7)
Cash and cash equivalents at beginning of year		**9.5**	17.6
Effect of foreign exchange rate changes		**(0.3)**	(0.4)
Cash and cash equivalents at end of year	25	**1.6**	9.5

Consolidated statement of changes in equity

For the year ended 31 December 2012

	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 2011	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**
Net profit for the year	**–**	**–**	**–**	**–**	**–**	**66.9**	**66.9**	**0.1**	**67.0**
Exchange differences on translation of overseas operations	**–**	**–**	**–**	**–**	**(14.2)**	**–**	**(14.2)**	**–**	**(14.2)**
Realisation of revaluation surplus	**–**	**–**	**–**	**(0.4)**	**–**	**0.4**	**–**	**–**	**–**
Actuarial losses on defined benefit pension schemes net of deferred tax	**–**	**–**	**–**	**–**	**–**	**(3.9)**	**(3.9)**	**–**	**(3.9)**
Total comprehensive income for the year	**–**	**–**	**–**	**(0.4)**	**(14.2)**	**63.4**	**48.8**	**0.1**	**48.9**
Issue of share capital	**0.1**	**0.2**	**–**	**–**	**–**	**–**	**0.3**	**–**	**0.3**
Acquired in the year / settlement of share options	**–**	**–**	**(4.6)**	**(5.0)**	**–**	**(1.4)**	**(11.0)**	**–**	**(11.0)**
Share-based payments	**–**	**–**	**–**	**3.9**	**–**	**–**	**3.9**	**–**	**3.9**
Deferred tax on share-based payment transactions	**–**	**–**	**–**	**–**	**–**	**1.0**	**1.0**	**–**	**1.0**
Dividends paid	**–**	**–**	**–**	**–**	**–**	**(21.3)**	**(21.3)**	**–**	**(21.3)**
31 December 2012	**33.1**	**177.1**	**(11.3)**	**141.6**	**10.5**	**152.0**	**503.0**	**1.4**	**504.4**

Included in other reserves is the capital redemption reserve arising on redemption of the Group's B shares of £129.4m (2011: £129.4m) and the share-based payments reserve of £10.9m (2011: £11.9m).

The own shares reserve represents the cost of shares in Bodycote plc purchased in the market. At 31 December 2012 4,373,136 (2011: 5,089,830) ordinary shares of 17 $^{3}/_{11}$p each were held by the Bodycote International Employee Benefit Trust to satisfy share-based payments under the Group's incentive schemes (see note 27).

Group accounting policies

Year ended 31 December 2012

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.

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.

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.

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) and have been identified as being particularly complex or involve subjective assessments.

Goodwill on acquisition

Accounting for goodwill arising in a business combination requires an assessment of the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary or associate at the acquisition date. Details of the accounting policies applied in respect of goodwill arising on acquisition are set out below.

In establishing the fair value for intangible assets recognised on acquisition and their estimated useful lives, the Group has to make various subjective assessments of projected data and takes account of the individual circumstances of the entity acquired. This includes consideration of trading data such as historic sales and profitability levels, assessment of the discount rate used to calculate present value, the likelihood of loss of customers, the ability of former owners to compete, together with the estimated impact of competition.

Provisions for restructuring costs

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 required by the restructuring and not associated with the ongoing activities of the Group. Uncertainty arises in the estimation of site clean up and dilapidation costs. The Group has to make a subjective assessment of the cost involved based on previous experience, there can be no guarantee that the assumptions used to estimate the provision will result in a wholly accurate prediction of the actual costs that may be incurred.

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. Due to the significant uncertainty associated with the future level of such environmental liabilities there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that will be incurred. The Directors take account of the advice of experts in quantifying the expected costs of future remediation.

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 £131.8m (2011: £102.6m). Details of the accounting policies applied in respect of impairment are set out below.

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 29. Details of the accounting policies applied in respect of retirement benefit schemes are set out below.

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.

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.

Group accounting policies continued

Year ended 31 December 2012

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.

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.

Group accounting policies continued

Year ended 31 December 2012

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.

Business combinations

Acquisitions of subsidiaries and businesses are accounted for using the acquisition method. The consideration for each acquisition is measured at the aggregate of the fair values (at the date of exchange) of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree. Acquisition-related costs are recognised in profit or loss as incurred.

Subsequent changes in such fair values are adjusted against the cost of acquisition where they qualify as measurement period adjustments (see below). All other subsequent changes in the fair value of contingent consideration classified as an asset or liability are accounted for in accordance with relevant IFRSs.

The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 Business Combinations (Revised 2008) are recognised at their fair value at the acquisition date, except that:

- deferred tax assets or liabilities and liabilities or assets related to employee benefit arrangements are recognised and measured in accordance with IAS 12 *Income Taxes* and IAS 19 *Employee Benefits* respectively; and
- liabilities or equity instruments related to the replacement by the Group of an acquiree's share-based payment awards are measured in accordance with IFRS 2 *Share-based Payment*.

Assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations are measured in accordance with that Standard.

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.

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 Financial Instruments: Recognition and Measurement 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 18 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.

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.

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 34.

The nature of the Group's operations and its principal activities are set out on page 35 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 19 (revised) — Employee Benefits
- IAS 27 (revised) — Separate Financial Statements

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 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 2012

1. Revenue

	2012 £m	2011 £m
Heat treatment and metal joining, hot isostatic pressing and surface technology services	**587.8**	570.7
Other operating income (see note 3)	**5.2**	4.5
Investment revenue (see note 5)	**0.2**	0.2
Total Revenue (as defined in IAS 18 Revenue)	**593.2**	575.4

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 2012 £m**	**AGI 2012 £m**	**Head Office and eliminations 2012 £m**	**Consolidated 2012 £m**
Revenue				
Total revenue	**260.4**	**327.4**	**–**	**587.8**
Result				
Headline operating profit prior to share-based payments and unallocated corporate expenses	**71.4**	**45.1**	**–**	**116.5**
Share-based payments	**(1.8)**	**(1.5)**	**(2.1)**	**(5.4)**
Unallocated corporate expenses	**–**	**–**	**(13.2)**	**(13.2)**
Headline operating profit / (loss)	**69.6**	**43.6**	**(15.3)**	**97.9**
Amortisation of acquired intangible fixed assets	**(1.1)**	**(0.9)**	**–**	**(2.0)**
Profit on disposal of investment	**–**	**–**	**2.4**	**2.4**
Acquisition costs	**(0.8)**	**(1.7)**	**–**	**(2.5)**
Reorganisation costs	**–**	**–**	**(2.4)**	**(2.4)**
Segment result	**67.7**	**41.0**	**(15.3)**	**93.4**
Investment revenue				**0.2**
Finance costs				**(3.8)**
Profit before taxation				**89.8**
Taxation				**(22.8)**
Profit for the year				**67.0**

Inter-segment sales are not material in either year.

The Group does not rely on any individual major customers.

2. Business and geographical segments (continued)

Aerospace, Defence & Energy	Western Europe 2012 £m	North America 2012 £m	Emerging markets 2012 £m	Total ADE 2012 £m
Revenue				
Total revenue	**118.3**	**140.4**	**1.7**	**260.4**
Result				
Headline operating profit / (loss) prior to share-based payments	**27.9**	**43.7**	**(0.2)**	**71.4**
Share-based payments	**(0.5)**	**(1.3)**	**–**	**(1.8)**
Headline operating profit / (loss)	**27.4**	**42.4**	**(0.2)**	**69.6**
Amortisation of acquired intangible fixed assets	**(0.3)**	**(0.8)**	**–**	**(1.1)**
Acquisition costs	**–**	**(0.8)**	**–**	**(0.8)**
Segment result	**27.1**	**40.8**	**(0.2)**	**67.7**

Automotive & General Industrial	Western Europe 2012 £m	North America 2012 £m	Emerging markets 2012 £m	Total AGI 2012 £m
Revenue				
Total revenue	**219.2**	**61.8**	**46.4**	**327.4**
Result				
Headline operating profit prior to share-based payments	**30.3**	**13.1**	**1.7**	**45.1**
Share-based payments	**(1.0)**	**(0.5)**	**–**	**(1.5)**
Headline operating profit	**29.3**	**12.6**	**1.7**	**43.6**
Amortisation of acquired intangible fixed assets	**(0.2)**	**(0.5)**	**(0.2)**	**(0.9)**
Acquisition costs	**–**	**(1.7)**	**–**	**(1.7)**
Segment result	**29.1**	**10.4**	**1.5**	**41.0**

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

Notes to the consolidated financial statements continued

Year ended 31 December 2012

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)
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

Other information

Group	**ADE 2012 £m**	**AGI 2012 £m**	**Head Office and eliminations 2012 £m**	**Consolidated 2012 £m**
Capital additions	**22.9**	**25.8**	**3.7**	**52.4**
Depreciation and amortisation	**19.6**	**31.4**	**1.9**	**52.9**
Balance sheet				
Assets:				
Segment assets	**313.4**	**449.6**	**28.0**	**791.0**
Other investments	**–**	**–**	**1.6**	**1.6**
Consolidated total assets	**313.4**	**449.6**	**29.6**	**792.6**
Liabilities:				
Segment liabilities	**(68.7)**	**(126.9)**	**(92.6)**	**(288.2)**
	244.7	**322.7**	**(63.0)**	**504.4**
Allocation of head office net liabilities	**(27.2)**	**(35.8)**	**63.0**	**–**
Adjusted segment net assets	**217.5**	**286.9**	**–**	**504.4**

2. Business and geographical segments (continued)

Aerospace, Defence & Energy	Western Europe 2012 £m	North America 2012 £m	Emerging markets 2012 £m	Total ADE 2012 £m
Capital additions	**6.5**	**16.4**	**–**	**22.9**
Depreciation and amortisation	**10.0**	**9.4**	**0.2**	**19.6**
Balance sheet				
Assets:				
Segment assets	**150.2**	**160.5**	**2.7**	**313.4**
Liabilities:				
Segment liabilities	**(36.1)**	**(31.4)**	**(1.2)**	**(68.7)**
Segment net assets	**114.1**	**129.1**	**1.5**	**244.7**

Automotive & General Industrial	Western Europe 2012 £m	North America 2012 £m	Emerging markets 2012 £m	Total AGI 2012 £m
Capital additions	**16.8**	**4.9**	**4.1**	**25.8**
Depreciation and amortisation	**22.3**	**4.0**	**5.1**	**31.4**
Balance sheet				
Assets:				
Segment assets	**273.0**	**112.1**	**64.5**	**449.6**
Liabilities:				
Segment liabilities	**(96.7)**	**(17.3)**	**(12.9)**	**(126.9)**
Segment net assets	**176.3**	**94.8**	**51.6**	**322.7**

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	32.2	757.9
Other investments	–	–	0.8	0.8
Consolidated total assets	314.0	411.7	33.0	758.7
Liabilities:				
Segment liabilities	(67.3)	(128.0)	(80.8)	(276.1)
	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

Notes to the consolidated financial statements continued

Year ended 31 December 2012

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

Geographical information

The Group's revenue from external customers and information about its segment assets (non-current assets excluding financial instruments, deferred tax assets and other financial assets) by country are detailed below:

	Revenue from external customers		**Non-current assets**	
	2012 £m	2011 £m	**2012 £m**	2011 £m
USA	**194.2**	156.3	**233.3**	153.4
France	**90.1**	91.9	**70.1**	74.6
UK	**63.9**	59.4	**72.7**	74.1
Germany	**60.5**	67.7	**64.7**	70.2
Sweden	**42.1**	47.3	**44.3**	43.2
Netherlands	**24.1**	25.7	**20.8**	21.4
Others	**112.9**	122.4	**111.2**	119.3
	587.8	570.7	**617.1**	556.2

3. Operating profit

	2012 £m	2011 £m
Revenue	**587.8**	570.7
Cost of sales	**(368.7)**	(361.1)
Gross profit	**219.1**	209.6
Other operating income	**5.2**	4.5
Distribution costs	**(17.6)**	(17.9)
Administration expenses*	**(103.8)**	(109.5)
Other operating expenses	**(5.0)**	(1.2)
Exceptional items:		
Amortisation of acquired intangible fixed assets*	**(2.0)**	(0.9)
Impairment charge*	**–**	(4.2)
Profit on disposal of investment*	**2.4**	–
Acquisition costs*	**(2.5)**	–
Reorganisation costs*	**(2.4)**	–
Operating profit	**93.4**	80.4

* Administration expenses total £108.3m (2011: £114.6m).

Exceptional items comprise:

	2012 £m	2011 £m
Amortisation of acquired intangible fixed assets	**2.0**	0.9
Impairment of goodwill	**–**	3.7
Impairment of acquired intangible fixed assets	**–**	0.5
Profit on disposal of investment	**(2.4)**	–
Acquisition costs	**2.5**	–
Reorganisation costs	**2.4**	–
	4.5	5.1

Further details of these items are included in the Finance Director's report on page 22.

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

	2012 £m	2011 £m
Continuing operations:		
Net foreign exchange losses	**–**	0.1
Depreciation of property, plant and equipment	**48.7**	48.2
Amortisation of intangible fixed assets	**4.2**	2.9
Impairment of goodwill (see note 10)	**–**	3.7
Impairment of acquired intangible fixed assets (see note 11)	**–**	0.5
Loss on disposal of property, plant and equipment	**0.1**	0.7
Staff costs (see note 4)	**228.8**	228.5
Release of negative goodwill	**–**	(0.6)
Acquisition reorganisation costs	**–**	0.5
Acquisition costs	**2.5**	0.1
Impairment loss on trade receivables	**0.4**	–
Impairment / (reversal of impairment) of fixed assets	**0.7**	(0.4)

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

	2012 £m	2011 £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	**0.6**	0.5
Total audit fees	**0.7**	0.6
Taxation compliance services	**0.1**	0.1
Corporate finance services	**–**	0.1
Total non-audit fees	**0.1**	0.2
	0.8	0.8

3. Operating profit (continued)

In addition to the amounts shown opposite, the auditor received fees of £6,000 (2011: £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.

4. Staff costs

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

	2012 Number	2011 Number
ADE:		
Western Europe	**1,025**	1,010
North America	**1,087**	939
Emerging Markets	**14**	12
AGI:		
Western Europe	**2,012**	2,075
North America	**622**	497
Emerging Markets	**867**	897
Shared services	**78**	70
Head office	**30**	33
	5,735	5,533

Their aggregate remuneration comprised:

	2012 £m	2011 £m
Wages and salaries	**193.7**	189.1
Social security costs	**29.0**	33.8
Other pension costs	**6.1**	5.6
	228.8	228.5

Disclosure of individual director's 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 46 to 51 and form part of these financial statements.

5. Investment revenue

	2012 £m	2011 £m
Interest on bank deposits	**0.1**	0.1
Other interest receivable	**0.1**	0.1
Total interest and investment revenue	**0.2**	0.2

All investment revenue relates to bank balances and other receivables.

6. Finance costs

	2012 £m	2011 £m
Interest on bank overdrafts and loans*	**0.5**	1.1
Interest on obligations under finance leases	**–**	0.1
Total interest expense	**0.5**	1.2
Interest on pension scheme liabilities	**4.7**	5.1
Return on pension assets	**(3.5)**	(4.4)
Other finance charges*	**2.1**	2.9
Total finance costs	**3.8**	4.8

* Amounts arising on financial liabilities measured at amortised cost.

7. Taxation

	2012 £m	2011 £m
Current taxation – charge for the year	**23.8**	18.0
Current taxation – adjustments in respect of previous years	**(0.5)**	(4.7)
Deferred tax (see note 19)	**(0.5)**	6.5
	22.8	19.8

UK corporation tax is calculated at 24.5% (2011: 26.5%) of the estimated accessible profit for the year. Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

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

	2012 £m	2011 £m
Profit before tax	**89.8**	75.8
Tax at the UK corporation tax rate of 24.5% (2011: 26.5%)	**22.0**	20.1
Tax effect of expenses that are not deductible in determining taxable profit	**0.3**	2.1
Deferred tax assets recognised	**(2.8)**	(1.7)
Tax effect of other adjustments in respect of previous years:		
Current tax	**(0.5)**	(4.7)
Deferred tax	**(1.7)**	0.7
Effect of different tax rates of subsidiaries operating in other jurisdictions	**5.5**	3.3
Tax expense for the year	**22.8**	19.8

Tax on items taken directly to equity is a credit of £2.4m (2011: £2.2m).

8. Dividends

	2012 £m	2011 £m
Amounts recognised as distributions to equity holders in the year:		
Final dividend for the year ended 31 December 2011 of 7.30p (2010: 5.75p) per share	**13.8**	10.7
Interim dividend for the year ended 31 December 2012 of 4.00p (2011: 3.60p) per share	**7.5**	6.7
	21.3	17.4
Proposed final dividend for the year ended 31 December 2012 of 8.30p (2011: 7.30p) per share	**15.9**	14.0

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.

9. Earnings per share

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

	2012 £m	2011 £m
Earnings		
Earnings for the purpose of basic earnings per share being net profit attributable to equity holders of the parent	**66.9**	55.8

	2012 Number	2011 Number
Number of shares		
Weighted average number of ordinary shares for the purpose of basic earnings per share	**186,981,962**	185,838,882
Effect of dilutive potential ordinary shares:		
Share options	**19,307**	3,780,964
Weighted average number of ordinary shares for the purpose of diluted earnings per share	**187,001,269**	189,619,846

	2012 Pence	2011 Pence
Earnings per share:		
Basic	**35.8**	30.0
Diluted	**35.8**	29.4

Headline earnings

	2012 £m	2011 £m
Net profit attributable to equity holders of the parent	**66.9**	55.8
Add back:		
Amortisation of acquired intangible fixed assets (net of tax)	**1.9**	0.8
Impairment charge	**–**	4.2
Profit on disposal of investment (net of tax)	**(2.2)**	–
Acquisition costs (net of tax)	**1.6**	–
Reorganisation costs (net of tax)	**1.8**	–
Headline earnings	**70.0**	60.8

Earnings per share from headline earnings:

	2012 Pence	2011 Pence
Basic	**37.4**	32.7
Diluted	**37.4**	32.1

10. Goodwill

	2012 £m	2011 £m
Cost		
At 1 January	**175.5**	178.1
Exchange differences	**(2.1)**	(2.6)
Recognised on acquisition of businesses (see note 24)	**29.5**	–
At 31 December	**202.9**	175.5
Accumulated impairment		
At 1 January	**72.9**	70.4
Exchange differences	**(1.8)**	(1.2)
Impairment losses for the year	**–**	3.7
At 31 December	**71.1**	72.9
Carrying amount	**131.8**	102.6

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:

	2012 £m	2011 £m
ADE:		
Western Europe	**26.7**	26.7
North America	**44.9**	37.1
AGI:		
Western Europe	**17.4**	17.6
North America	**36.6**	15.2
Emerging Markets	**6.2**	6.0
	131.8	102.6

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 in respect of future cash flows. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the cash generating units. The rate used to discount the forecast cash flows for cash generating units is 11.3% (2011: 9.5%). This rate is risk adjusted, for specific countries, where the Group perceives a risk premium is appropriate. 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. Cash flows after five years are based on an estimated growth rate of 3.2% (2011: 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 key assumptions applied to the value in use calculations for each cash generating unit. A decline in sales of 26.2% per annum would result in the recoverable amount of goodwill for the Group being reduced to its carrying value.

The Board has concluded that no impairment charge is required in 2012. The charge for impairment of goodwill and acquired intangible fixed assets in 2011 related to the Group's South American operations, where trading activity has previously lagged expectations, which together with an increase in the perceived risk adjusted discount rate, led to an impairment of goodwill and acquired intangible fixed assets. No goodwill nor intangible fixed assets remain on the Group's balance sheet in respect of the South American businesses.

Notes to the consolidated financial statements continued

Year ended 31 December 2012

11. Other intangible assets

	Software £m	Non-compete agreements £m	Customer relationships £m	Total £m
Cost				
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	–	–	0.3	0.3
Disposals	(0.8)	–	–	(0.8)
At 1 January 2012	**14.6**	**–**	**10.1**	**24.7**
Exchange differences	**(0.4)**	**–**	**(1.2)**	**(1.6)**
Additions	**3.6**	**–**	**–**	**3.6**
Acquired on acquisition of businesses (see note 24)	**–**	**2.9**	**24.8**	**27.7**
Disposals	**(0.1)**	**–**	**–**	**(0.1)**
At 31 December 2012	**17.7**	**2.9**	**33.7**	**54.3**
Amortisation				
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	–	–	0.5	0.5
Disposals	(0.5)	–	–	(0.5)
At 1 January 2012	**10.0**	**–**	**5.8**	**15.8**
Exchange differences	**(0.3)**	**–**	**(0.4)**	**(0.7)**
Charge for the year	**2.2**	**0.1**	**1.9**	**4.2**
At 31 December 2012	**11.9**	**0.1**	**7.3**	**19.3**
Carrying amount				
At 31 December 2012	**5.8**	**2.8**	**26.4**	**35.0**
At 31 December 2011	4.6	–	4.3	8.9

The amortisation periods for intangible assets are:

	Years
Software	3 to 5
Customer relationships	10 to 15
Non-compete agreements	4 to 5

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

12. 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 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 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 1 January 2012	**205.5**	**1.6**	**18.3**	**710.4**	**32.8**	**28.7**	**997.3**
Additions	**0.9**	**–**	**0.1**	**13.0**	**1.0**	**33.8**	**48.8**
Acquisition of businesses	**6.4**	**–**	**0.5**	**22.0**	**0.4**	**1.4**	**30.7**
Exchange differences	**(6.3)**	**–**	**(0.8)**	**(22.6)**	**(1.1)**	**(1.3)**	**(32.1)**
Transfer from assets held for sale	**2.1**	**–**	**–**	**–**	**–**	**–**	**2.1**
Recategorisation	**3.9**	**0.2**	**(1.3)**	**21.4**	**0.8**	**(25.0)**	**–**
Disposals	**(2.4)**	**–**	**(0.4)**	**(10.5)**	**(1.6)**	**(0.1)**	**(15.0)**
Disposal of subsidiaries	**(0.1)**	**–**	**–**	**(0.4)**	**–**	**–**	**(0.5)**
At 31 December 2012	**210.0**	**1.8**	**16.4**	**733.3**	**32.3**	**37.5**	**1,031.3**
Accumulated depreciation and impairment							
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 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 1 January 2012	**71.8**	**0.8**	**10.4**	**443.8**	**26.6**	**–**	**553.4**
Charge for the year	**5.8**	**0.3**	**0.6**	**40.1**	**1.9**	**–**	**48.7**
Acquisition of businesses	**–**	**–**	**0.4**	**8.1**	**0.2**	**–**	**8.7**
Impairment losses incurred	**0.3**	**–**	**–**	**0.4**	**–**	**–**	**0.7**
Exchange differences	**(2.2)**	**–**	**(0.5)**	**(14.0)**	**(0.9)**	**–**	**(17.6)**
Transfer from assets held for sale	**0.4**	**–**	**–**	**–**	**–**	**–**	**0.4**
Recategorisation	**0.3**	**–**	**(0.4)**	**0.1**	**–**	**–**	**–**
Eliminated on disposals	**(0.7)**	**–**	**(0.5)**	**(8.9)**	**(1.5)**	**–**	**(11.6)**
Eliminated on disposal of subsidiaries	**–**	**–**	**–**	**(0.1)**	**–**	**–**	**(0.1)**
At 31 December 2012	**75.7**	**1.1**	**10.0**	**469.5**	**26.3**	**–**	**582.6**
Carrying amount							
At 31 December 2012	**134.3**	**0.7**	**6.4**	**263.8**	**6.0**	**37.5**	**448.7**
At 31 December 2011	133.7	0.8	7.9	266.6	6.2	28.7	443.9

The carrying amount of leased assets is £0.6m (2011: £0.7m).

The Group has pledged land and buildings having a carrying amount of approximately £0.5m (2011: £0.6m) to secure banking facilities granted to the Group.

At 31 December 2012 the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £3.7m (2011: £4.6m).

In addition to the above, property, plant and equipment amounting to £2.1m (2011: £5.3m) has been classified as held for sale.

13. 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 105 and 106.

	2012 £m	2011 £m
Sundry investments	**1.6**	0.8

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

14. Inventories

	2012 £m	2011 £m
Raw materials	**11.9**	12.4
Work-in-progress	**6.2**	4.2
Finished goods and goods for resale	**0.3**	0.1
	18.4	16.7

15. Other financial assets

Trade and other receivables

	2012 £m	2011 £m
Amounts falling due within one year:		
Amount receivable for the supply of services	**92.4**	92.0
Other debtors and prepayments*	**17.1**	13.8
	109.5	105.8
Amounts falling due after more than one year:		
Other debtors and prepayments*	**1.6**	1.9

* 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 2012 is 58 days (2011: 59 days). An allowance has been made for estimated irrecoverable amounts from the supply of services of £6.2m (2011: £6.2m). 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.

15. Other financial assets (continued)

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 18.

Included in the Group's trade receivable balance are debtors with a carrying amount of £20.6m (2011: £17.7m) 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.

Ageing of past due but not impaired receivables:

	2012 £m	2011 £m
Amounts overdue by up to 1 month	**16.0**	14.6
Amounts overdue by 1–2 months	**2.2**	1.8
Amounts overdue by 2–3 months	**0.5**	0.4
Amounts overdue by more than 3 months	**1.9**	0.9
	20.6	17.7

Movement in the allowance for doubtful debts:

	2012 £m	2011 £m
At 1 January	**6.2**	6.9
Impairment losses recognised	**1.6**	1.6
Allowance acquired with subsidiaries	**0.2**	–
Amounts written off as uncollectable	**(0.4)**	(0.4)
Impairment losses reversed	**(1.2)**	(1.6)
Exchange differences	**(0.2)**	(0.3)
At 31 December	**6.2**	6.2

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 (2011: £8.9m). 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:

	2012 £m	2011 £m
Less than 3 months	**2.7**	2.8
3–12 months	**1.8**	1.8
Over 12 months	**4.4**	4.3
	8.9	8.9

15. Other financial assets (continued)

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:

	2012 £m	2011 £m
Sterling	**0.9**	2.2
Euro	**2.6**	6.2
US Dollar	**2.3**	2.5
Chinese Yuan	**0.6**	0.8
Indian Rupee	**0.6**	0.7
Swedish Krona	**0.6**	0.2
Polish Zloty	**0.5**	0.5
Danish Krone	**0.4**	0.5
Thai Baht	**0.3**	0.6
Turkish Lira	**0.2**	0.1
Czech Republic Koruna	**0.2**	0.4
Romanian Leu	**0.2**	0.4
Canadian Dollar	**0.1**	2.3
Swiss Franc	**0.1**	0.2
Mexican Peso	**0.1**	0.1
Brazilian Real	**0.1**	–
Other	**0.2**	0.4
Total cash and bank balances	**10.0**	18.1

16. Assets held for sale

Assets held for sale comprise the following:

	2012 £m	2011 £m
Property, plant and equipment	**2.1**	5.3

It is expected that the disposal of these assets will be completed during 2013. The assets held for sale are analysed between operating segments as follows:

	2012 £m	2011 £m
ADE:		
Western Europe	**–**	1.3
North America	**0.7**	0.7
AGI:		
Western Europe	**1.2**	1.6
North America	**0.2**	0.3
Emerging Markets	**–**	1.4
	2.1	5.3

17. Borrowings

	2012 £m	2011 £m
Borrowings at amortised cost:		
Bank overdrafts	**8.4**	8.6
Loans	**35.3**	8.7
	43.7	17.3
The borrowings are repayable as follows:		
On demand or within one year	**43.4**	10.8
In the second year	**0.1**	6.1
In the third to fifth years	**0.1**	0.2
After five years	**0.1**	0.2
	43.7	17.3
Less: Amount due for settlement within 12 months (shown under current liabilities)	**(43.4)**	(10.8)
Amount due for settlement after 12 months	**0.3**	6.5

Analysis of borrowings by currency:

	Sterling £m	Euro £m	US Dollar £m	Other currencies £m	Total £m
At 31 December 2012					
Bank overdrafts	**0.5**	**4.5**	**1.1**	**2.3**	**8.4**
Loans	**10.0**	**10.5**	**13.9**	**0.9**	**35.3**
	10.5	**15.0**	**15.0**	**3.2**	**43.7**
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

The weighted average interest rates paid were as follows:

	2012 %	2011 %
Bank overdrafts and loans	**2.5**	2.1

Loans and finance leases of £0.9m (2011: £1.4m) 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.

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

	2012 £m	2011 £m
Bank overdrafts	**8.4**	8.6
Loans	**35.3**	8.7

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

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

(ii) At 31 December 2012 the Group has two principal borrowing facilities which are secured by upstream guarantees provided by subsidiaries:

(a) Drawings of £nil (2011: £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 2012 was 1.15%).

(b) Drawings of £33.5m (2011: £6.0m) 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 2012 was 0.80%).

At 31 December 2012 the Group had available £192.9m (2011: £223.9m) of undrawn committed borrowing facilities.

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

18. Derivative financial instruments

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

Asset / (liability)	**Notional amount 2012 £m**	**Fair value 2012 £m**	Notional amount 2011 £m	Fair value 2011 £m
Current				
Forward foreign exchange contracts	**3.6**	**(0.1)**	1.3	(0.1)
Non-current				
Forward foreign exchange contracts	**–**	**–**	3.2	(0.2)
Total				
Forward foreign exchange contracts	**3.6**	**(0.1)**	4.5	(0.3)

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 2012 or 2011.

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 2012 £m**	**Euro 2012 £m**	**US Dollar 2012 £m**	**Total fair value 2012 £m**
Forward foreign exchange contracts	**0.3**	**(3.5)**	**3.1**	**(0.1)**
On demand or within one year	**0.3**	**(3.5)**	**3.1**	**(0.1)**

Asset / (liability)	Sterling 2011 £m	Euro 2011 £m	US Dollar 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)

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.

18. Derivative financial instruments (continued)

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 2012, the Group had revolving credit committed borrowing facilities of £226.4m (2011: £229.9m) which exceeded net debt of £34.2m (2011: net cash of £0.1m) by £192.2m (2011: £230.0m). 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. As at 31 December 2012 the Group's principal committed bank facilities have the following maturity dates:

- €125m Revolving Credit Facility 31 July 2013 (0.6 years)
- £125m Revolving Credit Facility 31 August 2016 (3.7 years)
- $10m Letter of Credit Facility 31 August 2016 (3.7 years)

On 18 February 2013, the €125m Revolving Credit Facility maturing on 31 July 2013, was refinanced for the same amount, extending the maturity to 1 March 2018, increasing the weighted average life of the committed facilities at that date to 4.2 years.

In addition, cash management pooling, netting and concentration techniques are used to minimise borrowings. As at 31 December 2012, the Group had gross cash of £10.0m (2011: £18.1m).

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 2012, 2% of gross debt and 0% of gross cash were at fixed rates (2011: 8% of gross debt, 0% of gross cash). The average tenure of the fixed rate debt was 3.5 years (2011: 3.6 years).

Currency risk

Bodycote has operations in 26 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 36%, USD 33% and SEK 7%). Cumulatively over the year, sterling rates moved such that the sales for the year were £19.6m worse than if sales had been translated at the rates prevailing in 2011.

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 2012, 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.

18. 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 2012 would reduce or increase profit before tax by approximately £0.4m (2011: £0.1m). There is no significant impact on equity.

Currency sensitivity

Taking the 2012 sales by currency, a 10% weakening/strengthening in the 2012 cumulative average rates for all currencies versus sterling would have given rise to a +£58.2m/-£47.6m 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 2012 operating profit mix, a 10% weakening/strengthening in 2012 cumulative average rates for all currencies would have given rise to a +£11.1m/-£9.1m 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.

19. 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 2011	41.1	(8.9)	(3.1)	(4.3)	24.8
Charge / (credit) 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 January 2012	**39.5**	**(4.4)**	**(3.2)**	**(4.7)**	**27.2**
Charge / (credit) to income	**2.8**	**(1.1)**	**(0.7)**	**(0.9)**	**0.1**
Credit to equity	**–**	**–**	**(1.4)**	**(1.0)**	**(2.4)**
Acquisition of subsidiaries	**–**	**–**	**–**	**(0.2)**	**(0.2)**
Transfers	**(0.1)**	**(0.8)**	**0.1**	**0.8**	**–**
Exchange differences	**(1.5)**	**0.2**	**0.1**	**0.2**	**(1.0)**
Effect of change in tax rate:					
Income statement	**(0.8)**	**0.4**	**–**	**(0.2)**	**(0.6)**
At 31 December 2012	**39.9**	**(5.7)**	**(5.1)**	**(6.0)**	**23.1**

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

	2012 £m	2011 £m
Deferred tax liabilities	**56.4**	79.5
Deferred tax assets	**(33.3)**	(52.3)
	23.1	27.2

19. Deferred tax (continued)

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 £122.3m (2011: £183.1m) available for offset against future profits. A deferred tax asset has been recognised in respect of £18.7m (2011: £96.3m) 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 £103.6m (2011: £86.8m) 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.

20. Obligations under finance leases

	Minimum lease payments		Present value of minimum lease payments	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Amounts payable under finance leases:				
Within one year	**0.2**	0.3	**0.2**	0.2
In the second to fifth years inclusive	**0.3**	0.5	**0.3**	0.5
	0.5	0.8	**0.5**	0.7
Less: future finance charges	**–**	(0.1)		
Present value of lease obligations	**0.5**	0.7		
Analysed as:				
Amount due for settlement after 12 months			**0.3**	0.5
Amount due for settlement within 12 months (shown under current liabilities)			**0.2**	0.2
			0.5	0.7

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

	2012	2011
Sterling	**0.4**	0.5
US Dollar	**0.1**	0.1
Euro	**–**	0.1
	0.5	0.7

It is the Group's policy to lease certain of its fixtures and equipment under finance leases. The average lease term is 3.7 years. For the year ended 31 December 2012, the average effective borrowing rate was 8.0% (2011: 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.

21. Other financial liabilities

Trade and other payables

	2012 £m	2011 £m
Amounts falling due within one year:		
Trade creditors	**35.2**	39.8
Other taxes and social security*	**18.3**	16.6
Other creditors	**20.6**	20.8
Accruals and deferred income	**58.8**	49.7
	132.9	126.9
Amounts falling due after more than one year:		
Other creditors	**4.1**	4.5

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

21. Other financial liabilities (continued)

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 2012 is 45 days (2011: 47 days).

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

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 2012 £m	1–2 years 2012 £m	2–5 years 2012 £m	5+ years 2012 £m	Total 2012 £m
Non-interest bearing*	141.8	2.2	6.3	5.0	155.3
Finance lease liability	0.2	0.1	0.2	–	0.5
Bank loans and overdrafts	43.8	0.1	0.1	0.2	44.2
Derivative financial instruments	3.7	–	–	–	3.7
	189.5	2.4	6.6	5.2	203.7

	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

Of the £44.2m (2011: £17.5m) bank loan and overdraft outflows disclosed above, £nil (2011: £nil) and £33.5m (2011: £6.0m) of bank loans are drawn under committed facilities maturing on 31 August 2016 and 31 July 2013 respectively. The overdrafts are on-demand and some are part of pooling arrangements, which include offsetting cash balances. Of the £3.7m (2011: £4.7m) derivative financial instrument outflows disclosed above, £3.6m (2011: £4.5m) 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.

22. Provisions

	Restructuring £m	Restructuring Environmental £m	Environmental £m	Total £m
At 1 January 2012	6.2	9.3	6.5	22.0
Increase in provision	4.5	–	1.2	5.7
Release of provision	(1.7)	(0.9)	–	(2.6)
Utilisation of provision	(4.4)	(0.9)	(0.6)	(5.9)
Exchange difference	(0.2)	(0.4)	(0.3)	(0.9)
At 31 December 2012	4.4	7.1	6.8	18.3
Included in current liabilities				8.9
Included in non-current liabilities				9.4
				18.3

The restructuring provision relates to the remaining costs associated with the closure of various Heat Treatment sites.

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 £2.4m of reorganisation and redundancy costs have been recognised in relation to the establishment of an accounting Shared Service Centre in Prague.

The majority of cash outflows in respect of these liabilities are expected to occur within 5 years.

23. Share capital

	2012 £m	2011 £m
Issued and fully paid:		
191,424,088 (2011: 191,263,667) ordinary shares of 17 3/11p each	**33.1**	33.0

24. Acquisition of businesses and subsidiaries

The Group made a number of acquisitions in the year, the most significant of which were as follows:

On 31 March 2012 the Group acquired the trade and assets of the heat treatment business of Curtiss-Wright Corporation for a cash consideration of £32.4m. The acquisition was made to provide additional capacity and a broader customer base in key regions of North America. The acquisition gives the Group a major presence in the strategically important aerospace industry hub in Wichita, Kansas; Louisiana provides access to the oil & gas market, and the northern plants fit well with the Group's automotive and general industrial network, enhancing service to existing customers and extending the geographic coverage.

On 16 October 2012 the Group acquired the trade and assets of Carolina Commercial Heat Treating, together with an additional facility in Southern Indiana, for a cash consideration of £41.4m. This acquisition was completed to develop a footprint in the south eastern USA, which continues to be amongst the highest recipients of inward investment in North America, with many domestic and overseas corporations establishing businesses and supply chains in the area.

All transactions have been accounted for by the purchase method of accounting and are summarised below.

	Heat Treatment business of Curtiss-Wright Corporation £m	Trade & assets of Carolina Commercial Heat Treating LLC £m	Other £m	Total Group £m
Fair value of net assets acquired:				
Intangible fixed assets	10.4	13.8	3.5	27.7
Property, plant and equipment	8.5	9.8	3.7	22.0
Deferred tax asset	–	0.2	–	0.2
Inventories	–	0.1	0.1	0.2
Trade and other receivables	3.7	3.0	1.1	7.8
Trade and other payables	(0.6)	(1.6)	(0.5)	(2.7)
	22.0	25.3	7.9	55.2
Goodwill	10.4	16.1	3.0	29.5
Total consideration	32.4	41.4	10.9	84.7
Satisfied by:				
Cash consideration	32.4	41.4	10.9	84.7
Net cash outflow arising on acquisition:				
Cash consideration	32.4	41.4	10.9	84.7

The carrying value of inventories, trade and other receivables and trade and other payables approximates their fair value. Fair values of the acquired identifiable tangible and intangible assets are provisional, pending completion of the final valuations.

The gross contractual value of trade and other receivables was £8.0m. The best estimate at the acquisition dates of the contractual cash flows not expected to be collected was £0.2m.

The goodwill arising on the acquisitions is attributable to the anticipated profitability of the Group's services in new markets and the anticipated future operating synergies from the combination with the Group of each of the acquired businesses.

Acquisition-related costs (reported in exceptional items) amounted to £2.5m.

The acquired businesses contributed £22.4m revenue and £5.1m to the Group's operating profit for the period between their dates of acquisition and the balance sheet date.

If the acquisition of all the businesses had been completed on the first day of the financial year, Group revenue for the year would have been £620.9m and Group operating profit would have been £98.7m.

Notes to the consolidated financial statements continued

Year ended 31 December 2012

25. Notes to the cash flow statement

	2012 £m	2011 £m
Profit for the year	**67.0**	56.0
Adjustments for:		
Investment revenue	**(0.2)**	(0.2)
Finance costs	**3.8**	4.8
Taxation	**22.8**	19.8
Depreciation of property, plant and equipment	**48.7**	48.2
Amortisation of intangible assets	**4.2**	2.9
Loss on disposal of property, plant and equipment	**0.1**	0.7
Share-based payments	**3.9**	5.4
Impairment / (reversal of impairment) of fixed assets	**0.7**	(0.1)
Impairment charge	**–**	4.2
Negative goodwill released to income	**–**	(0.6)
Gain on disposal of businesses	**(2.4)**	–
EBITDA*	**148.6**	141.1
Increase in inventories	**(1.8)**	(2.8)
Decrease / (increase) in receivables	**0.3**	(7.9)
Increase in payables	**6.4**	8.9
Decrease in provisions	**(2.8)**	(4.5)
Cash generated by operations	**150.7**	134.8
Cash (outflow) / inflow from settlement of derivative financial instruments	**(0.2)**	0.3
Income taxes paid	**(19.3)**	(15.3)
Net cash from operating activities	**131.2**	119.8

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

	2012 £m	2011 £m
Cash and cash equivalents comprise:		
Cash and bank balances	**10.0**	18.1
Bank overdrafts (included in borrowings)	**(8.4)**	(8.6)
	1.6	9.5

26. Operating lease arrangements – the Group as lessee

	2012 £m	2011 £m
Minimum lease payments under operating leases recognised as an expense	**14.8**	14.6

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:

	2012 £m	2011 £m
Within one year	**10.8**	10.7
In the second to fifth years inclusive	**22.9**	21.1
After five years	**15.0**	15.0
	48.7	46.8

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

27. Share-based payments

Equity-settled share option schemes

The Company operates two 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 exercisable three years from the date of grant if stated performance criteria have been met. Options lapse if not exercised 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 2012	2011
Sep-02	125.76	2005-2012	–	53,474
Sep-03	147.27	2006-2013	**32,084**	139,031
			32,084	192,505

Movements in share options are summarised as follows:

	Number of shares under option 2012	**Weighted average exercise price 2012 pence**	Number of shares under option 2011	Weighted average exercise price 2011 pence
Outstanding at the beginning of the year	**192,505**	**141.25**	685,951	165.18
Exercised during the year	**(160,421)**	**140.10**	(381,750)	172.15
Expired during the year	–	–	(111,696)	184.95
Outstanding and exercisable at the end of the year	**32,084**	**147.27**	192,505	141.25

The weighted average share price at the date of exercise for share options exercised during the year was 140.10 pence. The options outstanding at 31 December 2012 had a weighted average exercise price of 147.27 pence, and a weighted average remaining contractual life of 0.8 years. The average share price during the year was 369.8 pence.

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

		2012	2011
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 three 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. Ten per cent per annum compound growth in excess of growth in the CPI will be required for a vesting matching ratio of 1:1.

27. Share-based payments (continued)

The number of outstanding share awards is as follows:

	BIP 2012	**CIP 2012**	BIP 2011	CIP 2011
At 1 January	**5,384,567**	**235,982**	4,491,128	193,257
Granted during the year	**1,002,056**	**77,336**	1,372,585	64,176
Exercised during the year	**(2,103,870)**	**–**	–	–
Expired during the year	**(96,488)**	**–**	(479,146)	(21,451)
At 31 December	**4,186,265**	**313,318**	5,384,567	235,982

Exercise Price = £nil.

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

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

		2012	2011
Weighted average share price	pence	**369.8**	375.8
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 £3.9m (2011: £5.4m) related to equity-settled share-based payment transactions.

28. 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:

	2012 £m	2011 £m
Short-term employee benefits	**1.8**	1.9
Share-based payments	**1.3**	–
	3.1	1.9

Further information about the remuneration of the individual directors is provided in the Board Report on Remuneration on pages 46 to 51.

29. Retirement benefit schemes

Defined contribution schemes

The Group operates defined contribution retirement benefit schemes for employees in the United Kingdom, France, Belgium, Brazil, Canada, Italy and the United States of America. The assets of the schemes are held separately from those of the Group in funds under the control of trustees. Where there are employees who leave the schemes prior to vesting fully in the contributions, the contributions payable by the Group are reduced by the amount of forfeited contributions.

The Group's employees in Denmark, Finland, Sweden and the Netherlands are members of state-managed retirement benefit schemes operated by the governments of each country. The relevant subsidiaries are required to contribute a specified percentage of payroll costs to the retirement benefit schemes to fund the benefits. The only obligation of the Group with respect to these retirement benefit schemes is to make the specified contributions.

The total cost charged to income of £5.1m (2011: £4.5m) represents contributions payable to these schemes by the Group at rates specified in the rules of the plans. As at 31 December 2012 contributions of £0.3m (2011: £0.4m) due in respect of the current reporting period had not been paid over to the schemes.

29. Retirement benefit schemes (continued)

Defined benefit schemes

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:

	2012 £m	2011 £m
UK Scheme	**(4.2)**	(1.8)
Non-UK Schemes	**(14.3)**	(11.7)
	(18.5)	(13.5)

Total expense recognised in income statement

	2012 £m	2011 £m
UK Scheme	**1.2**	0.9
Non-UK Schemes	**1.1**	1.3
	2.3	2.2

Further details of the Group's defined benefit arrangements are given in the Finance Director's report on pages 24 and 25.

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 2012.

The contributions made by the employer over the financial year have been £1.5m, comprising £0.5m in respect of benefit accrual and £1.0m in respect of deficit recovery and 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

	2012 £m	2011 £m
Defined benefit obligation at start of year	**82.2**	75.8
Current service cost	**0.6**	0.8
Interest cost	**3.9**	4.1
Contributions by plan participants	**0.2**	0.3
Actuarial loss	**2.7**	7.2
Benefits paid, death in service insurance premiums and expenses	**(4.0)**	(6.0)
Defined benefit obligation at end of year	**85.6**	82.2

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

	2012 £m	2011 £m
Fair value of assets at start of year	**80.4**	75.2
Expected return on assets	**3.3**	4.0
Actuarial (loss) / gain	**(0.1)**	5.6
Contributions by employer	**1.5**	1.1
Contributions by plan participants	**0.2**	0.3
Age related rebate	**0.1**	0.2
Benefits paid, death in service insurance premiums and expenses	**(4.0)**	(6.0)
Fair value of assets at end of year	**81.4**	80.4

29. Retirement benefit schemes (continued)

Total expense recognised in the income statement

	2012 £m	2011 £m
Current service cost	**0.6**	0.8
Interest on pension scheme liabilities	**3.9**	4.1
Expected return on pension scheme assets	**(3.3)**	(4.0)
Total expenses	**1.2**	0.9

Of the total expenses for the year £0.6m (2011: £0.8m) has been included in cost of sales and overheads and the remaining £0.6m (2011: £0.1m) has been included in finance costs.

The cumulative amount of actuarial losses recognised in other comprehensive income since adoption of IAS 19 is £14.2m.

Assets

	2012 £m	2011 £m	2010 £m
Equities (including property)	**10.7**	27.1	32.2
Bonds (including gilts)	**47.6**	47.9	38.1
Cash	**0.1**	1.0	0.2
Hedge funds	**–**	4.4	4.7
Diversified growth funds	**23.0**	–	–
	81.4	80.4	75.2

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:

	2012 % per annum	2011 % per annum	2010 % per annum
Equities	**5.8**	5.4	6.9
Bonds	**3.7**	3.8	4.9
Hedge funds	**–**	5.4	6.9
Cash	**0.5**	0.5	0.5
Diversified growth funds	**5.3**	–	–
Overall for scheme	**4.4**	4.4	5.8

Actual return on plan assets

The actual return on the plan assets for the year ended 31 December 2012 was 4.1% (2011: 13.5%).

29. Retirement benefit schemes (continued)

Assumptions

	2012 % per annum	2011 % per annum	2010 % per annum
RPI inflation	**3.10**	3.25	3.65
CPI inflation	**2.60**	2.75	3.15
Salary increases	**3.00**	3.00	3.00
Rate of discount	**4.50**	4.75	5.50
Allowance for pension in payment increases of RPI or 5% p.a. if less	**3.37***	3.58*	3.55
Allowance for pension in payment increases of RPI or 3% p.a. if less	**2.34**	2.62	2.75
Allowance for revaluation of deferred pensions	**2.60**	2.75	3.15

* CPI minimum 3%, maximum 5% for 2012 and 2011.

Mortality – current pensioners:	**S1PxA YoB CMI 2010 1.5% long term trend**	S1PxA YoB CMI 2010 1.5% long term trend	PA 92 YoB MC, 1% underpin
Actuarial tables used	**2012**	2011	2010
Life expectancy for members currently aged 65	**22.7**	22.7	22.5

Mortality – future pensioners:	**S1PxA YoB CMI 2010 1.5% long term trend**	S1PxA YoB CMI 2010 1.5% long term trend	PA 92 YoB MC, 1% underpin
Actuarial tables used	**2012**	2011	2010
Life expectancy at age 65 for members currently aged 40	**25.6**	25.6	24.0

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

	2012 £m	2011 £m	2010 £m
Present value of defined benefit obligation	**85.6**	82.2	75.8
Fair value of plan assets	**(81.4)**	(80.4)	(75.2)
Deficit in the scheme	**4.2**	1.8	0.6

As all actuarial gains and losses are recognised, the deficit shown above at 31 December 2012 is that recognised in the balance sheet.

The best estimate of contributions to be paid into the plan for the year ending 31 December 2013 is £1.2m.

Amounts for the current and previous four years

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Fair value of assets	**(81.4)**	(80.4)	(75.2)	(69.9)	(63.0)
Present value of defined benefit obligation	**85.6**	82.2	75.8	73.6	63.7
Deficit in the scheme	**4.2**	1.8	0.6	3.7	0.7
Loss from experience adjustment on plan liabilities	**–**	(7.7)	–	–	(0.4)
(Loss)/gain from experience adjustment on plan assets	**(0.1)**	5.7	2.3	4.5	(10.7)

29. Retirement benefit schemes (continued)

Impact of changes to assumptions

The impact of changes to certain assumptions on the current deficit and the 2013 charge to the income statement on the UK scheme is shown in the table below:

	Impact on current deficit £m	Impact on 2013 charge to income statement £m
Change in discount rate by 0.25% (decrease in rate increases liability)	**4.0**	0.2
Change in inflation assumption by 0.25% (increase in rate increases liability)	**1.3**	0.1
Change in mortality assumption from S1PxA CMI 2010 1.5% long term trend rate to S1PxA CMI 2011 1.5% long term trend rate (change increases liability)	**0.2**	–
Change in the value of equities by 5% (decrease increases liability)	**0.5**	–
Change in the expected return on equities assumption by 0.25%	**–**	–

Combined non-UK disclosures

The Group operates schemes in the USA, Brazil and continental Europe.

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

	2012 £m	2011 £m
Defined benefit obligation at start of year	**22.0**	22.0
Current service cost	**0.5**	0.6
Interest cost	**0.8**	1.0
Actuarial loss	**2.9**	0.6
Benefits paid, death in service insurance premiums and expenses	**(1.6)**	(1.7)
Curtailments	**(0.1)**	–
Employee contributions	**0.1**	0.2
Acquisitions	**–**	0.1
Exchange rate gain	**(0.7)**	(0.8)
Defined benefit obligation at end of year	**23.9**	22.0

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

	2012 £m	2011 £m
Fair value of assets at start of year	**9.7**	10.4
Expected return on assets	**0.2**	0.4
Actuarial gain / (loss)	**0.4**	(0.2)
Contributions by employer	**0.2**	0.4
Contributions by employees	**0.1**	0.2
Benefits paid, death in service insurance premiums and expenses	**(1.2)**	(1.3)
Settlements	**(0.1)**	–
Exchange rate loss	**(0.3)**	(0.2)
Fair value of assets at end of year	**9.0**	9.7

29. Retirement benefit schemes (continued)

Total expense recognised in the income statement

	2012 £m	2011 £m
Current service cost	**0.5**	0.6
Interest on pension scheme liabilities	**0.8**	1.0
Expected return on pension scheme assets	**(0.2)**	(0.4)
Curtailments	**(0.1)**	–
Settlements	**0.1**	–
Acquisitions	**–**	0.1
Total expenses	**1.1**	1.3

The cumulative amount of actuarial losses recognised in the Consolidated Statement of Comprehensive Income since adoption of IAS 19 is £1.9m.

Assets

	2012 £m	2011 £m	2010 £m
Equities	**1.2**	1.1	1.1
Bonds	**0.3**	0.5	0.6
Cash	**1.4**	1.4	1.3
Insurance contracts – Brazil	**–**	0.2	1.2
Insurance contracts – Switzerland and Liechtenstein	**6.1**	6.5	6.2
	9.0	9.7	10.4

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 2012 was 1.1% (2011: 0.0%).

Assumptions for 2012

	Salary increases % per annum	Rate of discount % per annum	Inflation % per annum	Pension increases % per annum
USA	n/a	4.25	n/a	n/a
Brazil	6.59	8.70	4.50	n/a
France	3.00	3.00	2.00	n/a
Germany	2.50	2.69	n/a	1.75
Italy	n/a	2.77	2.00	n/a
Turkey	n/a	9.00	5.00	n/a
Liechtenstein	2.50	1.80	n/a	n/a
Switzerland	3.00	1.80	n/a	n/a

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

	2012 £m	2011 £m	2010 £m
Present value of defined benefit obligation	**23.9**	22.0	22.0
Fair value of plan assets	**(9.0)**	(9.7)	(10.4)
Deficit in the scheme	**14.9**	12.3	11.6
Unrecognised prior service cost	**(0.6)**	(0.6)	(0.6)
Net liability recognised in the balance sheet	**14.3**	11.7	11.0

As all actuarial gains and losses are recognised, the net liability shown above at 31 December 2012 is that recognised in the balance sheet.

29. Retirement benefit schemes (continued)

Amounts for the current and previous four years

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Fair value of assets	**(9.0)**	(9.7)	(10.4)	(8.5)	(8.4)
Present value of defined benefit obligation	**23.9**	22.0	22.0	19.8	22.6
Deficit in the scheme	**14.9**	12.3	11.6	11.3	14.2
Gain/(loss) from experience adjustment on plan liabilities	**0.4**	0.1	0.5	(0.3)	(3.7)
Gain/(loss) from experience adjustment on plan assets	**0.4**	(0.2)	1.1	0.6	2.9
Loss from effects of changing assumptions	**(3.3)**	(0.6)	(0.5)	(0.7)	(0.5)

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 2013 is £0.4m.

Five year summary

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Revenue					
Existing operations	**587.8**	570.7	499.8	435.4	551.8
Discontinued operations	**–**	–	–	–	164.9
Revenue – continuing and discontinued operations	**587.8**	570.7	499.8	435.4	716.7
Profit for continuing and discontinued operations:					
Headline operating profit	**97.9**	85.5	52.1	8.0	91.7
Amortisation and impairment of goodwill and intangible fixed assets	**(2.0)**	(0.9)	(0.9)	(32.8)	(33.8)
Impairment charge	**–**	(4.2)	–	–	(12.1)
Profit on disposal of investment	**2.4**	–	–	–	–
Acquisition costs	**(2.5)**	–	–	–	–
Major facility closure costs	**(2.4)**	–	–	(25.4)	(77.6)
Profit on disposal of operations	**–**	–	–	–	199.3
Profit / (loss) before interest and tax	**93.4**	80.4	51.2	(50.2)	167.5
Net interest payable	**(3.6)**	(4.6)	(6.0)	(4.3)	(10.0)
Profit / (loss) before taxation	**89.8**	75.8	45.2	(54.5)	157.5
Taxation	**(22.8)**	(19.8)	(17.5)	3.4	(6.8)
Profit / (loss) after taxation	**67.0**	56.0	27.7	(51.1)	150.7
Non-controlling interests	**(0.1)**	(0.2)	(0.1)	1.0	(0.9)
Profit / (loss) attributable to the equity holders of the parent	**66.9**	55.8	27.6	(50.1)	149.8
Headline earnings per share (pence)	**37.4**	32.7	18.3	0.4	17.5
Dividends per share (pence)	**12.3**	10.9	8.7	8.3	8.3
Assets employed					
Intangible fixed assets	**166.8**	111.5	118.1	118.8	154.4
Tangible fixed assets	**448.7**	443.9	458.0	461.8	533.3
Other assets and liabilities	**(76.9)**	(72.9)	(74.0)	(72.5)	(126.1)
	538.6	482.5	502.1	508.1	561.6
Financed by					
Share capital	**33.1**	33.0	32.8	32.5	32.4
Reserves	**469.9**	448.3	416.3	387.8	459.6
Shareholders' funds	**503.0**	481.3	449.1	420.3	492.0
Non-controlling interests	**1.4**	1.3	1.7	2.3	4.9
Net borrowings / (cash)	**34.2**	(0.1)	51.3	85.5	64.7
Capital employed	**538.6**	482.5	502.1	508.1	561.6
Net assets per share (pence)	**262.8**	251.6	236.5	223.4	262.4
Return on capital employed (%):					
Headline operating profit (continuing and discontinued operations) divided by monthly average capital employed	**19.5**	16.9	10.1	1.5	12.6

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 2012, 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 2012;
- 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 matters 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 2012 and the information in the Board Report on Remuneration that is described as having been audited.

Nicola Mitchell (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Manchester, UK
27 February 2013

Company balance sheet

At 31 December 2012

	Note	2012 £m	2011 £m
Fixed assets			
Tangible fixed assets	2	**4.6**	3.5
Investments	3	**393.2**	401.2
		397.8	404.7
Current assets			
Debtors:			
– due within one year	4	**15.7**	7.1
– due after one year	4	**7.9**	35.5
Cash at bank and in hand		**0.3**	1.3
		23.9	43.9
Current liabilities			
Creditors: Amounts falling due within one year	5	**(12.5)**	(10.1)
Net current assets		**11.4**	33.8
Total assets less current liabilities		**409.2**	438.5
Creditors: Amounts falling due after more than one year	5	**(5.4)**	(0.4)
Net assets		**403.8**	438.1
Capital and reserves			
Called-up share capital	7	**33.1**	33.0
Share premium account	7	**177.1**	176.9
Other reserves	7	**129.6**	135.4
Profit and loss account	7	**64.0**	92.8
Shareholders' funds		**403.8**	438.1

The financial statements of Bodycote plc, registered number 519057, were approved by the Board of Directors and authorised for issue on 27 February 2013. They were signed on its behalf by:

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

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 29.

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 2012

1. Loss for the year

Bodycote plc reported a loss for the financial year ended 31 December 2012 of £7.5m (2011: loss £10.0m).

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 46 to 51 and form part of these financial statements.

2. Tangible fixed assets

	Fixtures and fittings £m	Software £m	Total £m
Cost			
At 1 January 2012	0.8	5.4	6.2
Additions	–	3.0	3.0
Disposals	–	(0.1)	(0.1)
At 31 December 2012	**0.8**	**8.3**	**9.1**
Depreciation			
At 1 January 2012	0.2	2.5	2.7
Charge for the year	0.1	1.7	1.8
At 31 December 2012	**0.3**	**4.2**	**4.5**
Net book value			
At 31 December 2012	**0.5**	**4.1**	**4.6**
At 31 December 2011	0.6	2.9	3.5

3. Investments

	Shares £m	Sundry investments £m	Total £m
Cost			
At 1 January 2012	407.5	0.8	408.3
Acquisitions	0.3	–	0.3
Disposals	(7.8)	(0.2)	(8.0)
At 31 December 2012	**400.0**	**0.6**	**400.6**
Provision for impairment			
At 1 January 2012	7.1	–	7.1
Provision in the year	0.3	–	0.3
At 31 December 2012	**7.4**	**–**	**7.4**
Net book value			
At 31 December 2012	**392.6**	**0.6**	**393.2**
At 31 December 2011	400.4	0.8	401.2

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 105 and 106.

4. Debtors

	2012 £m	2011 £m
Amounts falling due within one year:		
Amounts owed by subsidiary undertakings	**1.6**	0.8
Corporation tax recoverable	**5.9**	3.4
Deferred taxation (note 6)	**1.4**	1.8
Other debtors and prepayments	**6.8**	1.1
	15.7	7.1
Amounts falling due after more than one year:		
Amounts owed by subsidiary undertakings	**7.5**	34.8
Other debtors	**0.4**	0.7
	7.9	35.5
	23.6	42.6

5. Creditors

	2012 £m	2011 £m
Amounts falling due within one year:		
Trade creditors	**1.0**	0.7
Amounts owed to subsidiary undertakings	**0.1**	0.1
Other taxes and social security	**0.8**	0.2
Other creditors	**2.3**	3.0
Accruals and deferred income	**8.3**	6.1
	12.5	10.1
Amounts falling due after more than one year:		
Amounts owed to subsidiary undertakings	**5.4**	0.4

6. Deferred tax asset

	£m
At 1 January 2012	1.8
Profit and loss charge	(0.4)
At 31 December 2012	**1.4**

	2012 £m	2011 £m
Deferred tax is recognised as follows:		
Tax losses	**–**	0.4
Other timing differences	**1.4**	1.4
Deferred tax asset	**1.4**	1.8

Notes to the company financial statements continued

Year ended 31 December 2012

7. Capital and reserves

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

	Number of shares	£m
At 1 January 2012	191,263,667	33.0
Allotted in the year	160,421	0.1
At 31 December 2012	**191,424,088**	33.1

Details of share options in issue on the Company's share capital and share-based payments are set out in note 27 to the consolidated financial statements.

Reserves:

	Share premium account £m	Other reserves £m	Profit and loss account £m	Total £m
At 1 January 2012	176.9	135.4	92.8	405.1
Dividends paid	–	–	(21.3)	(21.3)
Loss for the year	–	–	(7.5)	(7.5)
Premium arising on issue of equity shares (net of expenses)	0.2	–	–	0.2
Share-based payments	–	3.9	–	3.9
Acquisition of own shares	–	(11.0)	–	(11.0)
Settlement of share options	–	1.3	–	1.3
At 31 December 2012	**177.1**	**129.6**	**64.0**	**370.7**

The other reserves are stated after deducting £11.3m (2011: £6.7m) 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 2012 4,373,136 (2011: 5,089,830) 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 £19.8m (2011: £13.4m).

Included in other reserves is the capital redemption reserve of £129.4m (2011: £129.4m).

8. Contingent liabilities

The Company has guaranteed bank overdrafts, loans and letters of credit of certain subsidiary undertakings amounting to £47.2m (2011: £18.6m).

9. Financial commitments

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

	2012 £m	2011 £m
Within one year	**0.3**	0.3
In the second to fifth years inclusive	**0.8**	0.8
After five years	**0.1**	0.3
	1.2	1.4

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 29 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 29 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 £0.2m (2011: £0.4m) and £0.1m (2011: £0.1m) respectively. As at 31 December 2012, contributions of £nil (2011: £0.1m) due in respect of the current reporting period had not been paid over to the schemes.

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

Company name	Plants	Country of Incorporation
Bodycote Heat Treatments Limited*	Cambridge, Chard, 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, 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
Techniques Metallurgiques Avancees SAS	Metz-Tessy	France
Nitruvid SAS	Argenteuil	France
Bodycote Belgium SA	Brussels	Belgium
Bodycote Lämpökäsittely Oy	Pieksämäki, Tampere, Vaasa and Vantaa	Finland
Bodycote Varmebehandling A/S	Ejby and Herlev	Denmark
Bodycote Italia Srl	Gorgonzola	Italy
Bodycote Trattamenti Termici SPA	Flero, Madone and Rodengo	Italy
Bodycote Austria GmbH	Kapfenberg, Marchtrenk and Vienna	Austria
Bodycote Rheintal Wärmebehandlung AG	Schaan	Liechtenstein
Bodycote Schweiz Wärmebehandlung AG	Urdorf	Switzerland
Bodycote HT S.r.o	Brno, Krnov, Liberec, Plzen and Prague	Czech Republic
Bodycote Polska Sp z.o.o	Chelmno, Czestochowa, 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.	Athens AL, Fremont, Huntington Park, Rancho Dominguez, Santa Fe Springs, Vernon, Westminster CA, Berlin, South Windsor, Suffield, Waterbury CT, Conyers GA, Melrose Park IL, Elkhart, Fort Wayne, Greensburg, Indianapolis IN, Wichita KS, Lafayette LA, Ipswich, Worcester MA, Canton, Grand Rapids, Holland, Livonia MI, Eden Prairie MN, Lumberton, Reidsville NC, Laconia NH, Roselle NJ, Rochester NY, Cincinnati, Cleveland, Columbus, London OH, Oklahoma City, Tulsa OK, York PA, Fountain Inn SC, Morristown TN, Arlington, Houston, Fort Worth TX, Sturtevant and New Berlin WI	USA
Bodycote Thermal Processing Canada, Inc.	Kitchener and Newmarket ON	Canada
Bodycote Thermal Processing Mexico Limited	Guaymas and Silao, Mexico	England
Bodycote Brasimet Processamento Termico Ltda	Campinas, Joinville, Jundiaí and Sao Leopoldo	Brazil
Bodycote Wuxi Technology Co. Limited	Wuxi	China
Bodycote (Ningbo) Heat Treatment Co. Limited	Ningbo	China
Bodycote (Jinan) Heat Treatments Technology Co. Limited	Jinan	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.	Princeton KY, Andover MA, London OH and Camas WA	USA
Bodycote Heiß-Isostatisches Pressen GmbH	Haag	Germany
Bodycote Hot Isostatic Processing NV	Sint-Niklaas	Belgium
Bodycote Japan K.K.	Nagoya	Japan
Bodycote SAS	Magny-Cours	France
Bodycote Hot Isostatic Pressing AB	Surahammar	Sweden

Thermal Processing – Surface Engineering

Company name	Plants	Country of Incorporation
Bodycote Surface Technology Limited*	Knowsley, Newport, Neath, Skelmersdale, Stonehouse, 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

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.

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: ssd@capitaregistrars.com.

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

Forms for some of these matters can be downloaded from the registrars' website at www.capitaregistrars.com/shareholder. Shareholders can easily access and maintain their shareholding online by registering at www.capitashareportal.com. To register shareholders will require their investor code, which can be located on a share certificate or tax voucher.

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 online service, Capita's commission rates are 1% of the value of the deal (minimum £20.00, maximum £100.00) and for the telephone service, Capita's commission rates are 1.50% of the value of the deal (minimum £27.50, maximum £150.00).

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 0300 (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 3399. 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 from 9.00am to 5.30pm, Mon - Fri) or +44 20 8639 3405 (from outside the UK) or by logging on to www.international.capitaregistrars.com.

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 14 February 2013:

Holding range	Number of Shareholders	%	Number of shares	%
1 to 1,000	1,000	42.1	427,749	0.3
1,001 to 10,000	978	41.0	3,069,080	1.6
10,001 to 100,000	256	10.7	8,460,550	4.4
100,001 to 500,000	88	3.7	20,496,408	10.7
500,001 and over	60	2.5	158,970,301	83.0
	2,382	100.0	191,424,088	100.0

Type of shareholders	% of Shareholders	% of total shares
Directors' interests	0.3	0.2
Major institutional and corporate holdings	27.7	97.3
Other shareholdings	72.0	2.5
	100.0	100.0

As at 27 February 2013 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	26,961,182	13.94
Schroders plc	12,893,055	7.62
Aberforth Partners LLP	9,427,581	4.97
Baillie Gifford & Co	9,402,000	4.91

Company information

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

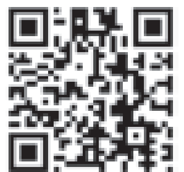
Solicitors
Eversheds LLP and Herbert Smith LLP

Financial Calendar

Annual General Meeting	24 April 2013
Final dividend for 2012	7 May 2013
Interim results for 2013	July 2013
Interim dividend for 2013	November 2013
Results for 2013	February 2014

To view the Bodycote Annual Report online visit

http://bodycote.annualreport2012.com



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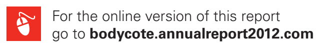

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