



Bodycote plc
Audited results for the year ended 31 December 2017

Financial highlights	2017	2016	% change
Revenue	£690.2m	£600.6m	14.9
Headline operating profit ¹	£123.9m	£99.6m	24
Return on sales ²	18.0%	16.6%	
Headline profit before taxation ¹	£121.5m	£97.0m	25
Net cash	£39.6m	£1.1m	
Basic headline earnings per share ³	49.2p	37.0p	33
Ordinary dividend per share	17.4p	15.8p	10
Special dividend per share	25.0p	nil	
Return on capital employed ⁴	19.3%	17.1%	

Statutory results

Operating profit	£119.4m	£94.5m
Profit before taxation	£117.0m	£91.9m
Basic earnings per share	51.0p	35.2p

Highlights

- Revenue growth of 14.9% to £690.2m; revenue growth at constant currency was 9.6%, well above the background market growth rates
- 24% growth in headline operating profit to £123.9m
- Return on sales improvement to 18.0% (2016: 16.6%)
- Basic headline EPS increased 33% to 49.2p
- ROCE increased to 19.3% (2016: 17.1%) notwithstanding the increased rate of capital investment
- Headline operating cash flow⁵ of £111.7m (2016: £91.4m)
- Headline operating cash conversion⁶ at 90%; £83.0m free cash flow⁷ (2016: £60.5m)
- Full year ordinary dividend 17.4p, up 10%, and special dividend 25.0p (2016: nil)

Commenting, Stephen Harris, Group Chief Executive said:

“2017 has once again demonstrated the quality of Bodycote’s business. Strong growth was achieved through contributions from contract wins on automotive and aerospace programmes, excellent growth in Emerging Markets (where our investments are yielding good returns), and broad-based growth across the general industrial sectors, an element of which was due to some customer restocking.

“The Group’s revenue growth, combined with continued discipline on costs, helped lift headline operating profit by 24%. Return on sales increased to 18.0% from 16.6%.

“To ensure that the business continues to deliver good results, we will continue to focus on efficiency, maintaining price discipline in light of increasing inflation across many economies, and the execution of our successful strategy.

“Our business, by its nature, has limited forward visibility, but we have entered the year with good momentum. Accordingly, and in spite of the foreign exchange headwind at current exchange rates, 2018 has started in line with our expectations.”

Definitions:

- ¹ Headline operating profit and headline profit before taxation exclude amortisation of acquired intangibles of £4.5m (2016: £4.5m) and acquisition costs of £nil (2015: £0.6m).
- ² Return on sales is defined as headline operating profit as a percentage of revenue.
- ³ A detailed EPS reconciliation is provided in note 4 to this announcement.
- ⁴ Return on capital employed (ROCE) is defined as headline operating profit of £123.9m (2016: £99.6m) divided by the average of opening and closing capital employed of £642.5m (2016: £582.3m). Capital employed is defined as net assets adjusted for net cash/(debt).
- ⁵ Headline operating cash flow is defined as cash generated by operations of £182.8m (2016: £146.3m) less net capital expenditure of £74.8m (2016: £63.1m) and before cash flow relating to restructuring of £3.7m (2016: £7.6m) and acquisition costs of £nil (2016: £0.6m).
- ⁶ Headline operating cash conversion is defined as headline operating cash flow divided by headline operating profit.
- ⁷ Free cash flow is defined as cash generated by operations of £182.8m (2016: £146.3m) less net capital expenditure of £74.8m (2016: £63.1m) and financing costs of £2.1m (2016: £2.3m) and taxation of £22.9m (2016: £20.4m).

A live webcast of the analysts' meeting will be available from 08.30am at www.bodycote.com.

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Overview

Bodycote reported revenue growth of 14.9% to £690.2m (2016: £600.6m), with revenue benefiting from foreign exchange translation gain. At constant currency, revenues grew 9.6%, including a contribution of 2.9% from acquisitions completed in 2016.

The following review reflects constant currency growth rates unless stated otherwise.

General industrial markets returned to growth after a multi-year negative trend. Moreover, this growth was broad-based, with improvements in general industrial demand occurring in all of our served geographies. Group revenues generated from the general industrial sectors, which represent some 39% of our business, grew 10%, which was well above the growth in background demand. Of this growth, 4 percentage points came from acquisitions made in 2016. The remainder of the Group's outperformance in general industrial versus the market came from the increased penetration of Specialist Technologies (which grew 14% in this sector), as well as an element of some customer restocking.

The decision we took to preserve the capacity at our Texas/Oklahoma facilities is being well rewarded, as we have also seen a reversal of the sharp declines that we had experienced in onshore oil and gas demand. Growth in onshore oil and gas saw a strong sequential increase in 2017, driven predominantly by demand from unconventional drilling activity in the Permian Basin. In the rest of the energy sector, subsea revenues continued to decline and large frame industrial gas turbines (IGT) are also in retreat following cutbacks at the original equipment manufacturers (OEMs). It is worth noting, however, that requests for quotation in the subsea sector have picked up considerably. In total, revenues from the energy sector increased by 4%.

Civil aviation grew 6% with our UK operations continuing to add significant business. This increase will require new facilities to be built in 2018 in the UK in order to service forecast demand. North America also started to contribute to the growth in a more meaningful way as the build rate of LEAP engines continues to grow. Bodycote has a much stronger position on the LEAP series than it did on the previous CFM56, which is a testament to the success of the focused sales and investment programme that has been undertaken over the last decade.

The automotive business saw growth of 14% with the majority of this increase coming from the car and light truck sector. This compares to background demand growth in Europe of low single digits and a slight decline in the USA. Our strong performance benefited from the contribution from the acquisitions made in 2016, together with the investments we have made in Emerging Markets and Specialist Technologies.

In our Specialist Technologies, we achieved double-digit revenue growth across our Specialty Stainless Steel Processes (S³P), low pressure carburising (LPC) and corr-i-dur (CiD) technologies. However, several factors dragged on overall sales growth during the year. The HIP Product Fabrication (HIP PF) and Surface Technology businesses are focused largely on oil and gas outside of the USA, with particular emphasis on subsea and these revenues continued to decline. In addition the weakness in IGT volumes resulted in a slowdown in the HIP Services business towards the end of the year. Also impacting our HIP Services business was an unplanned outage during the second half (which was fully resolved by year end). Forecast growth in all the Specialist Technologies looks strong.

The five sites we acquired in 2016 are performing well. They are all Classical Heat Treatment sites within the AGI division and contributed £23.0m of revenue in 2017, with return on sales in line with the Group. It is also worth highlighting that revenues at these facilities have accelerated since coming into the Group as a result of the benefits derived from being part of the Group's network of facilities.

With careful cost discipline in the face of growing revenues, the Group's headline operating profit grew 24% to £123.9m (26% growth in statutory operating profit to £119.4m) and the return on sales improved to 18.0% (2016: 16.6%). Once again, we increased our prices ahead of cost inflation. This is an area of heightened focus for the Group especially as we are entering a period of higher input cost inflation in some markets. It is worth noting, however, that Bodycote typically performs well in higher inflationary environments.

The Group's strong profit improvement, coupled with a headline tax rate of 22.9% (2016: 27.5%), increased basic headline earnings per share to 49.2p (2016: 37.0p). Basic earnings per share increased to 51.0p from 35.2p.

The return on capital employed rose in the current year to 19.3% from 17.1% in 2016.

Free cash flow increased to £83.0m (2016: £60.5m) as a result of our improved profitability and in spite of increased capital expenditure to support the future growth of the business. Headline operating cash conversion was, once again, above 90%, yielding a net cash position at the end of the year of £39.6m (2016: £1.1m).

Strategic Progress

The Group's strategy encompasses the drive for operational efficiency and improvement in return on sales; growth in markets with higher long term structural growth; the expansion of the Group's footprint in rapid growth markets; the focus on revenue growth in Specialist Technologies; and growth through targeted acquisitions, where these are more attractive than investing in new facilities. The Group has a minimum 20% hurdle rate return when looking at investments.

During 2017 we made further progress against our strategy, delivering higher Group return on sales of 18.0%. We believe there is still the opportunity to further improve from both management led initiatives, particularly in our AGI division, and growth in our higher return Specialist Technologies.

In 2017 we continued to invest in areas with superior growth potential, with a deliberate bias towards investments in rapid-growth markets, Specialist Technologies, and long-cycle programmes, particularly in civil aviation: Emerging Markets revenues increased 26% to £54.1m, representing 8% of Group turnover, with growth in Mexico and China both above 40%. We will continue to invest to support the future of our business in these rapid growth markets. During the year, we commissioned several new LPC and S³P lines. In HIP Services we acquired the HIP assets from Doncasters Group Limited's UK business and a new mega-HIP was ordered for Europe which will come on line in 2018. Further new facilities are expected to be commissioned in 2018 for both Specialist Technologies and Classical Heat Treatment in our focus geographies and markets. The additional capacity that will come on stream in 2018 will add to our ability to deliver strong growth and superior return on sales over the coming years.

We also continue to look at acquisition and investment opportunities that will grow our business. These are traditionally small bolt-on facilities that can provide us with infills to our existing network. Where opportunities to buy such facilities do not exist, we will build new facilities; these obviously have a ramp-up period, but have the advantage of being designed exactly in line with the Group's technology and operational efficiency focus. Since 2014 we have invested £164m in both acquisitions and investment for growth in new and existing facilities, with revenues from the latter still ramping up as these plants typically take 3-5 years to reach full production.

Organisation and people

Bodycote is a service business, and first class service is delivered by passionate and professional people, who understand their customers' needs and meet their demanding requirements time and time again. We will continue to invest in training and developing our employees to ensure that our talented workforce remains one of our competitive advantages.

Summary and Outlook

2017 has once again demonstrated the quality of Bodycote's business. Strong growth was achieved through contributions from contract wins on automotive and aerospace programmes, excellent growth in Emerging Markets (where our investments are yielding good returns), and broad-based growth across the general industrial sectors, an element of which was due to some customer restocking.

The Group's revenue growth, combined with continued discipline on costs, helped lift headline operating profit by 24%. Return on sales increased to 18.0% from 16.6%.

To ensure that the business continues to deliver good results, we will continue to focus on efficiency, maintaining price discipline in light of increasing inflation across many economies, and the execution of our successful strategy.

Our business, by its nature, has limited forward visibility, but we have entered the year with good momentum. Accordingly, and in spite of the foreign exchange headwind at current exchange rates, 2018 has started in line with our expectations.

BUSINESS REVIEW

The following review reflects constant currency growth rates unless stated otherwise.

Bodycote has more than 180 facilities around the world which are organised into two customer focused divisions; the ADE division and the AGI division. Our ADE customers tend to think and operate globally and our AGI division is organised globally as a result. Our AGI customers include many multinational businesses but which tend to operate on a regionally-focused basis, as well as numerous medium sized and smaller businesses, and all of which are important to Bodycote. Much of the business is locally oriented and the business is, therefore, organised on a regional basis.

Strategically we have focused on building customer relationships to enable our participation in long term programmes, in particular in the aerospace and automotive markets. Not only do we have a competitive advantage as a result of our scale and technical capabilities, but our global reach allows customers to work with us on multiple projects simultaneously, making us a valued business partner.

THE ADE DIVISION

A large number of Bodycote's multinational customers fall within our ADE division and Bodycote intends to continue to leverage its unique market position to increase revenues in the aerospace, defence and energy sectors. We have 63 facilities around the world including hot isostatic pressing (HIP) and surface technology facilities alongside our classical heat treatment plants.

Revenue in 2017 was £273.1m, an increase of 4.7% (8.8% at actual rates), including a contribution of 0.8 percentage points to the growth from new facility investments. Civil aviation growth was underpinned by a strong UK performance. It was also notable that growth in North American civil aviation revenues picked up through the year. The revenues from onshore oil & gas in the North America increased sequentially through the year. These two factors helped the ADE division achieve revenue growth of 7.2% in the second half of 2017 against 2.1% in the first half.

Headline operating profit was £64.2m an increase of 11% (15% at actual rates), benefiting from positive operational leverage as revenues grew. Accordingly, return on sales improved to 23.5% (2016: 22.2%). Statutory operating profit grew to £62.7m (2016: £54.1m).

Net capital expenditure in 2017 was £32.1m (2016: £19.9m), representing 1.5 times depreciation. In addition to the new Mega-HIP acquired for our European business, our new aerospace facility in Poland opened in 2017 and we commenced investment in a new UK facility to support our growing UK Civil aviation business.

Return on capital employed increased to 21.4% (2016: 19.7%), reflecting the improved profitability and careful management of the balance sheet.

THE AGI DIVISION

Our extensive network of more than 120 AGI facilities enables the business to offer the widest range of technical capability and security of supply, while continuing to increase the proportion of technically differentiated services that it offers. Bodycote has a long and successful history of servicing this division's wide-ranging customer base.

Revenue was £417.1m, 13.1% ahead of the prior year (19.3% at actual rates), including a contribution of 2.1 percentage points to the growth from investments in new facilities and 5.0 percentage points from the plants acquired in 2016.

Growth in Western European revenues underpinned the division's growth, with double-digit growth in its automotive revenues and solid growth in the General Industrial business.

Emerging Markets' revenues also grew very strongly and now represent 13% of Bodycote's AGI business. Mexico and China both achieved revenue growth above 40%.

Headline operating profit was £74.2m (2016: £58.5m) 20% ahead of the prior period (27% at actual rates). Return on sales expansion has been a focus for our AGI business over many years now, and, at 17.8% we delivered return on sales improvement once again (2016: 16.7%). Statutory operating profit grew to £71.2m (2016: £54.9m).

Net capital expenditure was £37.8m (2016: £37.4m) representing 1.0 times depreciation. We are continuing to invest in the rapid growth Emerging Markets, with investments in Mexico, China, Turkey and Poland contributing the majority of the growth from new facilities. We also made further investment in S³P as the strong growth in demand for this technology requires us to continue to add more capacity.

Return on capital employed increased to 17.8% (2016: 15.2%), reflecting the strong improvement in profitability and is the highest return that we have seen since this division was created.

Our Markets and Technologies

Markets

The following review reflects constant currency growth rates unless stated otherwise.

General industrial revenues were 10.4% higher than the prior year (16.5% at actual rates) including a contribution of 4.3% from acquisitions made in 2016. This growth was very broad based and sustained across our geographies and includes an element of restocking.

Automotive revenues were 14.1% ahead of the prior year (19.7% at actual rates) including a contribution of 3.6% from acquisitions made in 2016. Car and light truck, the predominant contributor to automotive revenue, saw growth of 14.2%, as a result of strong growth in Western Europe (which is benefiting from a number of contract wins, representing payback on our patient work over many years to build relationships with customers and gain a good position on new programmes), and excellent growth in our Emerging Markets, particularly Mexico and China.

Aerospace and defence revenues were 2.3% ahead of the prior year (6.6% at actual rates). Civil aviation growth was 5.6% and continued to be driven by strong revenue growth in the UK. North American defence revenues were down once again, although this was mainly due to a significant reduction of one programme at the end of 2016, which will drop out of the prior year comparisons in 2018.

Energy revenues were 4.4% ahead of prior year (7.9% at actual rates). The recovery in the North American onshore oil & gas market, which we previously noted began during the second quarter, contributed to a much improved second half performance for the energy sector. However, as announced by the key players in the market and others in the supply chain, large-frame IGT OEM production cuts have impacted volumes in Europe and North America, and we saw a slowdown in revenues towards the end of the year.

Our Technologies

Bodycote provides Classical Heat Treatment and Specialist Technologies processes from our network of over 180 facilities.

Classical Heat Treatment refers to a group of mature processes which are essential for treating all metal components. These tightly controlled processes condition the material properties including both the core properties and the surface characteristics.

Our Specialist Technologies refer to a group of processes which require very specialist expertise and technology. They have high barriers to entry. These differentiated technologies enable our customers to create innovative products with a competitive advantage, allowing them to derive higher sales and margins.

While there are many practical applications for these technologies and market potentials are very large, the adoption process is slowed by the fact that Bodycote needs to create its markets and grow its business by encouraging substitution from less value adding, more mature technologies provided by other companies. In some situations there are no alternative technologies to Bodycote's offerings, and in these instances customers are able to produce products that are 'new to world'.

Consequently, the growth in Specialist Technologies is often dictated by the pace of customer adoption of the technologies. As we continue to witness sustained growth in our Specialist Technologies business, we need to invest to supply additional capacity to meet this demand. This includes both equipment and human capital.

Financial Overview

	2017 £m	2016 £m
Revenue	<u>690.2</u>	<u>600.6</u>
Headline operating profit	123.9	99.6
Amortisation of acquired intangible fixed assets	<u>(4.5)</u>	<u>(4.5)</u>
Operating profit prior to exceptional items	119.4	95.1
Acquisition costs	<u>-</u>	<u>(0.6)</u>
Operating profit	119.4	94.5
Net finance charge	<u>(2.4)</u>	<u>(2.6)</u>
Profit before taxation	117.0	91.9
Taxation	<u>(19.7)</u>	<u>(24.9)</u>
Profit for the year	<u><u>97.3</u></u>	<u><u>67.0</u></u>

Group revenue was £690.2m, an increase of 14.9% at actual exchange rates, and 9.6% at constant currency. Acquisitions made in 2016 contributed 2.9% of the constant currency growth, with new facilities contributing a further 1.5%.

Headline operating profit for the year increased by 24% to £123.9m (2016: £99.6m), and return on sales increased to 18.0% (2016: 16.6%). Headline operating profit at constant currency increased by £18.0m, with the five acquired sites in 2016 contributing £3.0m to the improved headline operating profit. Price increases more than covered the increase in input costs. Statutory operating profit grew to £119.4m (2016: £94.5m).

Finance charge

The net finance charge was £2.4m compared to £2.6m in 2016, analysed as follows:

	2017 £m	2016 £m
Interest received on bank overdrafts and loans	<u>0.1</u>	<u>-</u>
Net Interest payable ¹	0.1	0.2
Financing and bank charges	2.0	2.1
Pension finance charge	<u>0.4</u>	<u>0.3</u>
Total finance charge	<u>2.5</u>	<u>2.6</u>
Net finance charge	<u><u>2.4</u></u>	<u><u>2.6</u></u>

¹ Amounts arising on financial liabilities measured at amortised cost.

As at 31 December 2017, the Group's £230m Revolving Credit Facility is totally undrawn. Having extended the facility during the year, it has a remaining life of 4.3 years.

Profit before Taxation

	2017 £m	2016 £m
Headline profit before taxation	121.5	97.0
Amortisation of intangibles	(4.5)	(4.5)
Acquisition costs	-	(0.6)
Profit before taxation	<u>117.0</u>	<u>91.9</u>

Statutory profit before tax increased to £117.0m (2016: £91.9m), while headline profit before tax increased 25% to £121.5m (2016: £97.0m).

Tax

The passing of the Tax Cuts and Jobs Act in the US in December 2017 resulted in a significant £6.4m net one-off tax gain, as the Group's US deferred tax liabilities were revalued as a result of the reduction in the US Federal corporate income tax rate. Accordingly, the Group's tax rate is significantly lower, at 17.0%. The Group's headline tax rate for the year excludes this gain and is, therefore, somewhat higher at 22.9%.

The final impact of the changes from the US Tax Cuts and Jobs Act are subject to a number of detailed provisions in the legislation and any implementation guidance issued by the Treasury Department and the IRS. Bodycote will continue to monitor any developments and give due consideration to the impact of any guidance, along with ongoing market interpretation and assessment on the accounting implications of this Act.

Earnings per Share

The improved Group business performance drove basic headline earnings per share up to 49.2p (2016: 37.0p), while basic earnings per share for the year increased to 51.0p (2016: 35.2p).

	2017 £m	2016 £m
Profit before taxation	117.0	91.9
Taxation	<u>(19.7)</u>	<u>(24.9)</u>
Profit for the year	97.3	67.0
Basic headline EPS	49.2p	37.0p
Basic EPS	<u>51.0p</u>	<u>35.2p</u>

Return on Capital Employed (ROCE)

The return on capital employed rose in the current year to 19.3% from 17.1% in 2016. This improvement was driven by the increase in the Group's operating profit. Moreover, since 2014, the Group has invested £125m in growth investment projects, many of which are not yet fully mature and are not contributing as fully to Group returns as they will once they have all reached financial maturity. The Group continues to exert strong financial discipline in the area of capital expenditure as well as in the profit and loss account, applying stringent financial returns hurdles to all of its projects.

Cash Flow

	2017 £m	2016 £m
Headline operating profit	123.9	99.6
Add back non-cash items:		
Depreciation and amortisation	59.8	55.2
Impairment of fixed assets	0.4	5.1
Share-based payments	7.8	0.5
Profit on disposal of property, plant and equipment	(0.7)	(4.5)
Headline EBITDA ¹	<u>191.2</u>	155.9
Net capital expenditure	(74.8)	(63.1)
Net working capital movement	(4.7)	(1.4)
Headline operating cash flow	<u>111.7</u>	91.4
Cash cost of restructuring	(3.7)	(7.6)
Acquisition costs	-	(0.6)
Operating cash flow	<u>108.0</u>	83.2
Interest paid	(2.1)	(2.3)
Taxation	(22.9)	(20.4)
Free cash flow	<u>83.0</u>	60.5
Acquisition spend	(14.2)	(23.7)
Disposals	-	2.2
Dividends	(30.6)	(48.1)
Other	0.3	0.2
Increase/(decrease) in net cash	<u><u>38.5</u></u>	<u><u>(8.9)</u></u>
Opening net cash	1.1	12.3
Loans acquired with subsidiaries	-	(2.3)
Increase/(decrease) in net cash	<u>38.5</u>	(8.9)
Closing net cash	<u><u>39.6</u></u>	<u><u>1.1</u></u>

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

The Group's headline operating cash flow increased by 22% to £111.7m, mainly reflecting the improvement in the operating profit. Statutory net cash from operating activities increased 27% to £159.9m. Headline operating cash conversion was 90% as the Group continues to demonstrate an impressive record of converting profit into cash. Consequently, free cash flow increased 37% to £83.0m and the Group ended 2017 with £39.6m of net cash (2016: £1.1m).

Capital Expenditure

Net capital expenditure (capital expenditure less proceeds from asset disposals) for the year was £74.8m (2016: £63.1m). The multiple of net capital expenditure to depreciation was 1.3 times (2016: 1.1 times). The Group continues to invest in maintaining its assets to a high quality. More importantly with regard to future revenue growth of the business, half of the capital expenditure was on growth investment projects, including investment in incremental capacity for Specialist Technologies (notably HIP Services, S³P and LPC), expenditure on several new facilities, and investments in capacity and technology expansion in a number of existing locations.

Acquisitions

In December, Bodycote completed the acquisition of the HIP assets and vacuum furnaces from Doncaster Group Limited's UK facility for consideration of £8.7m.

Deferred consideration payments from acquisitions completed in 2016 increased the cash outflow on acquisitions to £14.2m in the year.

Dividend and Dividend Policy

The Group aims to pay ordinary dividends so that dividend cover will be at or above 2.0 times earnings. The Board may also recommend payment of a supplemental distribution to shareholders. The amount of any supplemental distribution will be assessed in light of the cash position of the Group, along with funding requirements for both organic growth and acquisitions.

The Board has recommended a final ordinary dividend of 12.1p (2016: 10.8p), bringing the total ordinary dividend to 17.4p (2016: 15.8p). In addition, in light of the Group's strong balance sheet and year end net cash position, the Board has recommended a special dividend of 25.0p (2016: nil). If approved by shareholders, both the final ordinary dividend and the special dividend will be paid on 1 June 2018 to shareholders on the register at the close of business on 20 April 2018.

Borrowing Facilities

The Group is financed by a mix of cash flows from operations, short-term borrowings, long-term loans and finance leases. The Group's funding policy aims to ensure continuity of finance at reasonable cost, based on committed and uncommitted facilities and loans from several sources over a spread of maturities. The Group continues to have access to committed facilities at competitive rates and therefore currently deems this to be the most effective means of long-term funding.

The total undrawn committed facility funding available to the Group at 31 December 2017 was £230.0m (2016: £225m). At 31 December 2017, the Group had the following drawings and headroom under the committed facility:

Facility	Expiry date	Facility £m	Facility utilisation £m	Facility headroom £m
£230m Revolving Credit	3 April 2022	230.0	-	230.0

Post balance sheet events

There are no post balance sheet events that require disclosure in the financial statements.

Alternative performance measures

Bodycote uses alternative performance measures such as headline operating profit, headline earnings per share, headline profit before taxation, headline operating cash flow and free cash flow, together with current measures restated at constant currency, to allow the users of the financial statements to gain a clearer understanding of the underlying performance of the business, allowing the impact of restructuring and reorganisation activities and acquisition costs to be identified separately.

Going concern

In determining the basis of preparation for the Annual Report and the Group's viability statement, 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 cash resources, committed and uncommitted facilities, and overdrafts. The overdrafts and uncommitted facilities are repayable on demand but the committed facilities are due for renewal as set out below. There is sufficient headroom in the committed facility covenants to assume that these facilities can be operated as contracted for the foreseeable future.

The committed facilities as at 31 December 2017 were as follows:

- £230m Revolving Credit Facility maturing 3 April 2022

The December 2017 weighted average life of the committed facilities was 4.3 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.

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF BODYCOTE PLC ON THE PRELIMINARY ANNOUNCEMENT OF BODYCOTE PLC

As the independent auditor of Bodycote plc we are required by UK Listing Rule LR 9.7A.1(2)R to agree to the publication of Bodycote plc's preliminary announcement statement of annual results for the period ended 31 December 2017.

The preliminary statement of annual results for the period ended 31 December 2017 includes: disclosures required by the Listing Rules, financial highlights, trading overview, business review, finance overview, the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated cash flow statement, consolidated statement of changes in equity, and notes to the consolidated financial statements. We are not required to agree to the publication of presentations to analysts, trading statements, or interim management statements.

The directors of Bodycote plc are responsible for the preparation, presentation and publication of the preliminary statement of annual results in accordance with the UK Listing Rules.

We are responsible for agreeing to the publication of the preliminary statement of annual results, having regard to the Financial Reporting Council's Bulletin "The Auditor's Association with Preliminary Announcements made in accordance with UK Listing Rules".

Status of our audit of the financial statements

Our audit of the annual financial statements of Bodycote plc is complete and we signed our auditor's report on 6 March 2018. Our auditor's report is not modified and contains no emphasis of matter paragraph.

Our audit report on the full financial statements sets out the following key audit matters which had the greatest effect on our overall audit strategy; the allocation of resources in our audit; and directing the efforts of the engagement team, together with how our audit responded to those key audit matters and the key observations arising from our work:

IMPAIRMENT OF INTANGIBLE FIXED ASSETS (INCLUDING GOODWILL)

Key audit matter description

The Group has a significant non-current asset base relating to intangible assets (including goodwill) of £201.0m (2016: £206.7m) as shown in notes 11 and 12 in the full Financial Statements. Our risk assessment procedures have pinpointed our key audit matter with regards to impairment to focus on the Europe ST CGU, (which has £12.6m of goodwill allocated (2016: £12.6m), due to the continued adverse performance related to the oil and gas markets served by this CGU.

Performing an impairment review of the non-current assets within this CGU requires the exercise of judgement regarding future growth rates, discount rates and sensitivity assumptions as described in note 11 in the full Financial Statements, and is included as an area of focus in the Report of the Audit Committee in the full Financial Statements.

How the scope of our audit responded to the key audit matter

We challenged the assumptions used in the impairment model for intangible assets within the Europe ST CGU. As part of our procedures we:

- considered the appropriateness of the growth rate assumptions by comparing them to historical trading performance and World Bank historical GDP data for the markets served by Europe ST and reviewing and challenging management's budget for 2018;;
- considered the impact of the sensitivities performed by management in assessing whether they reflect a reasonable possible change scenario; and
- assessed the appropriateness of the assumptions concerning the discount rate applied by engaging our internal valuation specialists to review the inputs used to determine the discount rate applied by comparing them against external market data.

Key observations

Based on the procedures performed, no impairment was noted and we have concluded that the assumptions in the impairment model are appropriate.

TAXATION ACCOUNTING – VALUATION OF CERTAIN TAX STRUCTURE PROVISIONS

Key audit matter description

The tax risk concerns the judgements and estimates applied in the determination of provisions for liabilities attributed to specific uncertain tax positions linked to the Group's corporate arrangements as described as an area of focus in the Report of the Audit Committee in the full Financial Statements.

How the scope of our audit responded to the key audit matter

In conjunction with our taxation audit specialists, we have assessed the assumptions and judgements concerning the adequacy of certain tax structure provisions by challenging management's assumptions, reviewing the available correspondence from the various tax authorities and drawing on the experience of our taxation specialists in respect of similar situations

Key observations

From the work performed above we are satisfied that the provisions held on the balance sheet for certain tax structure positions are reasonable.

PENSIONS – UK DEFINED BENEFIT SCHEME LIABILITY ASSUMPTIONS

Key audit matter description

This risk concerns the appropriateness of the actuarial assumptions applied in calculating the Group's UK defined benefit scheme liability of £109.9m (2016: £126.6m) within the net UK defined benefit surplus of £2.4m (2016: liability of £3.6m) as shown in note 28 in the full Financial Statements. The valuation of the Group's IAS 19 liability involves significant judgement in the choice of discount rate used and in the key sources of estimation uncertainty in particular in relation to the discount rate assumptions, as described in the Group's accounting policies, and is included as an area of focus in the Report of the Audit Committee.

How the scope of our audit responded to the key audit matter

We have assessed the appropriateness of the assumptions underpinning the valuation of the scheme liabilities. Specifically we challenged the discount rate, inflation and mortality assumptions applied in the calculation by using our internal pension specialists to benchmark the assumptions applied against comparable third party data and assessed the appropriateness of the assumptions in the context of the Group's own position.

Key observations

From the work performed we are satisfied that the assumptions applied in respect of the valuation of the Group's IAS 19 UK defined benefit scheme liabilities are reasonable. We consider the assumptions to be towards the prudent end of our benchmarked range.

REVENUE RECOGNITION – MANUAL ADJUSTMENTS TO REVENUE

Key audit matter description

When assessing the potential risk of fraud in relation to revenue recognition, we have considered the nature of the automated and manual transactions recorded across the Group, considering the typical sales cycle for the services provided by the Group as described in the Group's accounting policies, and have determined that the key audit matter in relation to fraud is pinpointed to the risk of inappropriate manual adjustments being recorded in revenue.

How the scope of our audit responded to the key audit matter

We have profiled the population of journal entries made throughout the year in order to identify manual adjustments made to revenue and have tested the identified population to validate their authenticity and commercial substance.

Key observations

From the work performed we have not noted any manual adjustments to revenue that we would not expect in the usual course of business, or that cannot be supported.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we did not provide a separate opinion on these matters.

Procedures performed to agree to the preliminary announcement of annual results

In order to agree to the publication of the preliminary announcement of annual results of Bodycote plc we carried out the following procedures:

- (a) checked that the figures in the preliminary announcement covering the full year have been accurately extracted from the audited or draft financial statements and reflect the presentation to be adopted in the audited financial statements;
- (b) considered whether the information (including the management commentary) is consistent with other expected contents of the annual report;
- (c) considered whether the financial information in the preliminary announcement is misstated;
- (d) considered whether the preliminary announcement includes a statement by directors as required by section 435 of CA 2006 and whether the preliminary announcement includes the minimum information required by UKLA Listing Rule 9.7A.1;
- (e) where the preliminary announcement includes alternative performance measures (“APMs”), considered whether appropriate prominence is given to statutory financial information and whether:
 - the use, relevance and reliability of APMs has been explained;
 - the APMs used have been clearly defined, and have been given meaningful labels reflecting their content and basis of calculation;
 - the APMs have been reconciled to the most directly reconcilable line item, subtotal or total presented in the financial statements of the corresponding period; and
 - comparatives have been included, and where the basis of calculation has changed over time this is explained.
- (f) read the management commentary, any other narrative disclosures and any final interim period figures and considered whether they are fair, balanced and understandable.

Use of our report

Our liability for this report, and for our full audit report on the financial statements is 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 our audit report or this report, or for the opinions we have formed.

Mark Mullins ACA
For and on behalf of Deloitte LLP
Statutory Auditor
London, UK
6 March 2018

**CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2017**

	2017 £m	2016 £m	Note
Revenue	690.2	600.6	
Cost of sales and overheads	(570.8)	(505.5)	
Operating profit prior to exceptional items	119.4	95.1	
Acquisition costs	-	(0.6)	
Operating profit	119.4	94.5	2
Investment revenue	0.1	-	
Finance costs	(2.5)	(2.6)	
Profit before taxation	117.0	91.9	
Tax impact in relation to change in US tax rate	6.4	-	3
Taxation	(26.1)	(24.9)	3
Taxation charge	(19.7)	(24.9)	
Profit for the year	97.3	67.0	
Attributable to:			
Equity holders of the parent	97.1	67.0	
Non-controlling interests	0.2	-	
	97.3	67.0	
Earnings per share	Pence	Pence	4
Basic	51.0	35.2	
Diluted	51.0	35.2	

All activities have arisen from continuing operations.

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2017**

	2017 £m	2016 £m
Profit for the year	97.3	67.0
Items that will not be reclassified to profit or loss:		
Actuarial gains/(losses) on defined benefit pension schemes	6.7	(5.0)
Tax on items not reclassified	(1.0)	1.0
Total items that will not be reclassified to profit or loss	5.7	(4.0)
Items that may be reclassified subsequently to profit or loss:		
Exchange losses on translation of foreign operations	(11.7)	65.5
Cumulative exchange differences recycled to profit or loss on disposal of businesses/Group reorganisation	-	(2.2)
Total items that may be reclassified subsequently to profit or loss	(11.7)	63.3
Other comprehensive (expense)/income for the year	(6.0)	59.3
Total comprehensive income for the year	91.3	126.3
Attributable to:		
Equity holders of the parent	91.2	126.3
Non-controlling interests	0.1	-
	91.3	126.3

**CONSOLIDATED BALANCE SHEET
AT 31 DECEMBER 2017**

	2017 £m	2016 £m	Note
Non-current assets			
Goodwill	157.6	160.9	
Other intangible assets	43.4	45.8	
Property, plant and equipment	520.5	509.0	
Deferred tax assets	24.5	32.5	
Trade and other receivables	1.0	0.4	
	<u>747.0</u>	<u>748.6</u>	
Current assets			
Inventories	16.4	16.6	
Derivative financial instruments	-	0.1	
Current tax assets	12.8	19.0	
Trade and other receivables	140.4	126.3	
Cash and bank balances	41.0	12.0	
Assets held for sale	2.1	1.8	
	<u>212.7</u>	<u>175.8</u>	
Total assets	<u>959.7</u>	<u>924.4</u>	
Current liabilities			
Trade and other payables	138.4	133.5	
Current tax liabilities	29.2	36.5	
Obligations under finance leases	-	0.1	
Borrowings	1.4	5.8	
Provisions	8.7	11.7	5
	<u>177.7</u>	<u>187.6</u>	
Net current assets/(liabilities)	<u>35.0</u>	<u>(11.8)</u>	
Non-current liabilities			
Borrowings	-	5.0	
Retirement benefit obligations	15.2	21.5	
Deferred tax liabilities	57.2	68.8	
Provisions	8.7	8.8	5
Other payables	3.4	4.4	
	<u>84.5</u>	<u>108.5</u>	
Total liabilities	<u>262.2</u>	<u>296.1</u>	
Net assets	<u>697.5</u>	<u>628.3</u>	
Equity			
Share capital	33.1	33.1	
Share premium account	177.1	177.1	
Own shares	(7.2)	(8.0)	
Other reserves	141.0	133.9	
Translation reserves	45.9	57.5	
Retained earnings	307.1	234.3	
	<u>697.0</u>	<u>627.9</u>	
Equity attributable to equity holders of the parent	<u>697.0</u>	<u>627.9</u>	
Non-controlling interests	0.5	0.4	
Total equity	<u>697.5</u>	<u>628.3</u>	

**CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2017**

	2017 £m	2016 £m	Note
Net cash from operating activities	<u>159.9</u>	<u>125.9</u>	6
Investing activities			
Purchases of property, plant and equipment	(73.3)	(64.7)	
Proceeds on disposal of property, plant and equipment and intangible assets	3.7	7.6	
Purchases of intangible fixed assets	(5.2)	(6.0)	
Acquisition of businesses	(14.2)	(23.7)	
Disposal of sundry investments	-	0.3	
Disposal of businesses	-	1.9	
Net cash used in investing activities	<u>(89.0)</u>	<u>(84.6)</u>	
Financing activities			
Interest received	0.1	-	
Interest paid	(2.1)	(2.3)	
Dividends paid	(30.6)	(48.1)	
Repayments of bank loans	(5.0)	(2.3)	
Payments of obligations under finance leases	(0.1)	(0.1)	
New bank loans raised	-	5.0	
Net cash used in financing activities	<u>(37.7)</u>	<u>(47.8)</u>	
Net increase/(decrease) in cash and cash equivalents	33.2	(6.5)	
Cash and cash equivalents at beginning of year	6.2	12.4	
Effect of foreign exchange rate changes	<u>0.2</u>	<u>0.3</u>	
Cash and cash equivalents at end of year	<u><u>39.6</u></u>	<u><u>6.2</u></u>	6

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2017

	Share capital	Share premium account	Own shares	Other reserves	Translatio n reserves	Retained earnings	Equity attributable to equity holders of the parent	Non- controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m	£m
1 January 2016	33.1	177.1	(9.3)	134.1	(5.8)	220.0	549.2	0.4	549.6
Net profit for the year	-	-	-	-	-	67.0	67.0	-	67.0
Exchange differences on translation of overseas operations	-	-	-	-	65.5	-	65.5	-	65.5
Cumulative exchange differences recycled to profit or loss on disposal of businesses	-	-	-	-	(2.2)	-	(2.2)	-	(2.2)
Actuarial losses on defined benefit pension schemes net of deferred tax	-	-	-	-	-	(4.0)	(4.0)	-	(4.0)
Total comprehensive income for the year	-	-	-	-	63.3	63.0	126.3	-	126.3
Acquired in the year/settlement of share options	-	-	1.3	(0.7)	-	(0.6)	-	-	-
Share-based payments	-	-	-	0.5	-	-	0.5	-	0.5
Dividends paid	-	-	-	-	-	(48.1)	(48.1)	-	(48.1)
31 December 2016	33.1	177.1	(8.0)	133.9	57.5	234.3	627.9	0.4	628.3
Net profit for the year	-	-	-	-	-	97.1	97.1	0.2	97.3
Exchange differences on translation of overseas operations	-	-	-	-	(11.6)	-	(11.6)	(0.1)	(11.7)
Actuarial losses on defined benefit pension schemes net of deferred tax	-	-	-	-	-	5.7	5.7	-	5.7
Total comprehensive income for the year	-	-	-	-	(11.6)	102.8	91.2	0.1	91.3
Acquired in the year/settlement of share options	-	-	0.8	(0.7)	-	-	0.1	-	0.1
Share-based payments	-	-	-	7.8	-	-	7.8	-	7.8
Deferred tax on share-based payment transactions	-	-	-	-	-	0.6	0.6	-	0.6
Dividends paid	-	-	-	-	-	(30.6)	(30.6)	-	(30.6)
31 December 2017	33.1	177.1	(7.2)	141.0	45.9	307.1	697.0	0.5	697.5

Included in other reserves is the capital redemption reserve of £129.8m (2016: £129.8m) and the share-based payments reserve of £10.4m (2016: £3.3m).

The own shares reserve represents the cost of shares in Bodycote plc purchased in the market. At 31 December 2017 1,171,190 (2016: 1,289,378) ordinary shares of 17 3/11p each were held by the Bodycote International Employee Benefit Trust to satisfy share-based payments under the Group's incentive schemes.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS YEAR ENDED 31 DECEMBER 2017

1 Business and geographical segments

The Group has 187 locations across the world serving a range of market sectors with various thermal processing services. The range and type of services offered is common to all market sectors.

In accordance with IFRS 8 Operating Segments, the segmentation of Group activity reflects the way the Group is managed by the chief operating decision maker, being the Group Chief Executive, who on a monthly basis reviews the operating performance of six operating segments, split between the Aerospace, Defence & Energy (ADE) and Automotive & General Industrial (AGI) business areas, as follows:

- ADE – Western Europe;
- ADE – North America;
- ADE – Emerging markets;
- AGI – Western Europe;
- AGI – North America; and
- AGI – Emerging markets.

The split of operating segments by geography reflects the divisional reporting structure of the Group.

In accordance with the aggregation criteria of IFRS 8, the operating segments are aggregated into the Group's two key business areas, ADE and AGI, the split being driven by customer behaviour and requirements. Customers in the ADE segment tend to operate and purchase more globally and have long supply chains, whilst customers in the AGI segment tend to purchase more locally and have shorter supply chains.

Bodycote plants do not exclusively supply services to customers of a given market sector. Allocations of plants between ADE and AGI is therefore derived by reference to the preponderance of markets served.

Group	ADE 2017 £m	AGI 2017 £m	Central costs and eliminations 2017 £m	Consolidated 2017 £m
Revenue				
Total revenue	273.1	417.1	-	690.2
Result				
Headline operating profit prior to share-based payments and unallocated central costs	65.6	77.3	-	142.9
Share-based payments (including social charges)	(1.4)	(3.1)	(4.6)	(9.1)
Unallocated central costs	-	-	(9.9)	(9.9)
Headline operating profit/(loss)	64.2	74.2	(14.5)	123.9
Amortisation of acquired intangible fixed assets	(1.5)	(3.0)	-	(4.5)
Operating profit/(loss) prior to exceptional items	62.7	71.2	(14.5)	119.4
Segment result	62.7	71.2	(14.5)	119.4
Investment revenue				0.1
Finance costs				(2.5)
Profit before taxation				117.0
Taxation				(19.7)
Profit for the year				97.3

Inter-segment sales are not material in either year.

The Group does not rely on any individual major customers.

1 Business and geographical segments (continued)

Aerospace, Defence & Energy	Western Europe 2017 £m	North America 2017 £m	Emerging markets 2017 £m	Total ADE 2017 £m
Revenue				
Total revenue	<u>126.0</u>	<u>145.7</u>	<u>1.4</u>	<u>273.1</u>
Result				
Headline operating profit prior to share-based payments	30.7	34.7	0.2	65.6
Share-based payments (including social charges)	<u>(0.5)</u>	<u>(0.9)</u>	-	<u>(1.4)</u>
Headline operating profit	30.2	33.8	0.2	64.2
Amortisation of acquired intangible fixed assets	<u>(0.3)</u>	<u>(1.2)</u>	-	<u>(1.5)</u>
Operational profit prior to exceptional items	<u>29.9</u>	<u>32.6</u>	<u>0.2</u>	<u>62.7</u>
Segment result	<u>29.9</u>	<u>32.6</u>	<u>0.2</u>	<u>62.7</u>
Automotive & General Industrial	Western Europe 2017 £m	North America 2017 £m	Emerging markets 2017 £m	Total AGI 2017 £m
Revenue				
Total revenue	<u>258.9</u>	<u>105.5</u>	<u>52.7</u>	<u>417.1</u>
Result				
Headline operating profit prior to share-based payments	51.2	11.6	14.5	77.3
Share-based payments (including social charges)	<u>(2.4)</u>	<u>(0.4)</u>	<u>(0.3)</u>	<u>(3.1)</u>
Headline operating profit	48.8	11.2	14.2	74.2
Amortisation of acquired intangible fixed assets	<u>(0.4)</u>	<u>(2.6)</u>	-	<u>(3.0)</u>
Segment result	<u>48.4</u>	<u>8.6</u>	<u>14.2</u>	<u>71.2</u>
Group	ADE 2016 £m	AGI 2016 £m	Central costs and eliminations 2016 £m	Consolidated 2016 £m
Revenue				
Total revenue	<u>250.9</u>	<u>349.7</u>	-	<u>600.6</u>
Result				
Headline operating profit prior to share-based payments and unallocated central costs	56.3	57.9	-	114.2
Share-based payments (including social charges)	(0.7)	0.6	(0.6)	(0.7)
Unallocated central costs	-	-	(13.9)	(13.9)
Headline operating profit/(loss)	55.6	58.5	(14.5)	99.6
Amortisation of acquired intangible fixed assets	<u>(1.5)</u>	<u>(3.0)</u>	-	<u>(4.5)</u>
Operating profit/(loss) prior to exceptional items	54.1	55.5	(14.5)	95.1
Acquisition costs	<u>-</u>	<u>(0.6)</u>	-	<u>(0.6)</u>
Segment result	<u>54.1</u>	<u>54.9</u>	<u>(14.5)</u>	94.5
Finance costs				<u>(2.6)</u>
Profit before taxation				91.9
Taxation				<u>(24.9)</u>
Profit for the year				<u>67.0</u>

1 Business and geographical segments (continued)

Aerospace, Defence & Energy	Western Europe 2016 £m	North America 2016 £m	Emerging markets 2016 £m	Total ADE 2016 £m
Revenue				
Total revenue	<u>115.1</u>	<u>134.7</u>	<u>1.1</u>	<u>250.9</u>
Result				
Headline operating profit/(loss) prior to share-based payments	24.0	32.7	(0.4)	56.3
Share-based payments (including social charges)	<u>(0.2)</u>	<u>(0.5)</u>	<u>-</u>	<u>(0.7)</u>
Headline operating profit/(loss)	23.8	32.2	(0.4)	55.6
Amortisation of acquired intangible fixed assets	<u>(0.3)</u>	<u>(1.2)</u>	<u>-</u>	<u>(1.5)</u>
Operating profit prior to exceptional items	<u>23.5</u>	<u>31.0</u>	<u>(0.4)</u>	<u>54.1</u>
Segment result	<u>23.5</u>	<u>31.0</u>	<u>(0.4)</u>	<u>54.1</u>
Automotive & General Industrial	Western Europe 2016 £m	North America 2016 £m	Emerging markets 2016 £m	Total AGI 2016 £m
Revenue				
Total revenue	<u>214.9</u>	<u>94.3</u>	<u>40.5</u>	<u>349.7</u>
Result				
Headline operating profit prior to share-based payments	36.8	10.7	10.4	57.9
Share-based payments (including social charges)	<u>0.4</u>	<u>0.1</u>	<u>0.1</u>	<u>0.6</u>
Headline operating profit	37.2	10.8	10.5	58.5
Amortisation of acquired intangible fixed assets	<u>(0.4)</u>	<u>(2.6)</u>	<u>-</u>	<u>(3.0)</u>
Operating profit prior to exceptional items	36.8	8.2	10.5	55.5
Acquisition costs	<u>(0.4)</u>	<u>(0.2)</u>	<u>-</u>	<u>(0.6)</u>
Segment result	<u>36.4</u>	<u>8.0</u>	<u>10.5</u>	<u>54.9</u>
Other information				
Group	ADE 2017 £m	AGI 2017 £m	Central costs and eliminations 2017 £m	Consolidated 2017 £m
Gross capital additions	33.6	39.7	5.2	78.5
Depreciation and amortisation	23.5	39.3	1.5	64.3
Balance sheet				
Assets:				
Segment assets	<u>352.6</u>	<u>530.2</u>	<u>76.9</u>	<u>959.7</u>
Liabilities:				
Segment liabilities	<u>(60.2)</u>	<u>(133.2)</u>	<u>(68.8)</u>	<u>(262.2)</u>
Allocation of head office net liabilities	<u>292.4</u>	<u>397.0</u>	<u>8.1</u>	<u>697.5</u>
	<u>3.4</u>	<u>4.7</u>	<u>(8.1)</u>	<u>-</u>
Adjusted segment net assets	<u>295.8</u>	<u>401.7</u>	<u>-</u>	<u>697.5</u>

1 Business and geographical segments (continued)

	Western Europe 2017 £m	North America 2017 £m	Emerging markets 2017 £m	Total ADE 2017 £m
Aerospace, Defence & Energy				
Gross capital additions	23.4	9.3	0.9	33.6
Depreciation and amortisation	10.0	13.4	0.1	23.5
Balance sheet				
Assets:				
Segment assets	<u>168.0</u>	<u>179.9</u>	<u>4.7</u>	<u>352.6</u>
Liabilities:				
Segment liabilities	<u>(30.8)</u>	<u>(28.4)</u>	<u>(1.0)</u>	<u>(60.2)</u>
Segment net assets	<u>137.2</u>	<u>151.5</u>	<u>3.7</u>	<u>292.4</u>
	Western Europe 2017 £m	North America 2017 £m	Emerging markets 2017 £m	Total AGI 2017 £m
Automotive & General Industrial				
Gross capital additions	20.1	12.6	7.0	39.7
Depreciation and amortisation	23.6	10.5	5.2	39.3
Balance sheet				
Assets:				
Segment assets	<u>292.3</u>	<u>153.2</u>	<u>84.7</u>	<u>530.2</u>
Liabilities:				
Segment liabilities	<u>(96.7)</u>	<u>(20.6)</u>	<u>(15.9)</u>	<u>(133.2)</u>
Segment net assets	<u>195.6</u>	<u>132.6</u>	<u>68.8</u>	<u>397.0</u>
Group	ADE 2016 £m	AGI 2016 £m	Central costs and eliminations 2016 £m	Consolidated 2016 £m
Gross capital additions	25.8	39.0	5.9	70.7
Depreciation and amortisation	22.2	36.5	1.0	59.7
Balance sheet				
Assets:				
Segment assets	<u>343.1</u>	<u>514.8</u>	<u>66.5</u>	<u>924.4</u>
Liabilities:				
Segment liabilities	<u>(67.8)</u>	<u>(122.4)</u>	<u>(105.9)</u>	<u>(296.1)</u>
	275.3	392.4	(39.4)	628.3
Allocation of head office net liabilities	<u>(16.2)</u>	<u>(23.2)</u>	<u>39.4</u>	<u>-</u>
Adjusted segment net assets	<u>259.1</u>	<u>369.2</u>	<u>-</u>	<u>628.3</u>

1 Business and geographical segments (continued)

Aerospace, Defence & Energy	Western Europe 2016 £m	North America 2016 £m	Emerging markets 2016 £m	Total ADE 2016 £m
Gross capital additions	10.5	13.0	2.3	25.8
Depreciation and amortisation	9.3	12.7	0.2	22.2
Balance sheet				
Assets:				
Segment assets	<u>142.7</u>	<u>196.9</u>	<u>3.5</u>	<u>343.1</u>
Liabilities:				
Segment liabilities	<u>(29.7)</u>	<u>(36.3)</u>	<u>(1.8)</u>	<u>(67.8)</u>
Segment net assets	<u>113.0</u>	<u>160.6</u>	<u>1.7</u>	<u>275.3</u>
Automotive & General Industrial	Western Europe 2016 £m	North America 2016 £m	Emerging markets 2016 £m	Total AGI 2016 £m
Gross capital additions	20.2	10.6	8.2	39.0
Depreciation and amortisation	21.7	10.5	4.3	36.5
Balance sheet				
Assets:				
Segment assets	<u>279.8</u>	<u>163.3</u>	<u>71.7</u>	<u>514.8</u>
Liabilities:				
Segment liabilities	<u>(91.8)</u>	<u>(21.0)</u>	<u>(9.6)</u>	<u>(122.4)</u>
Segment net assets	<u>188.0</u>	<u>142.3</u>	<u>62.1</u>	<u>392.4</u>

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	
	2017 £m	2016 £m	2017 £m	2016 £m
USA	236.8	219.0	272.1	298.9
France	111.9	97.6	78.1	73.8
Germany	91.4	69.9	86.5	85.4
UK	51.9	48.5	91.0	76.4
Sweden	38.9	36.1	36.8	37.5
Netherlands	29.4	25.3	22.7	22.6
Others	129.9	104.2	134.3	121.1
	<u>690.2</u>	<u>600.6</u>	<u>721.5</u>	<u>715.7</u>

2 Operating profit

	2017 £m	2016 £m
Revenue	690.2	600.6
Cost of sales	<u>(429.9)</u>	<u>(378.4)</u>
Gross profit	260.3	222.2
Other operating income	4.5	4.4
Distribution costs	(21.3)	(20.9)
Administration expenses	<u>(118.6)</u>	<u>(101.7)</u>
	<u>(1.0)</u>	<u>(4.4)</u>
Headline operating profit	123.9	99.6
Amortisation of acquired intangible fixed assets	<u>(4.5)</u>	<u>(4.5)</u>
Operating profit prior to exceptional items	119.4	95.1
Exceptional items	-	(0.6)
Operating profit	<u>119.4</u>	<u>94.5</u>

Exceptional items comprise:

	2017 £m	2016 £m
Acquisition costs	-	0.6
	<u>-</u>	<u>0.6</u>

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

	2017 £m	2016 £m
Net foreign exchange gains	-	(0.5)
Inventory expensed	53.0	48.2
Depreciation of property, plant and equipment	58.1	54.1
Amortisation of intangible fixed assets	6.2	5.6
Gain on disposal of property, plant and equipment	(0.7)	(4.5)
Staff costs	283.8	239.5
Acquisition costs	-	0.6
Impairment loss on trade receivables	0.8	1.2
Impairment of fixed assets - recognised in operating profit	<u>0.4</u>	<u>5.1</u>

3 Taxation

	2017 £m	2016 £m
Current taxation – charge for the year	28.1	24.9
Current taxation – adjustments in respect of previous years	(6.3)	2.2
Deferred tax	(2.1)	(2.2)
	<u>19.7</u>	<u>24.9</u>

The Group has chosen to use a weighted average country tax rate rather than the UK tax rate for the reconciliation of the charge for the year to the profit before taxation per the consolidated income statement. The Group operates in several jurisdictions, many of which have a tax rate in excess of the UK tax rate. As such, a weighted average country tax rate is believed to provide the most meaningful information to the users of the financial statements. The appropriate tax rate for this comparison is 30.09% (2016: 32.36%).

As part of the calculation of the tax charge, the Group recognises a number of tax risk provisions in respect of ongoing tax inquiries and in recognition of the multinational tax environment that Bodycote operates in where the nature of the tax positions that are taken is often complex and subject to change.

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

	2017 £m	2016 £m
Profit before taxation	<u>117.0</u>	<u>91.9</u>
Tax at the weighted average country tax rate of 30.09% (2016: 32.36%)	35.2	29.7
Tax effect of expenses not deductible in determining taxable profit ¹	0.4	(0.4)
Impact of recognition or derecognition of deferred tax balances	(1.4)	2.1
Effect of long-term capital financing ²	0.7	(1.0)
Tax effect of other adjustments in respect of previous years:		
Current tax ³	(7.0)	2.2
Deferred tax ³	4.3	(0.6)
Effect of financing activities between jurisdictions ²	(9.2)	(7.2)
Impact of trade and minimum corporate taxes	1.3	1.1
Impact of US Tax Cuts and Jobs Act treated as an exceptional item ⁴	(6.4)	-
Effect of changes in statutory tax rates on deferred tax assets and liabilities	(0.1)	(1.2)
Other tax risk provision movements	1.9	0.2
Tax expense for the year	<u>19.7</u>	<u>24.9</u>

Tax on items taken directly to equity is a credit of £0.5m (2016: £1.0m).

¹ Those costs in various territories not deductible in calculating taxable profits.

² The Group is externally financed by a mix of cash flows from operations, short-term borrowings, long-term loans and finance leases. Internally, operating subsidiaries are predominantly financed via intercompany loans. The charge includes provisions based on management's estimation of tax risk.

³ 2017 prior year adjustments in current and deferred tax relate to changes in assumptions and outcomes in relation to overseas tax credits and other claims, whilst the 2016 adjustments mainly relate to changes in overseas pensions assumptions.

⁴ Net exceptional impact of the passing of the Tax Cuts and Jobs Act in the US in December 2017, made up of (i) £6.8m one-off tax gain resulting from a revaluation of the Group's US deferred tax liabilities, (ii) £0.4m tax charge on accumulated overseas profits of US entities.

4 Earnings per share

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

Earnings	2017	2016
	£m	£m
Earnings for the purpose of basic earnings per share being net profit attributable to equity holders of the parent	97.1	67.0
Number of shares	Number	Number
Weighted average number of ordinary shares for the purpose of basic earnings per share	190,250,855	190,166,794
Effect of dilutive potential ordinary shares:		
Share options	-	-
Weighted average number of ordinary shares for the purpose of diluted earnings per share	190,250,855	190,166,794
	Pence	Pence
Earnings per share:		
Basic	51.0	35.2
Diluted	51.0	35.2
Headline earnings	£m	£m
Net profit attributable to equity holders of the parent	97.1	67.0
Add back:		
Amortisation of acquired intangible fixed assets (net of tax)	2.9	2.8
Acquisition costs (net of tax)	-	0.5
Less impact of US Tax Cuts and Jobs Act treated as an exceptional item	(6.4)	-
Headline earnings	93.6	70.3
	Pence	Pence
Headline earnings per share:		
Basic	49.2	37.0
Diluted	49.2	37.0

5 Provisions

	Restructuring	Restructuring	Environmental	Total
	£m	environmental	£m	£m
		£m		
At 1 January 2017	6.7	6.6	7.2	20.5
Increase in provision	0.2	-	2.5	2.7
Release of provision	(0.5)	-	-	(0.5)
Utilisation of provision	(2.3)	(1.4)	(0.6)	(4.3)
Exchange difference	(0.1)	(0.3)	(0.6)	(1.0)
At 31 December 2017	4.0	4.9	8.5	17.4
Included in current liabilities				8.7
Included in non-current liabilities				8.7
				17.4

The restructuring provision materially relates to the costs associated with the closure of a number of Heat Treatment sites announced in 2015 and the restructuring of the Canadian operations announced in 2016.

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 identify separately environmental provisions relating to the restructuring programme from those arising in the ordinary course of business.

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

Whilst the Group's use of chlorinated solvents and other hazardous chemicals continues to reduce, the Group remains exposed to contingent liabilities in respect of environmental remediation liabilities. In particular, the Group could be subjected to regulatory or legislative requirements to remediate sites in the future. However, it is not possible at this time to determine whether and to what extent any liabilities exist, other than for those recognised above. Therefore no provision is recognised in relation to these items.

6 Notes to the cash flow statement

	2017 £m	2016 £m
Profit for the year	97.3	67.0
Adjustments for:		
Investment revenue	(0.1)	-
Finance costs	2.5	2.6
Taxation	19.7	24.9
Depreciation of property, plant and equipment	58.1	54.1
Amortisation of intangible assets	6.2	5.6
Profit on disposal of property, plant and equipment	(0.7)	(4.5)
Share-based payments	7.8	0.5
Impairment of fixed assets	0.4	5.1
Profit on disposal of businesses	-	(0.1)
EBITDA ¹	<u>191.2</u>	155.2
Decrease in inventories	0.5	5.5
Increase in receivables	(17.0)	(4.1)
Increase/(decrease) in payables	10.2	(6.7)
Decrease in provisions	(2.1)	(3.6)
Cash generated by operations	<u>182.8</u>	146.3
Income taxes paid	<u>(22.9)</u>	(20.4)
Net cash from operating activities	<u>159.9</u>	125.9

¹ Earnings before interest, tax, depreciation, amortisation, impairment of fixed assets and other assets, profit or loss on disposal of property, plant and equipment, profit on sale of businesses and share-based payments.

	2017 £m	2016 £m
Cash and cash equivalents comprise:		
Cash and bank balances	41.0	12.0
Bank overdrafts (included in borrowings)	<u>(1.4)</u>	<u>(5.8)</u>
	<u>39.6</u>	6.2

7 Alternative performance measures (APMs)

Bodycote uses various APMs, in addition to those reported under IFRS, as management believe these measures enable users of the financial statements to assess the underlying trading performance of the business. The APMs used include headline operating profit, headline profit before taxation, EBITDA, headline EBITDA, headline earnings per share (EPS), headline operating cash flow, free cash flow, net cash, return on capital employed (ROCE) . These measures reflect the underlying performance of the business as they exclude the impact of amortisation of acquired intangible assets and exceptional items and. The Group also uses revenue growth percentages adjusted for the impact of foreign exchange movements, where appropriate, also to better represent the underlying performance of the business. The measures described above are also used in the targeting process for executive and management annual bonuses (headline operating profit, operating cash-flow) and share schemes (headline operating profit, headline operating cash flow, ROCE, headline EPS).

The constant exchange rate comparison uses the current year reported segmental information, stated in the relevant functional currency, and translates the results into its presentational currency using the prior year's monthly exchange rates.

APMs are defined and reconciled to the IFRS statutory measure as follows:

Headline operating profit

	2017	2016
	£m	£m
Statutory operating profit	119.4	94.5
Add back:		
Amortisation of acquired intangibles	4.5	4.5
Acquisition costs	-	0.6
Headline operating profit	123.9	99.6

Headline profit before taxation

	2017	2016
	£m	£m
Profit before taxation	117.0	91.9
Add back:		
Amortisation of acquired intangibles	4.5	4.5
Acquisition costs	-	0.6
Headline profit before taxation	121.5	97.0

EBITDA and Headline EBITDA (Earnings Before Interest, Taxation, Depreciation, and Amortisation)

	2017	2016
	£m	£m
Operating profit	119.4	94.5
Depreciation and amortisation	64.3	59.7
Impairment of fixed assets	0.4	5.1
Profit on disposal of property, plant and equipment	(0.7)	(4.5)
Profit on disposal of businesses	-	(0.1)
Share-based payments	7.8	0.5
EBITDA	191.2	155.2
Add back exceptional items:		
Acquisition costs	-	0.6
Headline EBITDA	191.2	155.8

Headline earnings per share

A detailed reconciliation is provided in note 4 to this announcement

Headline operating cash flow

	2017 £m	2016 £m
Cash generated by operations	182.8	146.3
Less:		
Net capital expenditure	(74.8)	(63.1)
Add:		
Restructuring cash flows	3.7	7.6
Acquisition expenses	-	0.6
Headline operating cash flow	111.7	91.4

Free cash flow

	2017 £m	2016 £m
Cash generated by operations	182.8	146.3
Less:		
Net capital expenditure	(74.8)	(63.1)
Financing costs	(2.1)	(2.3)
Taxation	(22.9)	(20.4)
Free cash flow	83.0	60.5

Net Cash

	2017 £m	2016 £m
Cash and bank balances	41.0	12.0
Bank overdrafts (included in borrowings)	(1.4)	(5.8)
Loans	-	(5.0)
Finance leases	-	(0.1)
Net cash	39.6	1.1

Return on capital employed

	2017 £m	2016 £m
Headline operating profit	123.9	99.6
Average capital employed ¹	642.5	582.3
Return on capital employed	19.3%	17.1%

¹ Average capital employed is calculated as average of opening (£627.2m) and closing (£657.8m) capital employed.

Revenue and headline operating profit at constant exchange rates

Reconciled to revenue and headline operating profit in the table below.

	Year to 31 December 2017			
	ADE £m	AGI £m	Costs and eliminations £m	Consolidated £m
Revenue	273.1	417.1	-	690.2
Constant exchange rates adjustment	(10.5)	(21.6)	-	(32.1)
Revenue at constant exchange rates	262.6	395.5	-	658.1
Headline operating profit	64.2	74.2	(14.5)	123.9
Constant exchange rates adjustment	(2.4)	(4.0)	0.1	(6.3)
Headline operating profit at constant exchange rates	61.8	70.2	(14.4)	117.6

8 Basis of preparation

The financial information has been based on the Company's financial statements which are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the EU. Whilst the financial information contained in this preliminary announcement has been prepared in accordance with the recognition and measurement criteria of IFRS, this announcement does not itself contain sufficient information to comply with those standards. The Company expects to publish full financial statements that comply with IFRS in March 2018. The financial information has been prepared under the same accounting policies as the 2016 financial statements.

9 Non-statutory financial statements

The financial information set out above does not constitute the Company's statutory accounts for the years ended 31 December 2017 or 2016, but is derived from those accounts. Statutory accounts for 2016 have been delivered to the Registrar of Companies and those for 2017 will be delivered following the Company's Annual General Meeting. The auditor has reported on those accounts; the reports were unqualified, did not draw attention to any matters by way of emphasis and did not contain statements under s.498 (2) or (3) Companies Act 2006.