Bodycote

At a glance

Operating an international network of facilities, the Bodycote Thermal Processing Group 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.

Thermal processing is a vital part of any manufacturing process and includes a variety of techniques and specialist engineering processes which improve the properties of metals and alloys and extend the life of components.

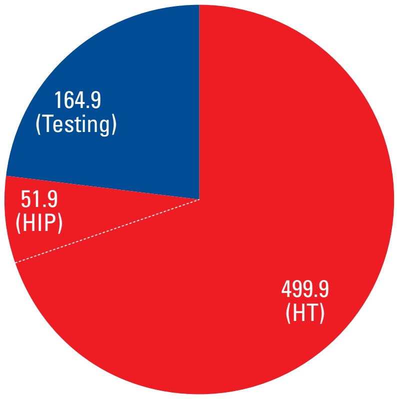
HEAT TREATMENTS

Heat treatment is used to improve the properties of metals and alloys, for example, by increasing hardness, wear resistance and fatigue strength. Bodycote offers an extensive range of heat treatment services and specialist metal joining techniques, including all standard heat treatment services plus advanced specialist processes such as Kolsterising®, honeycomb brazing, low pressure carburising (LPC), electron beam welding (EBW), vacuum brazing, plasma processing, cryogenic treatments, boronising, Corr-I-Dur, nitrocarburising, hydrogen annealing and hardening of stainless steels.

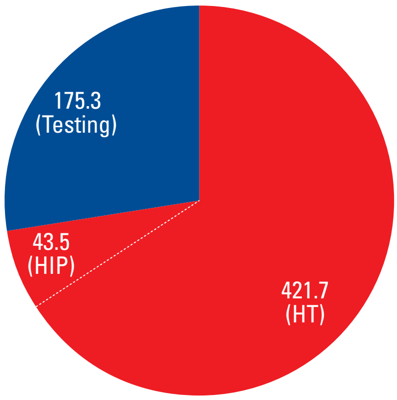
Bodycote's surface engineering services also include a wide range of coatings which are used extensively to prolong the working life of components and protect them from environmental factors such as corrosion and abrasion. Bodycote provides indispensable coatings systems for durability, anti-corrosion, wear resistance, improved hardness and electrical conductivity. The combination of modern computerised control systems and unrivalled coatings expertise means that Bodycote can offer specialist ceramic and thermal spray coatings, thermal diffusion, duplex coatings and organic coatings. Bodycote is a specialist provider of K-Tech coatings – a unique range of thermochemically formed ceramic coatings for the prevention of wear and corrosion in a wide variety of severe industrial applications including complex geometric shapes and internal bores.

HOT ISOSTATIC PRESSING (HIP)

HIP is an advanced technology which uses very high pressure inert gas at elevated temperatures in order to improve the properties of metals and other materials. HIP is used to eliminate porosity in castings and consolidate encapsulated powders to give fully dense 'wrought' materials. Incompatible materials can be bonded together to manufacture unique, cost-effective components. Operating the largest HIP capacity in the western world, Bodycote has also developed the Densal® process to cost-effectively densify aluminium. The flexibility of HIP technology allows engineers to optimise conventionally formed parts and also to design components unobtainable by other means.



2008 Revenue (continuing and discontinued operations) £716.7m



2007 Revenue (continuing and discontinued operations) £640.5m

- Thermal Processing
  - Heat Treatment (HT)
  - Hot Isostatic Pressing (HIP)
- Testing (discontinued operations)

www.bodycote.com/audiocast

Bodycote continually improves the website offerings for both customers and investors. The most recent is the addition of an audio webcast of Bodycote's 2008 results presentation in the Investor Relations section of the website. We invite you to view and to listen by visiting www.bodycote.com/audiocast

Cover image: Reflects the core services provided by Bodycote and of the renewed focus of the Group on thermal processing services.

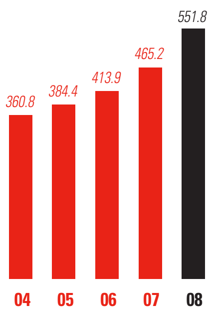
Financial Highlights

Bodycote

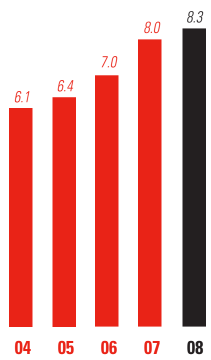
	2008	2007	Change %
Revenue - continuing operations	**£551.8m**	£465.2m	+18.6
Headline Operating Profit[1] - continuing operations	**£71.2m**	£70.3m	+1.3
Operating (Loss)/Profit - continuing operations	**£(51.7)m**	£63.1m	
Headline Profit Before Taxation[2]	**£67.6m**	£67.8m	– 0.3
(Loss)/Profit Before Taxation	**£(55.3)m**	£60.6m	
Operating Cash Flow[3]	**£61.0m**	£56.4m	+8.2
Basic Headline Earnings Per Share[4]	**17.5p**	16.6p	+5.4
Basic Earnings Per Share	**48.2p**	16.6p	+190.4
Dividend Per Share[5]	**8.3p**	8.0p	+3.8

[1] A detailed reconciliation is provided on page 5 and excludes the deduction of major facility closure costs of £77.6m (2007: £3.4m) and impairment of goodwill of £31.9m (2007: £3.5m).
[2] A detailed reconciliation is provided on page 7 and excludes profit on disposal of the Testing business of £199.3m (2007: £Nil).
[3] Operating cash flow is defined as cash generated by operations (£135.9m, 2007: £123.3m) less net capital expenditure (£74.9m, 2007: £66.9m).
[4] A detailed reconciliation is provided in note 10 on page 44.
[5] See note 9 on page 44.

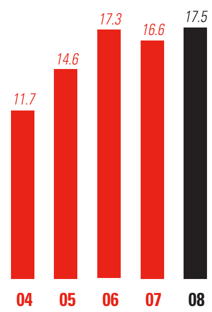
Revenue - Continuing Operations
£ Million



Dividend Per Share
Pence



Basic Headline Earnings Per Share[4]
Pence



CONTENTS

Chairman's Statement

2008 was a year of transformation for Bodycote, both in terms of the business and also the Board of Directors.

The Group revenue from continuing operations increased by 18.6% to £551.8m and headline operating profit from continuing operations was up 1.3% to £71.2m. Headline profit before tax for the Group was £67.6m compared to £67.8m in 2007.

In anticipation of a prolonged economic downturn, the Board has initiated a major re-organisation of the remaining Thermal Processing activities to achieve a slimmer fixed cost base and focus on higher value added services. This has resulted in exceptional charges of £122.9m and consequently there was an operating loss for the year of £51.7m compared to an operating profit of £63.1m in 2007.

As a result of an in-depth strategic review early in 2008, the Board decided to focus the Group on its core Thermal Processing operations and dispose of the Testing business, which was originally acquired in 1990 and expanded considerably in recent years. The ensuing auction process was highly competitive and resulted in a cash sale of the Testing business for a price of £419.7m, giving rise to a pre-tax exceptional profit of £199.3m. The Board considered carefully the appropriate use of proceeds in light of the deteriorating economic climate. As a result we returned £128.8m of the proceeds to shareholders in December 2008 through a return of capital and concurrent share capital reorganisation, made an additional contribution to the UK pension scheme of £21.0m and significantly strengthened the Group's balance sheet. The value realised from the sale of the Testing business (which accounted for 30% of annualised Group headline profit at the time of the sale) approximated the market value of the whole of Bodycote at the point of completion.

I became Chairman of Bodycote in April 2008 and would like to express the Board's appreciation to my predecessor James Wallace, who joined the Board in 1994 and served the company selflessly as Chairman of the Audit and Remuneration committees and latterly from the Chairman's position, which he had filled since 2002. His wise counsel will be missed.

Laurent Bermejo also stepped down after five years on the Board. His contribution to the Board's deliberations particularly on European issues was invaluable.

At this year's AGM in April we will also recognise the retirement from the Board of two executive directors, John Hubbard, Chief Executive from January 2002 until January 2009 and Derek Sleight, Corporate Development Director since 2003.

John Hubbard joined the Group in 1996 following the acquisition of his business by Bodycote. John has spent his entire career in the heat treatment industry and since taking over as Chief Executive in 2002 has worked tirelessly to create a cohesive group with common strategic and operational goals.

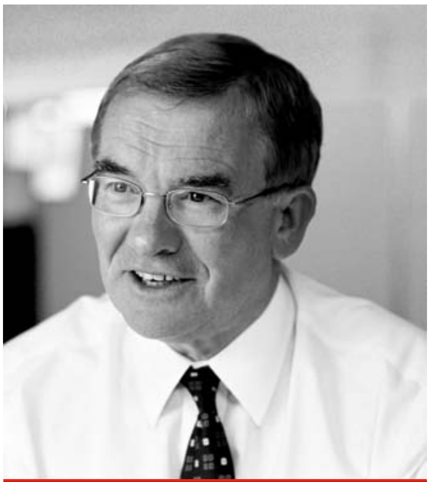
Derek Sleight joined Bodycote in 1990 with the acquisition of the Testing business and joined the Board in 1996. He led the Testing business until 2002, when he assumed the role of Corporate Development Director. In this role he was the architect behind the successful sale of the Testing business in 2008.

We wish both John and Derek well in the future in the knowledge that their expertise will be available to the Group after they step down from the Board.

The Group has already said farewell to the employees of our former Testing business and on behalf of the Board I would like to thank them and all continuing managers and staff at Bodycote for their commitment, dedication and support.

In September we welcomed Raj Rajagopal to the Board as a non-executive director. Raj served as an executive director on the Board of BOC for many years and his expertise in managing an international portfolio is proving to be invaluable.

After a global recruitment search, Stephen Harris joined the Board in November 2008 as Chief Executive designate and stepped up to the full role in January 2009. Stephen joins the Group after a career which has included Board appointments at Spectris plc and Powell Duffryn plc. Stephen is a qualified electrical engineer with wide international business experience. Since joining the company Stephen has carried out a full appraisal of the Group's structure, its operating activities and management strength.



Alan Thomson - Chairman

I am confident that he will successfully implement the major restructuring programme and accelerate the Group's financial returns thus creating significant value for shareholders.

The Board indicated at the time of the Testing disposal and the return of proceeds to shareholders that we intended to implement a progressive dividend policy which rewarded shareholders broadly in line with the Group's operating results. The Directors are, therefore, recommending to shareholders a final dividend of 5.35p which brings the total dividend to 8.3p, an increase of 3.8% over 2007. The final dividend will be paid to shareholders in May following approval at the AGM.

OUTLOOK

We are reshaping the Group to meet the challenges presented by the difficult economic and trading conditions across the globe and to reduce the proportion of low value-added work undertaken in our Heat Treatment businesses. Although automotive markets weakened considerably in the second half of 2008, our aerospace, oil and gas and energy activities remain steady.

With a business focused on Thermal Processing, a restructured cost base and maintenance of a strong balance sheet, the Group is in a favourable position to maximise value to shareholders when trading conditions improve.

A. M. Thomson
25 February 2009

2008 Group Business Review

Bodycote

Stephen Harris - Chief Executive

David Landless - Finance Director

OVERVIEW

Bodycote provides thermal processing services to manufacturers in virtually every sector of the world manufacturing economy. Up until 17 October 2008 the company also provided testing services. Following the sale of the Testing business, more than 7,000 employees continue to provide high quality services from over 190 locations in 27 countries, serving several tens of thousands of customers. In 2008 the Thermal Processing business delivered 77% of Group sales compared to 73% in 2007 and saw its sales increase by 18.6%. The Group operates in two principal business areas: Heat Treatment and Hot Isostatic Pressing (HIP).

During 2008 Bodycote has continued to execute its strategy of developing its presence in emerging markets and increasing the proportion of high added value services in developed economies. The disposal of Testing for a consideration of £419.7m brought net cash proceeds, after expenses and tax, of £378.2m and an exceptional profit after tax of £177.4m. In order to accelerate the move away from lower added value work and to reduce the Group's cost base in light of the global macro economic downturn, the Board also initiated a significant restructuring of the continuing Thermal Processing business. Headline operating profit of the continuing business was £71.2m, but after allowing for exceptional costs of restructuring and asset impairment there was a statutory operating loss for continuing operations of £51.7m. More information and a reconciliation are provided on page 5.

COMPETITIVE ENVIRONMENT

In the western hemisphere Bodycote is the clear leader in the provision of commercial thermal processing services. Bodycote mainly competes with local, privately owned companies and manufacturers' own in-house facilities. Competition and the customer base are both very fragmented with hundreds of providers servicing thousands of customers. The Group has developed a sustainable, competitive advantage over local entrepreneurs through the superior quality of systems, extensive knowledge base, breadth of technology, flexible capacity and a broad range of services. Bodycote's proven track record of supplying thermal processing services to many of the world's most respected manufacturers is a testament to the Group's success in outsourcing and subcontracting for manufacturers who need to reduce costs, whilst at the same time being confident that their critical components are processed to demanding specifications. The HIP business operates in a much smaller market and Bodycote's facilities account for more than 60% of the total capacity in the western hemisphere. Few manufacturers invest in this technology because of the high capital cost and the substantial proprietary know-how required. Competitors to Bodycote's HIP business vary from smaller private companies to a small number of large corporations.

REGULATORY ENVIRONMENT

As a service provider to virtually all manufacturing sectors and as a business operating in many countries, Bodycote is subject to a multitude of quality, safety, environmental and regulatory requirements. Management continuously monitors changes in laws, regulations and standards by adopting systems and policies to retain best-in-class compliance. Although this effort is costly in the short term, being a good corporate citizen clearly differentiates us in the market place. Customers have confidence in Bodycote's quality and the sustainability of the Group's services.

MACRO-ECONOMIC ENVIRONMENT

Most of the countries in which Bodycote operates started to experience significant reductions in demand in the second half of 2008 and, although not specific to Bodycote, the Group has not been immune to falling production rates. In anticipation of the downturn in demand, cost reduction programmes aimed at matching costs with revenues are being implemented. Bodycote's greatest cost is people and a Group wide reduction in the number of temporary and short-term workers is ongoing. Further far reaching restructuring actions are underway, which are expected to result in annualised cost savings of approximately £18m, some of which accrued in 2008, about half will be a benefit in 2009 and the full impact will be felt in 2010. Pay rates tend to be settled in the early part of the year and in 2008 the pay awards averaged 3.5%. This is expected to be significantly lower in 2009. Headcount in Thermal Processing peaked in 2008 at 7,736. By year-end this figure had fallen to 7,001. Energy prices have remained near record highs during the year with different countries experiencing varying levels of movement in unit costs. Overall, energy costs increased by one percent of sales, year on year. As a service provider Bodycote is ultimately subject to changes in production throughputs and market demand for its products. The sectors that the Group serves which have been particularly challenging in 2008 are automotive, heavy truck, construction and automotive related tooling. Aerospace, power generation and oil & gas demand has remained steady.

2008 Group Business Review

LONG TERM STRATEGY AND BUSINESS OBJECTIVES

The Group is now focused on Thermal Processing. The objective of the Group is to provide superior shareholder returns through the provision of thermal processing services, on a global basis, that are highly valued by the Group's customers. Bodycote aims to achieve this in safe working conditions and with minimal environmental impact.

Bodycote measures its performance in this regard using financial and non-financial indicators (shown in the table of Key Performance Indicators on page 5).

Return on capital employed and return on sales were both negatively impacted by the downturn in demand in the second half of the year. As a result, a major restructuring of the Thermal Processing business has begun and will continue throughout 2009. In addition to improving efficiency through the closure and consolidation of a number of the Group's facilities, a key focus is the management of people costs.

Bodycote continues to progress towards the target of ensuring that all of the Group's facilities meet the environmental standard ISO 14001. Significant improvements in work related accident rates are being achieved by a combination of training, systems and cultural change. Bodycote remains committed to achieving the highest standards of safety for its people and having zero accidents remains the goal.

ACQUISITIONS COMPLETED SINCE THE INTERIM RESULTS

Since the interim announcement, the Group has completed the bolt-on acquisition of Bertelmann GmbH in Leverkusen, Germany, at a cost of £2.5m. Bertelmann is a long-standing provider of heat treatment services with a capability that is geared towards the wind energy market.

FINANCIAL RESULTS FOR 2008

The continuing Thermal Processing business and the discontinued Testing business saw solid organic growth until September of 4.6% and 6.4% respectively. Reduced demand from automotive and general engineering customers in the second half resulted in organic growth for Thermal Processing being restricted to 0.5% for the year as a whole, with a reduction of 0.1% in Heat Treatment and growth of 6.2% in HIP.

Acquisitions added 5.9% to Thermal Processing revenues. The weakness of sterling against most currencies enhanced revenues of the continuing business by 12.2%.

Demand has remained steady in aerospace, power generation and oil & gas but has weakened markedly in the final quarter of the year in automotive and heavy truck, particularly in France, Germany and Sweden. North America has been soft all year in these sectors. Nevertheless outsourcing opportunities remain considerable in all territories and accounted for approximately 20% of Group sales.

Headline operating profit for continuing operations increased by 1.3% to £71.2m in 2008, with the impact of exchange rates on the translation of overseas profits accounting for £6.5m (9.3% favourable).

Headline operating margins in the continuing business declined from 15.1% to 12.9% due to the impact of weaker demand in the second half.

During the year the Group acquired three new businesses in the continuing Thermal Processing business at a cost of £16.5m, out of a total of £29.3m spent on acquisitions for the Group as a whole. The Thermal Processing acquisitions in the UK and Germany increase the Group's presence in thermal spray coatings for aerospace and oil & gas customers and in heat treatment for large wind turbine components.

REVIEW OF CONTINUING OPERATIONS – THERMAL PROCESSING

Thermal Processing reported sales of £551.8m, an increase of 18.6%. This comprised 0.5% organic, 5.9% acquired and 12.2% in respect of favourable foreign exchange translation impact.

Heat Treatment

Heat Treatment saw a growth of 18.5% in revenues to £499.9m representing 90.6% of the continuing group (2007: 90.6%). Margins were impacted by the economic slowdown and higher energy costs and eased to 12.0% (2007: 14.6%).

With its emphasis on aerospace and power generation, the UK business again saw solid organic growth of 3.6% in 2008.

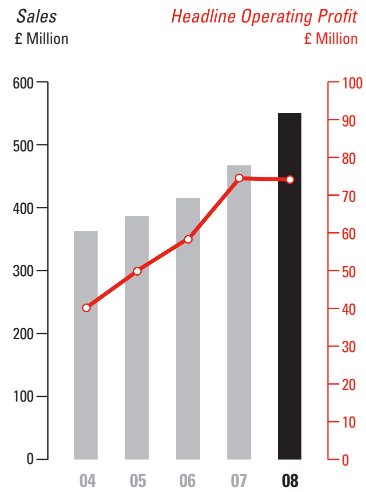
Results from the Nordic region were varied, with the Swedish business impacted by slowing truck and general engineering demand, while Finland was buoyed by continuing strength, particularly for wind energy. The Nordic region in total recorded an organic decline of 1.4%.

Despite the significant downturn in automotive demand in the second half, the Central European countries were still able to post modest organic growth of 0.4%. Eastern Europe was also impacted by slowing automotive demand towards the end of the year, but the region reported organic growth of 7.4% for the year as a whole. Conversely, France and Belgium have been severely impacted with organic sales down 4.6%.

North America saw the effect of the global slowdown earlier than Europe. In the US, organic sales were marginally ahead year on year although this was offset by a reduction in the heavily automotive-oriented Canadian business. North American sales, in total, finished the year 15.8% ahead. As with other automotive focused markets, the Group's South American business saw a year on year decline in organic sales of 4.0%.

The Group continued to make progress with its developing Asia business. Sales in 2008 doubled in China and trebled in India, the latter assisted by the opening of a new greenfield location near Pune.

Thermal Processing
Sales and Headline Operating Profit



Bodycote

HIP

With demand continuing to be solid for aerospace, power generation and powder metallurgy (for heavy engineering near-net shapes), organic growth in the European HIP business was satisfactory at 7.9%. Sales increased to £27.3m (2007: £21.7m) including the benefit of the acquisition of TCS in France. Organic growth in North America was 4.4% despite the modest negative effect from the Boeing strike during the second half.

Margins were reduced from 35.4% to 29.5%, however following notable capacity increases in North America and Europe (the latter via acquisition of TCS in France) and for which the sales ramp-up is expected to take at least two years.

Restructuring

In light of the global economic downturn, weak demand in the automotive, heavy truck and construction sectors and uncertainty as to the duration of these market conditions, a wide ranging review of the Group's Thermal Processing business has been undertaken. As a result, the Group has decided to consolidate or close 31 locations (13 in the Americas, 17 in Europe and one in Asia) and to permanently close departments in a number of other facilities. Actions in North America, which entered the downturn sooner, are well underway and are expected to be largely completed in the first half of 2009. In the UK, changes are modest and will be completed during the first quarter of 2009. In mainland Europe some actions will be completed very quickly but in some jurisdictions regulatory requirements mean that the restructuring will not be completed until the end of 2009. The total cost of the reorganisation is expected to be approximately £85m, of which £77.6m has been charged in 2008 and the balance will be charged in 2009 in compliance with IFRS. Of the amount charged in 2008, £42.7m relates to non-cash asset write downs, whilst cash costs are expected to be £34.9m split approximately equally between redundancy payments, site closure costs and environmental remediation. Environmental remediation is expected to be incurred over approximately five years. The restructuring programme will generate annualised cost savings of approximately £18m once it is completed and headcount will have been reduced by at least 10%.

Key performance indicators

	2008	2007*
Financial		
Return on capital employed[1]	**10.2%**	10.9%
Return on sales[2]	**12.9%**	15.1%
Non financial		
ISO 14001 compliant facilities	**137**	131
Accident frequency[3]	**2.0**	2.4

Definitions

[1] Headline operating profit** as a percentage of average capital employed from continuing operations. Capital employed includes tangible and intangible assets including all previously amortised or impaired goodwill and all non-interest bearing assets and liabilities.

[2] Headline operating profit** as a percentage of revenue from continuing operations.

** Headline operating profit, as referred to in this Group Business Review, is defined and reconciled in the Financial Results for 2008 section below.

[3] Accident frequency - the number of accidents x 200,000 (approximating 100 man years), divided by the total hours worked.

* As restated for Thermal Processing only.

Financial results for 2008

	Revenue[1]		Headline operating profit		Margin	
	2008 £m	2007 £m	**2008 £m**	2007 £m	**2008 %**	2007 %
Heat Treatment	**499.9**	421.7	**60.0**	61.6	**12.0**	14.6
HIP	**51.9**	43.5	**15.3**	15.4	**29.5**	35.4
Thermal Processing	**551.8**	465.2	**75.3**	77.0	**13.6**	16.6
Head office costs	**–**	–	**(4.1)**	(6.7)	**–**	–
Continuing operations	**551.8**	465.2	**71.2**	70.3	**12.9**	15.1
Discontinued operations	**164.9**	175.3	**20.5**	21.0	**12.4**	12.0
Group Total	**716.7**	640.5	**91.7**	91.3	**12.8**	14.3

[1] Revenue is calculated after deducting inter-segment sales.

Headline operating profit is defined as follows:

	2008 £m	2007 £m
Headline operating profit from continuing operations	**71.2**	70.3
Amortisation/impairment of acquired intangible fixed assets	**(1.3)**	(0.8)
Impairment of goodwill	**(31.9)**	(3.5)
Major facility closure costs	**(77.6)**	(3.4)
Impairment of loan due from associate	**(12.1)**	–
Change to pension scheme rules	**–**	2.6
Bid response costs	**–**	(2.1)
Operating (loss)/profit from continuing operations	**(51.7)**	63.1

2008 Group Business Review

Goodwill

Each year the Group conducts an assessment of the carrying value of goodwill. With demand currently lower than previously anticipated, the timing of any upturn uncertain and as a consequence of the plan to close or consolidate 31 locations, the Board has concluded that an impairment of £31.9m in the value of the Group's goodwill is appropriate.

Associated company - SSCP Coatings Sarl (SSCP)

SSCP is a highly leveraged private equity controlled business. In view of the relative ranking of Bodycote's shareholder loans to SSCP and the reduced saleability of such businesses in today's market, a 100% impairment provision of £12.1m has been made in 2008 against the unsecured element of these loans. Bodycote currently owns 24.4% of the share capital of SSCP.

REVIEW OF DISCONTINUED OPERATIONS - TESTING

During the 42 weeks to 17 October 2008 (date of sale) Testing recorded sales of £164.9m representing an increase from 2007 on a comparable basis of 12.7%. Of this, 0.5% was organic, 5.4% was due to acquisitions and 6.8% as a result of favourable exchange movements. Up to the point of sale Testing represented 26.8% of total Group revenues and 23.0% for the full year. Headline operating profit was £20.5m for the period to 17 October 2008 (2007: full year £21.0m) and operating profit for the period was £19.9m (2007: full year £15.7m). Headline operating margins increased to 12.4% (2007: 12.0%).

SALE OF TESTING BUSINESS

On 28 August 2008 Bodycote announced that it had entered into a conditional sale of its Testing business to CDR Tabasco Limited for a cash consideration of £419.7m on a cash free debt free basis and a vendor loan note in respect of the future sale proceeds of approximately 65 acres of land in Mississauga, Canada. The transaction was completed in accordance with the conditional sale agreement on 17 October 2008.

The net proceeds of the sale after taxation amounted to £378.2m. Of the sale proceeds £21.0m has been contributed to the Bodycote final salary pension plan, of which £19m was a statutory requirement, and £228.4m has been utilised to reduce Group net debt.

The remaining £129.5m was returned to shareholders by way of a special distribution of 40 pence per ordinary share on 16 December 2008 of which £128.8m was paid in December 2008 and the remainder will be paid in April 2009.

The after tax gain on sale of £177.4m is reflected in the Group Consolidated Income Statement along with £11.4m profit after tax resulting from trading during the year until the completion of the sale under discontinued operations.

FINANCIAL REVIEW

Revenue

Group revenue from continuing operations was £551.8m, an increase of £86.6m (18.6%) on 2007 (£465.2m). Revenue growth for Heat Treatment was £78.2m (up 18.5%) and for HIP £8.4m (up 19.3%). Organic growth accounted for £2.4m (0.5% of 2007 revenue) of total sales growth before the impact of closed sites which had annualised sales in 2007 amounting to £3.9m (0.8% of 2007 revenue). Acquisitions added £27.5m (5.9% of 2007 revenue). Foreign currency movements, resulting from the general weakening of sterling, had a favourable impact on revenues of £56.7m.

Operating profit and margins for continuing operations

Headline operating profit for the continuing operations of the Group, as defined in the Financial Results section on page 5, was £71.2m, an increase of £0.9m (up 1.3% on 2007). Headline operating profit from continuing operations showed an organic decline of £10.9m (down 15.5%), while acquisitions added £5.3m (up 7.5%) and favourable exchange movements £6.5m (up 9.3%). Headline operating profit margins from continuing operations fell from 15.1% to 12.9%.

Headline operating profit for Heat Treatment decreased by £1.6m (down 2.6%). Organic profit declined by £12.4m (down 20.1%) but acquisitions added £5.2m (up 8.4%) and currency movements £5.6m (up 9.1%). Margins slipped from 14.6% to 12.0%.

HIP saw its headline operating profit decrease by £0.1m (down 0.6%) with organic profit declining by £1.2m (down 7.8%). The TCS acquisition added £0.1m (up 0.6%) and currency movements added £1.0m (up 6.5%). Margins fell from 35.4% to 29.5%.

Operating loss for continuing operations, after deducting exceptional items of £122.9m (2007: £7.2m) was £51.7m (2007: profit £63.1m).

Finance charge

The net finance charge from the continuing operations of the Group was £3.6m compared to £2.5m in 2007.

Profit before tax from continuing operations

Headline profit before tax for the continuing operations was £67.6m compared to £67.8m in 2007. Loss before tax for the continuing operations was £55.3m compared to a profit of £60.6m.

Taxation

Total taxation was £6.8m for the year compared to £14.7m for 2007. The effective tax rate for the Group was 4.3% (2007: 21.5%).

The sale of the Testing business gave rise to taxation of £21.9m, an effective rate of taxation of 11.0%. The low rate of tax on the sale arises from the availability of participation exemptions in many of the countries in which the shares of the Testing business were disposed.

Excluding discontinued operations, taxation was £(17.2)m, representing an effective tax rate on continuing operations of 31.1%. The Group's underlying rate of tax on continuing operations, which represents the tax rate before impairment of goodwill and amortisation of acquired intangibles (both of which are generally not allowable for tax purposes) and excluding exceptional items was 18.3% (2007: 20.6%).

The effective tax rates reflect a blend of rates in the numerous worldwide locations where Bodycote is present, many of which have a lower tax rate than the UK standard rate of 28.5%.

Earnings per share

Basic headline earnings per share (as defined in note 10) increased by 5.4% to 17.5p from 16.6p. Earnings/(loss) per share for the year are provided in the table on page 7.

Dividend

The Board has recommended a final dividend of 5.35p bringing the total dividend to 8.3p per share, an increase of 3.8%. In addition, a special distribution of 40p per ordinary share was paid in December 2008.

The dividend is covered 2.1 times (2007: 2.1 times) by basic headline earnings per share (as defined in note 10).

If approved by shareholders, the final dividend of 5.35p per share for 2008 will be paid on 8 May 2009 to all shareholders on the register at close of business on 3 April 2009.

CAPITAL STRUCTURE

The Group's balance sheet at 31 December 2008 can be summarised as set out in the table to the right. Net assets increased by 0.1% to £496.9m (2007: £496.6m) and net assets per share (weighted average) were up by 2.6% to £1.60 (2007: £1.56). The main changes in the balance sheet arose from the sale of the Testing business, which led to a decrease in net assets (excluding net debt) of £133.2m to £561.6m and a decrease in net debt of £133.5m to £64.7m.

Net Debt

Group net debt was £64.7m (2007: £198.2m). Had the exchange rates prevailing at 31 December 2007 been applied, the amount would have been net cash of £10.0m. During the year, additional loans of £86.9m were drawn down under committed facilities and gross cash increased by £220.7m to £258.4m. 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 increase in cash and cash equivalents was £209.4m (2007: net decrease of £1.1m). This large increase is due to proceeds from the sale of the Testing business of £400.1m, less the increased dividends paid during 2008 of £154.3m (2007: £22.6m) and the lump sum contribution to the pension plan of £21.0m.

Cash generated by operations increased by 10.2% to £135.9m (2007: £123.3m). After allowing for net capital expenditure of £74.9m (2007: £66.9m) the Group generated an operating cash flow of £61.0m (2007: £56.4m), an increase of 8.2%. Acquisitions in subsidiaries and investment in an associate resulted in expenditure of £34.9m (2007: £32.9m).

Headline profit before taxation is defined as follows:

	2008 £m	2007 £m
Headline Operating Profit	**71.2**	70.3
Net Finance Charge	**(3.6)**	(2.5)
Headline Profit Before Tax	**67.6**	67.8
Amortisation of acquired intangible fixed assets	**(1.3)**	(0.8)
Impairment of goodwill	**(31.9)**	(3.5)
Major facility closure costs	**(77.6)**	(3.4)
Impairment of loan to associate	**(12.1)**	–
Change to pension scheme rules	**–**	2.6
Bid response costs	**–**	(2.1)
(Loss)/profit before tax	**(55.3)**	60.6

Earnings per share:

	2008 Pence	2007 Pence
Basic earnings/(loss) per share from:		
Continuing and discontinued operations	**48.2**	16.6
Discontinued operations	**60.7**	2.1
Continuing operations	**(12.5)**	14.5

Balance sheet at 31 December 2008

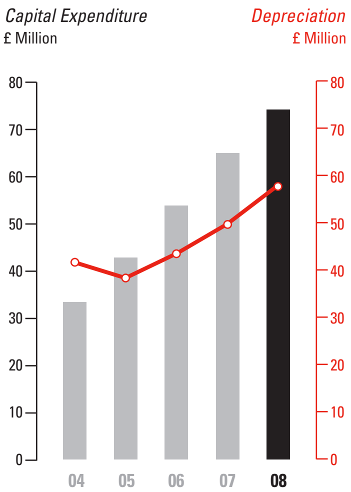
	Assets £m	Liabilities £m	Net assets £m
Property plant and equipment	533.3	–	533.3
Goodwill and intangible assets	154.4	–	154.4
Current assets and liabilities	148.2	(215.4)	(67.2)
Other non-current assets and liabilities	11.9	(30.1)	(18.2)
Retirement benefit obligations	–	(14.9)	(14.9)
Deferred tax	52.5	(78.3)	(25.8)
Total before net debt	900.3	(338.7)	561.6
Net debt	258.4	(323.1)	(64.7)
Total as at 31 December 2008	**1,158.7**	**(661.8)**	**496.9**
Total as at 31 December 2007	999.9	(503.3)	496.6

2008 Group Business Review

There has been a continued focus on cash collection and debtor days have been maintained at 68.

Net interest payments for the year were £8.0m (2007: £9.1m) and tax payments were £20.5m (2007: £16.0m).

V Capital Expenditure and Depreciation



Capital expenditure

Net capital expenditure for the year was £74.9m compared to £66.9m in 2007. The multiple of net capital expenditure to depreciation was 1.3 times (2007: 1.3 times), primarily reflecting the Group's investment in greenfield sites in emerging markets and the expansion of HIP capacity.

Given current macro-economic conditions, expenditure in 2009 is expected to be below depreciation. Notable projects in emerging markets with expenditure in 2008 included the construction of heat treatment plants in Silao (Mexico), Bangkok (Thailand) and Rangangaon (India). In addition, a new heat treatment plant in Tampere (Finland) and a new large HIP unit in Surahammar (Sweden) are being built.

Borrowing facilities

At 31 December 2008, Bodycote had three committed bank facilities: £225m (2007: £225m), expiring August 2010; €125m (2007: €125m), expiring July 2013; and US$20m (2007: US$20m) expiring July 2010, totalling £359.8m (2007: £326.9m). At the same date, the three facilities were drawn £194.8m (2007: £175.3m), £107.3m (2007: £44.1m) and £10.5m (2007: £4.6m) respectively, totalling £312.6m (2007: £224.0m).

Capital management

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern, 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 Group's Board of Directors. The Group's policy is to maintain gearing, determined as the proportion of net debt to total capital, within defined parameters, allowing movement in the capital structure appropriate to the business cycle and corporate activity. The gearing ratio at 31 December 2008 was 13% (2007: 40%).

The Group's debt funding policy is to borrow centrally, using a mixture of short-term borrowings, longer-term loans and finance leases. These borrowings, together with cash generated from operations, are lent or contributed as equity to certain subsidiaries. The aim of the Group's funding policy is to ensure continuity of finance at reasonable cost, based on committed facilities from several sources, arranged for a spread of maturities.

DEFINED BENEFIT PENSION ARRANGEMENTS

The Group has defined benefit pension obligations in the UK, Germany, Switzerland, Liechtenstein, Sweden, 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. In the UK, the Group has a final salary scheme which was closed to new members in April 2001, but continues to accrue benefits for the 165 current employee members.

Following the sale of the Testing business, a contribution of £21.0m was made into the UK scheme to meet legal requirements and following consultation with the Trustees. The deficit, as calculated by the scheme actuary at 31 December 2008 using the principles of IAS 19, is £0.7m. The Group's Heat Treatment business in Germany has inherited several defined benefit arrangements. They are all unfunded and are closed to new members but existing members continue to accrue benefits. The IAS 19 liability at 31 December 2008 was £3.3m. In Liechtenstein the IAS 19 liability at 31 December 2008 was £0.3m and in Switzerland the IAS 19 liability at 31 December 2008 was £0.1m, both of which are funded. In Sweden, the Group has a funded defined benefit arrangement in its HIP business which is open to new members. The IAS 19 liability at 31 December 2008 was £1.8m. In France, the Group operates a plan which pays a cash lump sum on retirement and also for long service. The plan is open to new employees but by its nature is not mortality dependent. It is unfunded and the IAS 19 liability at 31 December 2008 was £6.8m. Italy and Turkey also have cash lump sum obligations which are open to new members. The IAS 19 liability is £0.8m for Italy and £0.1m for Turkey. The company sponsors three defined benefit pension arrangements in the USA which were inherited with the acquisition of Lindberg and had a total IAS 19 deficit at 31 December 2008 of £1.2m. There are no further accruals on either of these plans. In Brazil, Bodycote operates a defined benefit plan for three senior members of staff. It is fully funded and the members continue to accrue benefits. At 31 December 2008 it had a surplus of £0.2m.

Bodycote

POST BALANCE SHEET EVENTS

There have been no post balance sheet events.

CHANGE IN ACCOUNTING POLICIES

During the year there were no changes to accounting policies.

GOING CONCERN

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in this Group Business Review. The review includes an overview of the Group's financial position, its cash flows, liquidity position and borrowing facilities. In addition there is a description of the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit and liquidity risk.

As highlighted in the Capital Structure section on page 7, 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 shown below. There is significant headroom in the committed facility covenants to assume that these facilities can be operated as contracted for the foreseeable future.

- US$20m Revolving Credit Facility maturing 29 July 2010
- £225m Revolving Credit Facility maturing 22 August 2010
- €125m Revolving Credit Facility maturing 31 July 2013

The current economic conditions create uncertainty, particularly over the levels of demand for the Group's services and the availability of bank and capital market finance in the future. However, 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 expect to renew facilities in due course and are not aware of any reason why renewal would not be forthcoming on acceptable market terms.

After making enquiries, 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.

PRINCIPAL RISKS AND UNCERTAINTIES

Operational

Markets

The key risk faced by the Group is a reduction in end market demand. Forecasting this demand, given short visibility and the macro uncertainty faced by much of Bodycote's customer base, is difficult and means the Group must remain constantly ready to adapt to the changing environment. However, Bodycote has excellent long-term relationships with its major customers and the Group's network of strategically located facilities ensures that it is the supplier of choice to these major manufacturers.

Commercial relationships

The Group benefits from many long term and partnership agreements with key customers. Damage to or loss of any of these relationships may be detrimental to Group results, although management believe this is highly unlikely. Given that Bodycote's top ten customers account for less than 12% of sales, with the balance made up by many thousands of customers, revenue concentration risk is low and therefore there is no significant customer dependency.

Competitors

With the exception of HIP, Bodycote's markets are fragmented and this means that the actions of competitors are typically felt locally rather than across the Group. The small market and concentrated supply of HIP means that there is a greater risk of material impact on this division should competitors add significant capacity, although Bodycote has the extensive knowledge and experience needed to preserve its competitive advantage.

Human resources

People are Bodycote's greatest asset and also form its largest cost. The Group works hard at maintaining a respectful and trusting relationship with all employees. However, Bodycote is mindful that there must be strong control on people costs, which can be adjusted more easily in North America, the UK and some emerging economies, but much less so in Western Europe where the Group strives to keep a portion of its workforce flexible against a background of more restrictive employment laws.

Defined benefit pension arrangements

The Group provides retirement benefits for its former and current employees through a number of pension schemes in the UK and overseas. Future actuarial valuations and annual funding checks for these arrangements may require increased employer contributions, the level of which will depend on investment performance, mortality rates, annuity rates and changes in other actuarial assumptions.

Safety and health

The Group's work environment has numerous and varied risks. Bodycote strives to mitigate these by providing systems, equipment, training and supervision. Risk is evaluated by internal and external resources so that it is continuously managed and mitigated.

Brand and reputation

Bodycote is a valuable and well-known business to business brand. Any damage to the brand because of the breakdown of commercial relationships, non-compliance with laws and regulations, misuse of human or other resources in breach of the Group's corporate ethos could have an adverse impact on the business as a whole.
For these reasons Bodycote has instituted an effective programme under which employees can and do use the Group's open door policy to report legitimate concerns about business conduct to the most senior executives and non-executive directors.

Energy

An increase in energy cost is a risk which the Group has been able to largely mitigate so far, although with some time lag, through price adjustments or surcharges and Bodycote expects to be able to continue this practice.

2008 Group Business Review

Operations
The Group's stringent quality systems, along with internal and external auditing as well as customers' verification of results, minimise the risk of releasing faulty parts or test results into use, which could arise as a result of system or human failure.

Environment
Bodycote is mindful of the need to reduce its impact on the environment to a minimum. Some of the Group's heat treatment plants use solvents and other hazardous chemicals in small quantities and, where such substances are used, there is the potential for ground contamination. Past exposures are remediated as and when required. The likelihood of future problems is mitigated by stringent procedures, typically under the requirement of ISO 14001 environmental systems.

Foreign exchange
Although 88% of the Group's sales are generated outside the UK, the overwhelming majority of those sales are supplied locally to customers buying in the same currency as input costs. Consequently transaction risk is low. Bodycote is, however, exposed to fluctuation in exchange rates in respect of the translation of non-sterling denominated results. In common with the majority of UK listed companies Bodycote does not hedge this exposure. However, the Group does partially hedge its balance sheet assets and liabilities through a mixture of local currency loans and cross currency swaps.

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

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 or the Group's approach to the management of those risks.

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 5 year rolling strategic plan, an annual budget agreed by the Board each December and a quarterly re-forecast undertaken during the financial year. The resulting forecast net debt is measured against a liquidity headroom policy which, at the current net debt levels, requires committed facilities (plus term loans in excess of one year) to exceed net debt by 50%.

As at 31 December 2008, the Group had committed facilities of £359.8m (2007: £326.9m) which exceed net debt of £64.7m (2007: £198.2m) by 456% (2007: 65%). 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. The Group's principal committed bank facility of £225m has a maturity of 1.6 years. The €125m committed bank facility has a maturity of 4.6 years. In addition, cash management pooling, netting and concentration techniques are used to minimise borrowings.

As at 31 December 2008, the Group had gross cash of £258.4m (2007: £37.7m), of which £231.3m was held centrally on term deposits or money market funds.

Market risk
Interest rate risk
Interest rate risk arises on borrowings and cash balances (and derivative liabilities and assets) being at floating interest rates. Changes in interest rates could have the effect of either increasing or decreasing the Group's net result. 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. These major currencies currently include the US Dollar, Euro, Sterling and Swedish Krona. Measurement of this interest rate risk and its potential volatility to the Group's reported financial performance is undertaken on a monthly basis.

As at 31 December 2008, 23% of net financial liabilities were at fixed rates for an average period of 3.7 years.

Currency risk
Bodycote has operations in 27 countries and is therefore exposed to foreign exchange translation risk when the profits and net assets of these entities are consolidated into the Group accounts. Assets are hedged, where appropriate, by matching the currency of borrowings to the net assets. The Group principally borrows in the US Dollar, Euro and Swedish Krona, consistent with the location of the Group's non-sterling assets. The Group also creates further currency financial liabilities and assets using cross currency swaps in order to better match currency assets with currency liabilities. The Group recognises foreign exchange movements in equity for the translation of these net investment hedging instruments and balances. As at 31 December 2008, £321.6m of gross debt and £90.5m of foreign exchange and cross currency swap liabilities were in currencies other than sterling and gross cash of £229.8m and cross currency swap assets of £60.2m were in sterling.

It is Group policy not to hedge exposure for the translation of reported profits in line with the majority of UK listed companies.

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. However, the nature of the business is such that cross border sales and purchases are limited and, other than currency 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 2008, 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.

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 (and derivative assets) or net borrowings (and derivative liabilities) at 31 December 2008 would reduce or increase profit before tax by approximately £0.7m. There is no material impact on equity.

Currency sensitivity

The currency risk sensitivity analysis is based on the assumption that changes in exchange rates affect the non-sterling financial assets and liabilities and the interest relating to those financial assets and liabilities.

Under this assumption, a 10% strengthening or weakening of sterling against all exchange rates at 31 December 2008 for non-sterling financial assets and liabilities would have reduced or increased profit before tax and equity (before tax effects) as follows:

Currency sensitivity - impact +/-

£m	On equity	On profit before tax
CAD	1.9	0.0
Euro	22.1	1.0
SEK	3.5	0.2
USD	10.3	0.5
Other	0.6	0.1
Total	38.4	1.8

Non-sterling financial liabilities offset the exchange rate impact on non-sterling net assets.

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. The counterparties to the financial instruments transacted by the Group are major international financial institutions and, whilst these counterparties may expose the Group to credit losses in the event of non-performance, it considers the risk of material loss to be acceptable. The notional amounts of financial instruments used in interest rate and foreign exchange management do not represent the credit risk arising through the use of these instruments. The immediate credit risk of these instruments is generally estimated by the fair value of contracts with a positive value. The maximum exposure to credit risk for time deposits and other financial assets is represented by their carrying amount.

Credit risk

Credit risk arises from the possibility that customers may not be able to settle their obligations as agreed. To manage this risk the Group periodically assesses the financial reliability of customers. The majority of the Group's trade receivables are due for maturity within 60 days.

Concentrations of credit risk with respect to trade receivables are limited. The Group has a diverse customer base of many tens of thousands of customers and is not reliant on any one business sector, end market, or client. The largest customer represents approximately 3.2% of total Group revenue and the top ten customers account for less than 12%. Bodycote's diverse client base provides the Group with balanced demand from a number of sectors. Management is mindful of current difficult trading conditions being experienced in a number of sectors in which Bodycote trades and has reviewed the provisions for bad and doubtful debts accordingly.

CORPORATE RESPONSIBILITY

The Group takes its responsibilities as a good citizen seriously. The policies below explain how the Group has successfully implemented these:

People

The strength of the Group primarily rests in its people and one of the key challenges for management is to ensure availability of appropriately qualified people to support its continued growth. Bodycote is fortunate to have a competent and committed international team that is well respected in technical and business circles. Most acquisitions are based on historical relationships with Bodycote personnel which is a testament to the integrity of the Group's people. The Board has established a remuneration policy which rewards performance while offering competitive base packages. In line with the Group's policy of continuous improvement, training programmes have been established to improve the succession pipeline for future business leadership. 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.

2008 Group Business Review

Education
The Group sponsors The Bodycote Educational Foundation, a registered charity, whose aim is to fund relevant educational and training opportunities. These aims are fulfilled by supporting short-term student placements at Bodycote facilities to work on specific projects of benefit to the Group. Since 1996, the Foundation has sponsored over 280 students from 10 countries. The Foundation also supports the annual Prize Paper Competition. Now in its fourteenth year, the Prize Paper has become one of the most highly regarded competitions in its field. Numerous entries from universities and materials science institutes worldwide follow a rigorous selection process, with five entrants reaching the final presentation judged by management and engineering academics. Winners receive a cash prize, publication in a peer reviewed journal and potential for career development within the Group.

Ethical standards
All Bodycote personnel are expected to apply a high ethical standard, consistent with an international UK-listed company.

Compliance with laws
Bodycote has systems in place designed to ensure compliance with all applicable laws and regulations and conformity with all relevant codes of business practice.

Competition
Bodycote aims to win business in a differentiated high value manner. Bodycote 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.

Conflicts of interest
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 trading codes.

Politics
Bodycote does not make political donations.

Safety & health
Appropriate safety and health policies and procedures are in force in the Group. In 2004 the Group commenced reporting its performance internally in terms of lost time, frequency and severity of accidents in a uniform manner. As a result, each facility is now able to benchmark its safety and health performance and formulate strategies for improvements. Bodycote is committed to the highest practicable standards of safety and health management. Bonus payments to Directors and senior executives are in part dependent on achievement of these targets, which are now key performance indicators.

Environment
Bodycote operates modern, efficient equipment around the clock. The Group aggregates demand from a wide range of customers to maximise efficiency and minimise energy costs. By replacing under-utilised, in-house thermal processing operations with Bodycote's state-of-the art equipment, the overall amount of energy used by industry can be dramatically reduced.

The replacement, where possible, of harmful materials has reduced the need for disposal of waste products. At the same time the adoption of recuperative heating and closed water cooling systems has reduced energy consumption and reduced emissions.

The success of Bodycote's processes in addressing these issues is key to its environmental credentials. The Group does not simply aim to minimise its own energy consumption, but also to effect substantial reductions in its customers' energy use.

CURRENT TRADING AND PROSPECTS
Following the sale of the Testing activities Bodycote is a focused business with a strong balance sheet. While automotive markets have softened, demand from aerospace, power generation and oil & gas markets remain steady.

In response to the difficult economic and trading environment, the business is being restructured to ensure it remains strong throughout the downturn and is well positioned to benefit when trading conditions improve. The focus of the restructuring is to both drive down the cost base of the business while at the same time reshaping it to concentrate on those areas that present strong growth opportunities for the future.

Despite the uncertain economic environment, we remain confident in the medium and long term prospects for the Group.

S. C. Harris
Chief Executive
25 February 2009

D. F. Landless
Finance Director
25 February 2009

The Directors are pleased to submit their report and the audited financial statements for the year ended 31 December 2008. The Chairman's Statement, the Group Business Review, the Audit Committee Report, the Nomination Committee Report, the Board Report on Remuneration and the details of the Board of Directors and Advisers on pages 2 to 28 together comprise the Directors' Report for the year ended 31 December 2008.

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 84 to 86. The Group Business Review contains a survey of the Group's activities, significant acquisitions and disposals during the year together with an outline of future developments.

On 30 April 2008 the Group announced that it intended to sell its Testing business. The sale was completed on 17 October 2008, and as a result, the Testing business has been reclassified as a discontinued operation in the 2008 financial statements.

£128.8m of the proceeds from the sale was distributed to shareholders on 19 December 2008 by way of a B share scheme ('Return of Cash') approved by shareholders on 8 December 2008. The balance falls due for payment on 6 April 2009, in accordance with the B share scheme, to those B shareholders who elected for the Final Redemption.

GROUP BUSINESS REVIEW

The enhanced business review for the Group, entitled Group Business Review, is provided on pages 3 to 12 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 2008, key performance indicators and a description of the principal risks and uncertainties facing the Group. The Group Business 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.

CHANGE OF NAME

On 30 April 2008, following approval by shareholders at the annual general meeting, the company changed its name to Bodycote plc.

TRADING RESULTS

The loss of the continuing operations of the Group before taxation was £55.3m (2007: profit £60.6m). Profit attributable to shareholders amounted to £149.8m (2007: £52.8m) and, after providing for dividends of £154.9m (2007: £23.4m) and other items of recognised income and expense, the balance of £14.3m has been transferred from reserves (2007: £31.0m transferred to reserves).

DIVIDENDS

The Board is recommending a final dividend of 5.35p per ordinary share making a total relating to the year of 8.3p per share (2007: 8.0p). The final dividend, if approved, will be paid on 8 May 2009 to shareholders on the register at the close of business on 3 April 2009.

SHARE CAPITAL

The Company's issued ordinary share capital as at 31 December 2008 was £32.4m and during the year was increased by the issue of 244,173 shares of 10p each between 7 April and 8 December 2008 for a total consideration of £371,285 pursuant to options granted under the Company's executive share option schemes. At the general meeting on 8 December 2008 the shareholders authorised the Company to purchase up to 18,753,111 new ordinary shares of 17 3/11 pence. This authority expires at the conclusion of the forthcoming Annual General Meeting to be held on 27 April 2009, at which time a further authority will be sought from shareholders. 1,646,178 shares held in treasury were transferred on 8 December 2008 to the Company's employee benefit trust at nil cost, leaving a total of 219,318 shares of 17 3/11 pence held in treasury as at 31 December 2008.

In addition as at 31 December 2008 the Company had in issue 1,658,625 unlisted non-cumulative redeemable preference shares of 40 pence each (representing 2% of total issued capital) which, in accordance with the shareholder circular dated 21 November 2008, are each redeemable at par by the Company on 6 April 2009. Holders of these shares have no right to attend or vote at any general meeting of the Company save when the business includes consideration of a resolution for the winding-up of the Company.

In accordance with the articles of association and the terms in respect of the issue of the B shares in connection with the Return of Cash the Company redeemed and immediately cancelled the following shares:

(i) 70,328,634 deferred shares of 40p each (100% of the then issued deferred share capital) for an aggregate consideration of 1p; and

(ii) 251,551,315 non-cumulative redeemable preference shares of 40p each ('B' shares) (99% of the then issued B share capital) for an aggregate consideration of £100,620,526.

CAPITAL STRUCTURE

Details of the authorised and issued share capital are shown in note 24. Concurrently with the Return of Cash, the issued ordinary share capital of 10 pence each was consolidated on an 11 for 19 basis into ordinary shares of 17 3/11 pence each being equivalent in all material respects to the ordinary shares in issue immediately before the consolidation, including as to dividend rights. The consolidation was affected with the intention of ensuring the market price of each consolidated share was approximately equal to the market price of each ordinary 10 pence share immediately before the consolidation.

Directors' Report

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 30 and shares held by the Bodycote International Employee Benefit Trust abstain from voting and waive dividend. 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 Combined 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 on page 17. Under the Articles of Association the Company has authority to issue ordinary shares with a nominal value of £1,619,586. 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.

DIRECTORS

The current Directors and their biographical details are listed on page 28 and, with the exception of Dr Rajagopal who was appointed on 24 September 2008 and Mr Harris who was appointed on 1 November 2008, all served throughout the year. Mr L P Bermejo resigned on 29 February 2008 and Mr J A S Wallace retired on 30 April 2008. Messrs J.D. Hubbard and D.R. Sleight are both retiring by rotation, but are not seeking re-election as directors. Dr K. Rajagopal and Mr S.C. Harris, appointed as directors since the last annual general meeting, and both being eligible, offer themselves for election by shareholders at the forthcoming Annual General Meeting. The service agreement for Mr Harris is terminable by 12 months' notice. Dr Rajagopal does not have a service agreement with the Company and his appointment is terminable by six months' notice.

DIRECTORS' INTERESTS IN CONTRACTS & SHARES

Details of the Executive Directors' service contracts and details of the Directors' interests in the Company's shares, share option schemes and share incentive plans are shown in the Board Report on Remuneration on pages 22 to 27. No Director has had any dealings in any shares or options in the Company since 31 December 2008.

Qualifying third party indemnity provision (as defined by section 309C of the Companies Act 1985) has remained in force for the Directors for the year ended 31 December 2008 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 relationship to more than one organisation (a 'Situational Conflict') which typically will be the case where a non-executive director holds directorships in more than one company.

In order to ensure that each director was complying with the new duties, each director provided the Company with a formal declaration to disclose what Situational Conflicts affected him. The board reviewed the declarations and approved the existence of each declared Situational Conflict until October 2009 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.

Proposals for Re-election

Dr Rajagopal and Mr Harris were each appointed by the board of directors since the date of the company's last annual general meeting and, in accordance with article 120 now stand for election by the shareholders of the Company. The Board recommends to shareholders the election of the two directors offering themselves for election on the basis that they are both effective directors of the Company and demonstrate the appropriate level of commitment in their respective roles.

EMPLOYMENT

The Group recognises the value that can be added to its future profitability and strength by the efforts of employees. The commitment of employees to excel is key to the Group's continued success. Through their attendance at, or participation in, production, safety and health meetings at site level, employees are kept up to date with the performance and progress of the Group, the contribution to the Group made by their site and are advised of safety and health issues. The Group publishes in ten languages, via the Group extranet, an electronic magazine for all staff detailing the Group's activities, performance and some of its personalities and has also featured the Group's open door policy under which employee concerns can be voiced on a confidential basis. Approximately 1,600 Bodycote employees are connected to the Bodycote extranet, 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 £11,050 (2007: £10,650). There were no political contributions in 2007 or 2008.

CREDITORS POLICY

Group operating companies are responsible for agreeing the terms and conditions under which business transactions are conducted. It is Group policy that payments to suppliers are made in accordance with the terms agreed, provided that these suppliers have also complied with applicable terms and conditions. Creditor days at the year end for the Company were 45 days (2007: 45 days).

SHAREHOLDERS

An analysis of the Company's shareholders and the shares in issue at 18 February 2009 and details of the interests of major shareholders in voting shares notified to the Company pursuant to the Disclosure and Transparency Rules are given on page 87.

AUDITORS

In accordance with the provisions of section 384 of the Companies Act 1985, a resolution for the reappointment of Deloitte LLP (formerly known as Deloitte & Touche LLP) as auditors is to be proposed at the forthcoming Annual General Meeting. Each Director of the Company states that, in accordance with and as defined by the Companies Act 1985:-

(1) so far as each Director is aware, there is no relevant audit information of which the Company's auditors are unaware, and;

(2) each Director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This statement is given and should be interpreted in accordance with the provisions of section 234ZA of the Companies Act 1985.

ANNUAL GENERAL MEETING

The 2009 Annual General Meeting will be held on 27 April 2009 in accordance with the notice being sent to Shareholders.

By order of the Board.

J. R. Grime
Secretary
25 February 2009

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

Statement of Directors' Responsibilities

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. The Directors are required by the IAS Regulation to prepare the group financial statements under IFRSs (IFRSs) as adopted by the European Union. The group financial statements are also required by law to be properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. International Accounting Standard 1 requires that IFRS financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs.

However, Directors are also required to:

(1) properly select and apply accounting policies;

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

(3) provide additional disclosures when compliance with the specific requirements in 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.

The Directors 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). The parent company financial statements are required by law to give a true and fair view of the state of affairs of the Company.

In preparing these financial statements, the Directors are required to:

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

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

(c) state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the parent company financial statements comply with the Companies Act 1985. 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.

We confirm to the best of our knowledge:

1. the financial statements, prepared for the purposes of the consolidation in accordance with International Financial Reporting Standards as adopted by the EU and for the purposes of the parents' separate financial statements in accordance with UK Generally Accepted Accounting Practice, 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
2. the Group Business Review, which is incorporated into the Directors' Report, 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 they face.

By order of the Board.

S. C. Harris
Chief Executive
25 February 2009

D. F. Landless
Finance Director
25 February 2009

The Group's mission is:

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

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

Compliance with 2006 Combined Code

Bodycote complies with the provisions of The Combined Code on Corporate Governance published by the UK Financial Reporting Council in June 2006 ('the Code'), save in the following two areas where the reasons for the variance are noted:

(1) Audit Committee and Auditors (code provision C.3.1)

Between the date when Mr Bermejo resigned as a director on 29 February 2008 and the appointment of Dr Rajagopal as a non-executive director on 24 September 2008 the audit committee comprised only 2 directors, notwithstanding that the Code lays down a membership of at least three independent non-executive directors. This was to enable an appropriate search for a replacement to be completed.

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

Bodycote believes that generally it is the responsibility of the Chief Executive and the Finance Director to manage relationships with institutional investors. The Chairman 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 Company expect the Senior Independent or other Non-Executive Directors to become involved, notwithstanding that the 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. Non-Executive Directors are also encouraged to attend one of the results presentations each year.

Apart from these distinct areas, Bodycote was in compliance with the provisions of the Code throughout 2008.

Operation of the Code

Taken together with the Audit Committee Report, the Nomination Committee Report and the Board Report on Remuneration presented on pages 19 to 27, this statement explains how Bodycote has applied the principles of good corporate governance set out in the Code.

Leadership

The Board of Directors comprises eight members, of whom four are Non-Executive Directors and four are Executive Directors led by the Company's part-time Non-Executive Chairman, Mr A.M. Thomson, who also chairs the Nomination Committee.

The Chief Executive is Mr S.C. Harris who succeeded Mr J.D. Hubbard in that role on 12 January 2009. The Chairman is Mr A.M. Thomson, who became Chairman on 30 April 2008, and the Senior Independent Non-Executive Director is Mr J. Vogelsang, who also chairs the Remuneration Committee. The Audit Committee is chaired by Mr J.A. Biles. Brief biographical details of all Directors are given on page 28. The Board meets at least eight times a year and visits are made to UK and overseas facilities. Certain defined 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 the UK Pension Scheme.

In advance of board meetings Directors are supplied with up-to-date information about the trading performance of each operating location, the Group's overall financial position and its achievement against prior year, budgets and forecasts. They are also supplied with the latest available information on Safety, Health and Environmental and risk management issues and details of the safety and health performance of the Group, and each strategic business unit in terms of severity and frequency rates for accidents at work.

Where required, a Director may seek independent professional advice 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. 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 16. The Board also operates three committees. These are the Nomination Committee, the Remuneration Committee and the Audit Committee.

Corporate Governance

Independence of Non-Executive Directors

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

Commitment

Attendance of Directors at regular scheduled meetings of the Board and its Committees is shown in the table below. In addition there were further unscheduled meetings of the Board, and a number of ad hoc committee meetings to deal with nomination and divestment issues.

	Board meetings	Audit Committee	Remuneration Committee	Nomination Committee
Scheduled	8	4	2	2
A M Thomson	8	–	2	2
J D Hubbard	8	–	–	2
D F Landless	8	–	–	–
D R Sleight	8	–	–	–
S C Harris	2	–	–	–
K Rajagopal	4	1	1	–
J Vogelsang	8	4	2	2
J A Biles	8	4	2	2
L Bermejo	1	1	1	1
J A S Wallace	3	–	–	1

All directors attended the maximum number of board or committee meetings that they were scheduled to attend

Performance Evaluation

Messrs D F Landless and D R Sleight were appraised internally during 2008. In February 2008 the Board carried out its own evaluation of the Board as a whole. The Remuneration and Nomination Committees reviewed their own performance in November 2008 and the Audit Committee reviewed its performance in December 2008.

Internal Control

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss. The Board has applied Principle C.2 of the 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 which is in accordance 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.

During 2008, in compliance with provision C.2.1, the Board also performed a specific assessment for the purpose of this annual report. The assessment considered all significant aspects of internal control arising during the period covered by the report including the work of Internal Audit. In addition, the Managing Director of each of the Group's Strategic Business Units reported on the existing internal control procedure and any failings or weaknesses. They identified and made an assessment of the risks affecting the businesses they control, in each case with the assistance of input from those reporting directly to them. Such risks were measured against their own stated objectives, and actions for any improvements were scheduled against a timetable for later verification by Internal Audit. The Group also conducted a review of risks which principally affected the head office functions and with the help of an external consultant reviewed these with the Finance Director, Group Financial Controller, Group Treasurer, the Head of Tax, the Senior Internal Auditor, the Chief Engineer (Europe), the Insurance Manager, the Director of Safety, Health and Environmental Compliance and the Chief Information Officer. No significant previously unidentified risks were uncovered as part of this process, and the necessary actions have been or are being taken to remedy any significant failings or weaknesses identified as part of the reviews.

Investor relations

The Chief Executive and Finance Director regularly talk with and meet institutional investors, both individually and collectively, and this has enabled institutional investors to increase their understanding of the Group's strategy. The business of the Annual General Meeting now comprises a review of the Group's operations for the benefit of shareholders attending. In addition, since 1998, internet users have been able to view up-to-date news on the Group and its share price via the Bodycote website at www.bodycote.com. Users of the website can also enrol free for a service that automatically notifies them of results announcements and recent significant Group events. Bodycote's financial advisers, corporate brokers and financial public relations consultants provide the Directors with opinion surveys from analysts and investing institutions following visits and meetings with the Chief Executive and Finance Director. Non-Executive Directors are themselves invited to attend analysts' presentations at the time of the regular results announcements. As stated on page 17 the Chairman and Senior Independent Non-Executive Director are available to discuss any issues not resolved by the Chief Executive and Finance Director. On specific issues, such as the introduction in 2003 of the share option scheme, in 2005 with the stock bonus plan, in 2006 with the introduction of long term incentive and share matching schemes, the bid approach from Sulzer AG and in 2008 the return of cash, the Company will seek the views of leading investors.

Report of the Nomination Committee

Role Of The Nomination Committee

The Nomination Committee is a sub-committee of the board whose purpose is to advise the board on the appointment and, if necessary, dismissal of executive and non-executive directors. The full terms of reference of the Nomination Committee are provided on the Company's website.

Composition Of The Nomination Committee

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

The Chairman acts as the Chairman of the Committee, although the Chairman may not chair the Committee when it is dealing with the matter of succession to the Chairmanship of the Company.

Only members of the Committee have the right to attend the Committee meetings. However, other individuals and external advisers, may be invited to attend for all or part of any meeting as and when appropriate.

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

Nomination Committee Meetings

The Nomination Committee had two scheduled and three unscheduled meetings in 2008. Mr A.M. Thomson chairs the Nomination Committee which also comprises, Messrs J.A. Biles, J. Vogelsang, J.D. Hubbard, Dr K. Rajagopal (from 24 September 2008) and Mr S.C. Harris (from 1 November 2008). Mr J.A.S. Wallace chaired the committee until he retired on 30 April 2008 and Mr L.P. Bermejo was a committee member until 29 February 2008. The meetings in 2008 proposed the nominations for re-election at the 2008 Annual General Meeting, and discussed general succession planning and specific positions and reviewed and approved potential conflicts of interest. During 2008 the Committee also recommended the appointments of Dr Rajagopal as a non-executive director and Mr Harris as Chief Executive Designate in each case following preparation of a job specification, the appointment of specialist executive search consultants, and interviews by the Committee with a range of candidates.

On behalf of the Nomination Committee:

A. M. Thomson
Chairman of the Nomination Committee
25 February 2009

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.
Its responsibilities are set out in written terms of reference which are available for inspection on the Company's website and include:

- reviewing the form and content of interim and full year accounts and results announcements of the Company, interim management statements and any other formal announcements relating to the Company's financial performance, including monitoring their integrity and reviewing significant reporting issues and judgements contained therein, and recommending them to the board for approval;
- reviewing the Group's systems of risk management and internal financial control;
- monitoring and reviewing the effectiveness of the Company's internal audit function and considering regular reports from internal audit on internal financial controls and risk management;
- considering the appointment, re-appointment or changing of external auditors and overseeing the process for their selection and making recommendations to the board on their appointment which will be put to the shareholders for their approval at a general meeting and to approve their remuneration and terms of engagement;
- agreeing the nature and scope of the external auditor's work and considering their reports on the Company's accounts, reports to shareholders and their evaluation of the systems of internal financial control and risk management; and
- monitoring and reviewing the external auditor's independence, objectivity and effectiveness, taking into account professional and regulatory requirements.

Composition Of The Audit Committee

The Audit Committee comprises Messrs J.A. Biles, J. Vogelsang and Dr K. Rajagopal (from 24 September 2008) who are all independent non-executive directors. Their biographical details are set out on page 28 and their remuneration is shown on page 25. 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 1988 to 2004 and Chubb Security plc from 1991 to 1997) and is currently also the Chairman of the Audit Committee of Charter International plc (2005) and Hermes Fund Managers Limited (2005).
The Company Secretary is secretary to the Audit Committee.
The Chairman, Chief Executive, Finance Director, Corporate Development Director, Senior Internal Auditor, Group Financial Controller, Group Treasurer, Head of Tax, other senior finance personnel and external auditors attend Audit Committee meetings as appropriate by invitation.

Main Activities Of The Audit Committee

The Audit Committee met four times during 2008, and in February 2009 to consider this financial report and all committee members attended the maximum meetings they were scheduled to attend.

The Committee also meets separately with the Senior Internal Auditor and with the external auditors, without management being present, after the end of most formal meetings.

In addition, the Committee Chairman has preparatory meetings with the external 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:-

- At their February and July meetings, the Audit Committee reviewed respectively the preliminary and interim announcements of results and the draft reports and accounts for the financial year and the half year. On these occasions the Committee reviewed reports from the external auditors, identifying any accounting or judgemental items requiring its attention (including approval of the processes, assumptions and outcomes to assess fair values and impairments) and commenting on risk management and control matters.
- At the July and December 2008 and February 2009 meetings the accounting treatment for all aspects of the sale of the Testing SBU was considered as a special item.
- A quarterly report from the Senior Internal Auditor was presented at each meeting and the findings discussed. During the year the plan for the ensuing year's work was considered.
- The external auditors also presented their audit plan 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 auditors' findings in respect of 2007.
- Executives are, from time to time, required to make presentations to the Audit Committee on risk and other subjects. Presentations were made on tax, treasury and information services.
- The Audit Committee has also been presented with an update on material litigation in which the Group is involved.
- At each meeting an update is presented of 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 going concern assumptions for preparation of the financial statements. This response to the current global financial and economic circumstances, which affects all businesses, took account of the impact on the Bodycote business of the current financial and economic environment. The Committee's activities supported the Directors in their assessment of the going concern position of the Group, which is set out on page 9.

During 2008 the Audit Committee also:

- assessed the independence of the external auditors;
- having reviewed the effectiveness of the audit, the performance and capabilities of the external auditors and having taken into account their tenure of office and when the position was last open for tender, recommended to the board to reappoint the auditors and agreed their fees;
- approved the Group's accounting policies;
- approved the management representations to the auditors;
- reviewed arrangements for reporting and investigating fraud and employee concerns;
- reviewed Bodycote business principles;
- reviewed the effectiveness of internal controls and risk management process;
- reviewed the terms of reference for the Audit Committee; and
- assessed the Committee's own effectiveness.

Independence Of External Auditors

The Audit Committee has put in place safeguards to ensure that the independence of the audit is not compromised. The policy in respect of services provided by the external auditors is as follows.

- Audit related services. The external auditors are invited to provide services where their position as auditors renders them best placed to undertake the work. This includes reporting and certification connected with borrowings, shareholders and other circulars, regulatory requirements and work in respect of acquisitions and disposals.
- Tax consulting. Where the external auditors are best suited to carry out the work they are asked to do it; this particularly applies to work relating to tax compliance. Major exercises or any work where conflicts would arise are put out to tender.
- General consulting work. In general and where conflicts arise, the work is not awarded to the external auditors and is put out to tender.
- There are no contractual restrictions on who the audit committee can choose as external auditor.

Internal Audit

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 a high degree of financial and geographical coverage. 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 effectiveness of the internal audit function is reviewed and discussed on an annual basis with the Group Financial Controller and Senior Internal Auditor.

On behalf of the Audit Committee

J. A. Biles
Audit Committee Chairman
25 February 2009

Board Report on Remuneration

The Remuneration Committee is responsible for remuneration policies that aim to create value for shareholders.

Remuneration structures and packages therefore include competitive basic salaries, a high potential for variable pay but clearly linked with superior performance and absolute value delivered in the business, with key business value drivers used as a basis for measuring performance and a significant proportion of variable pay in restricted conditional shares.

This report has been prepared in accordance with the Combined Code, Schedule 7A to the Companies Act 1985 and the UK Listing Authority Listing Rules.

Shareholders will be given the opportunity to approve the report at the Annual General Meeting. The Chairman of the Remuneration Committee will be available at the Annual General Meeting to answer questions about Directors' remuneration.

The sections of this report dealing with Directors' emoluments paid, pensions and share options and incentives have been audited. The remaining sections are not subject to audit.

THE REMUNERATION COMMITTEE

The Committee is responsible for the remuneration of Executive Directors and senior executives (in all its forms), and the terms of the service contracts and all other terms and conditions of employment of the Executive Directors.

The Committee's full terms of reference are available on the Group's website. The members of the Remuneration Committee during 2008 were Messrs J. Vogelsang (Chairman), L.P Bermejo (retired 29 February 2008), J.A. Biles, A.M. Thomson and Dr K. Rajagopal (appointed on the recommendation of the nomination committee on 24 September 2008). During the year, the Committee has taken independent advice from Ernst & Young LLP in determining appropriate levels of remuneration. In addition, the Company received actuarial and other pensions advice from KPMG LLP and Deloitte LLP concerning the management of risk arising from the UK final salary pension scheme as well as advising on the pension implications arising from the disposal of the Testing business.

REMUNERATION POLICY

The Committee aims to provide a remuneration policy consistent with the Group's overall business objectives and thereby attract and retain high calibre executives, align executives' rewards with the creation of shareholder value and motivate executives to achieve and maintain challenging levels of company and individual performance. Market rates are determined by reference to other companies of similar size, activities and complexity. At the same time, policy in this area is sensitive to the remuneration structure within the Group. The Committee keeps both the fixed and variable elements of each Executive Director's and senior executive's overall package under review. In recent years, the Committee has progressively increased the proportion of variable as against fixed element of pay, and for 2009 will increase the maximum potential for annual cash bonuses to 100% of basic salaries for executive directors and senior executives.

The Committee also considers the targets set for the variable element of Executive Directors' and senior executives' remuneration and has sought to encourage and incentivise "stretch" or exceptional and sustainable financial performance.

FIXED ELEMENTS OF PAY

The fixed elements of remuneration are salaries, pensions and other benefits.

Basic salary

The basic salaries for each Executive Director and senior executives are reviewed annually by the Committee and are determined by taking into account the responsibilities and performance of the individual, having regard to current market practice. In line with the remuneration policy the Committee has, since 2002, only made inflationary (and where appropriate market) adjustments following benchmarking. The Committee has used UK engineering businesses and FTSE 250 companies, as well as other North American or European companies in similar trades, as comparables.

Pension

Pensions for UK domiciled Executive Directors appointed prior to April 2001 are provided for under the Group's UK contributory final salary pension scheme which has a normal retirement age of 65 and which is closed to new members.

Since April 2007 increases in pensionable salaries have been capped at 3% per annum for all non-senior members (as defined in the rules) of the scheme. For senior members in the scheme the increase in pensionable salaries has been capped since 1 January 2004 (with the cap since 5 April 2007 being set as 3% per annum) unless otherwise restricted by the UK Government's Earnings Cap. The Finance Act 2004 removed the Earnings Cap and therefore the Group agreed that it should no longer apply and in its place the scheme specific salary cap (the 'Salary Limit') would apply (albeit respectively from 1 January 2004) to any affected members. For members with basic salaries above the Salary Limit, the Group will contribute between 14% and 16% of the excess to a defined contribution arrangement.

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

a) Pensions from age 65 of 1/60th highest average salary of any consecutive three years out of the last ten years prior to retirement for each year of pensionable service, and with increases in pensionable salary after 31 December 2006 restricted to 3% each year ('the Salary Limit');

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

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

d) Member's contributions are 8% of basic salary; and

e) For Executive Directors with basic salaries above the Salary Limit or the earnings cap the Group will contribute between 14% and 16% of the excess to a defined contribution arrangement.

An analysis of accrued pension entitlements for the two Directors with accruing benefits under the final salary scheme during 2008 is given on page 27.

Arrangements for Mr Hubbard are for a contribution to a defined contribution arrangement of 16% of his basic salary (including any payments being made by the Group into the Group's US 401k retirement plan) from January 2007 onwards. Pension contributions for Mr Landless' salary above the Salary Limit amounted to £40,508 (2007: £20,573), which included an additional payment of approximately £18,000 to allow for the retrospective impact of removing the UK Government's earnings cap from the UK contributory final salary scheme, and for Mr Sleight amounted to £2,328 (2007: Nil).

Mr Harris joined the Group's defined contribution arrangement from 1 November 2008 and the Group will contribute 22% of Mr Harris' basic salary. Mr Harris will be entitled, in addition, to a cash death-in-service benefit of eight times basic salary at the date of death.

Other fixed elements

The Company provides other benefits in line with market practices. These include the provision of a company car (or an allowance in lieu), private medical insurance for the Executive Directors and their families, relocation assistance where appropriate, and long-term disability insurance.

VARIABLE ELEMENTS OF PAY

There are essentially four variable elements of pay.

Annual Bonuses

For 2008 an annual bonus is payable to all Executive Directors and senior executives, based on the Group and individual performance. For those senior executives with Strategic Business Unit (SBU) responsibilities, part of the performance-related bonus is based on their relevant sphere of responsibility.

Payment of the maximum cash bonus for 2008 required Executive Directors and senior executives to achieve challenging target increases over 2007 performance in Economic Profit (target fully achieved), ROCE (Group return on capital employed) (fully achieved), organic sales (not achieved) and quantitative improvements in safety and health (fully achieved). As a result, Executive Directors received a cash bonus of 70% of basic salary (against a maximum of 80%) and senior executives' cash bonuses ranged from 20% to 35.9% depending upon individual SBU performances (again compared to maximum of 80%).

Share Awards

Bodycote Incentive Plan ("BIP")

The Company operates the BIP under which Executive Directors and senior executives are rewarded for the delivery of the Company's Strategic Plan and in particular enhanced Economic Profit. Economic Profit for these purposes is defined as adjusted earnings before interest and tax (EBIT), less a 15% charge per annum for the aggregate average of shareholders' funds, net borrowings and goodwill previously written off to reserves, amortised or impaired. To achieve the improvement in Economic Profit both pre-tax ROCE as well as EBIT improvements have to be made.

The Strategic Plan targets ROCE improvement by approximately one percentage point each year until a mid-teens pre-tax ROCE performance has been achieved. In addition significant growth in EBIT is targeted. Maximum vesting under the BIP will require a compound annual growth of EBIT of approximately 30%. Minimum vesting will be made for compound annual growth in EBIT of approximately 15%. Below this level no vesting will be made. A sliding scale will be applied to performance between the maximum, target and minimum. As a result of the economic profit performance of the Group in 2008, it is expected, subject to satisfactory fulfilment of any remaining qualification criteria, that a significant proportion of the BIP awards made in 2006 will vest as shares in May 2009. Details of the awards under the BIP are noted on page 26.

Deferred Share Awards

Bodycote Share Match Plan ("BSMP")

The Company operates the BSMP which provides a link between the Company's short and long term incentive arrangements. The BSMP allows the grant of awards of matching shares to participants on an annual basis. This will be based on the number of shares purchased by participants with the gross amount of monies deferred under their annual bonus arrangements.

Under the terms of the plan, annual bonus up to the value of 20% of base salary may be deferred into Company shares for three years. The maximum level of matching shall be calculated by reference to the gross bonus deferral on a one to one basis, subject to the achievement of a robust and challenging ROCE target. Details of the awards under the BSMP are noted on page 27.

The Bodycote Short Term Stock Bonus Plan ("STSBP")

The BSMP also replaced the STSBP which was introduced in 2005 as a temporary measure until the BIP and BSMP could be presented to shareholders for approval. Under the STSBP, Executive Directors and senior executives received the maximum awards as a consequence of Bodycote being in the upper quartile of TSR achieved by companies within the FTSE 350 Engineering & Machinery Index and certain other comparator companies. The shares will vest in March 2009 and at the end of the holding period, the awards will be enhanced by an amount reflecting dividends paid on the award shares over the three-year period. No further awards will be made under the STSBP following the introduction of the BIP and BSMP. Details of shares held by Directors pursuant to the schemes noted are given on page 26.

Deferred Restricted Stock Bonus Plan ("DRSBP")

The BSMP also replaced the DRSBP which permitted Executive Directors and senior executives to defer up to one-third of their cash bonus payable in 2003 and 2004 for shares to be held for three years and which the Company would then match. No further awards will be made under the DRSBP following the introduction of the BIP and BSMP. Details of shares held by Directors pursuant to the plan are given on page 26.

Option Arrangements

The Committee also reviews and manages share incentive schemes established between 1994 and 2003. Following adoption of the BIP no further share options have been granted to Executive Directors and staff pursuant to the 2003 executive share option scheme, but share options granted before this decision will continue to be capable of exercise. At the time each scheme was approved by shareholders, institutional guidelines were followed and latterly leading investors were consulted. All outstanding share options are now capable of exercise because the relevant performance criteria were achieved.

Board Report on Remuneration

The market price of Bodycote's ordinary shares at 31 December 2008 was 123p, the range during 2008 was 99.44p to 261.44p and the average was 193.59p. The aggregate notional gain made by John Hubbard, the only executive director to have exercised any share options in 2008, before the impact of tax and national insurance was £54,390 for Mr Hubbard. An analysis of all Executive Directors' share options is given on page 26.

Arrangements relating to the appointment of Mr Stephen Harris

On the 1 November 2008 Mr Stephen Harris joined the Board as Chief Executive Officer Designate in preparation for taking on the role of Chief Executive Officer from John Hubbard in January 2009.

In accordance with Rule 9.4.2(2) of the Listing Rules, an arrangement was made to facilitate the recruitment of Stephen Harris ('Joining Award'). As part of the committee's policy to fully align the interests of the new Chief Executive Officer with those of Bodycote's shareholders, Mr Harris was invited to deposit share certificates for Bodycote plc shares which he purchased (before commission and stamp duty) out of his own funds with the Company Secretary ('Deferred Shares'). The 145,474 Deferred Shares acquired on 20 October 2008 and 7 November 2008 will be treated as if they were purchased under the BSMP and the Joining Award will replicate a 'Matching Award' under the BSMP (for example, as to continued employment with Bodycote, the maximum number of shares that may be awarded and the achievement of robust and challenging ROCE targets over the next three financial years). The Joining Award will not be pensionable.

The Committee believe these arrangements reinforce the link between the chief executive's remuneration and the creation of value for all shareholders which is a key part of the Bodycote remuneration policy.

IMPACT OF THE DISPOSAL AND RETURN OF CASH

Participants under the Bodycote share incentive arrangements are not the beneficial owners of the shares and so were unable to participate in the Return of Cash (other than where they are required to make an investment in Bodycote shares under the terms of the relevant scheme). The Board determined that no adjustment should be made to their options and awards as the 11 for 19 share capital consolidation had the effect of maintaining the value of these options and awards, subject to normal market fluctuations. Following the 11 for 19 share capital consolidation, all such participants remained entitled to receive the same number of shares on exercise of their options and or vesting of their awards as under their previous entitlement. Participants in the BSMP as well as the Joining Award made to Mr Stephen Harris noted above, who are required to make an investment in shares (Deferred Shares) as a condition to the grant of a matching award, were entitled to participate in the Return of Cash in respect of their Deferred Shares. The remuneration committee has also determined it is appropriate to adjust the performance targets attaching to the BIP and BSMP awards made in 2007 and 2008 to reflect the fact the size of the business has been reduced following the disposal of the Testing Unit.

TOTAL SHAREHOLDER RETURN (TSR)

The graph on page 27 illustrates the Company's TSR performance since 2003 relative to the FTSE All Share Industrial Index of which the Company is a component part. This sector is considered the most appropriate comparator group over the five year period to December 2008. 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 one year's remuneration in lieu of notice by the employer, and by one year's remuneration in the event of a change in control of the Company (save for Mr Harris where the change of control provision does not apply). 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, Mr Hubbard's contract is dated 5 February 2002 and those for Messrs Landless and Sleight are each dated 26 September 2001.

EXTERNAL APPOINTMENTS

The Company believes that there are benefits to the individual and the Company for Executive Directors holding one non-executive directorship in other organisations, provided that they do not conflict with the Company's interests and that, provided the Executive Director's performance is not impaired, he could retain the fees earned in connection with such an appointment.

The total amount of fees earned in the financial year (from the date of his appointment) by Mr Harris in respect of his non-executive directorship with Brixton plc was £6,333.

NON-EXECUTIVE DIRECTORS

The remuneration of Non-Executive Directors is determined by the Chairman and the Executive Directors. Remuneration for the Chairman is determined by the whole board (excluding the Chairman). Remuneration for the Chairman and Non-Executive Directors takes into account the time commitments and duties and responsibilities involved. The Chairman and each Non-Executive Director hold letters of appointment for terms of three years (or 41 months in respect of the chairman). Each is terminable under the Company's articles of association, the Companies Act 1985, the Director's resignation or otherwise on six months' notice (twelve months in the case of the Chairman) if termination occurs before expiry of the term.

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 the time commitment attached to each appointment. The Board keeps fees under review. The Chairman and Non-Executive Directors are not entitled to any pension or other employment benefits or to participate in any incentive scheme.

Approved by the Board

J. Vogelsang
Chairman of the Remuneration Committee
25 February 2009

Directors' emoluments – audited

	Basic salary and fees £000	Benefits £000	Annual Bonus £000	**2008** **Total £000**	2007 Total £000
Executive Directors					
S. C. Harris (appointed 1 November 2008)	63	5	44	**112**	–
J. D. Hubbard	405	17	284	**706**	592
D. F. Landless	260	26	182	**468**	385
D. R. Sleight	198	17	138	**353**	293
	926	65	648	**1,639**	1,270
Non-Executive Directors					
A. M. Thomson	108	–	–	**108**	5
J. Vogelsang	45	–	–	**45**	42
J. A. Biles	46	–	–	**46**	17
K. Rajagopal (appointed 24 September 2008)	11	–	–	**11**	–
Former Directors					
J. A. S. Wallace (retired 30 April 2008)	41	–	–	**41**	124
L. P. Bermejo (retired 29 February 2008)	6	–	–	**6**	36
	1,183	65	648	**1,896**	1,494

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 2008 or date of leaving if earlier** **Number of New 17 3⁄11p Ordinary Shares**	31 December 2007 or date of appointment if later Number of 10p Ordinary shares
Executive Directors		
S. C. Harris	**84,221**	71,076
J. D. Hubbard	**680,693**	962,067
D. F. Landless	**38,244**	37,824
D. R. Sleight	**99,622**	107,500
Non-Executive Directors		
A. M. Thomson	**31,841**	25,000
J.Vogelsang	–	–
J. A. Biles	**23,157**	20,000
K. Rajagopal	**17,368**	–
Former Directors		
J. A. S. Wallace	**76,587**	132,287
L. P. Bermejo	**–**	–

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.

Executive Directors' Shareholding Retention Policy

The committee introduced in 2005 a shareholding retention policy under which Executive Directors and other senior executives will be required, within five years, to build up a shareholding in the Company. In respect of Executive Directors the requirement will be for their Directors' interests in shares to be worth at least 100% of basic salary.

Board Report on Remuneration

Share Options – audited

Director	Options as at 1 January 2008	Lapsed	Exercised in year	Options at 31 December 2008	Option prices (pence) at date of grant	Prices (pence) at date of exercise	Dates from which exercisable	Expiry date
J. D. Hubbard	40,107	–	–	40,107	370.26	–	26/04/2002	26/04/2009
	26,738	–	–	26,738	292.19	–	14/12/2002	12/12/2009
	12,834	–	–	12,834	231.42	–	20/05/2003	02/05/2010
	16,042	–	–	16,042	203.37	–	24/04/2004	24/04/2011
	64,170	–	64,170	–	125.76	174.5	16/09/2005	16/09/2012
	84,882	–	84,882	–	147.27	174.5	15/09/2006	15/09/2013
D. F. Landless	8,021	–	–	8,021	370.26	–	26/04/2002	26/04/2009
D. R. Sleight	8,021	–	–	8,021	370.26	–	26/04/2002	26/04/2009

The performance criteria are set out in the Option Arrangements section on page 23.

Directors' share interests - Deferred Restricted Stock Bonus Scheme – audited

Director	At 1 January 2008	Awarded in year[1]	Vested in year	At 31 December 2008	Earliest vesting date
J. D. Hubbard	38,695	609	39,304	–	April 2008
D. F. Landless	25,795	406	26,201	–	April 2008
D. R. Sleight	19,927	314	20,241	–	April 2008

[1]These additional awards take into account the interim dividend for the financial year ended 31 December 2007.

Directors' share interests - Short Term Stock Bonus Plan – audited

Director	At 1 January 2008	Awarded in year[1]	At 31 December 2008	Market price at award date	Earliest vesting date
J. D. Hubbard	64,788	2,949	67,737	£2.58	March 2009
D. F. Landless	42,859	1,952	44,811	£2.58	March 2009
D. R. Sleight	32,095	1,460	33,555	£2.58	March 2009

[1]These additional awards take into account the interim and final dividend for the financial year ended 31 December 2007.

Directors' share interests under the Bodycote Incentive Plan – audited

Director	At 1 January 2008	Awarded in year	At 31 December 2008	Market price at award date	Earliest vesting date
J. D. Hubbard	125,322	–	125,322	£2.59	May 2009
	110,420	–	110,420	£2.94	May 2010
	–	206,349	206,349	£1.89	March 2011
D. F. Landless	82,905	–	82,905	£2.59	May 2009
	76,784	–	76,784	£2.94	May 2010
	–	132,275	132,275	£1.89	March 2011
D. R. Sleight	62,083	–	62,083	£2.59	May 2009
	57,078	–	57,078	£2.94	May 2010
	–	100,529	100,529	£1.89	March 2011

Directors' share interests - Bodycote Share Match Plan – audited

Director	Interests as at 1 January 2008	Awarded in year[1]	Interests as at 31 December 2008	Market price at award date	Earliest vesting date
J. D. Hubbard	21,793	–	21,793	£2.93	May 2010
	–	42,915	42,915	£1.79	March 2011
D. F. Landless	3,380	–	3,380	£2.93	May 2010
	–	8,252	8,252	£1.79	March 2011
D. R. Sleight	–	20,907	20,907	£1.79	March 2011

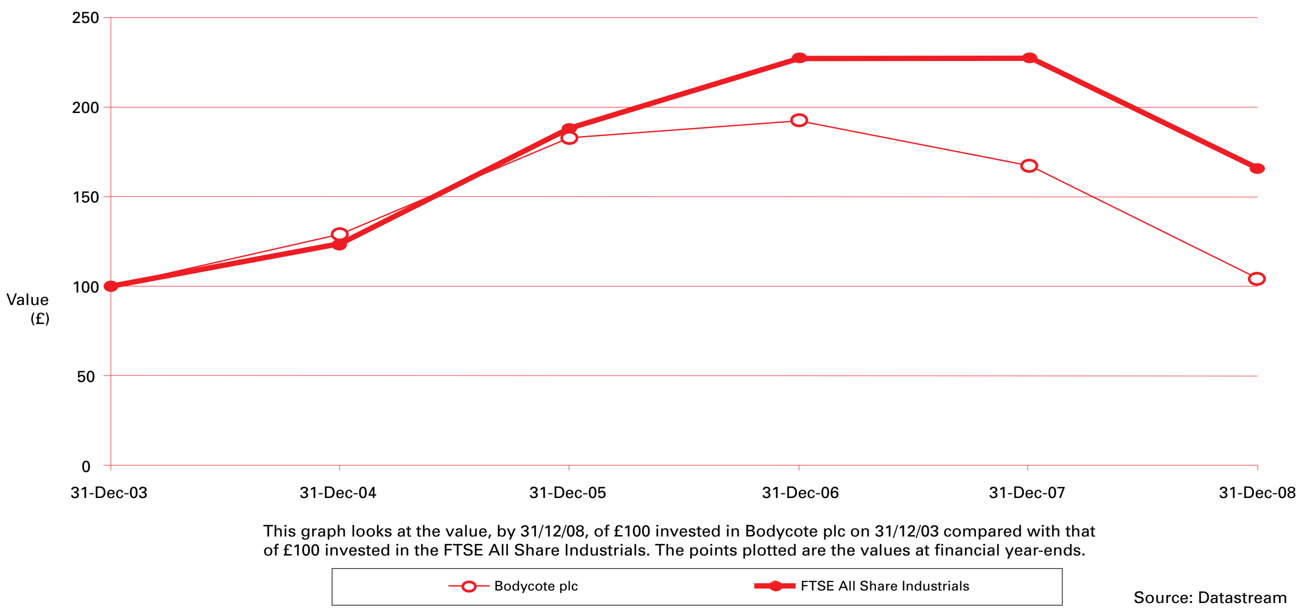
[1]Shares acquired via investment of the net of tax annual bonus under the BSMP are eligible for a matching award by reference to the gross amount invested.

Directors' pensions – audited

Director	Accrued annual pension at 01/01/08 £000	Transfer value at 01/01/08 £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 31/12/08 £000	Transfer value at 31/12/08 £000
D. F. Landless	16	165	15	1	16	34	106	155	32	434
D. R. Sleight	72	1,028	1	4	5	14	299	14	77	1,392

The increase in Mr Landless' accrued annual pension (and consequently his transfer value) are due to a transfer payment that will be received by the UK defined benefit scheme in respect of Mr Landless.

Total Shareholder Return (TSR)



This graph looks at the value, by 31/12/08, of £100 invested in Bodycote plc on 31/12/03 compared with that of £100 invested in the FTSE All Share Industrials. The points plotted are the values at financial year-ends.

Source: Datastream

Board of Directors

EXECUTIVE DIRECTORS

S. C. Harris Chief Executive (50)
Appointed a Director on 1 November 2008 and Chief Executive from 12 January 2009. Non-executive Director of Brixton plc (2006), Executive Director at Spectris plc from 2003 to 2008 and at Powell Duffryn plc from 1995 to 2003. Prior to this he held several senior positions in APV Inc. in the United States from 1984 to 1995. Member of the Nomination Committee. A Chartered Engineer.

J. D. Hubbard (61) United States
Appointed a Director in 2001 and served as Chief Executive from 2002 to 2009. Previously served as President of Bodycote's North American Heat Treatment operations from 1996 to 2001. Member of the Nomination Committee. A licensed professional Metallurgical Engineer.

D. F. Landless Finance Director (49)
Appointed Finance Director and joined the Group in 1999. From 1989 to 1997 served as Finance Director in UK and US divisions of Courtaulds Plc. Finance Director of Courtaulds Coatings (Holdings) Limited from 1997 to 1999. A Chartered Management Accountant.

D. R. Sleight Corporate Development Director (59)
Appointed Corporate Development Director in 2002 having joined the Board in 1996, and served previously as Finance Director (1990 to 1995) and Joint Managing Director (1995 to 2001) of Bodycote's Testing operations. A Chartered Accountant.

NON-EXECUTIVE DIRECTORS

A. M. Thomson Chairman (62)
Appointed a director in 2007. Chairman of Hamsard 3054 Ltd (Polypipe), and Non-executive director of Johnson Matthey plc and Alstom SA. Senior Vice-President of the Institute of Chartered Accountants of Scotland. Served as Finance Director of Smiths Group plc from 1995 to 2006 and of Rugby Group plc from 1992 to 1995. Member of the Remuneration Committee and Chairman of the Nomination Committee. A Chartered Accountant

J. Vogelsang Senior Independent Non-executive director (66) Netherlands
Appointed a director in 2003. Non-executive director of Metex SA (2007). President of Technology at Basell Polyolefins (2001 to 2002), President of Montell Polyolefins Europe (1999 to 2001), Vice-President Shell Chemical Europe and Africa (1994 to 1999) and Chief Executive of the Shell Companies in Sweden (1992 to 1994). Chairman of the Remuneration Committee and member of the Audit and Nomination Committees. A Chemical Engineer.

J. A. Biles (61)
Appointed a director in 2007. Non-executive Director of Charter International plc (2005), Hermes Fund Managers Limited (2005) and of ArmorGroup International plc (2004 to 2008). Finance Director of FKI plc from 1998 to 2004 and Group Finance Director of Chubb Security PLC (1991 to 1997). Chairman of the Audit Committee and member of the Remuneration and Nomination Committees. A Chartered Accountant.

K. Rajagopal (55)
Appointed a Director on 24 September 2008. Non-executive Director of Dyson Group plc (2007) W.S. Atkins plc (2008) and Spirax-Sarco Engineering plc (2009). Member of UK Council on Science and Technology, and the Audit Commission. Executive Director of BOC Group plc (2000 to 2006) and Chief Executive of BOC Edwards (1998 to 2006) and Non-Executive Director of Foseco plc (2005 to 2008). Member of the Audit, Remuneration and Nomination Committees. A Mechanical Engineer.

SECRETARY AND REGISTERED OFFICE

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Registered Number 519057 England and Wales

ADVISERS

AUDITORS	Deloitte LLP
PRINCIPAL BANKERS	HSBC Bank plc, Barclays Bank PLC, The Royal Bank of Scotland plc, Svenska Handelsbanken AB, Lloyds TSB Bank plc, Bayerische Hypo und Vereinsbank AG, ING Bank NV and Scotiabank Europe plc
SOLICITORS	Eversheds LLP
BROKERS & FINANCIAL ADVISERS	Credit-Suisse Securities (Europe) Limited
REGISTRARS	Capita Registrars Limited, Huddersfield

Independent Auditors' Report
To The Members Of Bodycote plc

Bodycote

We have audited the group financial statements of Bodycote plc for the year ended 31 December 2008 which comprise the Consolidated Income Statement, the Consolidated Balance Sheet, the Consolidated Cash Flow Statement, the Consolidated Statement of Recognised Income and Expense, the Statement of Accounting Policies and the related notes 1 to 32. These group financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Board Report on Remuneration that is described as having been audited.

We have reported separately on the parent company financial statements of Bodycote plc for the year ended 31 December 2008.

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

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors' responsibilities for preparing the Annual Report, the Board Report on Remuneration and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

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

We report to you our opinion as to whether the group financial statements give a true and fair view, whether the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation and whether the part of the Board Report on Remuneration described as having been audited has been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the group financial statements. The information given in the Directors' Report includes that specific information presented in the Group Business Review that is cross referred from the Directors' Report.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding director's remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited group financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the group financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the group financial statements and the part of the Board Report on Remuneration to be audited. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

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

OPINION

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group's affairs as at 31 December 2008 and of its profit for the year then ended;
- the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the part of the Board Report on Remuneration described as having been audited has been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the Group financial statements.

Deloitte LLP

Deloitte LLP
Chartered Accountants and Registered Auditors

Manchester
25 February 2009

Consolidated Income Statement
for the year ended 31 December 2008

	2008 £m	2007 £m	Note
Revenue			
Existing operations	**541.4**	456.1	
Acquisitions	**10.4**	9.1	
Revenue - continuing operations	**551.8**	465.2	1
Operating (loss)/profit			3
Existing operations	**(54.7)**	61.8	
Acquisitions	**3.0**	1.2	
Share of results of associates	**–**	0.1	14
Operating (loss)/profit - continuing operations	**(51.7)**	63.1	
Operating profit prior to exceptional items	**71.2**	70.3	
Amortisation of acquired intangible fixed assets	**(1.3)**	(0.8)	12
Impairment of goodwill	**(31.9)**	(3.5)	11
Major facility closure costs	**(77.6)**	(3.4)	
Impairment of loan due from associate	**(12.1)**	–	
Change to pension scheme rules	**–**	2.6	
Bid response costs	**–**	(2.1)	
Operating (loss)/profit - continuing operations	**(51.7)**	63.1	
Investment revenue	**4.9**	2.9	5
Finance costs	**(8.5)**	(5.4)	6
(Loss)/profit before taxation	**(55.3)**	60.6	
Taxation	**17.2**	(13.6)	7
(Loss)/profit for the year - continuing operations	**(38.1)**	47.0	
Profit for the year - discontinued operations	**188.8**	6.8	8
Profit for the year	**150.7**	53.8	
Attributable to:			
Equity holders of the parent	**149.8**	52.8	
Minority interest	**0.9**	1.0	
	150.7	53.8	
	Pence	Pence	
Earnings/(loss) per share			10
From continuing operations:			
Basic	**(12.5)**	14.5	
Diluted	**(12.5)**	14.4	
From continuing and discontinued operations:			
Basic	**48.2**	16.6	
Diluted	**48.1**	16.6	

Consolidated Balance Sheet
at 31 December 2008

Bodycote

	2008 £m	2007 £m	Note
Non-current assets			
Goodwill	**141.6**	213.0	11
Other intangible assets	**12.8**	14.3	12
Property, plant and equipment	**533.3**	508.9	13
Interests in associates	**8.2**	0.6	14
Finance lease receivables	**0.7**	1.0	16
Deferred tax asset	**52.5**	29.7	20
Derivative financial instruments	**–**	0.1	19
Trade and other receivables	**3.0**	13.3	17
	752.1	780.9	
Current assets			
Inventories	**14.0**	19.8	15
Finance lease receivables	**0.4**	0.4	16
Derivative financial instruments	**1.8**	–	19
Trade and other receivables	**128.4**	159.3	17
Cash and cash equivalents	**258.4**	37.7	17
Assets classified as held for sale	**3.6**	1.8	
	406.6	219.0	
Total assets	**1,158.7**	999.9	
Current liabilities			
Trade and other payables	**118.9**	124.5	22
Dividends payable	**9.4**	8.8	9
Current tax liabilities	**33.6**	13.0	
Obligations under finance leases	**1.2**	1.7	21
Borrowings	**16.3**	9.0	18
Derivative financial instruments	**26.3**	5.2	19
Provisions	**27.2**	5.7	23
	232.9	167.9	
Net current assets	**173.7**	51.1	
Non-current liabilities			
Borrowings	**302.9**	221.8	18
Retirement benefit obligations	**14.9**	23.9	31
Deferred tax liabilities	**78.3**	74.3	20
Obligations under finance leases	**2.7**	3.4	21
Derivative financial instruments	**5.2**	3.0	19
Provisions	**15.5**	2.2	23
Other payables	**9.4**	6.8	22
	428.9	335.4	
Total liabilities	**661.8**	503.3	
Net assets	**496.9**	496.6	
Equity			
Share capital	**32.4**	32.4	24
Share premium account	**175.7**	305.0	25
Own shares	**(10.9)**	(11.0)	25
Other reserves	**137.3**	6.0	25
Hedging and translation reserves	**31.1**	16.9	25
Retained earnings	**126.4**	140.7	25
Equity attributable to equity holders of the parent	**492.0**	490.0	
Minority interest	**4.9**	6.6	25
Total equity	**496.9**	496.6	

The financial statements were approved by the Board of Directors and authorised for issue on 25 February 2009. They were signed on its behalf by:

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

Consolidated Cash Flow Statement

for the year ended 31 December 2008

	2008 £m	2007 £m	Note
Net cash from operating activities	**102.5**	108.0	28
Investing activities			
Purchases of property, plant and equipment	**(77.1)**	(72.5)	
Proceeds on disposal of property, plant and equipment and intangible assets	**4.6**	6.6	
Purchases of intangible fixed assets	**(2.4)**	(1.0)	
Acquisition of investment in an associate	**(5.6)**	(0.2)	
Acquisition of subsidiaries	**(29.3)**	(32.7)	
Disposal of subsidiaries	**400.1**	–	
Lump sum contribution to pension scheme	**(21.0)**	–	
Net cash received from/(used in) investing activities	**269.3**	(99.8)	
Financing activities			
Interest received	**12.5**	3.4	
Interest paid	**(20.5)**	(12.5)	
Dividends paid	**(154.3)**	(22.6)	
Dividends paid to a minority shareholder	**(0.1)**	(0.1)	
Repayments of bank loans	**(6.0)**	(187.1)	
Payments of obligations under finance leases	**(2.6)**	(1.9)	
New bank loans raised	**8.0**	216.4	
New obligations under finance leases	**0.3**	0.6	
Proceeds on issue of ordinary share capital	**0.2**	3.1	
Own shares purchased/settlement of share options	**0.1**	(8.6)	
Net cash used in financing activities	**(162.4)**	(9.3)	
Net increase/(decrease) in cash and cash equivalents	**209.4**	(1.1)	
Cash and cash equivalents at beginning of year	**34.3**	33.4	
Effect of foreign exchange rate changes	**5.8**	2.0	
Cash and cash equivalents at end of year	**249.5**	34.3	

Consolidated Statement of Recognised Income and Expense

for the year ended 31 December 2008

	2008 £m	2007 £m
Exchange differences on translation of foreign operations	**14.2**	12.5
Actuarial (losses)/gains on defined benefit pension schemes	**(11.4)**	4.7
Tax on items taken directly to equity	**2.2**	(3.1)
Net income recognised directly in equity	**5.0**	14.1
Profit for the year	**150.7**	53.8
Total recognised income and expense for the year	**155.7**	67.9
Attributable to:		
Equity holders of the parent	**154.8**	66.9
Minority interests	**0.9**	1.0
	155.7	67.9

Accounting Policies

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. 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 share-based payments and certain financial instruments. The principal accounting policies adopted are set out below.

BASIS OF CONSOLIDATION

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

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

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

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

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

INVESTMENTS IN ASSOCIATES

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

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

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

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

NON-CURRENT ASSETS HELD FOR SALE

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

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

GOODWILL

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

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

On disposal of a subsidiary 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.

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.

Accounting Policies

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

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

THE GROUP AS LESSOR

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

FOREIGN CURRENCIES

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

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

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

BORROWING COSTS

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

GOVERNMENT GRANTS

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

INCOME STATEMENT

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. Amounts presented in the income statement for acquisitions relate to businesses acquired during the current or prior year.

DISCONTINUED OPERATIONS

In accordance with IFRS 5, non-current assets held for sale and discontinued operations, the Group has separately disclosed the results of the Testing business as discontinued following the disposal of the business in October 2008. Comparative amounts in the income statement have also been restated.

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 statement of recognised income and expense.

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

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

TAXATION

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

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

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

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

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

PROPERTY, PLANT AND EQUIPMENT

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

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

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

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

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

IMPAIRMENT OF TANGIBLE AND INTANGIBLE ASSETS

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.

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 of 68 days, 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 uncollectible, 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.

INVENTORIES

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

FINANCIAL INSTRUMENTS

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

Trade Receivables

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

Cash and Cash Equivalents

Cash and cash equivalents comprise cash 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.

Trade Payables

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

Equity Instruments

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

PROVISIONS

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

DERIVATIVE FINANCIAL INSTRUMENTS

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

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

Derivative financial instruments are recognised as assets and liabilities measured at their fair value on the balance sheet date. Changes in the fair value of any derivative instruments that do not fulfil the criteria for hedge accounting contained in IAS 39 are recognised immediately in the income statement.

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.

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.

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 equity 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 forecasted 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 directly in equity rather than in the income statement.

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

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

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

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

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

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

Impairment of Goodwill 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.

Retirement Benefit Schemes
Accounting for retirement benefit schemes under IAS19 requires an assessment of the future benefits payable in accordance with actuarial assumptions, which are set out in note 31.

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 28. The nature of the Group's operations and its principal activities are set out on page 13 of the Directors' Report.

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

At the date of authorisation of these financial statements, the following Standards and Interpretations that are expected to impact on the Group but which have not been applied in these financial statements, were in issue but not yet effective.

With the exception of changes in disclosure, the Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group. The Directors anticipate that the Group will adopt these standards and interpretations on their effective dates.

- IFRS 8 Operating segments, issued in November 2006, effective for periods beginning on or after 1 January 2009.
- IAS 23 Borrowing costs, revised version issued in March 2007, effective for annual periods beginning on or after 1 January 2009.
- IAS 1 Presentation of financial statements, revised version issued in September 2007, effective for annual periods beginning on or after 1 January 2009.
- IAS 27 Consolidated and separate financial statements, revised version issued in January 2008 effective for annual periods beginning on or after 1 July 2009.
- IFRS 3 Business Combinations, revised version issued in January 2008 effective for annual periods beginning on or after 1 July 2009.

The impact of all other standards and interpretations not yet adopted is not expected to be material.

1. Revenue

	2008 £m	2007 £m
Continuing operations		
Heat treatment and hot isostatic pressing services	551.8	465.2
Other operating income	6.6	5.2
Investment revenue (see note 5)	4.9	2.9
	563.3	473.3
Discontinued operations		
Testing services	165.7	175.7
Total Revenue (as defined in IAS 18, Revenue)	729.0	649.0

2. Business and geographical segments

	Heat Treatment 2008 £m	Hot Isostatic Pressing 2008 £m	Head Office and eliminations 2008 £m	Consolidated 2008 £m	Discontinued operations (Testing) 2008 £m	Total Group 2008 £m
Revenue						
Total revenue	499.9	51.9	–	551.8	164.9	716.7
Result						
Segment result prior to exceptional items and share of associates' profit after tax	60.0	15.3	–	75.3	20.5	95.8
Unallocated corporate expenses	–	–	(4.1)	(4.1)	–	(4.1)
Headline operating profit	60.0	15.3	(4.1)	71.2	20.5	91.7
Amortisation/Impairment of acquired intangible assets and impairment of goodwill	(33.2)	–	–	(33.2)	(0.6)	(33.8)
Major facility closure costs	(77.1)	(0.5)	–	(77.6)	–	(77.6)
Impairment of loan due from associate	–	–	(12.1)	(12.1)	–	(12.1)
Disposal of Testing business	–	–	–	–	199.3	199.3
Segment result	(50.3)	14.8	(16.2)	(51.7)	219.2	167.5
Investment revenue				4.9		
Finance costs				(8.5)		
Loss before tax				(55.3)		
Tax				17.2		
Profit for the period from discontinued operations				188.8		
Profit for the year				150.7		

Following the disposal of the Testing business, which was formerly disclosed as two segments, the Directors concluded that presentation as a single segment within discontinued operations is most appropriate. The prior year comparatives have been re-presented accordingly.

Inter-segment sales are not material in either year.

2. Business and geographical segments continued

	Heat Treatment 2007 £m	Hot Isostatic Pressing 2007 £m	Head Office and eliminations 2007 £m	Consolidated 2007 £m	Discontinued operations (Testing) 2007 £m	Total Group 2007 £m
Revenue						
Total revenue	421.7	43.5	–	465.2	175.3	640.5
Result						
Segment result prior to exceptional items and share of associates' profit after tax	61.6	15.3	–	76.9	21.0	97.9
Share of associates' operating profit	–	0.1	–	0.1	–	0.1
Unallocated corporate expenses	–	–	(6.7)	(6.7)	–	(6.7)
Headline operating profit	61.6	15.4	(6.7)	70.3	21.0	91.3
Amortisation/impairment of acquired intangible assets and impairment of goodwill	(4.3)	–	–	(4.3)	(4.8)	(9.1)
Major facility closure costs	(3.4)	–	–	(3.4)	(2.0)	(5.4)
Change to pension scheme rules	2.0	0.2	0.4	2.6	1.5	4.1
Bid response costs	–	–	(2.1)	(2.1)	–	(2.1)
Segment result	55.9	15.6	(8.4)	63.1	15.7	78.8
Investment revenue				2.9		
Finance costs				(5.4)		
Profit before tax				60.6		
Tax				(13.6)		
Profit for the year from discontinued operations				6.8		
Profit for the year				53.8		

Other information

	Heat Treatment 2008 £m	**Hot Isostatic Pressing 2008 £m**	**Discontinued operations (Testing) 2008 £m**	**Head Office and eliminations 2008 £m**	**Consolidated 2008 £m**
Capital additions	**58.1**	**7.7**	**11.7**	**2.0**	**79.5**
Depreciation and amortisation	**43.7**	**6.1**	**10.6**	**0.2**	**60.6**
Impairment losses recognised in income	**72.6**	**0.4**	**–**	**12.1**	**85.1**
Balance sheet					
Assets:					
Segment assets	**816.6**	**106.7**	**–**	**227.2**	**1,150.5**
Interests in associates	**8.2**	**–**	**–**	**–**	**8.2**
Consolidated total assets	**824.8**	**106.7**	**–**	**227.2**	**1,158.7**
Liabilities:					
Segment liabilities	**235.3**	**29.2**	**–**	**397.3**	**661.8**
Segment net assets	**589.5**	**77.5**	**–**	**(170.1)**	**496.9**

2. Business and geographical segments continued

	Heat Treatment	Hot Isostatic Pressing	Discontinued operations (Testing)	Head Office and eliminations	Consolidated
	2007 £m	2007 £m	2007 £m	2007 £m	2007 £m
Capital additions	44.2	12.6	16.2	0.5	73.5
Depreciation and amortisation	36.0	4.3	11.1	0.2	51.6
Impairment losses recognised in income	3.8	–	4.5	–	8.3
Balance sheet					
Assets:					
Segment assets	941.4	100.2	235.3	(277.6)	999.3
Interests in associates	0.6	–	–	–	0.6
Consolidated total assets	942.0	100.2	235.3	(277.6)	999.9
Liabilities:					
Segment liabilities	522.9	48.2	165.4	(233.2)	503.3
Segment net assets	419.1	52.0	69.9	(44.4)	496.6

By geographical market

	Revenue	
	2008 £m	2007 £m
Europe, Middle East and Africa	**379.4**	317.4
Americas	**168.8**	146.6
Asia Pacific	**3.6**	1.2
	551.8	465.2

Revenue from the Group's discontinued operations was derived principally from Europe, Middle East and Africa £100.2m (2007: £104.6m), Americas £62.3m (2007: £68.8m) and Asia Pacific £2.4m (2007: £1.9m).

	Carrying amount of segment assets/(liabilities)		Additions to property, plant and equipment and intangible assets	
	2008 £m	2007 £m	**2008 £m**	2007 £m
Europe, Middle East and Africa	**366.1**	395.1	**53.6**	45.4
Americas	**131.1**	101.0	**19.0**	24.0
Asia Pacific	**(0.3)**	0.5	**6.9**	4.1
	496.9	496.6	**79.5**	73.5

Notes to the Consolidated Financial Statements
Year ended 31 December 2008

3. Operating (loss)/profit

	Existing operations 2008 £m	Acquisitions 2008 £m	Continuing operations 2008 £m	Existing operations 2007 £m	Acquisitions 2007 £m	Continuing operations 2007 £m
Revenue	**541.4**	**10.4**	**551.8**	456.1	9.1	465.2
Cost of sales	**(371.0)**	**(6.0)**	**(377.0)**	(301.7)	(5.6)	(307.3)
Gross profit	**170.4**	**4.4**	**174.8**	154.4	3.5	157.9
Other operating income	**6.0**	**–**	**6.0**	4.5	0.2	4.7
Distribution costs	**(20.0)**	**(0.3)**	**(20.3)**	(15.4)	(0.7)	(16.1)
Other administration expenses*	**(88.2)**	**(1.0)**	**(89.2)**	(74.5)	(1.8)	(76.3)
Other operating expenses	**–**	**(0.1)**	**(0.1)**	–	–	–
Amortisation/impairment of acquired intangible fixed assets*	**(1.3)**	**–**	**(1.3)**	(0.8)	–	(0.8)
Impairment of goodwill*	**(31.9)**	**–**	**(31.9)**	(3.5)	–	(3.5)
Major facility closure costs*	**(77.6)**	**–**	**(77.6)**	(3.4)	–	(3.4)
Impairment of loan due from associate*	**(12.1)**	**–**	**(12.1)**	–	–	–
Change to pension scheme rules*	**–**	**–**	**–**	2.6	–	2.6
Bid response costs*	**–**	**–**	**–**	(2.1)	–	(2.1)
Operating (loss)/profit before income from associates	**(54.7)**	**3.0**	**(51.7)**	61.8	1.2	63.0
Income from associates after interest and tax			**–**			0.1
Operating (loss)/profit			**(51.7)**			63.1

*Administration expenses (total £212.1m, 2007: £83.5m).

Exceptional items comprise:

	2008 £m	2007 £m
Amortisation of acquired intangible fixed assets	**1.3**	0.8
Impairment of goodwill	**31.9**	3.5
Major facility closure costs	**77.6**	3.4
Impairment of loan due from associate	**12.1**	–
Change to pension scheme rules	**–**	(2.6)
Bid response costs	**–**	2.1
	122.9	7.2

Further details of these items are included in the Group Business Review on pages 3 to 12.

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

	2008 £m	2007 £m
Continuing and discontinued operations		
Net foreign exchange (gains)/losses	**(0.2)**	0.1
Depreciation of property, plant and equipment	**57.8**	49.3
Impairment of loan due from associate	**12.1**	–
Amortisation of acquired intangible fixed assets	**1.9**	1.9
Impairment of goodwill	**31.9**	7.2
Loss/(profit) on disposal of property, plant and equipment	**0.1**	(0.1)
Staff costs (see note 4)	**317.6**	285.3
Auditors' remuneration for audit services (see page 41)	**0.9**	0.8

3. Operating Profit continued

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

	2008 £m	2007 £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 pursuant to legislation	**0.8**	0.7
Tax Services	**0.1**	0.4
All other services (corporate finance services)	**1.2**	–
	2.2	1.2

In addition to the amounts shown above, the auditor received fees of £9,000 (2007: £9,000) for the audit of the Group pension schemes.

Fees payable to the Company's auditor, Deloitte LLP, and its associates for services other than the statutory audit of the Company are not disclosed in subsidiaries' accounts since the consolidated accounts of the subsidiaries' parent, Bodycote plc, are required to disclose non-audit fees on a consolidated basis.

A description of the work of the Audit Committee is set out in the Report of the Audit Committee 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:

	2008 Number	2007 Number
Continuing and discontinued operations		
Heat Treatment	**7,135**	6,913
Hot Isostatic Pressing	**417**	375
Testing	**3,000**	3,720
	10,552	11,008

Their aggregate remuneration comprised:

	£m	£m
Wages and salaries	**266.5**	239.0
Social security costs	**43.7**	38.3
Other pension costs	**7.4**	8.0
	317.6	285.3

Disclosure of individual director's remuneration, share interests, share options, long term incentive schemes, pension consideration and pension entitlements required by the Companies Act 1985 and those specified for audit by the Financial Services Authority are shown in the tables in the Board Report on Remuneration on pages 22 to 27 and form part of these financial statements.

5. Investment revenue

	Continuing operations		Discontinued operations		Total	
	2008 £m	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m
Interest on bank deposits	**2.9**	0.4	**0.8**	0.4	**3.7**	0.8
Interest on derivative financial instruments	**1.1**	1.9	**–**	–	**1.1**	1.9
Other interest receivable	**0.9**	0.6	**–**	–	**0.9**	0.6
	4.9	2.9	**0.8**	0.4	**5.7**	3.3

All investment revenue relates to loans and receivables.

6. Finance costs

	Continuing operations		Discontinued operations		Total	
	2008 £m	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m
Interest on bank overdrafts and loans*	**5.8**	3.0	**6.8**	7.8	**12.6**	10.8
Interest on obligations under finance leases	**0.3**	0.3	**–**	–	**0.3**	0.3
Interest on pension scheme liabilities	**3.0**	2.6	**1.5**	1.2	**4.5**	3.8
Return on pension assets	**(2.2)**	(1.9)	**(1.3)**	(1.0)	**(3.5)**	(2.9)
Other finance charges*	**1.6**	1.4	**0.2**	0.2	**1.8**	1.6
Total finance costs	**8.5**	5.4	**7.2**	8.2	**15.7**	13.6

*Amounts arising on financial liabilities measured at amortised cost.

7. Taxation

	Continuing operations		Discontinued operations		Total	
	2008 £m	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m
Current taxation - charge for the year	**12.9**	14.2	**23.6**	2.8	**36.5**	17.0
Current taxation - adjustments in respect of previous years	**0.2**	0.4	**0.3**	3.0	**0.5**	3.4
Deferred tax (see note 20)	**(30.3)**	(1.0)	**0.1**	(4.7)	**(30.2)**	(5.7)
	(17.2)	13.6	**24.0**	1.1	**6.8**	14.7

UK corporation tax is calculated at 28.5% (2007: 30%) of the estimated assessable profit for the year. Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions. Of the total charge/(credit) to current tax, approximately £2.0m (2007: £5.8m) related to profits arising in the Testing business, which was disposed of during the year. A tax charge of £21.9m arose on the disposal of the various subsidiaries which comprised the business.

7. Taxation continued

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

	2008 £m	2007 £m
(Loss)/profit before tax:		
Continuing operations	**(55.3)**	60.6
Discontinued operations	**212.8**	7.9
	157.5	68.5
Tax at the UK corporation tax rate of 28.5% (2007: 30%)	**44.9**	20.6
Tax effect of expenses that are not deductible in determining taxable profit	**20.2**	0.7
Tax effect of non-taxable disposal proceeds	**(39.2)**	–
Deferred tax assets not recognised	**1.7**	(0.2)
Tax settlements in respect of prior years	**(8.6)**	(1.6)
Tax effect of other adjustments in respect of previous periods	**(2.2)**	(2.6)
Effect of different tax rates of subsidiaries operating in other jurisdictions	**(10.0)**	(2.2)
Tax expense for the year	**6.8**	14.7

The tax credit on items taken directly to equity is £2.2m (2007: charge £3.1m).

8. Discontinued operations

The Testing business was sold on 17 October 2008.

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

	Period ended 17 October 2008 £m	2007 £m
Revenue	**164.9**	175.3
Expenses	**(151.4)**	(167.4)
Profit before tax	**13.5**	7.9
Attributable tax expense	**(2.1)**	(1.1)
Profit on disposal of discontinued operations	**199.3**	–
Attributable tax expense	**(21.9)**	–
Net profit attributable to discontinued operations	**188.8**	6.8

During the year, the Testing business contributed £5.2m (2007: £13.4m) to the Group's net cash from operating activities, paid £12.7m (2007: received £2.2m) in respect of investing activities and received £16.7m (2007: paid £7.9m) in respect of financing activities.

A profit of £199.3m arose on the disposal of the Testing business, being the proceeds of disposal less the carrying amount of the division's net assets and attributable goodwill and costs of disposal.

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

9. Dividends

	2008 £m	2007 £m
Amounts recognised as distributions to equity holders in the year:		
Final dividend for the year ended 31 December 2007 of 5.25p (2006: 4.50p) per share	**16.7**	14.6
Interim dividend for the year ended 31 December 2008 of 2.95p (2007: 2.75p) per share	**9.4**	8.8
B share special dividend or redemption for the year ended 31 December 2008 of 40.00p (2007: nil) per share	**128.8**	–
	154.9	23.4
Proposed final dividend for the year ended 31 December 2008 of 5.35p (2007: 5.25p) per share	**10.0**	17.0

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.

10. Earnings/(loss) per share

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

	2008 £m	2007 £m
Earnings		
Earnings for the purposes of basic earnings per share being net profit attributable to equity holders of the parent	**149.8**	52.8

	2008 Number	2007 Number
Number of shares		
Weighted average number of ordinary shares for the purposes of basic earnings per share	**310,936,573**	317,934,910
Effect of dilutive potential ordinary shares:		
Share options	**239,456**	732,862
Weighted average number of ordinary shares for the purposes of diluted earnings per share	**311,176,029**	318,667,772

	2008 £m	2007 £m
From continuing operations		
Earnings/(loss)		
Net profit attributable to equity holders of the parent	**149.8**	52.8
Adjustments to exclude profit for the year from discontinued operations	**(188.8)**	(6.8)
(Loss)/earnings from continuing operations for the purpose of basic (loss)/earnings per share excluding discontinued operations	**(39.0)**	46.0

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

10. Earnings per share continued

	2008 Pence	2007 Pence
Earnings per share from continuing and discontinued operations:		
Basic	**48.2**	16.6
Diluted	**48.1**	16.6
Earnings per share from discontinued operations:		
Basic	**60.7**	2.1
Diluted	**60.7**	2.1
(Loss)/earnings per share from continuing operations:		
Basic	**(12.5)**	14.5
Diluted	**(12.5)**	14.4

	2008 £m	2007 £m
Headline earnings		
Net profit attributable to equity holders of the parent	**149.8**	52.8
Add back:		
Impairment of goodwill	**31.4**	3.5
Amortisation of acquired intangible fixed assets	**1.2**	0.8
Impairment of loan due from associate	**8.7**	–
Major facility closure costs	**52.0**	2.3
Change to pension scheme rules	**–**	(1.9)
Bid response costs	**–**	2.1
Profit for the year - discontinued operations	**(188.8)**	(6.8)
Headline earnings	**54.3**	52.8

	Pence	Pence
Earnings per share from headline earnings:		
Basic	**17.5**	16.6
Diluted	**17.4**	16.6

11. Goodwill

	2008 £m	2007 £m
Cost		
At 1 January	**230.0**	211.7
Exchange differences	**11.8**	4.0
Recognised on acquisition of subsidiaries	**24.9**	14.3
Derecognised on disposal of subsidiaries	**(86.4)**	–
At 31 December	**180.3**	230.0
Accumulated impairment		
At 1 January	**(17.0)**	(9.8)
Exchange differences	**(0.3)**	–
Impairment losses for the year	**(31.9)**	(7.2)
Derecognised on disposal of subsidiaries	**10.5**	–
At 31 December	**(38.7)**	(17.0)
Carrying amount	**141.6**	213.0

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:

	2008 £m	2007 £m
Heat Treatment	**139.3**	143.9
Hot Isostatic Pressing	**2.3**	1.6
Testing	**–**	67.5
	141.6	213.0

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

The recoverable amounts of the cash generating units are determined from value in use calculations. The key assumptions for those calculations are the discount rates, growth rates and expected changes to selling prices and direct costs during the period. Management estimates discount rates 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 all cash generating units is 9.4% (2007: 8.4%). The recoverable amount is the sum of the discounted cash flows over a fifteen year period.

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 generation unit's profitability at the forecast level of sales and incorporates the impact of the restructuring programme, where appropriate. Cash flows after five years are based on an estimated growth rate of 3.1%, 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.

Goodwill and tangible fixed assets were impaired for heat treatment locations across the Group as a result of the current uncertain market conditions. The most significant impairments were made in locations in France, Italy, Germany and North America.

12. Other intangible assets

	Software	Other intangible assets acquired through business combinations	Total
	£m	£m	£m
Cost			
At 1 January 2007	6.1	9.4	15.5
Exchange differences	0.4	1.0	1.4
Additions	1.0	–	1.0
Acquired on acquisition of subsidiaries	0.3	4.3	4.6
Recategorisation	0.1	–	0.1
Disposals	(0.5)	–	(0.5)
At 1 January 2008	7.4	14.7	22.1
Exchange differences	2.1	1.9	4.0
Additions	2.4	–	2.4
Acquired on acquisition of subsidiaries	0.1	–	0.1
Recategorisation	0.1	–	0.1
Disposals	(0.2)	–	(0.2)
Disposed on disposal on subsidiaries	(0.5)	(5.6)	(6.1)
At 31 December 2008	**11.4**	**11.0**	**22.4**
Amortisation			
At 1 January 2007	3.9	1.2	5.1
Exchange differences	0.2	0.1	0.3
Charge for the year	0.8	1.5	2.3
Acquired on acquisition of subsidiaries	0.1	–	0.1
Recategorisation	0.1	–	0.1
Impairment loss	–	0.4	0.4
Disposals	(0.5)	–	(0.5)
At 1 January 2008	4.6	3.2	7.8
Exchange differences	1.5	0.3	1.8
Charge for the year	1.0	1.9	2.9
Recategorisation	0.3	–	0.3
Impairment loss	0.2	–	0.2
Disposals	(0.2)	–	(0.2)
Disposed on disposal on subsidiaries	(0.3)	(2.9)	(3.2)
At 31 December 2008	**7.1**	**2.5**	**9.6**
Carrying amount			
At 31 December 2008	**4.3**	**8.5**	**12.8**
At 31 December 2007	2.8	11.5	14.3

The amortisation periods for intangible assets are:

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

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

13. Property, plant and equipment

	Land and buildings						
	Freehold £m	Long leasehold £m	Short leasehold £m	Plant and machinery £m	Fixtures and fittings £m	Assets under construction £m	Total £m
Cost or valuation							
At 1 January 2007	148.3	15.6	8.3	564.9	35.5	25.2	797.8
Additions	4.4	2.0	2.4	31.0	3.2	29.5	72.5
Acquisition of subsidiaries	7.1	1.1	0.3	16.9	1.0	0.7	27.1
Exchange differences	8.5	1.0	0.2	33.8	2.3	1.0	46.8
Reclassified as held for sale	(1.7)	–	–	–	–	–	(1.7)
Recategorisation	2.8	(0.4)	0.8	27.5	(2.2)	(28.9)	(0.4)
Disposals	(2.2)	(0.7)	(0.2)	(28.4)	(2.3)	–	(33.8)
At 1 January 2008	167.2	18.6	11.8	645.7	37.5	27.5	908.3
Additions	6.2	0.5	0.9	36.5	3.4	29.6	77.1
Acquisition of subsidiaries	0.4	0.1	0.5	9.0	0.7	0.1	10.8
Exchange differences	43.6	3.9	0.7	155.2	7.2	9.5	220.1
Reclassified as held for sale	(5.8)	–	–	–	–	–	(5.8)
Recategorisation	4.2	(1.7)	1.9	25.7	5.2	(24.8)	10.5
Disposals	(2.7)	–	–	(18.5)	(1.3)	(0.1)	(22.6)
Disposal of subsidiaries	(12.3)	(10.3)	(10.8)	(82.2)	(14.3)	(1.2)	(131.1)
At 31 December 2008	**200.8**	**11.1**	**5.0**	**771.4**	**38.4**	**40.6**	**1,067.3**
Accumulated depreciation and impairment							
At 1 January 2007	28.6	8.0	3.1	283.0	26.7	–	349.4
Charge for the year	3.9	0.7	0.8	40.8	3.1	–	49.3
Acquisition of subsidiaries	1.5	0.2	–	5.0	0.8	–	7.5
Impairment loss	–	–	–	0.2	–	–	0.2
Exchange differences	2.2	0.7	–	17.9	1.8	–	22.6
On assets reclassified as held for sale	(1.1)	–	–	–	–	–	(1.1)
Recategorisation	0.2	–	–	2.6	(2.9)	–	(0.1)
Eliminated on disposals	(0.7)	(0.2)	(0.1)	(25.2)	(2.2)	–	(28.4)
At 1 January 2008	34.6	9.4	3.8	324.3	27.3	–	399.4
Charge for the year	4.6	0.7	0.7	48.6	3.2	–	57.8
Acquisition of subsidiaries	–	–	0.3	5.6	0.5	–	6.4
Impairment loss	7.9	0.1	–	32.0	0.3	0.6	40.9
Exchange differences	10.4	2.2	–	80.5	5.5	0.1	98.7
On assets reclassified as held for sale	(2.3)	–	–	–	–	–	(2.3)
Recategorisation	6.7	–	0.3	(1.5)	4.9	–	10.4
Eliminated on disposals	(0.6)	–	–	(17.1)	(1.2)	–	(18.9)
Eliminated on disposal of subsidiaries	(2.9)	(8.6)	(2.9)	(33.5)	(10.5)	–	(58.4)
At 31 December 2008	**58.4**	**3.8**	**2.2**	**438.9**	**30.0**	**0.7**	**534.0**
Carrying amount							
At 31 December 2008	**142.4**	**7.3**	**2.8**	**332.5**	**8.4**	**39.9**	**533.3**
At 31 December 2007	132.6	9.2	8.0	321.4	10.2	27.5	508.9

The carrying amount of leased assets is £15.3m (2007: £13.7m). The Group has pledged land and buildings having a carrying amount of approximately £3.6m (2007: £5.5m) to secure banking facilities granted to the Group. At 31 December 2008 the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £15.9m (2007: £9.6m).

In addition to the above, property, plant and equipment amounting to £3.6m (2007: £1.8m) has been classified as held for sale.

Impairment losses are recognised with administration expenses.

14. Subsidiaries and associates

A list of the significant investments in subsidiaries, including the name, country of incorporation and proportion of ownership interest is given on pages 84 to 86. The Group's significant associate is disclosed in note 3 of the Company Financial Statements on page 80.

	2008 £m	2007 £m
Aggregated amounts relating to associates		
Total assets	**132.1**	108.6
Total liabilities	**189.5**	132.7
Revenues	**72.9**	65.6
Loss	**(14.8)**	(15.3)

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

	2008 £m	2007 £m
Operating profit	**–**	0.1
Less: Interest	**–**	–
Less: Tax	**–**	–
Share of results of associates prior to impairment	**–**	0.1
Interest in associates	**8.2**	0.6

15. Inventories

	2008 £m	2007 £m
Raw materials	**11.3**	11.2
Work-in-progress	**2.4**	8.2
Finished goods and goods for resale	**0.3**	0.4
	14.0	19.8

16. Finance lease receivables

	Minimum lease payments		Present value of minimum lease payments	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Amounts receivable under finance leases:				
Within one year	**0.4**	0.4	**0.4**	0.4
In the second to fifth years inclusive	**0.8**	1.1	**0.7**	1.0
	1.2	1.5	**1.1**	1.4
Less: unearned finance income	**(0.1)**	(0.1)		
Present value of minimum lease payments receivable	**1.1**	1.4		
Analysed as:				
Non-current finance lease receivables (recoverable after 12 months)			**0.7**	1.0
Current finance lease receivables (recoverable within 12 months)			**0.4**	0.4
			1.1	1.4
The present value of minimum lease payments is denominated in the following currencies:				
Euro			**0.7**	0.9
US Dollar			**0.4**	0.5
			1.1	1.4

The Group has entered into finance leasing arrangements with SSCP Coating Sàrl, an associated company, for 3 PVD machines. The average term of finance leases entered into is 7 years. Unguaranteed residual values of assets leased under finance leases at the balance sheet date are £1.1m (2007: £1.4m). The interest rate inherent in the leases is fixed at the contract date for the entire lease term. The average effective interest rate contracted approximates to 4.5% (2007: 4.4%). The fair value of the Group's finance lease receivables at 31 December 2008 is estimated at £1.1m (2007: £1.5m). The lease receivables are secured on the related assets.

17. Other financial assets

	2008 £m	2007 £m
Trade and other receivables		
Amounts falling due within one year:		
Amount receivable for the supply of services	**107.1**	133.6
Other debtors and prepayments	**21.3**	25.7
	128.4	159.3
Amounts falling due after more than one year:		
Other debtors and prepayments	**3.0**	13.3

The average credit period given to customers for the supply of services is 68 days (2007: 68 days). An allowance has been made for estimated irrecoverable amounts from the supply of services of £8.4m (2007: £7.2m). 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.

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 are set out in the Group Business Review on pages 3 to 12.

Included in the Group's trade receivable balance are debtors with a carrying amount of £30.5m (2007: £44.5m) 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:

	2008 £m	2007 £m
Amounts overdue by up to 1 month	**20.0**	27.0
Amounts overdue by 1-2 months	**5.8**	12.6
Amounts overdue by 2-3 months	**1.6**	2.7
Amounts overdue by more than 3 months	**3.1**	2.2
	30.5	44.5

Movement in the allowance for doubtful debts:

	2008 £m	2007 £m
Balance at 1 January	**7.2**	6.9
Impairment losses recognised	**4.3**	4.7
Allowance acquired with subsidiaries	**0.1**	0.4
Amounts written off as uncollectable	**(1.7)**	(2.4)
Impairment losses reversed	**(1.8)**	(2.8)
Allowance disposed with subsidiaries	**(1.5)**	–
Exchange differences	**1.8**	0.4
	8.4	7.2

17. Other financial assets continued

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 balance of £10.5m (2007: £9.0m). 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

	2008 £m	2007 £m
3-12 months	**6.2**	4.4
Over 12 months	**4.3**	4.6
	10.5	9.0

Bank and cash balances

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

	2008 £m	2007 £m
Sterling	**229.8**	4.4
US Dollar	**2.0**	5.9
Euro	**17.7**	14.2
Swedish Krona	**1.2**	1.2
United Arab Emirates Dirham	**–**	2.9
Czech Republic Koruna	**0.9**	1.7
Brazilian Real	**0.7**	0.6
Canadian Dollar	**0.7**	0.5
Danish Krone	**0.5**	1.6
Other	**4.9**	4.7
Total bank and cash balances	**258.4**	37.7

18. Borrowings

	2008 £m	2007 £m
Borrowings at amortised cost:		
Bank overdrafts	**8.9**	3.4
Non cumulative redeemable preference shares	**0.7**	–
Bank loans	**309.6**	227.4
	319.2	230.8

	2008 £m	2007 £m
The borrowings are repayable as follows:		
On demand or within one year	**16.3**	9.0
In the second year	**194.8**	0.8
In the third to fifth years	**107.7**	175.5
After five years	**0.4**	45.5
	319.2	230.8
Less: Amount due for settlement within 12 months (shown under current liabilities)	**(16.3)**	(9.0)
Amount due for settlement after 12 months	**302.9**	221.8

Analysis of borrowings by currency:

	Sterling £m	Euro £m	US$ £m	Swedish Krona £m	Swiss Franc £m	Other currencies £m	Total £m
At 31 December 2008							
Bank overdrafts	**–**	**7.7**	**0.4**	**0.5**	**–**	**0.3**	**8.9**
Non cumulative redeemable preference shares	**0.7**	**–**	**–**	**–**	**–**	**–**	**0.7**
Bank loans	**–**	**120.8**	**152.9**	**22.5**	**9.8**	**3.6**	**309.6**
	0.7	**128.5**	**153.3**	**23.0**	**9.8**	**3.9**	**319.2**
At 31 December 2007							
Bank overdrafts	0.4	0.2	0.3	1.5	–	1.0	3.4
Bank loans	3.0	94.7	98.2	16.8	7.1	7.6	227.4
	3.4	94.9	98.5	18.3	7.1	8.6	230.8

	2008 %	2007 %
The weighted average interest rates paid were as follows:		
Bank overdrafts and loans	**4.5**	5.1

Loans and finance leases of £4.6m (2007: £7.9m) 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.

18. Borrowings continued

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

	2008 £m	2007 £m
Bank overdrafts	**8.9**	3.4
Non cumulative redeemable preference shares	**0.7**	–
Bank loans	**309.6**	227.4

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

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

(ii) The Group has three principal loans which are secured by upstream guarantees provided by subsidiaries:

(a) Drawings of £194.8m (2007: £175.3m) under a Revolving Credit Facility of £225m. This unsecured facility commenced on 22 August 2005 for a period of five years. The multi currency drawings under this facility carry an interest rate of between 0.50% and 0.75% above LIBOR (the margin at 31 December 2008 was 0.55%).

(b) Drawings of £107.3m (2007: £44.1) under a Revolving Credit Facility of €125m. This unsecured facility commenced on 31 July 2006 for a period of seven years. The Euro drawings under this facility carry an interest rate of between 0.80% and 1.10% above LIBOR (the margin at 31 December 2008 was 0.9%).

(c) Letters of credit and loan drawings of £10.5m (2007: £4.6m) under a Revolving Credit and Letter of Credit Facility of $20m. This unsecured facility commenced on 17 August 2007 for a period of three years. The US Dollar drawings and Letter of Credit fees under this facility carry a margin/fee of between 0.50% and 0.75% above LIBOR (the margin/fee at 31 December 2008 was 0.55%).

At 31 December 2008 the Group had available £47.1m (2007: £102.9m) of undrawn committed borrowing facilities.

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

19. Derivative financial instruments

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

	Notional amount 2008 £m	**Fair value 2008 £m**	Notional amount 2007 £m	Fair value 2007 £m
Asset/(liability)				
Current				
Forward foreign exchange contracts	**(50.4)**	**1.6**	11.6	–
Cross currency swaps - fixed/fixed	**46.1**	**(17.1)**	23.6	(1.8)
Cross currency swaps - floating/floating	**39.7**	**(9.0)**	51.6	(3.4)
	35.4	**(24.5)**	86.8	(5.2)
Non-current				
Cross currency swaps - fixed/fixed	**2.1**	**(0.2)**	41.7	(2.7)
Cross currency swaps - floating/floating	**20.5**	**(5.0)**	13.3	(0.2)
	22.6	**(5.2)**	55.0	(2.9)
Total				
Forward foreign exchange contracts	**(50.4)**	**1.6**	11.6	–
Cross currency swaps - fixed/fixed	**48.2**	**(17.3)**	65.3	(4.5)
Cross currency swaps - floating/floating	**60.2**	**(14.0)**	64.9	(3.6)
	58.0	**(29.7)**	141.8	(8.1)

19. Derivative financial instruments continued

The Group utilises currency derivatives to hedge material future transactions and cash flows. The Group uses foreign currency forward contracts in the management of its exchange rate exposures. The contracts are primarily denominated in the currencies of the Group's principal markets. The unrecognised gains and losses were not material either in 2008 or 2007.

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

At the balance sheet date the Group had entered into foreign currency denominated cross currency swaps that were designated as a hedging instrument for the purposes of hedging the translation of its foreign operations. The contracts are entered into either with both currencies at floating interest rates (generally based on 3 month LIBOR interest rates) or both currencies at fixed interest rates. The details are:

	Sterling 2008 £m	**Euro 2008 £m**	**US Dollar 2008 £m**	**Swedish Krona 2008 £m**	**Danish Krone 2008 £m**	**Canadian Dollar 2008 £m**	**Swiss Franc 2008 £m**	**Singapore Dollar 2008 £m**	**Total fair value 2008 £m**
Asset/(liability)									
Forward foreign exchange contracts	**(50.4)**	**1.2**	**50.1**	**(4.8)**	**–**	**3.0**	**–**	**2.5**	**1.6**
Fixed/fixed	**48.2**	**(53.1)**	**–**	**(4.8)**	**–**	**(3.0)**	**(4.6)**	**–**	**(17.3)**
Floating/floating	**60.2**	**(56.0)**	**–**	**(3.5)**	**(6.5)**	**(3.2)**	**(5.0)**	**–**	**(14.0)**
Total	**58.0**	**(107.9)**	**50.1**	**(13.1)**	**(6.5)**	**(3.2)**	**(9.6)**	**2.5**	**(29.7)**
On demand or within one year	**35.4**	**(85.7)**	**50.1**	**(13.1)**	**(3.2)**	**(3.2)**	**(7.3)**	**2.5**	**(24.5)**
In the second year	**22.6**	**(22.2)**	**–**	**–**	**(3.3)**	**–**	**(2.3)**	**–**	**(5.2)**
	58.0	**(107.9)**	**50.1**	**(13.1)**	**(6.5)**	**(3.2)**	**(9.6)**	**2.5**	**(29.7)**

	Sterling 2007 £m	Euro 2007 £m	US Dollar 2007 £m	Swedish Krona 2007 £m	Danish Krone 2007 £m	Canadian Dollar 2007 £m	Swiss Franc 2007 £m	Singapore Dollar 2007 £m	Total fair value 2007 £m
Asset/(liability)									
Fixed/fixed	65.3	(58.4)	–	(3.3)	–	(6.6)	(1.5)	–	(4.5)
Floating/floating	64.9	(31.6)	–	(17.7)	(4.9)	(9.3)	(5.0)	–	(3.6)
Total	130.2	(90.0)	–	(21.0)	(4.9)	(15.9)	(6.5)	–	(8.1)
On demand or within one year	77.5	(42.5)	–	(21.0)	(4.9)	(9.3)	(5.0)	–	(5.2)
In the second year	52.7	(47.5)	–	–	–	(6.6)	(1.5)	–	(2.9)
	130.2	(90.0)	–	(21.0)	(4.9)	(15.9)	(6.5)	–	(8.1)

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.

Additional information on financial instruments is given in the Group Business Review on pages 3 to 12.

20. 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 2007	62.0	0.2	(9.1)	(7.6)	45.5
Charge/(credit) to income	2.5	(1.6)	0.4	(4.6)	(3.3)
Charge to equity	–	–	2.8	–	2.8
Acquisition of subsidiaries	0.4	–	(0.2)	(0.4)	(0.2)
Exchange differences	2.4	(0.8)	(0.7)	1.0	1.9
Effect of change in tax rate:					
Income statement	(2.4)	–	0.1	(0.1)	(2.4)
Equity	–	–	0.3	–	0.3
At 1 January 2008	64.9	(2.2)	(6.4)	(11.7)	44.6
Credit to income	(8.4)	(7.9)	(0.2)	(13.7)	(30.2)
Credit to equity	–	–	(2.1)	(0.1)	(2.2)
Acquisition of subsidiaries	0.6	(0.1)	–	(0.8)	(0.3)
Disposal of subsidiaries	(1.7)	1.2	0.3	6.0	5.8
Transfers	–	1.1	–	0.2	1.3
Exchange differences	15.7	(1.4)	(0.5)	(7.0)	6.8
Effect of change in tax rate:					
Income statement	–	–	–	–	–
Equity	–	–	–	–	–
At 31 December 2008	**71.1**	**(9.3)**	**(8.9)**	**(27.1)**	**25.8**

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

	2008 £m	2007 £m
Deferred tax liabilities	**78.3**	74.3
Deferred tax assets	**(52.5)**	(29.7)
	25.8	44.6

At the balance sheet date, the Group has unused tax losses of £115.0m (2007: £18.2m) available for offset against future profits. A deferred tax asset has been recognised in respect of £42.2m (2007: £16.7m) 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 £72.8m (2007: £1.5m) of such losses. All losses may be carried forward indefinitely.

At the balance sheet date, the aggregate amount of undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £601.9m (2007: £474.0m). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future. Temporary differences arising in connection with interests in associates and joint ventures are insignificant.

21. Obligations under finance leases

	Minimum lease payments 2008 £m	Minimum lease payments 2007 £m	Present value of minimum lease payments 2008 £m	Present value of minimum lease payments 2007 £m
Amounts payable under finance leases:				
Within one year	**1.5**	2.0	**1.2**	1.7
In the second to fifth years inclusive	**2.8**	3.4	**2.3**	2.7
After five years	**0.4**	0.8	**0.4**	0.7
	4.7	6.2	**3.9**	5.1
Less: future finance charges	**(0.8)**	(1.1)		
Present value of lease obligations	**3.9**	5.1		

	2008 £m	2007 £m
Analysed as:		
Amount due for settlement after 12 months	**2.7**	3.4
Amount due for settlement within 12 months (shown as current liabilities)	**1.2**	1.7
	3.9	5.1

	2008 £m	2007 £m
The present value of minimum lease payments were denominated in the following currencies:		
Euro	**1.4**	2.6
Sterling	**0.8**	0.8
Danish Krone	**0.8**	0.7
US Dollar	**0.7**	0.7
Other	**0.2**	0.3
	3.9	5.1

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 2008, the average effective borrowing rate was 7.8% (2007: 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.

22. Other financial liabilities

	2008 £m	2007 £m
Trade and other payables		
Amounts falling due within one year:		
Trade creditors	**42.6**	43.7
Other taxes and social security	**16.1**	18.5
Other creditors	**16.0**	12.2
Accruals and deferred income	**44.2**	50.1
	118.9	124.5
Amounts falling due after more than one year:		
Other creditors	**9.4**	6.8

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 53 days (2007: 53 days). The Directors consider that the carrying amount of trade payables approximates to their fair value.

22. Other financial liabilities continued

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

	Less than 1 year 2008 £m	**1-2 years 2008 £m**	**2-5 years 2008 £m**	**5+ years 2008 £m**	**Total 2008 £m**
Non-interest bearing	**146.1**	**11.6**	**7.4**	**5.9**	**171.0**
Finance lease liability	**1.5**	**1.5**	**1.2**	**0.5**	**4.7**
Bank loans and overdrafts	**337.6**	**0.1**	**0.4**	**0.4**	**338.5**
Derivative financial instruments	**175.5**	**28.9**	**–**	**–**	**204.4**
	660.7	**42.1**	**9.0**	**6.8**	**718.6**

	Less than 1 year 2007 £m	1-2 years 2007 £m	2-5 years 2007 £m	5+ years 2007 £m	Total 2007 £m
Non-interest bearing	130.2	4.5	1.2	3.3	139.2
Finance lease liability	1.9	1.4	2.0	0.7	6.0
Bank loans and overdrafts	273.9	0.9	0.3	1.4	276.5
Derivative financial instruments	93.9	61.9	–	–	155.8
	499.9	68.7	3.5	5.4	577.5

Of the £338.5m (2007: £276.5m) bank loan and overdraft outflows disclosed above, £194.8m (2007: £175.3m) and £107.3m (2007: £44.1m) of bank loans are drawn under committed facilities maturing on 22 August 2010 and 31 July 2013 respectively. The overdrafts are on-demand and largely part of pooling arrangements, which include offsetting cash balances. Of the £204.4m (2007: £155.8m) derivative financial instrument outflows disclosed above, £174.0m (2007: £148.6m) are matched by derivative cash inflows.

23. Provisions

	Restructuring provision £m	Environ-mental £m	Total £m
At 1 January 2008	1.6	6.3	7.9
Increase of provision	23.6	11.3	34.9
Release of provision	–	(0.1)	(0.1)
Utilisation of provision	(2.6)	(1.6)	(4.2)
Exchange difference	1.6	2.6	4.2
At 31 December 2008	**24.2**	**18.5**	**42.7**
Included in current liabilities			27.2
Included in non-current liabilities			15.5
			42.7

The restructuring provision relates to the remaining costs associated with the closure of various Heat Treatment sites. Further details are contained in the Group Business Review. The Group provides for the costs of environmental remediation that have been identified, either as part of acquisition due diligence, or in other circumstances where remediation by the Group is required. This provision is reviewed annually. Cash outflows in respect of these liabilities are expected to occur within five years.

24. Share capital

	2008 £m	2007 £m
Authorised:		
248,947,368 ordinary shares of 17 3⁄11p each (2007: 430,000,000 ordinary shares of 10p each)	**43.0**	43.0
325,000,000 B shares of 40p each (2007: Nil)	**130.0**	–

	Number of shares	£m
Ordinary shares:		
At 1 January 2008	323,673,223	32.4
Exercise of share options (see note 30)	244,173	–
Effect of share consolidation	(136,386,272)	–
At 31 December 2008	**187,531,124**	**32.4**
B shares (Non cumulative redeemable preference shares of 40p each):		
Issued	323,538,574	129.4
Converted to deferred shares	(70,328,634)	(28.1)
Purchased and cancelled	(251,551,315)	(100.6)
At 31 December 2008	**1,658,625**	**0.7**
Deferred shares:		
Converted from B shares	70,328,634	28.1
Purchased and cancelled	(70,328,634)	(28.1)
At 31 December 2008	**–**	**–**
Share capital classified as equity at 31 December 2008		32.4
Share capital classified as debt at 31 December 2008		0.7
Total share capital at 31 December 2008		**33.1**

During the year the Group issued £129.4m of B shares out of the share premium account. The B shares could be converted into deferred shares with a negligible value in return for a dividend of 40p per share or redeemed for 40p per share in cash. £0.2m of associated costs were charged to the share premium account

321.9 million B shares were redeemed on 16 December 2008, including 70.3 million B shares which had been converted into deferred shares and, as a result, £128.7m was transferred from retained earnings to a capital redemption reserve.

25. Reserves

	Share premium £m	Own shares £m	Other reserves £m	Hedging and translation reserves £m	Retained earnings £m	Total £m
At 1 January 2007	302.1	(2.4)	3.8	4.4	109.4	417.3
Premium arising on issue of equity shares	2.9	–	–	–	–	2.9
Acquired in the year/settlement of share options	–	(8.6)	–	–	–	(8.6)
Share-based payments	–	–	2.5	–	–	2.5
Release of revaluation reserve on disposal of assets	–	–	(0.3)	–	0.3	–
Exchange differences on translation of overseas operations	–	–	–	22.2	–	22.2
Movement on hedges of net investments	–	–	–	(9.7)	–	(9.7)
Dividends paid	–	–	–	–	(23.4)	(23.4)
Net profit for the year	–	–	–	–	52.8	52.8
Other items taken directly to equity	–	–	–	–	1.6	1.6
At 1 January 2008	305.0	(11.0)	6.0	16.9	140.7	457.6
Premium arising on issue of equity shares (net of expenses)	0.3	–	–	–	–	0.3
Return of capital to shareholders and redemption of B shares	(129.6)	–	128.7	–	–	(0.9)
Acquired in the year/settlement of share options	–	0.1	–	–	–	0.1
Share-based payments	–	–	2.6	–	–	2.6
Exchange differences on translation of overseas operations	–	–	–	183.3	–	183.3
Movement on hedges of net investments	–	–	–	(169.1)	–	(169.1)
Dividends paid	–	–	–	–	(154.9)	(154.9)
Net profit for the year	–	–	–	–	149.8	149.8
Other items taken directly to equity	–	–	–	–	(9.2)	(9.2)
At 31 December 2008	**175.7**	**(10.9)**	**137.3**	**31.1**	**126.4**	**459.6**

Included in other reserves is the capital redemption reserve arising on redemption of the Group's B shares of £128.7m (2007: £Nil). The own shares reserve represents the cost of shares in Bodycote PLC purchased in the market, 2,490,760 ordinary shares of 17 3⁄11p each of which are held by the Bodycote International Employee Benefit Trust (2007: 3,112,931 ordinary shares of 10p each) to satisfy share-based payments under the Group's incentive schemes (see note 30).

Minority interest

	2008 £m	2007 £m
At 1 January	**6.6**	4.4
Share of profits for the year	**0.9**	1.0
On acquisition of subsidiaries	**–**	0.8
On disposal of subsidiaries	**(3.8)**	–
Sale of minority interest	**0.5**	–
Purchase of minority interest	**–**	(0.1)
Dividend paid to minority shareholder	**(0.1)**	(0.1)
Exchange difference	**0.8**	0.6
At 31 December	**4.9**	6.6

26. Disposal of subsidiaries

As referred to in note 8, on 17 October 2008 the Group disposed of its Testing business.

The net assets of the Testing business at the date of disposal and at 31 December 2007 were as follows:

	17 October 2008 £m	31 December 2007 £m
Intangible fixed assets	**2.9**	3.4
Interests in associates	**0.2**	0.1
Deferred tax asset	**8.0**	7.0
Property, plant and equipment	**72.7**	60.9
Inventories	**8.6**	5.1
Trade and other receivables	**64.4**	47.5
Bank balances and cash	**16.3**	17.7
Assets classified as held for sale	**1.2**	-
Finance leases	**(0.1)**	(0.2)
Retirement benefit obligation	**(1.3)**	(1.2)
Deferred tax liability	**(2.2)**	(2.0)
Current tax liability	**(0.8)**	(3.3)
Trade and other payables	**(24.9)**	(31.5)
Bank overdraft	**(0.4)**	(3.9)
Attributable goodwill	**75.9**	67.0
	220.5	166.6
Less: Minority interest	**(3.8)**	
Net assets disposed	**216.7**	
Directly attributable costs of disposal	**19.6**	
Gain on disposal	**199.3**	
Total consideration	**435.6**	
Satisfied by:		
Cash	**435.6**	
Net cash inflow arising on disposal:		
Cash consideration	**435.6**	
Cash and cash equivalents disposed of	**(15.9)**	
Net consideration	**419.7**	
Directly attributable costs of disposal	**(19.6)**	
	400.1	

The impact of the Testing business on the Group's results in the current and prior year is disclosed in note 8.

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27. Acquisition of subsidiaries

The Group acquired the following subsidiaries during the year:

Interest	Date of acquisition	% of shares acquired	Principal activity
Accutest Laboratories Limited	25 Jan 2008	100.0	Testing
Metlab (Int.) Limited	08 Feb 2008	100.0	Testing
Plasma & Thermal Coatings Limited	29 Feb 2008	100.0	Thermal Processing
SAP Engineering Limited	03 Mar 2008	100.0	Thermal Processing
Centech SA	10 Mar 2008	100.0	Testing
Rotterdam Paint Consultants BV	30 May 2008	100.0	Testing
Orange County Materials Test Laboratory Inc.	31 May 2008	100.0	Testing

In addition the Group acquired the following businesses during the year:

Interest	Date of acquisition	Principal activity
Brandhaus Höchst (Fire Testing division of Siemens AG)	30 May 2008	Testing
Karl Bertelmann Härterei-Betrieb GmbH & Co Kg	01 Aug 2008	Thermal Processing

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

	Thermal Processing £m	Testing £m	Total Group £m
Book value and fair value of net assets acquired:			
Deferred tax assets/(liabilities)	0.3	–	0.3
Property, plant and equipment	2.3	2.1	4.4
Inventories	0.7	0.5	1.2
Trade and other receivables	2.6	2.4	5.0
Cash and cash equivalents	0.8	1.9	2.7
Trade and other payables	(3.5)	(1.6)	(5.1)
Current tax liability	(0.3)	(0.2)	(0.5)
Bank loans	(0.1)	(0.4)	(0.5)
Finance leases	(0.3)	(0.1)	(0.4)
	2.5	4.6	7.1
Goodwill	14.8	10.1	24.9
Total consideration	17.3	14.7	32.0
Satisfied by:			
Cash	17.2	14.4	31.6
Directly attributable costs	0.1	0.3	0.4
	17.3	14.7	32.0
Net cash outflow arising on acquisition:			
Cash consideration	17.3	14.7	32.0
Cash and cash equivalents acquired	(0.8)	(1.9)	(2.7)
	16.5	12.8	29.3

The goodwill arising on the acquisitions is attributable to the anticipated profitability of the distribution of the Group's services in new markets and the anticipated future operating synergies from the combination. The acquired businesses contributed £10.4m revenue and £3.2m to the Group's profit before tax 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 revenues for continuing operations for the year would have been £554.4m and Group profit attributable to equity holders of the parent would have been £150.0m.

28. Notes to the cash flow statement

	2008 £m	2007 £m
Profit for the year	**150.7**	53.8
Adjustments for:		
Investment revenues - continuing and discontinued	**(5.7)**	(3.3)
Finance costs - continuing and discontinued	**15.7**	13.6
Taxation - continuing and discontinued	**6.8**	14.7
Depreciation of property, plant and equipment	**57.8**	49.3
Amortisation of intangible assets	**2.9**	2.3
Loss/(gain) on disposal of property, plant and equipment	**0.1**	(0.1)
Income from associates	**–**	(0.1)
Share-based payments	**2.6**	2.5
Impairment of intangible assets acquired through business combinations	**–**	0.4
Impairment of goodwill	**31.9**	7.2
Major facility closure costs	**42.7**	5.4
Impairment of loan due from associate	**12.1**	–
Gain on disposal of discontinued operations	**(199.3)**	–
Change to pension scheme rules	**–**	(4.1)
Bid response costs	**–**	2.1
EBITDA*	**118.3**	143.7
Decrease/(increase) in inventories	**1.5**	(3.7)
Decrease/(increase) in receivables	**2.3**	(8.4)
Decrease in payables	**(16.8)**	(2.9)
Increase/(decrease) in provisions	**30.6**	(5.4)
Cash generated by operations	**135.9**	123.3
Cash (outflow)/inflow from settlement of derivative financial instruments	**(12.9)**	0.7
Income taxes paid	**(20.5)**	(16.0)
Net cash from operating activities	**102.5**	108.0

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

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

29. Operating lease arrangements - the Group as lessee

	2008 £m	2007 £m
Minimum lease payments under operating leases recognised as an expense	**11.6**	15.2

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:

	2008 £m	2007 £m
Within one year	**9.5**	13.3
In the second to fifth years inclusive	**23.3**	29.6
After five years	**13.6**	11.1
	46.4	54.0

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

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

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

Date of grant	Option price in pence	Exercise period	No of options outstanding 2008	2007
Jan-98	353.06	2001-2008	–	184,447
May-98	475.92	2001-2008	–	33,688
Oct-98	285.18	2001-2008	–	189,023
Apr-99	370.26	2002-2009	**167,108**	175,129
Dec-99	292.19	2002-2009	**58,823**	58,823
May-00	231.42	2003-2010	**324,985**	342,095
Apr-01	203.37	2004-2011	**572,975**	639,810
Apr-01	203.37	2004-2008*	–	21,390
Sep-02	125.76	2005-2012	**295,495**	359,667
Sep-02	125.76	2005-2009*	**25,349**	25,349
Sep-03	147.27	2006-2013	**568,067**	702,614
			2,012,802	2,732,035

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

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

Movements in share options are summarised as follows:

	2008 Number of shares under option	**2008 Weighted average exercise price pence**	2007 Number of shares under option	2007 Weighted average exercise price pence
Outstanding at beginning of the year	**2,732,035**	**210.50**	4,854,096	219.98
Exercised during the year	**(244,173)**	**152.06**	(1,505,161)	203.23
Expired during the year	**(475,060)**	**322.56**	(619,900)	302.85
Outstanding and exercisable at the end of the year	**2,012,802**	**197.04**	2,732,035	210.50

The weighted average share price at the date of exercise for share options exercised during the year was 180.91 pence. The options outstanding at 31 December 2008 had a weighted average exercise price of 197.04 pence, and a weighted average remaining contractual life of 2.3 years. The average share price during the year was 193.59 pence.

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

		2008	2007
Weighted average share price	pence	**157.5**	157.5
Weighted average exercise price	pence	**157.5**	157.5
Expected volatility		**0.4**	0.4
Expected life	years	**3.0**	3.0
Risk-free rate	%	**4.0**	4.0
Expected dividends	%	**4.3**	4.3

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

The Group recognised total expenses of £2.6m (2007: £2.5m) related to equity-settled share-based payment transactions.

31. Retirement benefit obligations

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

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

	2008 £m	2007 £m
UK Scheme	**0.7**	13.4
American Schemes	**1.0**	0.2
European Schemes	**13.2**	10.3
	14.9	23.9

Total expense recognised in income statement

	2008 £m	2007 £m
UK Scheme	**1.5**	(2.4)
American Schemes	**(0.1)**	–
European Schemes	**0.5**	0.7
	1.9	(1.7)

Further details of the Group's defined benefit pension arrangements are given in the Group Business Review on page 8.

UK Scheme

The Company sponsors the Bodycote International UK Pension Scheme which is a funded defined benefit arrangement for UK employees. The last full actuarial valuation of the scheme was carried out by a qualified independent actuary as at 6 April 2008 and updated on an approximate basis to 31 December 2008.

The contributions made by the employer over the financial year have been £24.1m, comprising £0.9m in respect of benefit accrual, £2.2m in respect of ongoing deficit payments and £21.0m as a result of the sale of the Testing business. This level of contribution has been reviewed following the triennial valuation of the scheme completed as at 6 April 2008 and it is expected that the deficit will be extinguished by December 2015.

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 the statement of recognised income and expense.

31. Retirement benefit obligations continued

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

	2008 £m	2007 £m
Defined benefit obligation at start of year	**61.0**	67.2
Current service cost	**1.1**	1.3
Interest cost	**3.4**	3.2
Past service credit	**–**	(4.1)
Contributions by plan participants	**0.6**	0.6
Actuarial gain	**(0.6)**	(4.9)
Benefits paid, death in service insurance premiums and expenses	**(1.8)**	(2.3)
Defined benefit obligation at end of year	**63.7**	61.0

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

	2008 £m	2007 £m
Fair value of assets at start of year	**47.6**	43.9
Expected return on assets	**3.0**	2.8
Actuarial loss	**(10.7)**	(0.8)
Contributions by employer	**24.1**	3.3
Contributions by plan participants	**0.6**	0.6
Benefits paid, death in service insurance premiums and expenses	**(1.6)**	(2.2)
Fair value of assets at end of year	**63.0**	47.6

Total expense recognised in the income statement

	2008 £m	2007 £m
Current service cost	**1.1**	1.3
Interest on pension scheme liabilities	**3.4**	3.2
Past service credit	**–**	(4.1)
Expected return on pension scheme assets	**(3.0)**	(2.8)
Total expense	**1.5**	(2.4)

The cumulative amount of actuarial losses recognised in the statement of recognised income and expense since adoption of IAS 19 is £10.2m.

31. Retirement benefit obligations continued

Assets

	2008	2007	2006
	£m	£m	£m
Equities	**22.1**	29.2	28.1
Bonds	**14.9**	11.7	9.6
Short-term treasury bonds	**21.0**	–	–
Cash	**0.6**	0.5	3.2
With profits insured policy	**0.3**	1.5	3.0
Hedge funds	**4.1**	4.7	–
	63.0	47.6	43.9

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 cash is equal to bank base rates at the balance sheet date. The expected return on bonds is determined by reference to UK long dated gilt and bond yields at the balance sheet date. The expected rate of return on equities and property have been determined by setting an appropriate risk premium above gilt/bond yields having regard to market conditions at the balance sheet date. The £21m, paid in December 2008 as a result of the sale of the Testing business, is currently invested in Short-Term Treasury Bonds. The Trustees are due to complete an investment strategy review in March 2009 after which it is likely that the £21m will be invested broadly in line with the rest of the fund. As such, although this investment has been classed as 'Short-Term Treasury Bonds', the expected return for these assets represents an average of the current holding in Short-Term Treasury Bonds and the likely return on assets that will be held post the review in March 2009.

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

	2008	2007	2006
	% per annum	% per annum	% per annum
Equities	**6.6**	7.4	7.5
Bonds	**4.8**	5.0	4.8
Short-term treasury bonds	**5.5**	–	–
With profits insured policy	**4.8**	5.1	4.6
Hedge funds	**6.6**	7.4	–
Cash	**1.5**	5.5	5.0
Overall for scheme	**5.7**	6.7	6.3

Actual return on plan assets

The actual return on the plan assets over the year ended 31 December 2008 was -16.0%.

Assumptions

	2008	2007	2006
	% per annum	% per annum	% per annum
Inflation	3.15	3.35	3.0
Salary increases	3.0	3.0	4.25
Rate of discount	6.0	5.6	5.0
Allowance for pension in payment increases of RPI or 5% p.a. if less	3.1	3.35	3.0
Allowance for revaluation of deferred pensions of RPI or 5% p.a. if less	3.15	3.65	3.0

Mortality - current pensioners			
Actuarial tables used	**pa 92 YOB MC 1% underpin**	pa 92 YOB MC	pa 92 YOB MC
Life expectancy for members currently aged 65	**22.5**	21.9	21.8
Mortality - future pensioners			
Actuarial tables used	**pa 92 YOB MC 1% underpin**	pa 92 YOB MC	pa 92 YOB MC
Life expectancy at age 65 for members currently aged 40	**24.0**	23.2	23.2

31. Retirement benefit obligations continued

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

	2008 £m	2007 £m	2006 £m
Present value of defined benefit obligation	**(63.7)**	(61.0)	(67.2)
Fair value of plan assets	**63.0**	47.6	43.9
Deficit in the scheme	**(0.7)**	(13.4)	(23.3)

As all actuarial gains and losses are recognised, the deficit shown above at 31 December 2008 is that recognised in the balance sheet.

The best estimate of contributions to be paid into the plan for the year ending 31 December 2009 is £0.9m.

Amounts for the current and previous four years

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Fair value of assets	**63.0**	47.6	43.9	37.7	30.0
Defined benefit obligation	**(63.7)**	(61.0)	(67.2)	(59.5)	(50.7)
Deficit in the scheme	**(0.7)**	(13.4)	(23.3)	(21.8)	(20.7)
(Gain)/loss from experience adjustment on plan liabilities	**0.4**	(0.1)	–	0.4	0.1
Experience adjustment on plan assets	**(10.7)**	(0.8)	0.7	4.5	0.9
Gain/(loss) from the effects of changes in the demographic and financial assumptions underlying the present value of the plan liabilities	**1.0**	4.8	(3.8)	(6.0)	(9.4)

Combined American disclosures

The Group sponsors three defined benefit pension arrangements in the USA. These are Metallurgical Inc Pension Plan, Combined Bodycote Pension Plan and the Supplemental Retirement Plan. All are closed to new accrual. The last full actuarial valuation of these schemes was carried out by a qualified independent actuary as at 1 January 2008 (31 December 2008 for the Metallurgical Plan) and updated on an approximate basis to 31 December 2008. Contributions made by the Company over the year were $0.2m. The Group also operates a defined benefit scheme for 3 employees in Brazil.

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

	2008 £m	2007 £m
Defined benefit obligation at start of year	**2.7**	2.6
Current service cost	**–**	–
Interest cost	**0.3**	0.2
Actuarial gain	**–**	(0.1)
Acquisition	**–**	–
Benefits paid, death in service insurance premiums and expenses	**(0.1)**	(0.1)
Exchange rate loss	**0.8**	0.1
Defined benefit obligation at end of year	**3.7**	2.7

31. Retirement benefit obligations continued

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

	2008 £m	2007 £m
Fair value of assets at start of year	**2.5**	2.2
Expected return on assets	**0.4**	0.2
Actuarial loss	**(0.6)**	–
Contributions by employer	**0.2**	0.2
Benefits paid, death in service insurance premiums and expenses	**(0.1)**	(0.1)
Acquisition	**–**	–
Exchange rate gain	**0.3**	–
Fair value of assets at end of year	**2.7**	2.5

Total expense recognised in the income statement

	2008 £m	2007 £m
Current service cost	**–**	–
Interest on pension scheme liabilities	**0.3**	0.2
Expected return on pension scheme assets	**(0.4)**	(0.2)
Total expense	**(0.1)**	–

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

Assets

	2008 £m	2007 £m	2006 £m
Equities	**1.3**	1.4	1.3
Bonds	**0.8**	0.5	0.3
Cash	**–**	0.1	0.3
Insurance contracts	**0.6**	0.5	0.3
	2.7	2.5	2.2

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 bonds is a weighted average of real return of 3.3% on long duration bonds and 5.0% on high yield bonds. The expected return on equities is a weighted average of 6.0% real return on US large caps, 6.5% real return on US small caps, 6.0% real return on international. These returns were then adjusted to reflect 2.25% inflation, and a rebalancing/diversification adjustment. The expected rate of return on insurance contracts in Brazil has been calculated based on 10.24% per annum in line with the expected return on the policies held in Brazil.

31. Retirement benefit obligations continued

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

	2008 % per annum	2007 % per annum	2006 % per annum
Equities	**9.15**	9.8	9.1
Bonds	**6.36**	6.5	5.0
Cash	**–**	5.2	5.0
Insurance policy	**10.24**	10.2	10.2
Overall for scheme	**8.6**	9.0	8.1

Actual return on plan assets

The actual return on the plan assets over the year ending 31 December 2008 was -27%.

Assumptions

	USA 2008 % per annum	**Brazil 2008 % per annum**
Salary increases	**–**	**6.1**
Rate of discount	**6.25**	**10.24**
Price inflation	**2.25**	**4.0**

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

	2008 £m	2007 £m	2006 £m
Defined benefit obligation	**(3.7)**	(2.7)	(2.6)
Fair value of plan assets	**2.7**	2.5	2.2
Deficit in scheme	**(1.0)**	(0.2)	(0.4)

As all actuarial gains and losses are recognised, the deficit shown above at 31 December 2008 is that recognised in the balance sheet.

The best estimate of contributions to be paid into the plan for the year ending 31 December 2009 is £1.1m.

Amounts for the current and previous four years

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Fair value of assets	**2.7**	2.5	2.2	1.9	1.7
Defined benefit obligation	**(3.7)**	(2.7)	(2.6)	(2.9)	(2.6)
Deficit in the schemes	**(1.0)**	(0.2)	(0.4)	(1.0)	(0.9)
(Gain)/loss from experience adjustment on plan liabilities	**–**	–	–	–	0.2
Experience adjustment on plan assets	**(0.6)**	0.1	0.3	–	0.1
Gain/(loss) from the effects of changes in the demographic and financial assumptions underlying the present value of the plan liabilities	**–**	–	0.3	–	–

31. Retirement benefit obligations continued

Continental European schemes

The Group operates defined benefit pension, post retirement and long-service arrangements for certain employees in France, Germany, Italy, Sweden, Turkey, Switzerland and Liechtenstein.

The pension plans in Switzerland and Liechtenstein have previously been accounted for on a defined contribution basis but the Group has decided to recognise the underlying defined benefit guarantees in the balance sheet at 31 December 2008.

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

	2008 £m	2007 £m
Defined benefit obligation at start of year	**11.9**	10.6
Current service cost	**0.5**	0.3
Interest cost	**0.8**	0.5
Actuarial loss/(gain)	**4.2**	(0.3)
Benefits paid	**(1.1)**	(1.0)
Curtailments	**–**	(0.1)
Acquisitions	**–**	1.2
Settlements	**(2.5)**	–
Employee contributions	**0.2**	–
Exchange rate loss	**4.9**	0.7
Defined benefit obligation at end of year	**18.9**	11.9

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

	2008 £m	2007 £m
Fair value of assets at start of year	**1.6**	1.5
Expected return on assets	**0.1**	–
Actuarial gain	**3.5**	–
Benefits paid	**(0.1)**	–
Contributions by employer	**0.2**	–
Contributions by employees	**0.2**	–
Settlement	**(1.8)**	–
Exchange rate gain	**2.0**	0.1
Fair value of assets at end of year	**5.7**	1.6

Total expense recognised in the income statement

	2008 £m	2007 £m
Current service cost	**0.5**	0.3
Interest on pension scheme liabilities	**0.8**	0.5
Expected return on pension scheme assets	**(0.1)**	–
Settlement gain on disposal	**(0.7)**	–
Curtailments	**–**	(0.1)
Total expense	**0.5**	0.7

The cumulative amount of actuarial losses recognised in the statement of recognised income and expense since adoption of IAS 19 is £0.6m. The asset held is an insurance contract in respect of the pension plans in Switzerland and Liechtenstein. The expected long term return on this asset is 2.5% per annum.

31. Retirement benefit obligations continued

Assumptions

	France 2008 % per annum	Germany 2008 % per annum	Italy 2008 % per annum	Sweden 2008 % per annum	Turkey 2008 % per annum	Liechtenstein 2008 % per annum	Switzerland 2008 % per annum
Salary increases	4.0	2.5	–	3.0	–	2.5	3.0
Rate of discount	5.75	5.85	5.53	4.0	12.0	3.25	3.25
Price inflation	2.20	–	2.4	2.0	5.4	–	–
Pensions increases	–	1.75	–	2.75	–	–	–

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

	2008 £m	2007 £m	2006 £m
Defined benefit obligation	**(18.9)**	(11.9)	(10.6)
Fair value of plan assets	**5.7**	1.6	1.5
Deficit in the schemes	**(13.2)**	(10.3)	(9.1)
(Gain)/loss from the effects in changes in assumptions underlying the present value of the liabilities	**0.5**	1.2	–
Gain/(loss) from experience adjustment on plan liabilities	**(3.7)**	(0.9)	0.6
Experiemce adjustment on plan assets	**3.5**	–	–
Gain on acquisition	**–**	–	0.4

As all actuarial gains and losses are recognised, the deficit shown above at 31 December 2008 is that recognised in the balance sheet. The only funded plans are those operated in Switzerland and Liechtenstein. The best estimate of contributions to be paid into the plans for the year ending 31 December 2009 is £0.2m.

32. Related party transactions

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

Trading transactions

During the year, Group companies entered into the following transactions with related parties who are not members of the Group, namely SSCP Coatings S.à.r.l. and the Thai Induction Services Company Ltd:

	Sale of goods and services		Purchase of goods and services		Amounts owed by related parties		Amounts owed to related parties	
	2008 £m	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m
Associates	**3.1**	2.0	**0.2**	0.1	**18.2**	12.2	**–**	–

Sales of goods and services include payments received from finance leases (see note 16) the provision of management services and interest receivable. All transactions were made at arm's length. The amounts outstanding will be settled in cash, of which £1.9m is secured. No guarantees have been given or received. £16.0m of provisions have been made for doubtful debts of which £14.9m (2007: £1.1m) was expensed during the year in respect of the amounts owed by related parties. The remuneration of the Board of Directors, who are considered key management personnel of the Group was as follows:

	2008 £m	2007 £m
Short-term employee benefits	**1.9**	1.5
Share-based payments	**0.3**	0.2
	2.2	1.7

Further information about the remuneration of the individual directors is provided in the Board Report on Remuneration on pages 22 to 27.

Five Year Summary

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Revenue					
Existing operations	**551.8**	465.2	413.9	384.4	360.8
Discontinued operations	**164.9**	175.3	144.7	88.0	96.4
Revenue - continuing and discontinued operations	**716.7**	640.5	558.6	472.4	457.2
Profit for continuing and discontinued operations:					
Headline operating profit	**91.7**	91.3	79.7	67.8	53.1
Share of results of associates' interest and tax	**–**	–	(0.6)	(0.8)	–
Amortisation and impairment of goodwill and intangible fixed assets	**(33.8)**	(9.1)	(7.0)	(6.0)	–
Impairment of investment in associate	**(12.1)**	–	(8.3)	–	–
Major facility closure costs	**(77.6)**	(5.4)	(5.0)	–	(7.4)
Change to pension scheme rules	**–**	4.1	–	–	–
Bid response costs	**–**	(2.1)	–	–	–
(Loss)/profit on disposal of operations	**199.3**	–	–	–	(3.8)
Profit before interest and tax	**167.5**	78.8	58.8	61.0	41.9
Net interest payable	**(10.0)**	(10.3)	(12.2)	(8.3)	(8.8)
Profit before taxation	**157.5**	68.5	46.6	52.7	33.1
Taxation	**(6.8)**	(14.7)	(2.7)	(11.8)	(4.6)
Profit after taxation	**150.7**	53.8	43.9	40.9	28.5
Minority interests	**(0.9)**	(1.0)	(0.8)	(0.2)	(0.2)
Profit attributable to the equity holders of the parent	**149.8**	52.8	43.1	40.7	28.3
Headline earnings per share (pence)	**17.5**	16.6	17.3	14.6	11.7
Dividends per share (pence)	**8.3**	8.0	7.0	6.4	6.1
Assets employed					
Intangible fixed assets	**154.4**	227.3	212.3	157.9	141.1
Tangible fixed assets	**533.3**	508.9	448.4	442.9	425.9
Other assets and liabilities	**(126.1)**	(41.4)	(45.9)	(58.7)	(54.7)
	561.6	694.8	614.8	542.1	512.3
Financed by					
Share capital	**32.4**	32.4	32.2	32.1	32.1
Reserves	**459.6**	457.6	417.3	400.0	388.9
Shareholders' funds	**492.0**	490.0	449.5	432.1	421.0
Minority interests	**4.9**	6.6	4.4	1.4	1.0
Net borrowings	**64.7**	198.2	160.9	108.6	90.3
	561.6	694.8	614.8	542.1	512.3
Net assets per share (pence)	**262.4**	151.4	139.5	134.5	131.2
Return on capital employed:					
Headline operating profit before amortisation of acquired intangibles and impairment of goodwill (%)	**14.6**	13.9	13.8	12.9	9.7
Profit before interest and tax (%)	**26.7**	12.0	10.2	11.6	7.7
Return on capital employed (including cumulative goodwill written back to reserves):					
Headline operating profit before amortisation of acquired intangibles and impairment of goodwill (%)	**11.6**	11.3	10.8	9.9	7.6

Company Balance Sheet
as at 31 December 2008

	2008 £m	2007 £m	Note
Fixed assets			
Tangible fixed assets	**2.6**	1.0	2
Investments	**411.0**	422.7	3
	413.6	423.7	
Current assets			
Debtors	**106.7**	50.7	4
Cash at bank and in hand	**3.5**	4.1	
	110.2	54.8	
Current liabilities			
Creditors: Amounts falling due within one year	**(23.2)**	(21.2)	5
Net current assets	**87.0**	33.6	
Total assets less current liabilities	**500.6**	457.3	
Non-current liabilities			
Creditors: Amounts falling due after more than one year	**(5.1)**	(67.7)	5
Net assets	**495.5**	389.6	
Capital and reserves			
Called-up share capital	**32.4**	32.4	7
Share premium account	**175.7**	305.0	7
Other reserves	**124.1**	(6.9)	7
Profit and loss account	**163.3**	59.1	7
Equity shareholders' funds	**495.5**	389.6	

Approved by the Board of Directors on 25 February 2009 and signed on its behalf by:

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

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

Independent Auditors' Report to the members of Bodycote plc

We have audited the parent company financial statements of Bodycote plc for the year ended 31 December 2008 which comprise the Balance Sheet and the related notes 1 to 10. These parent company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the group financial statements of Bodycote plc for the year ended 31 December 2008 and on the information in the board report on remuneration report that is described as having been audited.

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

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors' responsibilities for preparing the Annual Report and the parent company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

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

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the Directors' Report is consistent with the parent company financial statements. The information given in the Directors' Report includes the information presented in the Group Business Review cross-referred from the Directors' Report.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited parent company financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

BASIS OF AUDIT OPINION

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

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

OPINION

In our opinion:

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2008;
- the parent company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the parent company financial statements.

Deloitte LLP

Deloitte LLP
Chartered Accountants and Registered Auditors

Manchester
25 February 2009

Accounting Policies

Bodycote

ACCOUNTING CONVENTION

The financial statements have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards. The accounting policies have been applied consistently throughout the year and the preceding year in dealing with items that are considered material in relation to the Company's financial statements.

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

INVESTMENTS

Investments are held at cost less provision for impairment.

PENSION COSTS

For defined benefit schemes, the amount charged to the profit and loss account in respect of pension costs is the contributions payable in the year.

LEASES

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

THE COMPANY AS LESSOR

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

TANGIBLE FIXED ASSETS

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

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

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

TAXATION

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

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

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

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

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

DEBT

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

DERIVATIVE FINANCIAL INSTRUMENTS

The Company may enter into 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 the group's activities.
The Company does not use derivative financial instruments for speculative purposes.

The use of financial derivatives is governed by group policies approved by the board of directors, which provide written principles on the use of financial derivatives.

Derivative financial instruments are recognised as assets or 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 FRS 26 are recognised immediately in the income statement.

Accounting Policies

HEDGE ACCOUNTING

The Company 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 Company 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 or cash flow hedges:

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.

Cash Flow Hedge

Cash flow hedging matched 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 equity 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 forecasted 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.

Bodycote

1. Profit for the year

As permitted under section 230 of the Companies Act 1985 the Company has elected not to present its own profit and loss account for the year. Bodycote plc reported a profit for the financial year ended 31 December 2008 of £259.2m (2007: £1.5m).

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

Total employee costs (including Executive Directors) were:

	2008 £m	2007 £m
Wages and salaries	**5.9**	4.6
Social security costs	**0.7**	0.5
Other pension costs	**0.4**	0.3
	7.0	5.4

2. Tangible Fixed Assets

	Fixtures and fittings £m
Cost	
At 1 January 2008	1.5
Additions	2.6
At 31 December 2008	4.1
Depreciation	
At 1 January 2008	0.5
Charge for the year	0.2
Impairment loss	0.8
At 31 December 2008	1.5
Net book value	
At 31 December 2008	2.6
At 31 December 2007	1.0

Notes to the Company Financial Statements
Year ended 31 December 2008

3. Investments

	Shares £m	Shares in associates £m	Loans £m	Total £m
Cost				
1 January 2008	403.7	7.3	27.6	438.6
Acquisitions and advances	20.3	–	–	20.3
Disposals and repayments	(6.6)	–	(25.4)	(32.0)
At 31 December 2008	417.4	7.3	2.2	426.9
Provision for impairment				
1 January 2008 and 31 December 2008	8.6	7.3	–	15.9
Net book value				
At 31 December 2008	408.8	–	2.2	411.0
At 31 December 2007	395.1	–	27.6	422.7

Shares in associates comprise:

Name of company	Nature of business	Country of incorporation	% Holding of ordinary shares
SSCP Coatings S.à.r.l.	PVD Coatings	Luxembourg	24

4. Debtors

	2008 £m	2007 £m
Amounts falling due within one year:		
Amounts owed by subsidiary undertakings	**8.3**	4.1
Corporation tax recoverable	**5.3**	0.4
Deferred taxation	**5.0**	3.3
Finance lease receivables	**0.4**	0.4
Other debtors and prepayments	**1.4**	1.8
	20.4	10.0
Amounts falling due after more than one year:		
Amounts owed by subsidiary undertakings	**85.6**	30.8
Finance lease receivables	**0.7**	1.1
Other debtors	**–**	8.8
	86.3	40.7
	106.7	50.7

5. Creditors

	2008 £m	2007 £m
Amounts falling due within one year:		
Bank loans	**3.5**	–
Bank overdrafts	**–**	8.5
B shares - Non cumulative redeemable preference shares (note 7)	**0.7**	–
Trade creditors	**1.0**	0.3
Amounts owed to subsidiary undertakings	**1.9**	1.4
Dividends payable	**9.4**	8.8
Other taxes and social security	**0.1**	0.1
Other creditors	**0.9**	0.5
Accruals and deferred income	**5.7**	1.6
	23.2	21.2
Amounts falling due after more than one year:		
Amounts owed to subsidiary undertakings	**5.1**	67.6
Other creditors	**–**	0.1
	5.1	67.7
Bank loans are repayable:		
On demand or within 12 months	**3.5**	–
	3.5	–

6. Deferred taxation

	Deferred tax £m
At 1 January 2008	3.3
Profit and loss credit	7.8
Reclassification to corporation tax recoverable	(6.1)
At 31 December 2008	**5.0**

Deferred tax

	2008 £m	2007 £m
Deferred tax is (recognised)/provided as follows:		
Tax losses	**(4.8)**	(1.9)
Other timing differences	**(0.2)**	(1.4)
Deferred tax asset	**(5.0)**	(3.3)

7. Capital and reserves

Share capital:

	2008 £m	2007 £m
Authorised 248,947,368 ordinary shares of 17 3/11p each (2007: 430,000,000 ordinary shares of 10p each)	**43.0**	43.0
Authorised 325,000,000 B shares of 40p each (2007: Nil)	**130.0**	–

Ordinary shares

	Number of shares	£m
At 1 January 2008	323,673,223	32.4
Exercise of share options	244,173	–
Effect of share consolidation	(136,386,272)	–
At 31 December 2008	187,531,124	32.4

Details of share options in issue on the Company's share capital and share-based payments are set out in note 30 to the consolidated financial statements.

B shares (Non cumulative redeemable preference shares of 40p each):

	Number of shares	£m
Issued	323,538,574	129.4
Converted to deferred shares	(70,328,634)	(28.1)
Purchased and cancelled	(251,551,315)	(100.6)
At 31 December 2008	1,658,625	0.7

Deferred shares:

	Number of shares	£m
Converted from B shares	70,328,634	28.1
Purchased and cancelled	(70,328,634)	(28.1)
At 31 December 2008	–	–

Share capital classified as equity at 31 December 2008	32.4
Share capital classified as debt at 31 December 2008	0.7
Total share capital at 31 December 2008	33.1

During the year the Group issued £129.4m of B shares out of the share premium account. The B shares could be converted into deferred shares with a negligible value in return for a dividend of 40p per share or redeemed for 40p per share in cash. £0.2m of associated costs were charged to the share premium account.

321.9 million B shares were redeemed on 16 December 2008, including 70.3 million B shares which had been converted into deferred shares and, as a result, £128.7m was transferred from retained earnings to a capital redemption reserve.

Reserves:

	Share premium account £m	Other reserves £m	Profit and loss account £m	Total £m
At 1 January 2008	305.0	(6.9)	59.1	357.2
Dividends paid	–	–	(154.9)	(154.9)
Profit for the year	–	–	259.2	259.2
Return of capital to shareholders and redemption of B shares	(129.6)	128.7	–	(0.9)
Premium arising on issue of equity shares (net of expenses)	0.3	–	–	0.3
Share based payments and acquisition of own shares	–	2.3	(0.1)	2.2
At 31 December 2008	175.7	124.1	163.3	463.1

The Other reserve is stated after deducting £7.2m (2007: £7.3m) relating to shares held in the Bodycote International Employee Benefit Trust and £3.7m (2007: £3.7m) relating to shares held in treasury. 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 2008 2,490,760 (2007: 3,112,931 ordinary shares of 10p each) ordinary shares of 17 $\frac{3}{11}$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 was £3.1m (2007: £5.8m).

Included in Other reserves is the capital redemption reserve arising on redemption of the B shares of £128.7m (2007: £Nil).

At 31 December 2008 219,318 (2007: 2,025,000 ordinary shares of 10p each) ordinary shares of 17 $\frac{3}{11}$p each were held in treasury. The market value of these was £0.3m (2007: £3.8m).

8. Contingent liabilities

The company has guaranteed bank overdrafts, loans and letters of credit of certain subsidiary undertakings amounting to £318.4m (2007: £225.6m).

9. Pension commitments

The Company participates in a group defined benefit scheme, the details of which are disclosed in note 31 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 31 to the consolidated financial statements.

10. Related party transactions

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

	Sale of goods and services		Amounts owed by related parties	
	2008 £m	2007 £m	**2008 £m**	2007 £m
Associates	**2.2**	1.3	**18.1**	12.0

Sales of goods and services include payments received from finance leases, the provision of management services and interest receivable. All transactions were made at arm's length.

The amounts outstanding will be settled in cash, of which £1.9m is secured. No guarantees have been given or received. £16.0m of provisions have been made for doubtful debts of which £14.9m was expensed during the year in respect of the amounts owed by related parties.

Principal Subsidiary Undertakings

Thermal Processing - Heat Treatment & Metal Joining

		Country of incorporation or registration
*Bodycote Heat Treatments Limited	Cambridge, Chard, Cheltenham, Coventry, Derby, Gillingham, Great Barr, Hazel Grove, Macclesfield, Rotherham, Skelmersdale, Stillington and Woodford	England
Bodycote Wärmebehandlung GmbH	Ebersbach, Eching, Essen, Esslingen, Garching, Karben, Köln, Korntal, Landsberg, Langenfeld, Langenselbold, Lüdenscheid, Menden, Nürnberg, Otterfing, Remscheid, Sömmerda, Sprockhövel and Wehingen	Germany
Nitrion GmbH	Munich	Germany
Bodycote Hardingscentrum BV	Diemen, Hengelo, Tilburg and Venlo	Netherlands
Bodycote Hardiff BV	Apeldoorn	Netherlands
Bodycote Värmebehandling AB	Anderstorp, Göteborg, Hudiksvall, Karlskoga, Malmö, Mora, Stockholm, Värnamo and Västerås	Sweden
Bodycote SAS	Ambazac, Amiens, Beaugency, Brétigny sur Orge, Billy-Berclau, Cernay, Chanteloup les Vignes, Chassieu, Condé sur Noireau, Gemenos, Gennevilliers, Lagny sur Marne, La Monnerie Le Montel, La Talaudière, Le Subdray, Neuilly en Thelle, Nogent, Pusignan, Serres Castet, St Aubin les Elbeuf, St Dié, St Nicolas d'Aliermont, St Rémy en Mauges, Villaz and Voreppe	France
Techmeta SA	Metz-Tessy	France
Nitruvid SAS	Argenteuil, Fraisses and Gandrange	France
Bodycote Belgium	Brussels and Nivelles	Belgium
Bodycote Lämpökäsittely Oy	Hämeenlinna, Pieksämäki, Tampere, Vaasa and Vantaa	Finland
Bodycote Varmebehandling A/S	Herlev and Ejby	Denmark
Bodycote Italia Srl	Gorgonzola	Italy
Bodycote Trattamenti Termici SPA	Flero, Madone and Rodengo	Italy
Bodycote Austria Wärmebehandlung GmbH	Kapfenberg, Marchtrenck and Vienna	Austria
Bodycote Rheintal Wärmebehandlung AG	Schaan	Liechtenstein
Bodycote Switzerland Wärmebehandlung AG	Fallanden and Urdorf	Switzerland
Bodycote HT S.r.o.	Brno, Liberec, Modrice, Pilzen, Prague and Pribram	Czech Republic
Bodycote Polska Sp z.o.o.	Czestochowa, Chelmno, Grodzisk Mazowiecki, Swiebodzin, Warsaw and Zabrze	Poland
Bodycote Tratamente Termice SRL (75% owned)‡	Brasov, Bucharest and Cugir	Romania
Bodycote Hokezelo KFT	Budapest	Hungary
Bodycote Istas Isil Islem Sanayi ve Ticaret AS (60% owned)‡	Adana, Ankara, Bursa, Istanbul and Izmir	Turkey
Bodycote IMT Inc.	London OH and Camas WA	USA
Bodycote Thermal Processing, Inc.	Fremont, Santa Fe Springs, Santa Ana, Gardena, Huntington Park, Rancho Dominguez, Vernon and Westminster CA, Berlin, Waterbury, South Windsor and Suffield CT, Ipswich and Worcester MA, Canton and Livonia MI, Cincinnati and Cleveland OH, Oklahoma City and Tulsa OK, Arlington, Dallas, Houston and Fort Worth TX, Laconia NH, Melrose Park IL, Indianapolis IN, Eden Prairie MN, Rochester NY, Sturtevant and New Berlin WI	USA

Thermal Processing - Heat Treatment & Metal Joining continued

Bodycote Canada, Inc.	Newmarket and Kitchener ON	Canada
Bodycote Thermal Processing de Mexico S de RL de CV	Silao	Mexico
Brasimet Commercio e Industria SA	Campinas, Guarulhos, Joinville, Sao Leopoldo and Sao Paulo	Brazil
Bodycote Wuxi Technology Co. Limited	Wuxi	China
Bodycote (Ningbo) Heat Treatment Co. Limited	Ningbo	China
Bodycote Metallurgical Services India Pte Limited	Pimpri, Ranjangaon and Gurgaon	India
Bodycote Thai Thermal Processing Limited (90% owned)‡	Bangkok	Thailand
Bodycote Japan KK	Tokyo	Japan

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

Thermal Processing - Hot Isostatic Pressing

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

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

Thermal Processing - Surface Engineering

		Country of incorporation or registration
*Bodycote Metallurgical Coatings Limited	Knowsley, Macclesfield, Neath, Newport, Skelmersdale, Stonehouse and Wolverhampton	England
Bodycote K-Tech, Inc	Hot Springs AR	USA
Bodycote Ytbehandling AB	Katrineholm, Karlstad and Västra Frölunda	Sweden
Bodycote Surface Engineering GmbH & Co KG.	Kaufbeuren	Germany
Bodycote Singapore Pte Limited	Singapore	Singapore
IonBond do Brasil Tretamento de Superficies Ltda	Sorocaba	Brazil
IonBond Argentina SA	Buenas Aires	The Argentine

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

Principal Subsidiary Undertakings

Group Services

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

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

*Bodycote IT Limited	Edinburgh	Scotland

Information Services

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

Bodycote

Enquiries on the following administrative matters can be addressed to the Company's registrars, Capita Registrars, Northern House, Woodsome Park, Fenay Bridge, Huddersfield HD8 0LA. Telephone: 0871 664 0300 (calls to 0871 numbers cost 10p per minute plus network extras) or +44(0)208 639 3399; Fax: +44(0)1484 600911; and email: shareholder.services@capitaregistrars.com.

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

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

Share Dealing Service

Information on a low cost share dealing service offered by our registrar is available from Capita on 0871 664 0300 (calls to 0871 numbers cost 10p per minute plus network extras) or at www.capitadeal.com.

Shareholder Analysis

Analysis of share register as at 18 February 2009

Holding range:	Number of shareholders	%	Number of Shares	%
1 to 1,000	1,304	40.8	584,873	0.3
1,001 to 10,000	1,393	43.7	4,236,963	2.3
10,001 to 100,000	322	10.1	10,859,720	5.8
100,001 to 500,000	113	3.5	23,647,161	12.6
500,001 and over	64	2.0	148,202,407	79.0
	3,196	100.0	187,531,124	100.0

Types of shareholders:	% of shareholders	% of total shares
Directors' interests	0.1	1.9
Major institutional and corporate holdings	7.9	89.9
Other shareholdings	92.0	8.2
	100.0	100.0

As at 25 February 2009 the following interests of 3% or more in the voting rights in the Company had been notified:

	Number of shares	%
Standard Life plc	20,548,315	10.97
Sprucegrove Investment Management Limited	12,059,211	6.44
Lloyds Banking Group plc	10,706,898	5.72
AXA SA	9,266,080	4.95
JPMorgan Chase & Co	8,788,617	4.69
Franklin Resources Inc.	7,428,357	3.97
Legal & General Group plc	7,426,737	3.96
LD Pensions	6,585,747	3.52

Financial Calendar

Annual general meeting	27 April 2009
Final dividend for 2008	8 May 2009
Interim results for 2009	July 2009
Interim dividend for 2009	January 2010
Results for 2009	February 2010

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