

**BODYCOTE INTERNATIONAL PLC****PRELIMINARY RESULTS****FOR THE YEAR ENDED 31 DECEMBER 2007****Financial highlights**

- Revenue from continuing operations increased by 15% to £640.5 million (2006: £558.6 million)
- Headline operating profit <sup>1</sup> rose 15% to £91.3 million (2006: £79.7 million)
- Operating profit ahead 34% at £78.8m (200: £58.8m)
- Headline profit before tax <sup>2</sup> up 16% to £81.0 million (2006: £70.0 million)
- Profit before tax improved by 47% to £68.5m (2006: £46.6m)
- Basic headline earnings per share <sup>3</sup> increased 17% to 20.3p (2006: 17.3p)
- Basic earnings per share increased 24% to 16.6 (200: 13.4p)
- Return on capital employed improved to 11.3% (2006: 10.8%)
- Full year total proposed dividend 8.0 pence per share (2006: 7.0p), up 14.3%

**Operational highlights**

- Robust demand in key markets - aerospace, power generation and oil and gas sectors
- Organic sales growth 10% in Testing and 9% in Thermal Processing
- Emerging market sales increased to £58.6m (2006: £25.9m)
- Revenue from Strategic Partnerships and Long Term Agreements increased 17% to £123 million (2006: £105 million)

Commenting on the results, John Hubbard, Chief Executive said:

“Bodycote delivered record sales and headline operating profits in 2007 and further increased return on capital employed. The geographic spread of our operations, range of services we provide and diversity of end markets we serve helped to ensure another robust performance despite weakness in some areas. Demand in several of our key markets – aerospace, power generation and oil and gas – remained strong as manufacturers continued to fulfill orders from significant committed order books. Our customers are forecasting positive growth in 2008 and we enter the year confident that Bodycote will deliver another successful performance.”

<sup>1</sup> a detailed reconciliation is provided in the Group Business Review Financial Results 2007 section

<sup>2</sup> a detailed reconciliation is provided in the Group Business Review Financial Review section

<sup>3</sup> a detailed reconciliation is provided in Note 4 to the Accounts.

## CHAIRMAN'S STATEMENT – 2007

Dear Shareholder,

After an eventful and successful year, Bodycote produced record sales and headline operating profits building on five years of annual improvement. Sales increased 14.7% to £640.5m (2006: £558.6m) and operating profit was up 34.0% to £78.8m (2006: £58.8m). Despite the recent general and specific concerns of the stock market, I am confident that with the increased financial rigour and discipline we have demonstrated in recent years, coupled with the high level of entrepreneurial flair across the Group, Bodycote will continue to prosper and that financial markets will, in due course, reflect the value our customers and staff already recognise in the business.

The board is recommending a final dividend of 5.25p per share (2006: 4.5p), an increase of 16.7%, to be paid on 4 July 2008 to all shareholders on the register at the close of business on 6 June 2008. The total proposed dividend in respect of 2007 is therefore up by 14.3% to 8.0p per share (2006: 7.0p) of which 2.75p per share (2006: 2.5p) has already been paid as an interim dividend. The 2007 total dividend is covered 2.1 times (2006: 1.9 times) by basic earnings per share.

Thermal processing, the major part of our business, has shown significant improvement in 2007 and we expect that it will continue to do so. Europe, accounting for approximately 70% of sales, performed particularly well in 2007 with good growth from all sectors and return on capital employed of 13.0%. We expect to see further improvement in 2008. In North America there have been areas of strength, primarily related to the aerospace, power generation and oil & gas sectors and areas of softness related to general engineering and automotive but overall our business continues to grow. In the developing economies of Latin America, Eastern Europe, the Middle East and Asia our footprint is expanding successfully. These long term initiatives are being financed with an inevitable impact on short term performance.

We have grown significantly our Testing businesses over the last three years increasing our range of services across a wider geographical network. This is an exciting and attractive area of our overall business but the results to date, although satisfactory, are below where we expect to be in future.

When I became Chairman in 2002 Bodycote was overstretched and market conditions underwent a severe downturn. Return on capital employed had fallen below the cost of capital. Under the leadership of Chief Executive John Hubbard and with the mantra of restoring our return on capital, we have spent the last six years reshaping and improving the business. We have come a long way in that time and now have a pre-tax return on capital of over 11% and a strategy and commitment to achieve much more. Bodycote today is a far stronger and more resilient business and we have a track record of successfully meeting the challenges that inevitably face any business.

We are committed to a long term approach which implies that we will be professional, ethical and rigorous in all that we do. Being disciplined without being bureaucratic, Bodycote will continue to foster the right entrepreneurial and safe working environment for all our staff. We continue to review all aspects of the business and strategy to ensure that we respond to and take advantage of opportunities as they arise.

In February 2007 Sulzer AG made a takeover approach for the company but eventually withdrew when it was clear that a majority of shareholders and the directors believed that the company was worth more than Sulzer indicated.

Early trading results suggest that 2008 will be another record year for Bodycote. We continue to invest in the business, but we are vigilant in ensuring that Bodycote is in a position to respond to any significant change in economic conditions.

I have served Bodycote as a director since 1994 and am privileged to have been Chairman for the last six years. There have been significant changes and progress during this time with much more to come. The

process of refreshing the Board has already commenced. John Biles has joined us as Chairman of the Audit Committee and the Chairman's baton will pass on at the AGM to be held on 30 April 2008. I wish my successor Alan Thomson, who was appointed to the board in December 2007, and everyone at Bodycote continued success.

Finally, I would like to thank everyone at Bodycote for their commitment and dedication and for the support they have given me personally and to the Company.

James Wallace  
Chairman  
26 February 2008

## 2007 GROUP BUSINESS REVIEW

### **Operations**

Bodycote provides thermal processing and testing services to manufacturers in virtually every sector of the world economy. From over 300 locations in 35 countries, more than 11,000 employees provide high quality services to over 60,000 customers. The Thermal Processing Strategic Business Unit (SBU) delivered 73% of Group sales compared to 74% in 2006 and saw its sales increase by 12.4%. This SBU is organised into two divisions: Heat Treatment and Hot Isostatic Pressing (HIP). The expansion of this SBU into emerging markets continued through both acquisitions and greenfield start-ups. In line with our strategy to grow rapidly the Testing SBU, sales increased by 21.1% and this SBU now makes up 27% of Group sales compared to 26% in 2006. The Testing SBU is organised into two divisions: Materials Testing, Engineering & Technology and Measurement Technology (MEM) and Health Sciences & Environmental (HSE).

### **Competitive Environment**

In the western hemisphere we are the clear leader in thermal processing and have a unique multi-disciplinary presence in the testing market. In both thermal processing and testing, Bodycote mainly competes with local, privately owned companies and manufacturers' captive facilities. Both supply and demand are very fragmented with hundreds of providers servicing thousands of customers. We have developed a sustainable advantage over local entrepreneurs through the superior quality of our systems, our extensive knowledge base, our breadth of technology, our flexible capacity and our broad range of services. Our proven track record of supplying thermal processing and testing services to many of the world's most respected manufacturers is a testament to our 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 specification. Our HIP business operates in a much smaller market. We have more than 60% of the total capacity in the western hemisphere and few manufacturers invest in this technology because of the high capital cost which represents a significant barrier to entry. Competitors we have vary from smaller private companies to a small number of large corporations.

### **Regulatory environment**

As a service provider to virtually all market sectors and as a business operating in many countries, we are subject to a multitude of quality, safety, environmental and regulatory requirements. We continuously monitor 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 our quality and the sustainability of our services.

### **Macro-economic environment**

Generally, the countries in which we operate continue to experience positive manufacturing economic conditions with inflation largely under control, although there is some uncertainty about the near term outlook especially with regard to the USA. Energy prices have remained near record highs during 2007 with different countries experiencing varying levels of movement in unit costs, but, overall, we have marginally reduced energy costs as a percentage of sales. Materials such as nickel, chrome and molybdenum, used in the baskets and fixtures in our thermal processing plants, have significantly increased in price, but we have successfully managed these costs. As a service provider we are ultimately subject to the cyclicity of our customers' requirements. Aerospace, power generation and oil & gas demand continues to be robust. The only significant sector that we serve which has exhibited softness is automotive in North America. However, we continue to offset this softer demand by winning new business in our traditional territories, principally through outsourcing and by expanding into new geographies. In total, automotive sales increased by £14.7m (10.6% growth) in the year.

## Long term strategy and business objectives

After a thorough review in early 2005, we have articulated a strategy which incorporates four key initiatives, each aimed at enhancing shareholder value and accelerating growth:

- expand the Group into developing manufacturing geographies;
- increase Testing to about half of Group's sales;
- develop our high added value technologies; and
- intensify outsourcing initiatives.

We measure our performance against the delivery of this strategy using the financial and non-financial indicators shown in the table below. Our most important indicator is the return on capital employed (ROCE) and further progress has been made in 2007 towards our 5 year target.

<u>Key performance indicators</u>	<u>2007</u>	<u>2006</u>	<u>Five Year Target</u>
<b>Financial</b>			
Return on capital employed <sup>(1)</sup>	11.3%	10.8%	Mid teens %
Return on sales <sup>(2)</sup>	14.3%	14.3%	Mid to high teens %
Organic sales growth % <sup>(3)</sup>	8.8%	5.5%	Mid to high single digit %
People costs as a percentage of sales <sup>(4)</sup>			
Thermal Processing	39.5%	40.7%	40%
Testing	53.3%	51.8%	50%
Capital expenditure/depreciation ratio <sup>(5)</sup>	1.3x	1.2x	0.8 – 1.3x
<b>Non financial</b>			
Capacity utilisation (Heat Treatment only) <sup>(6)</sup>	74%	72%	>80%
Capacity utilisation HIP <sup>(6)</sup>	71%	75%	>80%
ISO 14001/17025 compliant facilities <sup>(7)</sup>	233	184	All facilities
Accident frequency <sup>(8)</sup>	1.6	2.2	Zero

### Definitions

- (1) Headline operating profit\* as a percentage of average capital employed. Capital employed includes tangible and intangible assets including all previously amortised/impaired goodwill and all non-interest bearing assets and liabilities.
- (2) Headline operating profit\* as a percentage of revenue from continuing operations.
- (3) Year on year increase in revenue, at constant currencies, from continuing operations excluding revenue from acquisitions made within the prior twelve months.
- (4) The salary and benefit costs of all employees as a percentage of revenue from continuing operations.
- (5) Net capital expenditure divided by depreciation.
- (6) Actual revenues expressed as a percentage of theoretical maximum revenue assuming that heat treatment facilities operate 24 hours per day, 365 days per year.
- (7) The number of facilities holding registrations for ISO 14001 or ISO 17025.
- (8) Accident frequency - the number of accidents x 200,000 (approximating 100 man years), divided by the total hours worked.

\* Headline operating profit, as referred to in this Group Business Review, is defined and reconciled in the Financial Results for 2007 section.

Overall return on sales was unchanged, with both Heat Treatment (+1%) and HIP (+3%) increasing while, as anticipated, greenfield investments, mix changes, additional infrastructure costs and difficult trading conditions in our Food and Environmental Testing businesses have resulted in a reduction of margins in the Testing SBU (-3%). Group organic sales growth (9%) was again within our target range. People costs are the Group's largest expense. Thermal Processing saw a reduction in these costs to 39.5% of sales thus achieving our target of 40%. People costs in Testing however, increased slightly due to the impact of added resources needed to support our acquisition programme.

Capital expenditure was within our target range and was above the level of depreciation, reflecting the Group's establishment of new facilities in emerging markets and also the support of new outsourcing contracts. Additional capital expenditure also reinforces our commitment to additional HIP capacity with the aim of supporting growing demand in aerospace, power generation and oil & gas. We expect to benefit from these investments beginning in 2008 but particularly in 2009 and 2010.

Capacity utilisation is the key factor in improving profitability in Thermal Processing. In 2007 we saw further progress towards our goal of >80% with current utilisation in heat treatment at 74% (2006: 72%). HIP utilisation has temporarily decreased following the installation of a new large unit at our Washington facility to 71% (2006: 75%).

We have largely achieved our target of having all the Group's facilities meet the environmental standard ISO 14001 or the laboratory management standard ISO 17025. Significant improvements in our work related accident rates have been achieved over the past four years by a combination of training, systems and cultural change. We remain committed to achieving the highest standards of safety for our people and having zero accidents remains our goal.

### **Acquisitions completed since the interim announcement**

Since the interim announcement and in line with our strategy, the Group has completed seven bolt-on acquisitions aimed at increasing expansion into emerging markets, enhancing market position in developed economies and increasing the scale of the Testing SBU, at a cost of £29.8m as follows:

#### **Further expansion into emerging markets**

##### **Thailand – Thai Inductions Services Co Ltd (TISCO)**

On 8 January 2008, Bodycote acquired the assets of TISCO, one of Thailand's largest metallurgical services providers, offering heat treatment, induction and nitriding technologies to western and Japanese manufacturers. As part of the planned expansion a greenfield production facility with a wide range of heat treatment capabilities will be added in Bangpoo, east of Bangkok, in the third quarter of 2008 to support the rapid expansion of Thailand's engineering manufacturing sector.

#### **Enhancing market position in developed economies:**

##### **Texas, USA – Metroplex Heat Treat Inc**

Bodycote completed the acquisition of Metroplex Heat Treat Inc., based in Arlington, Texas on 12 December 2007. Metroplex specialises in heat treatment, induction hardening, brazing and plasma nitriding. The Texas/Oklahoma region is an important and growing market for Bodycote focused on oil & gas, aerospace and power generation. Metroplex's outstanding customer base secures a market leading position for the Group.

##### **Germany - Nitrion GmbH**

On 18 December 2007, Bodycote announced the acquisition of nitriding specialist, Nitrion GmbH. Nitrion was founded in 1988 and is one of the largest nitriding service providers in Germany. The company has three plants in the Munich area, specialising in plasma nitriding for a wide range of applications and has an excellent customer base throughout southern Europe. It also operates a state-of-the art metallurgical laboratory, as well as salt spray test chambers for corrosion testing which complement the development of the Testing SBU in this region.

##### **France – Traitements Compression Services SAS (TCS)**

On 21 December 2007, Bodycote acquired the remaining 51% of the equity of TCS, the only provider of HIP services in France. TCS was formed ten years ago as a joint venture between Bodycote France (49%) and Aubert & Duval (51%), the French specialist steel manufacturer. TCS, located in Magny-Cours, deals with powder metallurgy applications and precision castings particularly for the aerospace and power generation markets. TCS will now be able to focus not

only on the growing requirements of Aubert & Duval but also on servicing the needs of the wider subcontract market in southern Europe, better utilising its capacity.

#### Increasing the scale of the Testing SBU:

Australia – Warrington Fire Research (Aust) Pty Ltd

On 28 November 2007, Bodycote acquired the remaining stake in Warrington Fire Research (Aus) Pty Ltd in support of the strategic growth plans in the region. This provides the business with a much greater ability to facilitate growth in its local and surrounding markets. The business has fire safety engineering offices in Melbourne, Sydney and Brisbane with a fire testing laboratory also in Melbourne. The business has been renamed Bodycote Warringtonfire (Aust) Pty Ltd.

Accutest Laboratories Limited, Canada

On 25 January 2008, Bodycote completed its nationwide coverage of Canadian analytical facilities through the acquisition of Ottawa based Accutest Laboratories Limited.

Metlab (Int.) Limited, Eire

On 8 February 2008 we established our first metallurgical laboratory in Eire through the acquisition of Metlab (Int.) Limited. Metlab provides both materials testing and non-destructive testing to the engineering and construction industries.

#### Financial Results for 2007

	<u>Revenue</u> <sup>1</sup>		<u>Headline operating profit</u>		<u>Margin</u>	
	<u>2007</u> <u>£ m</u>	<u>2006</u> <u>£ m</u>	<u>2007</u> <u>£ m</u>	<u>2006</u> <u>£ m</u>	<u>2007</u> %	<u>2006</u> %
Heat Treatment	421.7	375.0	61.6	50.3	14.6	13.4
HIP	43.5	38.9	15.4	12.8	35.4	32.9
Thermal Processing	<b>465.2</b>	<b>413.9</b>	<b>77.0</b>	<b>63.1</b>	<b>16.6</b>	<b>15.2</b>
Testing	175.3	144.7	21.0	21.3	12.0	14.7
Head office costs	-	-	(6.7)	(4.7)	-	-
Group Total	<b>640.5</b>	<b>558.6</b>	<b>91.3</b>	<b>79.7</b>	<b>14.3</b>	<b>14.3</b>

<sup>1</sup> Revenue from continuing operations after deducting inter-segment sales

Headline operating profit is defined as follows:

	<u>2007</u> <u>£ m</u>	<u>2006</u> <u>£ m</u>
Headline operating profit	91.3	79.7
Share of associates' interest and tax	-	(0.6)
Amortisation/impairment of acquired intangible fixed assets	(1.9)	(1.0)
Impairment of goodwill	(7.2)	(6.0)
Impairment of investment in associate	-	(8.3)
Change to pension scheme rules	4.1	-
Major facility closure costs	(5.4)	(5.0)
Bid response costs	(2.1)	-
Operating profit from continuing operations per financial statements	<b>78.8</b>	<b>58.8</b>

In 2007 Bodycote has again shown strong growth with sales increasing by 14.7% to £640.5m (2006: 18.6% growth to £558.6m). Organic sales accounted for 8.8% (2006: 5.5%) of this improvement before the impact of closed sites and acquisitions for 9.6% (2006: 13.1%). The impact of the movement in exchange rates on translation of sales was adverse by 2.6% (2006: nil).

We have seen increasing demand in several key markets, most notably aerospace, power generation and oil & gas. Outsourcing (Strategic Partnerships and Long Term Agreements) provided £18m of additional sales (17% growth), resulting in a total of £123m in 2007 (2006: £105m). Some notable outsourcing agreements concluded in the year were with Sandvik, Dubai Light Railway, Rolls-Royce, General Motors, AM General, Nokia and Faurecia. Outsourcing sales continue to account for approximately 20% of Group sales and we expect further growth both in absolute terms and as a share of Group activity.

Headline operating profit increased by 14.6% to £91.3m in 2007 (2006: up 17.6% to £79.7m). The impact of exchange rates on the translation of overseas profits was adverse 2.8% (£2.2m) this year (2006: -0.1%).

Operating profit improved by £20.0m due to improved trading and as favourable changes to the rules of the UK final salary pension scheme (£4.1m) more than offset bid response costs (£2.1m) and there was no impairment of investments in associates in 2007 (2006: £8.3m).

Overall, our headline operating margin remained consistent at 14.3% in both 2007 and 2006. Whilst the Heat Treatment business saw its headline margin\* increase to 14.6% (2006: 13.4%) and HIP to 35.4% (2006: 32.9%), Testing saw its margin fall to 12.0% (2006: 14.7%). This is largely attributable to increased infrastructure costs to support a larger business, greenfield start-up losses and weak performance in the food consumer products and environmental businesses within the Health Science and Environmental division of the Testing SBU in both Canada and the UK.

A charge of £1.7m (2006: £1.0m) has been accrued in head office costs for a share-based long term incentive plan (LTIP) for senior managers which is designed to incentivise growth in profit and ROCE. The LTIP was approved by shareholders at the 2006 AGM. The amount charged reflects the expected fair value, spread over the three year vesting period, adjusted for current progress towards planned targets.

As part of our plans to increase activity in Asia, we have continued to invest in equipment, real estate and in business development. We now have two heat treatment facilities in India, a further two in China and a joint Testing and Thermal Spray location in Singapore. The total operating loss associated with these developments was £1.8m (2006: £0.5m).

During the year we acquired ten new businesses and the outstanding equity, not already owned by Bodycote, in two others at a net cost of £32.7m. Only one acquisition and the purchase of the remainder of Warrington Fire Research (Aus) Pty Ltd were in Testing as we have been concentrating on the integration of the twelve businesses (38 laboratories) acquired in 2006. We expect significantly more activity in 2008 and by February 26<sup>th</sup> three businesses at a cost of £10.4m have joined the Group. Of the ten businesses acquired by the Thermal Processing SBU during the year, four are in emerging markets (China, India, Brazil and Argentina), five are focused on high added value specialist technologies in Germany and France and one gives Bodycote the market leading position in the Texas/Oklahoma aerospace and oil & gas market.

## **Review by Strategic Business Unit (SBU)**

### Thermal Processing SBU

Thermal Processing reported sales of £465.2m, an increase of 12.4% on 2006. This was split 8.6% organic, 7.8% acquired and a reduction of 2.3% (£9.5m) in respect of adverse foreign exchange translation impact. ROCE improved to 12.0% (2006: 9.9%) and margins increased to 16.6% (2006: 15.2%). The ten businesses acquired represent fourteen facilities at a net cost of £30.9m. Energy cost increases have been less in 2007 than 2006. Taking the last two years together, all energy cost increases have now been recovered. As part of our continuous review of operations, we closed three heat treatment facilities: Lexington (USA), Charvonnex (France) and Koping (Sweden) with a proportion of the work and some of the equipment transferred to other locations. All of the associated cost has been charged to headline operating profit. However, the costs associated with closing five sites previously treated as exceptional have risen and the associated provision has been increased by £3.4m.



### Heat Treatment Division

The division delivered 12.5% (2006: 7.4%) growth with sales of £421.7m, which accounts for 66% of the Group revenues (2006: 67%). Margins rose to 14.6% (2006: 13.4%).

The UK continued to see strong demand from power generation, aerospace and oil & gas customers resulting in 7.7% organic growth with demand for thermal spray and K-Tech coatings being particularly robust. Our Nordic group continued to perform very well and organic sales growth was an excellent 13.6% (at constant exchange rates) on the back of several additional outsourcing contracts with a variety of blue-chip engineering customers. Demand in Germany and the Netherlands was solid with good automotive growth resulting in an organic sales increase of 9.6% (at constant exchange rates). The acquisition of Nitron GmbH immediately before the year-end significantly enhances the Group's position in nitriding technologies. Our Eastern European facilities continue to grow strongly with organic growth of 28.8% and a further 31.8% (at constant exchange rates) from the first full year of Bodycote ISTAS in Turkey, in which the Group has a 60% interest. Margins in Eastern Europe are generally good but the results in Turkey have been marginally impacted by costs associated with bringing safety, quality and business systems up to the standard expected by the Group. France and Belgium made further excellent progress and margins now match other parts of our European business. Organic growth was 7.1% (at constant exchange rates), with increasing demand from both aerospace and automotive customers. The business was also strengthened by the acquisition of Techmeta (electron beam welding) in February and Nitruvid SAS (a nitriding specialist, which Nitron will complement) in July. Southern Europe had a reasonable year with very strong growth in Austria and Liechtenstein partly offset by softness in Italy and Switzerland.

North America saw organic sales grow 2.0% (at constant exchange rates) in the continuing business, although overall sales dropped by £4.8m (at constant exchange rates). Margins remained consistent with last year at 10.0%. Demand continues to be strong in the aerospace, oil & gas and power generation markets but automotive and general engineering demand is subdued. We continue to review our various locations in the light of our strategy to provide value added services with growth potential. Our investment in low pressure carburizing capability (used for new generation automotive transmission gears in particular) in Silao, Mexico, will begin production in Q3 2008 to complement our Livonia, Michigan, facility which has been operating for 15 months. We are also continuing to look for ways to consolidate the industry in key regions of the USA and the acquisition in December of Metroplex Heat Treat Inc based in Arlington, Texas, secures a leading market position for the Group in Texas/Oklahoma. 2007 was the first full year for the Group in Brazil following the acquisition of Brasimet. Market conditions were reasonable during the year and the business had a satisfactory performance. Brasimet has a long standing physical vapour deposition (PVD) capability and to enhance our offering in the market place Bodycote acquired the small PVD activities of our associate company, SSCP Coatings Sarl, in both Brazil and Argentina.

Our activities in Asia made significant progress with acquisitions in both China and India adding to the start-ups in Singapore, Ranjangaon (India) and Wuxi (China) and we absorbed losses in the greenfield locations of £0.7m.

### HIP Division

The division achieved an impressive 17.0% (at constant exchange rates) organic growth rate on the back of strong demand from aerospace, power generation and oil & gas customers and a widening use of the technology.

especially for powder based near net shapes. Sales were £43.5m which amounted to 7% of total Group revenues (2006: 7%). Margins were 35.4% (2006: 32.9%). The strong performance balances the disappointing results experienced when end markets were at a cyclical low in 2002/2003. Aerospace and power generation led the growth in North America while power generation and oil

& gas demand were the key drivers of European growth. In late December, we purchased the remaining 51% of the equity of Traitements Compression Services SAS, (TCS), the only provider of HIP services in France.

### Testing SBU

Testing recorded sales of £175.3m, an increase of 21.1%. This was split 9.5% organic, 14.9% acquisition and a reduction of £4.8m (3.3%) due to foreign exchange translation impact. ROCE declined to 13.1% and margins slipped to 12.0% (2006: 14.7%) due to the costs associated with the greenfield laboratory (£1.2m), start-ups (Singapore, Bahrain, Croatia, Saudi Arabia, Kuwait, Dubai, Canada, USA and Mexico), additional infrastructure to support the growing business and difficult trading conditions in our environmental and food businesses in both Canada and the UK.

We acquired only one Testing business and the outstanding minority in Warrington Fire Research (Aus) Pty Ltd in 2007 while we concentrated on the integration of the twelve businesses with 38 laboratories that we purchased in 2006. In line with our strategy to grow Testing relative to the size of Thermal Processing, this SBU now represents 27% of the Group's increased revenue (2006: 26%).

### Materials Testing, Engineering & Technology and Measurement Technologies MEM

The division delivered 24.9% sales growth of which 13.0% was organic. Sales were £124.4m, which accounts for 19% of group sales (2006: 18%). Margins were 13.6% (2006: 14.4%). Oil & gas, aerospace and construction demand was robust across all regions, with the Middle East particularly strong. Sales in Asia Pacific were £1.9m (2006: £1.2m).

We continued to progress the expansion of the network into emerging markets, with full service laboratories opened in Croatia, Bahrain, Singapore and Brazil. Outsourcing remains a central plank of the organic growth strategy with a significant number of deals concluded, including aerospace contracts for our laboratories in Plzen, Czech Republic and Monterrey, Mexico; automotive engine development agreements at Mississauga, Canada; civil engineering/construction contracts in Dubai and control systems at Rockford, Illinois USA.

In response to a tough trading environment in the North American automotive market, a major consolidation project has been undertaken, reducing four sites to one automotive centre of excellence in Warren, Michigan, USA. Know-how continues to be transferred around the Group with a number of areas benefiting, particularly in the emerging economies, as Group expertise is established in these new operations, e.g. Bahrain, Singapore and Mexico. A technical development laboratory has been established in the UK to formalise the roll-out of specialist energy/aerospace related testing activities.

### Health Sciences/Environmental (HSE) Division

The division delivered 12.9% sales growth, with sales of £50.9m, which accounts for 8% of Group revenues (2006: 8%). Margins were 8.1% (2006: 15.5%), having been impacted by a combination of pricing pressures, wage inflation and poor weather conditions in the first half in the Environmental business in western Canada and by price pressure in both the Environmental and Food business in the UK. We have been actively addressing these issues and we are continuing to increase our emphasis on added value services. For example, our UK Food & Advisory division successfully tendered for a number of contracts from major retailers which improves our order book visibility for 2008. And to enhance our Canadian Environmental performance, we have added three further laboratories through a combination of greenfield, outsourcing and acquisition activity in Hinton and Drayton Valley, both in Alberta and Accutest Laboratories in Ontario.

Following the major acquisition activity in 2006 we have improved operational efficiencies with laboratories closed in Windsor, UK, and in Quebec and Alberta, Canada. We continue to penetrate the fledgling environmental market in the Gulf region with long-term contracts secured in Bahrain,

Oman and the UAE. Significant investment is being made in our IS systems to allow clients to download results and sample data from our laboratory information management systems via a client portal over the internet.

### **Associated Company - SSCP Coatings Sarl (SSCP)**

SSCP provides high quality PVD coatings to the same market sectors as Bodycote. Trading in 2006 was disappointing and at the beginning of 2007, as part of the refinancing of SSCP, its shareholders agreed that share warrants would be attached to £10.4m of new funding. Bodycote decided that it was in the Group's interest to maintain its shareholding in SSCP and therefore subscribed to a pro rata portion of the new funding for £3.4m. During 2007, trading performance has improved and is expected to continue to do so in 2008. The Group currently owns 24.4% of the share capital of SSCP.

## **Financial Review**

### Revenue

Group revenue from continuing operations was £640.5m, an increase of £81.9m (up 14.7%) on 2006 (£558.6m). Revenue growth for Heat Treatment was £46.7m (up 12.5%), for HIP £4.6m (up 11.8%) and for Testing £30.6m (up 21.1%). Organic growth accounted for £49.4m of total sales growth before the impact of closed sites which had annualised sales amounting to £7.1m and acquisitions for £53.9m, while foreign currency movements had an adverse impact on revenues of £14.3m mostly resulting from the weakening of the US Dollar.

### Operating Profit and Margins

Demand was robust in most of our markets in 2007 with the notable exception of North America. This had a particularly significant effect on our Testing businesses. Increases in energy and commodity prices have eased and we have managed to recover these increases through price increases. Consequently, operating profit increased by 34.0% from £58.8m to £78.8m and the margin increased from 10.5% to 12.3%

Heat Treatment benefited from strong growth in all of our European markets. Operating profit increased by 61.6% despite the adverse impact of foreign currency movements of 1.6%. Margins increased from 9.2% to 13.3%.

HIP continued to benefit from robust aerospace and power generation demand and showed an increase in operating profit of 21.9%. As the US business forms a greater proportion of the HIP SBU, foreign currency movements have had a much greater impact on its results, decreasing operating profit by 5.7%. Despite this margins increased from 32.9% to 35.9%.

Despite difficulties in its North American markets Testing has also continued to invest in building its infrastructure to support its growth plans. Headline operating profit grew by 1.7% before the adverse impact of foreign currency movements of 3.2%, which ultimately resulted in a fall of 1.5% in headline operating profit. Further costs for amortisation/impairment of acquired intangible assets and goodwill (£4.8m), major facility closure costs (£2.0m) less gains on changes to pension scheme rules (£1.5m) totaled £5.3m (2006: £4.6m) and this resulted in operating profit falling by 6%.

### Finance Charge

The net finance charge for the Group was £10.3m compared to £9.1m in, 2006, excluding the make whole for the early termination of the US Private Placement senior notes (£3.1m).

### Profit before tax

Headline profit before tax was £81.0m compared to £70.0m in 2006. Profit before tax was £68.5m compared to £46.6m in 2006.

Headline Profit Before tax is defined as follows:

	<u>2007</u>	<u>2006</u>
	<u>£ m</u>	<u>£ m</u>
Headline Operating Profit*	91.3	79.7
Net Finance Charge after the deduction of the early settlement of US Private Placement	(10.3)	(9.1)
Share of associates' interest	-	(0.6)
Headline Profit Before Tax	81.0	70.0
Amortisation/impairment of intangible fixed assets	(1.9)	(1.0)
Impairment of goodwill	(7.2)	(6.0)
Impairment of investment in associate	-	(8.3)
Change to pension scheme rules	4.1	-
Major facility closure costs	(5.4)	(5.0)
Bid response costs	(2.1)	-
Early settlement of US Private Placement	-	(3.1)
Profit Before Tax	<u>68.5</u>	<u>46.6</u>

### Taxation

Taxation was £14.7m for the year, £12m higher than the 2006 charge which had benefited from tax settlements of £11.2m. The effective tax rate for the Group was 21.5% (2006: 5.8%).

The Group's underlying rate of tax 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 before non-recurring items was 19.0% (2006: 7.7%). The 2006 underlying rate is stated after the impact of specific settlements with tax authorities that reduced the tax liability by £11.2m.

The effective tax rates reflect a blend of rates in the numerous worldwide locations in which Bodycote is present, and many of these have a lower tax rate than the UK standard rate of 30%. Additionally, a number of jurisdictions have reduced their tax rates or have announced tax rate reductions, which have had a favourable impact on the Group's effective rate.

### Earnings per share

Basic headline earnings per share (as defined in note 4) increased by 17.3% to 20.3p from 17.3p. Basic and diluted earnings per share for the year were 16.6p (2006: 13.4p), an increase of 23.9%

### Dividend

The Board has recommended a final dividend of 5.25p bringing the total dividend in 2007 to 8.0p (2006: 7.0p) an increase of 14.3%. The dividend is covered 2.5 times (2006: 2.5 times) by headline earnings per share (as defined in note 4) and 2.1 times (2006: 1.9 times) by basic earnings per share.

## Capital Structure

Our balance sheet at 31 December 2007 can be summarised as set out in the table below:

	<u>Assets</u>	<u>Liabilities</u>	<u>Net Assets</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Property, plant & equipment	508.9		508.9
Goodwill and intangibles	227.3		227.3
Current assets and liabilities	181.3	(157.2)	24.1
Other non-current assets and liabilities	15.0	(12.0)	3.0
Retirement benefit obligations		(23.9)	(23.9)
Deferred tax	29.7	(74.3)	(44.6)
Total before net debt	962.2	(267.4)	694.8
Net debt	37.7	(235.9)	(198.2)
Total as at 31 December 2007	999.9	(503.3)	496.6
Total as at 31 December 2006	889.4	(435.5)	453.9

Net assets increased by 9.4% to £496.6m (2006: £453.9m) and net assets per share by 9% to £1.56 (2006:£1.41). The main increases in the assets on the balance sheet were due to an increase in property, plant and equipment of £60.5m and an increase in goodwill and intangible assets of £15.0m, which arose from the acquisitions completed during the year. The increases in assets were partially offset by an increase in net debt of £37.3m.

## Net Debt

Group net debt was £198.2m (2006: £160.9m). During the year, additional loans of £36.0m were drawn down under committed facilities. The Group continues to be able to borrow at competitive rates and therefore currently deems this to be the most effective means of funding. In 2007, a three year committed loan facility of \$20m was completed.

## Cash Flow

Cash flow from operating activities was £108.0m compared to £109.2m in 2006, a decrease of 1.1%. After allowing for net capital expenditure of £66.9m (2006: £55.4m), the Group generated operating cash flow of £41.1m compared to £53.8m in 2006. There has been continued focus on cash collection and debtor days have decreased by 2 days to 68 days. Net interest payments in the year were £9.1m (2006: £12.8m) and tax payments were £16.0m (2006: £8.4m). Acquisitions and disposals resulted in net cash outgoings of £32.9m (2006: £86.2m).

## Capital Expenditure

Net capital expenditure for the year was £66.9m compared to £55.4m in 2006. The multiple of net capital expenditure to depreciation was 1.3 times as the Group expands into emerging markets and continues to take advantage of outsourcing opportunities. With buoyant demand continuing in most markets, the Group anticipates a ratio of 1.3 times again in the current year. During the year work continued on 21 greenfield investments started since 2006 such as the greenfield heat treatment plant in Mexico, various testing facilities in the Middle East, the new testing facility in Mexico and the construction of our Indian heat treatment facility. Expansion projects with expenditure in 2007 included a new heat treatment plant in Finland, the completion of a large HIP unit in the US and the commencement of work on a new large HIP unit in Sweden.

## Borrowing Facilities

At 31 December 2007, Bodycote had three committed bank facilities of £225m (2006: £225m), expiring July 2010; €125m (2006: €125m), expiring July 2013; and \$20m (2006: nil) expiring July 2010 totalling £326.9m (2006: £309.2m). At the same date, the three facilities were drawn £175.3m (2006: £140.3m), £44.1m (2006: £43.1m) and £4.6m (2006: nil) respectively, totalling £224.0m (2006: £183.4m).

## **Financial Risk Management**

The Group's treasury function provides a centralised service to the Group for funding, foreign exchange, interest rate management and counterparty risk. Treasury activities have the objective of minimising risk. Treasury operations are conducted within a framework of policies and guidelines authorised and reviewed by the Company's Board of directors, most recently on 13 December 2007.

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.

## 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 Company'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 2007 was 28% (2006: 26%).

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.

## 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 2007, the Group had committed facilities of £326.9m (2006: £309.2m) which exceed net debt of £198.2m (2006: £160.9m) by 65% (2006: 92%). 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 long term liquidity through long term 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 2.6 years. The €125m committed bank facility has a maturity of 5.6 years. In

addition cash management pooling, netting and concentration techniques are used to minimise borrowings.

## 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, Swedish Krona and Canadian Dollar. 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 2007, 6% of net borrowings were at fixed rates for an average period of 3.0 years.

### Currency risk

Bodycote has operations in 35 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, Swedish Krona and Canadian Dollar, 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 match currency assets with currency liabilities better. The Group recognises foreign exchange movements in equity for the translation of these net investment hedging instruments and balances. As at 31 December 2007, £231.7m of gross debt and £148.8m of FX and cross currency swap liabilities were in currencies other than sterling and net cash of £33.3m and cross currency swap assets of £140.2m were in sterling.

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

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 and 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 2007, for all financial instruments with all other variables remaining constant. This analysis is for illustrative purposes only, as in practice market rates rarely change in such a manner. 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 2007 would reduce or increase profit before tax by approximately £1.9m. 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 2007 would have reduced or increased profit before tax and equity (before tax effects) as follows:

£m		CAD	Euro	SEK	USD	Other	Total
Impact on equity	+ / -	2.3	17.5	3.8	9.3	0.8	33.7
Impact on profit before tax	+ / -	0.1	0.7	0.1	0.5	0.1	1.5

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

#### Counterparty risk

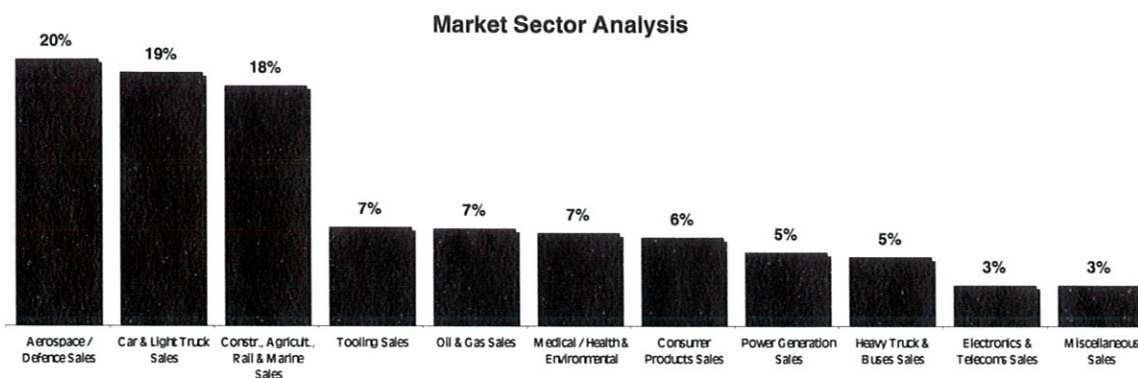
Counterparty risk encompasses settlement risk on derivative financial instruments and money market contracts and credit risk on cash and time deposits. The Group monitors its credit exposure to its counterparties via their credit ratings (where applicable) and through its policy, thereby limiting its 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, given our policy, 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 over 60,000 customers and is not reliant on any one business sector, end market, or client. The largest customer represents c. 3% of total Group revenue and the top ten customers account for c. 9%. Bodycote's diverse client base provides the Group with balanced demand from a number of sectors as seen below. Management therefore believes there is no further credit risk provision required in excess of the normal provision for bad and doubtful receivables.





### Defined Benefit Pension Arrangements

The Group has defined benefit pension obligations in the UK, Germany, Sweden, USA and Brazil and cash lump sum obligations in France, Italy and Turkey, which are all reflected in the Group balance sheet. In the UK, the Group has a final salary scheme, which was closed to new members in April 2001, but continues to accrue benefits for the 260 current employee members. The deficit as calculated by the scheme actuary at 31 December 2007 using the principles of IAS 19 is £13.4m. 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 2007 was £2.6m. In Sweden, the Group has two defined benefit arrangements. One is funded and one is unfunded and each is open to new employees. The IAS 19 liability at 31 December 2007 was £2.0m. The company sponsors five defined benefit pension arrangements in the USA which were inherited with the acquisition of Lindberg and had a total IAS 19 deficit at 31 December 2007 of £0.2m. There are no further accruals on any of these plans. Brasimet 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 2007 it had a surplus of £0.1m. In France we operate a plan which pays a cash lump sum on retirement and also for long service. The plan is open to new employees but by its nature is not mortality dependent. It is unfunded and the IAS 19 liability at 31 December 2007 was £4.9 m. Italy and Turkey also have cash lump sum obligations which are open to new members. The IAS 19 liability is £0.7m for Italy and £0.1m for Turkey.

### Post balance sheet events

After the year end the Group purchased Accutest Laboratories Limited, a Canadian analytical testing business, Metlab (Int.) Ltd in Eire which provides materials testing and non-destructive testing services and Thai Induction Services Co. Limited, Thailand's largest metallurgical services provider. The total consideration for these transactions was £10.4m.

### Change in accounting policies

During the year there were no material changes to accounting policies.

### Going concern

After making enquiries, the directors have formed the opinion that at the time of approving the financial statements, 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

### Markets

The key risk we face is a reduction in end market demand, but with the exception of the automotive sector in western markets, forecast demand in the near term appears robust.

### Commercial relationships

The Group benefits from many long term and partnership arrangements with key customers. Damage to or loss of any of these relationships may be detrimental to Group results although we believe this is highly unlikely. Given that our top ten customers account for only c. 9% of sales, with the balance made up by many thousands of customers, we have low revenue concentration risk. The Group has no significant supplier dependency.

### Competitors

With the exception of HIP, our 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.

### Human Resources

People are the Group's greatest asset and also form its largest cost. We work hard at maintaining a respectful and trusting relationship with all employees. However, we are mindful that there must be strong control on these costs, which can be flexed more easily in North America, the UK and emerging economies, but much less so in Western Europe where we strive to keep about 15% of our workforce flexible against a background of more restrictive employment laws.

### Safety and Health

Our work environment has numerous and varied risks which we strive to mitigate 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 our corporate ethos could have an adverse impact on the Group 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 we have been able to mitigate so far, although with some time lag, through price adjustments or surcharges and we expect to be able to continue this practice.

### Operations

Our stringent quality systems, our internal and external auditing as well as our customers verification of our results, minimise the risk of releasing faulty parts or test results into use, which could arise as a result of system or human failure.

## Environmental

Some of our heat treatment plants use solvents and other hazardous chemicals in small quantities. There is therefore the potential for ground contamination at our facilities. Past exposures are remediated as and when required. The likelihood of future problems is mitigated by our procedures, typically under the requirement of ISO 14001 environmental systems.

## Foreign exchange

Although the Group has all but 17% of its sales generated outside the UK, the overwhelming majority of those sales are supplied locally to customers buying in the currency of our input costs. Consequently transaction risk is low. We are, 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 we do not hedge this exposure. However, we do partially hedge our balance sheet assets and liabilities through a mixture of local currency loans and cross currency swaps.

## **Resources**

The Group has key resources which are critical to its continued success: People, Technology, Approvals and Systems.

### People

The strength of our Group primarily rests in our people and one of the key challenges for management is to ensure availability of appropriately qualified people to support our continued growth. We are fortunate to have a competent and committed international team that is well respected in technical and business circles. Most of our acquisitions are based on historical relationships with Bodycote personnel which is a testament to the integrity of our people. The Board has established a remuneration policy which rewards performance while offering competitive base packages. In line with our policy of continuous improvement we have established a leadership development programme to improve the succession pipeline for our future business leadership. With the opportunity for career development we believe we can continue to sustain and grow the Group into the future.

### Technology

The technology we apply in delivering our services is mostly generic. The differentiator is in our know-how in applying that technology, the quality standards we adhere to, the depth of technical knowledge we are able to deliver and the consistency of service. In those instances where we have unique technology, we have principally relied upon confidentiality with patent protection for niche areas.

### Approvals

We have 56 facilities registered to Nadcap, the international aerospace quality standard. All thermal processing facilities are certified to at least one quality standard (e.g. ISO 9001, TS 16949, Nadcap) and by the end of 2007 the year 131 out of 194 thermal processing facilities were certified to ISO 14001 environmental standards. Testing has 102 of its 115 facilities accredited to the laboratory management standard ISO 17025. Our reputation for strong compliance differentiates us in the market place and assures customers of our ability to deliver consistent quality. This makes our customers' decision to outsource critical components easier.

### Systems

Information Systems provide the systems that allow us to operate successfully operate a large distributed network. It is critical that we continue to develop our systems so we can have the most efficient information processes for ourselves, our customers and so we have the ability to identify and control costs

across the whole of the Group. We use computer and internet technology to provide secure real-time job status as well as technical support to our customers.

### **Corporate ethos**

In achieving Bodycote's aim to be recognised globally as the leading provider of thermal processing and in testing services, the Board has over time developed several principles which will apply in its dealings with stakeholders and the wider community.

#### Safety, health and the environment

Bodycote has a proactive approach to safety, health and the environment and is committed to the highest practicable standards of safety and health management and to the minimisation of adverse environmental impacts.

#### Human Resources

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.

#### 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: We do not employ unfair trading methods and we compete vigorously but fairly within the requirements of the applicable laws. Employees are prohibited from either giving or receiving any inducements.

#### Conflicts of interest

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.

As a result of these principles, some key areas of focus have emerged, namely in respect of people, safety, health and the environment.

### **Key areas of focus**

#### Training and 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 265 students from 10 countries. The Foundation also supports the annual Prize Paper Competition. In its twelfth year, the competition has become one of the most highly regarded 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.

### Safety & Health

Appropriate safety and health policies and procedures are in force in both SBUs. 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 SBU is now able to benchmark its safety and health performance and formulate criteria for improvements. Bonus payments to Directors and senior executives are in part dependent on achievement of these targets.

### Environment

Bodycote has for many years contributed to the reduction of the environmental impact of industry. By adopting the latest technologies as they have become available, Bodycote has provided its customers with environmentally friendly solutions to their heat treatment requirements. The replacement, where possible, of harmful materials has reduced the need for disposal of waste products. At the same time the adoption of high efficiency heating systems has reduced energy consumption and reduced emissions.

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

Bodycote operates modern, efficient heat treatment furnaces around the clock. We aggregate 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 can be dramatically reduced.

The range of services offered across the Group is designed to enhance the suitability and operational lifetime of components and for recycling at the end of their working lives. This increase in the working life of components has a major effect on the amount of raw materials that are processed. Modern treatments also allow new technologies, such as common rail diesel systems, to be introduced within acceptable financial constraints. This, in turn, reduces the environmental impact of motor vehicles by improving fuel consumption and reducing emissions. At every stage where Bodycote is involved in the manufacturing cycle, our operations aim to lessen the overall impact on the environment.

### **Current Trading and Prospects**

Our customers in aerospace, oil & gas, power generation and health sciences are forecasting positive growth through 2008 despite widespread predictions of economic slowdown. Many of the markets that Bodycote serves notably aerospace, power generation and oil & gas, operate on long cycles, with significant committed order books. North American automotive (4.9% of our Group sales) is forecast to build 1% fewer cars and light trucks in 2008, compared to 2007.

Outsourcing by western manufacturers continues to grow with sales reaching £123m in 2007, an increase of 17% (2006: £105m) and this trend is set to continue. Our focus on maximising capacity utilisation will allow us to provide manufacturers with lower overall costs for their thermal processing and testing needs. The increased outsourcing growth has partially been absorbed into existing plant and equipment and in some cases additional equipment has been installed. We expect this pattern to be repeated in 2008.

Our strategy to increase our presence in developing economies, including those in Asia, Latin America, Eastern Europe and the Middle East, is progressing. Sales now account for 9.1% of Group sales (2006:

4.6%). The early demand for high quality subcontracting is somewhat lower than anticipated in Asia but we remain confident of the long term opportunity. In total our greenfield sites in the emerging markets recorded operating losses of £2.4m in 2007.

We enter 2008 with market conditions for heat treatment remaining favourable in all territories and market sectors with the exception of the Great Lakes area of North America, where much of the work comes from the automotive industry. Given the strength of the order books amongst our aerospace, power generation and oil & gas customer base and, given our market share gains in the automotive sector, we are confident about the Group's prospects notwithstanding the uncertainty about the level of consumer demand in 2008, particularly in North America.

HIP continues to experience increasing demand from its key aerospace, power generation and oil & gas markets. A new large HIP vessel went into production in September in the USA and is ramping up sales as forecast. We have expanded our Swedish facility to improve the efficiency of fabricating containers used in powder HIPped near-net-shape components and in preparation for a new large HIP vessel which will go into production in Q1 2010. The acquisition of the remaining 51% of the equity of Traitements Compression Services SAS (TCS) in Magny-Cours, France gives us control over this facility enabling us to utilise this capacity in Southern Europe more effectively.

After another good performance in 2007, the MEM division of testing is expected to continue its success in 2008. The weakness in the North American automotive market has been addressed by restructuring our laboratory facilities in Michigan. In HSE a major cost reduction exercise has been undertaken which has seen us exit several locations in Canada and management has been reorganised accordingly across the whole of North America. Similarly in the UK, a number of environmental facilities have been closed to reduce the cost base and the Food Group have increased their focus on high added value advisory services. We expect a significant improvement in the performance of the HSE division in 2008.

Since the end of 2007 we have acquired three businesses (two Testing, one Thermal Processing) for a total consideration of £10.4m. We have a strong pipeline of acquisition candidates for both Thermal Processing and Testing. On average we expect to continue investing about £60m per annum on acquisitions.

Capital expenditure for 2008 are expected to be at 1.3 times depreciation (2007: 1.3 times) reflecting the continuing investment in greenfield locations in developing economies, expanding our HIP capacity and supporting our continuing outsourcing growth. Ongoing operations require around 0.8 times depreciation to sustain their businesses.

Since the start of the current financial year, trading has been above the levels for the same period in 2007 in both SBUs and in all geographies. We enter 2008 with renewed confidence that we will deliver another successful performance.

Finally, the employees and the Board of Bodycote would like to thank our outgoing Chairman, James Wallace, for his dedicated service to the company. Under James' leadership, Bodycote has been strengthened while growing our businesses in line with our strategy. We all wish James continued success and personal happiness in the future.

J D Hubbard  
26 February 2008

D F Landless  
26 February 2008

**Consolidated Income Statement  
for the year ended 31 December 2007**

	2007 £ m	2006 £ m
<b>Revenue</b>		
Existing operations	631.4	510.3
Acquisitions	9.1	48.3
	<u>640.5</u>	<u>558.6</u>
<b>Operating profit</b>		
Existing operations	77.5	51.3
Acquisitions	1.2	7.2
Share of results of associates	0.1	0.3
	<u>78.8</u>	<u>58.8</u>
Operating profit prior to exceptional items	91.3	79.1
Amortisation/impairment of acquired intangible fixed assets	(1.9)	(1.0)
Impairment of goodwill	(7.2)	(6.0)
Major facility closure costs	(5.4)	(5.0)
Impairment of investment in associate	-	(8.3)
Change to pension scheme rules	4.1	-
Bid response costs	(2.1)	-
<b>Operating profit</b>	78.8	58.8
Investment revenue	3.3	3.4
Finance costs	(13.6)	(15.6)
<b>Profit before taxation</b>	<u>68.5</u>	<u>46.6</u>
Taxation	(14.7)	(2.7)
<b>Profit for the year</b>	<u><u>53.8</u></u>	<u><u>43.9</u></u>
Attributable to:		
Equity holders of the parent	52.8	43.1
Minority interests	1.0	0.8
	<u><u>53.8</u></u>	<u><u>43.9</u></u>
<b>Earnings per share</b>	<b>Pence</b>	<b>Pence</b>
From continuing operations:		
Basic	16.6	13.4
Diluted	16.6	13.4

**Consolidated Statement of Recognised Income and Expense  
for the year ended 31 December 2007**

	2007 £ m	2006 £ m
Exchange differences on translation of foreign operations	12.5	(6.7)
Actuarial gains/ (losses) on defined benefit pension schemes	4.7	(3.7)
Tax on items taken directly to equity	<u>(3.1)</u>	<u>1.6</u>
<b>Net income/(loss) recognised directly in equity</b>	14.1	(8.8)
<b>Profit for the year</b>	53.8	43.9
<b>Recognised income for the year</b>	<u><u>67.9</u></u>	<u><u>35.1</u></u>
Attributable to:		
Equity holders of the parent	66.9	34.3
Minority interests	1.0	0.8
	<u><u>67.9</u></u>	<u><u>35.1</u></u>

All activity arose from continuing operations.



**Consolidated Balance Sheet  
at 31 December 2007**

	2007	2006
	£ m	£ m
<b>Non-current assets</b>		
Goodwill	213.0	201.9
Other intangible assets	14.3	10.4
Property, plant and equipment	508.9	448.4
Interests in associates	0.6	1.2
Finance lease receivables	1.0	1.4
Deferred tax asset	29.7	23.2
Derivative financial instruments	0.1	0.6
Trade and other receivables	13.3	11.3
	<u>780.9</u>	<u>698.4</u>
<b>Current assets</b>		
Inventories	19.8	13.7
Finance lease receivables	0.4	0.3
Derivative financial instruments	-	1.9
Trade and other receivables	159.3	138.1
Cash and cash equivalents	37.7	34.7
Assets classified as held for sale	1.8	2.3
	<u>219.0</u>	<u>191.0</u>
<b>Total assets</b>	<u><u>999.9</u></u>	<u><u>889.4</u></u>
<b>Current liabilities</b>		
Trade and other payables	124.5	111.1
Dividends payable	8.8	8.0
Current tax liabilities	13.0	6.7
Obligations under finance leases	1.7	1.4
Bank overdrafts and loans	9.0	4.4
Derivative financial instruments	5.2	0.2
Provisions	5.7	2.5
	<u>167.9</u>	<u>134.3</u>
<b>Net current assets</b>	<u>51.1</u>	<u>56.7</u>
<b>Non-current liabilities</b>		
Bank loans	221.8	186.5
Retirement benefit obligation	23.9	32.8
Deferred tax liabilities	74.3	68.7
Obligations under finance leases	3.4	3.3
Derivative financial instruments	3.0	0.1
Provisions	2.2	4.1
Other payables	6.8	5.7
	<u>335.4</u>	<u>301.2</u>
<b>Total liabilities</b>	<u>503.3</u>	<u>435.5</u>
<b>Net assets</b>	<u><u>496.6</u></u>	<u><u>453.9</u></u>

Consolidated Balance Sheet (continued)  
at 31 December 2007

	2007	2006
	£ m	£ m
<b>Equity</b>		
Share capital	32.4	32.2
Share premium account	305.0	302.1
Own shares	(11.0)	(2.4)
Other reserves	6.0	3.8
Hedging and translation reserves	16.9	4.4
Retained earnings	140.7	109.4
<b>Equity attributable to equity holders of the parent</b>	490.0	449.5
<b>Minority interest</b>	6.6	4.4
<b>Total equity</b>	496.6	453.9

Consolidated Cash Flow Statement  
for the year ended 31 December 2007

	2007 £ m	2006 £ m
<b>Net cash from operating activities</b>	108.0	109.2
<b>Investing activities</b>		
Purchases of property, plant and equipment	(72.5)	(59.5)
Proceeds on disposal of property, plant and equipment and intangible assets	6.6	4.8
Purchases of intangible fixed assets	(1.0)	(0.7)
Acquisition of investment in an associate	(0.2)	-
Acquisition of subsidiaries	(32.7)	(86.3)
Disposal of subsidiaries	-	0.1
<b>Net cash used in investing activities</b>	<u>(99.8)</u>	<u>(141.6)</u>
<b>Financing activities</b>		
Interest received	3.4	2.9
Interest paid	(12.5)	(15.7)
Dividends paid	(22.6)	(20.5)
Dividends paid to a minority shareholder	(0.1)	(0.1)
Repayments of bank loans	(187.1)	(65.5)
Payments of obligations under finance leases	(1.9)	(1.8)
New bank loans raised	216.4	46.0
New obligations under finance leases	0.6	0.5
Proceeds on issue of ordinary share capital	3.1	1.9
Own shares purchased/settlement of share options	(8.6)	0.1
<b>Net cash used in financing activities</b>	<u>(9.3)</u>	<u>(52.2)</u>
<b>Net decrease in cash and cash equivalents</b>	(1.1)	(84.6)
<b>Cash and cash equivalents at beginning of year</b>	33.4	120.7
Effect of foreign exchange rate changes	<u>2.0</u>	<u>(2.7)</u>
<b>Cash and cash equivalents at end of year</b>	<u><u>34.3</u></u>	<u><u>33.4</u></u>

Reconciliation of operating profit to net cash from operating activities

	2007	2006
	£ m	£ m
Operating profit	78.8	58.8
Share of associates' interest and tax	-	0.6
Depreciation of property, plant and equipment	49.3	44.8
Amortisation/impairment of intangible assets	2.7	1.6
Impairment of goodwill	7.2	6.0
Major facility closure costs	5.4	5.0
Impairment of investment in associate	-	8.3
Change to pension scheme rules	(4.1)	-
Bid response costs	2.1	-
EBITDA <sup>1</sup>	<u>141.4</u>	<u>125.1</u>
(Gain)/loss on disposal of property, plant and equipment	(0.1)	0.3
Income from associates	(0.1)	(0.9)
Share-based payments	<u>2.5</u>	<u>2.1</u>
Operating cash flows before movements in working capital	143.7	126.6
Increase in inventories	(3.7)	(0.4)
Increase in receivables	(8.4)	(15.5)
(Decrease)/increase in payables	(2.9)	9.5
Decrease in provisions	<u>(5.4)</u>	<u>(2.6)</u>
Cash generated by operations	123.3	117.6
Cash inflow from settlement of derivative financial instruments	0.7	-
Income taxes paid	<u>(16.0)</u>	<u>(8.4)</u>
Net cash from operating activities	<u><u>108.0</u></u>	<u><u>109.2</u></u>

<sup>1</sup> Earnings before interest, tax, depreciation and amortisation and other exceptional items

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.

## 1. Operating profit

	2007			2006		
	Existing operations	Acquisitions	Continuing operations	Existing operations	Acquisitions	Continuing operations
	£ m	£ m	£ m	£ m	£ m	£ m
Revenue	631.4	9.1	640.5	510.3	48.3	558.6
Cost of sales	(412.5)	(5.6)	(418.1)	(334.7)	(31.3)	(366.0)
Gross profit	218.9	3.5	222.4	175.6	17.0	192.6
Other operating income	5.0	0.2	5.2	2.8	-	2.8
Distribution costs	(22.9)	(0.7)	(23.6)	(16.5)	(2.1)	(18.6)
Other administration expenses*	(111.0)	(1.8)	(112.8)	(90.7)	(7.1)	(97.8)
Other operating expenses	-	-	-	(0.2)	-	(0.2)
Amortisation/impairment of acquired intangible fixed assets*	(1.9)	-	(1.9)	(0.4)	(0.6)	(1.0)
Impairment of goodwill*	(7.2)	-	(7.2)	(6.0)	-	(6.0)
Major facility closure costs*	(5.4)	-	(5.4)	(5.0)	-	(5.0)
Impairment of investment in associate*	-	-	-	(8.3)	-	(8.3)
Change to pension scheme rules	4.1	-	4.1	-	-	-
Bid response costs	(2.1)	-	(2.1)	-	-	-
Operating profit before income from associates	<u>77.5</u>	<u>1.2</u>	<u>78.7</u>	<u>51.3</u>	<u>7.2</u>	<u>58.5</u>
Income from associates after interest and tax			<u>0.1</u>			<u>0.3</u>
Operating profit			<u><u>78.8</u></u>			<u><u>58.8</u></u>

\* Administration expenses (total £125.3m, 2006: £118.1m)

Exceptional items comprise amortisation/impairment of acquired intangible fixed assets, impairment of goodwill, major facility closure costs, impairment of investment in associate, change to pension scheme rules and bid response costs.

## 2. Business and geographical segments

	Heat Treatment	Hot Isostatic Pressing	Testing - MEM*	Testing - HSE*	Head Office and eliminations	Continuing operations
	2007 £ m	2007 £ m	2007 £ m	2007 £ m	2007 £ m	2007 £ m
<b>Revenue</b>						
External sales	421.7	43.5	124.4	50.9	-	640.5
Inter-segment sales	-	-	0.8	-	(0.8)	-
<b>Total revenue</b>	<b>421.7</b>	<b>43.5</b>	<b>125.2</b>	<b>50.9</b>	<b>(0.8)</b>	<b>640.5</b>

Inter-segment sales are charged at prevailing market prices.

### Result

Segment result prior to exceptional items and share of associates' profit after tax	61.6	15.3	16.9	4.1	-	97.9
Share of associates' operating profit	-	0.1	-	-	-	0.1
Unallocated corporate expenses	-	-	-	-	(6.7)	(6.7)
<b>Headline operating profit</b>	<b>61.6</b>	<b>15.4</b>	<b>16.9</b>	<b>4.1</b>	<b>(6.7)</b>	<b>91.3</b>
Amortisation /impairment of acquired intangible assets and impairment of goodwill	(4.3)	-	(0.3)	(4.5)	-	(9.1)
Major facility closure costs	(3.4)	-	(0.4)	(1.6)	-	(5.4)
Change to pension scheme rules	2.0	0.2	1.3	0.2	0.4	4.1
Bid response costs	-	-	-	-	(2.1)	(2.1)
<b>Segment result</b>	<b>55.9</b>	<b>15.6</b>	<b>17.5</b>	<b>(1.8)</b>	<b>(8.4)</b>	<b>78.8</b>
Share of associates' interest and tax	-					-
Operating profit						78.8
Investment revenues						3.3
Finance costs						(13.6)
<b>Profit before tax</b>						<b>68.5</b>
Tax						(14.7)
<b>Profit for year</b>						<b>53.8</b>

\* Testing comprises MEM (Materials Testing/Engineering and Technology/Measurement Technology) and HSE (Health Sciences and Environmental).

These divisions have been presented as separate segments in the current year in line with the Group's internal reporting structure.

## 2. Business and geographical segments (continued)

	Heat Treatment	Hot Isostatic Pressing	Testing - MEM	Testing - HSE	Head Office and eliminations	Continuing operations
	2006 £ m	2006 £ m	2006 £ m	2006 £ m	2006 £ m	2006 £ m
<b>Revenue</b>						
External sales	375.0	38.9	99.6	45.1	-	558.6
Inter-segment sales	-	-	0.6	-	(0.6)	-
<b>Total revenue</b>	<b>375.0</b>	<b>38.9</b>	<b>100.2</b>	<b>45.1</b>	<b>(0.6)</b>	<b>558.6</b>

Inter-segment sales are charged at prevailing market prices.

### Result

Segment result prior to exceptional items and share of associates' profit after tax	49.5	12.7	14.3	7.0	-	83.5
Share of associates' operating profit	0.8	0.1	-	-	-	0.9
Unallocated corporate expenses	-	-	-	-	(4.7)	(4.7)
	50.3	12.8	14.3	7.0	(4.7)	79.7
Amortisation/impairment of acquired intangible assets and impairment of goodwill and investment in associate	(10.7)	-	(4.0)	(0.6)	-	(15.3)
Major facility closure costs	(5.0)	-	-	-	-	(5.0)
<b>Segment result</b>	<b>34.6</b>	<b>12.8</b>	<b>10.3</b>	<b>6.4</b>	<b>(4.7)</b>	<b>59.4</b>
Share of associates' interest and tax	(0.6)					(0.6)
Operating profit						58.8
Investment revenues						3.4
Finance costs						(15.6)
Profit before tax						46.6
Tax						(2.7)
<b>Profit for year</b>						<b>43.9</b>

## 2. Business and geographical segments (continued)

### Other information

	Heat Treatment	Hot Isostatic Pressing	Testing - MEM	Testing - HSE	Head office and eliminations	Consolidated
	2007	2007	2007	2007	2007	2007
	£ m	£ m	£ m	£ m	£ m	£ m
Capital additions	44.2	12.6	13.1	3.1	0.5	73.5
Depreciation and amortisation	36.0	4.3	7.9	3.2	0.2	51.6
Impairment losses recognised in income	3.8	-	0.4	4.1	-	8.3
<b>Balance sheet</b>						
<u>Assets:</u>						
Segment assets	941.4	100.2	152.9	82.4	(277.6)	999.3
Interests in associates	0.6	-	-	-	-	0.6
Consolidated total assets	942.0	100.2	152.9	82.4	(277.6)	999.9
<u>Liabilities:</u>						
Segment liabilities	522.9	48.2	107.5	57.9	(233.2)	503.3
<u>Segment net assets</u>	419.1	52.0	45.4	24.5	(44.4)	496.6

	Heat Treatment	Hot Isostatic Pressing	Testing - MEM	Testing - HSE	Head office and eliminations	Consolidated
	2006	2006	2006	2006	2006	2006
	£ m	£ m	£ m	£ m	£ m	£ m
Capital additions	38.8	6.6	10.6	3.9	0.3	60.2
Depreciation and amortisation	33.1	4.3	5.9	2.7	0.2	46.2
Impairment losses recognised in income	13.9	-	3.7	0.2	-	17.8
<b>Balance sheet</b>						
<u>Assets:</u>						
Segment assets	772.6	87.2	126.0	70.5	(168.1)	888.2
Interests in associates	1.2	-	-	-	-	1.2
Consolidated total assets	773.8	87.2	126.0	70.5	(168.1)	889.4
<u>Liabilities:</u>						
Segment liabilities	445.7	36.1	107.7	60.3	(214.3)	435.5
<u>Segment net assets</u>	328.1	51.1	18.3	10.2	46.2	453.9



## 2. Business and geographical segments (continued)

### By geographical market

	<u>Revenue</u>	
	2007	2006
	£ m	£ m
Europe, Middle East and Africa	422.0	356.8
Americas	215.4	200.6
Asia Pacific	3.1	1.2
	<u>640.5</u>	<u>558.6</u>

	Carrying amount of segment assets		Additions to property, plant and equipment and intangible assets	
	2007	2006	2007	2006
	£ m	£ m	£ m	£ m
Europe, Middle East and Africa	395.1	321.5	45.4	37.3
Americas	101.0	129.8	24.0	19.6
Asia Pacific	0.5	2.6	4.1	3.3
	<u>496.6</u>	<u>453.9</u>	<u>73.5</u>	<u>60.2</u>

### 3. Taxation

	2007	2006
	£ m	£ m
Current taxation – charge for the year	17.0	10.5
Current taxation - adjustment in respect of previous years	3.4	1.6
Deferred tax	<u>(5.7)</u>	<u>(9.4)</u>
	<u>14.7</u>	<u>2.7</u>

UK corporation tax is calculated at 30% (2006: 30%) of the estimated assessable profit for the year. Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

Reductions in tax rates have been announced in a number of jurisdictions in which Bodycote operates. The impact of these reductions has been included within deferred tax balances and going forward will be reflected in current tax rates.

#### 4. Earnings per share

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

	2007 £ m	2006 £ m
<b>Earnings</b>		
Earnings for the purposes of basic earnings per share being net profit attributable to equity holders of the parent	<u>52.8</u>	<u>43.1</u>
<b>Number of shares</b>		
	Number	Number
Weighted average number of ordinary shares for the purposes of basic earnings per share	317,934,910	320,462,772
Effect of dilutive potential ordinary shares:		
Share options	<u>732,862</u>	<u>880,065</u>
Weighted average number of ordinary shares for the purposes of diluted earnings per share	<u>318,667,772</u>	<u>321,342,837</u>
	Pence	Pence
Basic	<u>16.6</u>	<u>13.4</u>
Diluted	<u>16.6</u>	<u>13.4</u>
<b>Headline earnings</b>		
	2007 £ m	2006 £ m
Net profit attributable to equity holders of the parent	52.8	43.1
Add back:		
Impairment of goodwill	7.2	6.0
Amortisation/impairment of acquired intangible fixed assets	1.9	1.0
Impairment of investment in associate	-	8.3
Major facility closure costs	3.6	5.0
Change to pension scheme rules	(3.0)	-
Bid response costs	2.1	-
Cost of early settlement of US Dollar private placement debt	-	3.1
Tax settlements in respect of prior years	<u>-</u>	<u>(11.2)</u>
Headline earnings	<u>64.6</u>	<u>55.3</u>
<b>Earnings per share from headline earnings:</b>		
	Pence	Pence
Basic	<u>20.3</u>	<u>17.3</u>
Diluted	<u>20.3</u>	<u>17.2</u>

## **5. Basis of preparation**

The financial information has been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the EU.

Whilst the financial information contained in this preliminary announcement has been computed in accordance with International Financial Reporting Standards, this announcement does not itself contain sufficient information to comply with IFRS. The Company expects to publish full financial statements that comply with IFRS in April 2008.

The financial information has been prepared under the same accounting policies as the 2006 financial statements.

## **6. Non-statutory financial statements**

The financial information set out above does not constitute the Group's statutory financial statements for the year ended 31 December 2007 or 2006 but is derived from those financial statements. Statutory financial statements for 2006 have been delivered to the Register of Companies. Those for 2007 will be delivered following the company's annual general meeting, which will be convened on 30 April 2008. The auditors have reported on those accounts: their report was unqualified and did not contain any statement under Section 237(2) or (3) of the Companies Act 1985.

This report was approved by the Board of Directors on 26 February 2008.