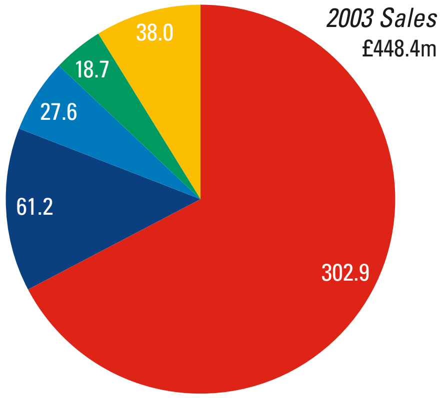
annual report **2003**

Bodycote

At a glance

Bodycote Heat Treatments…

…providing a vital link in the manufacturing process for the automotive, aerospace,, construction, power generation, electronics, consumer products and general engineering industries. Operating 145 plants in 18 countries; an unrivalled strategically located network, experienced in supporting large multi-national customers and their supply chains, as well as local niche specialists. Expanding in Italy and developing the Bodycote Kolsterising® technology in France and the USA.

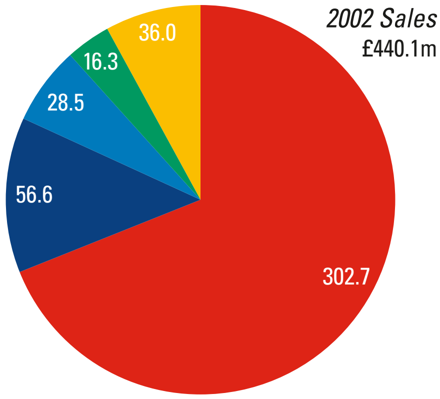


Bodycote Materials Testing…

…assessing and certifying the quality and reliability of materials and products for many clients in the fields of civil engineering, environmental protection, food and household goods, microbiology, pharmaceuticals, pipeline polymers, and transport. Offering a fully accredited group of 46 testing laboratories in 10 countries, serving international customers. Expanding in the Czech Republic and the Middle East, providing a beneficial outsource option for advancing businesses.

Bodycote Hot Isostatic Pressing…

…applying the unique product enhancement and novel material production benefits of this advanced technology to an increasing number of customers in precision foundry, power generation, aerospace, automotive, medical, precision tooling, and electronic engineering. Managing the western world's largest HIPping capacity at 11 locations across 6 countries. Developing new materials and manufacturing techniques by collaborative projects with market-leading OEMs.



Bodycote Specialty Coatings…

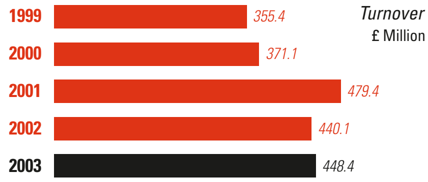
…improving the performance, durability and appearance of components and tools by the application of functional and decorative coatings utilising, physical vapour deposition (PVD), plasma spray and ceramic coatings processes. Operating 11 environmentally friendly coatings centres in 6 countries. Expanding the international provision of PVD coatings services for tooling, tribological and decorative applications and establishing CoatAlloy™, the unique new Bodycote coating service for the petrochemical industry.

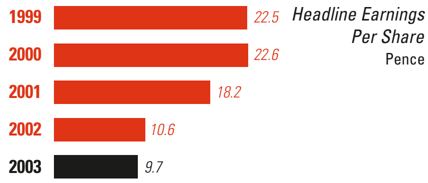
Bodycote Wet Coatings…

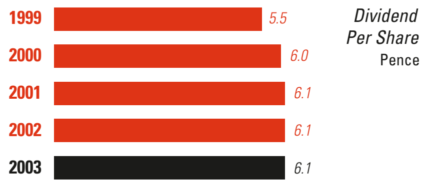
…enhancing the corrosion resistance and appearance of constructional components and consumer products by the application of electroplating and mechanical plating processes. Operating 22 environmentally friendly coatings centres in 5 countries.

Bodycote

	2003	2002
Turnover	**£448.4m**	£440.1m
Headline Operating Profit [1]	**£41.7m**	£49.4m
Operating Profit	**£25.1m**	£22.4m
Headline Profit Before Taxation [1]	**£32.0m**	£38.2m
(Loss)/Profit Before Taxation	**(£11.1m)**	£11.2m
Headline Earnings Per Share [1,2]	**9.7p**	10.6p
Basic (Loss)/Earnings Per Share	**(6.8p)**	2.4p
Dividend Per Share	**6.1p**	6.1p







[1] Headline Operating profit and profit before taxation are stated before exceptional items (2003: £34.0m; 2002: £18.3m) and amortisation of goodwill (2003: £9.1m; 2002: £8.7m).

[2] A reconciliation of headline EPS is given on page 30.

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Chairman's Statement

Introduction

It has been another tough year. At the beginning of 2003 there was a general view amongst macro-economic commentators that the difficult market conditions that commenced in the middle of 2001 would start to abate in the second half of 2003. However, as in 2002, the encouraging mid-year signs turned out to be another false dawn. The programme of self-help initiatives that we have taken have been extensive and the benefits have gone some way to compensate for the effects of downward market demand, pressure on pricing and the increased costs particularly of medical insurances, depreciation and utilities.

Trading

Aided by some acquisition growth and favourable foreign exchange conversion rates turnover was up by a modest amount at **£448.4m** (2002:£440.1m). Operating profit of **£25.1m** (2002: £22.4m) was up 12 per cent. However, despite our cost saving measures our operating margins weakened and consequently our profit before taxation, goodwill amortisation of **£9.1m** (2002: £8.7m) and exceptional items of **£34.0m** (2002: £18.3m) fell to **£32.0m** (2002:£38.2m).

Heat Treatment turnover held up well in Europe but was severely affected in North America, which also suffered from the adverse effects of currency translation. Materials Testing was again our most successful Strategic Business Unit with an improvement in both sales and operating profit. HIPping, particularly in the early part of the year, experienced a further downturn in turnover and profitability. Metallurgical Coatings, whilst increasing turnover, has not so far secured the benefits from the rationalisation programme and the increased losses within this division are all attributable to wet coatings which is an area of activity that we have concluded does not fit with Bodycote's longer term strategy. A decision has thus been taken to exit the wet coatings business area in an orderly and timely fashion.

It is particularly pleasing to note that our efforts to reduce capital expenditure and to improve working capital continue to show benefits and we have generated free cash of £30.3m in the year (2002: £22.0m) and our year end indebtedness now stands at £210.3m (2002:£234.2m).

Operating Exceptionals and Exceptional charges

Principally as a result of the decision to dispose of our wet coatings businesses we incurred £34.0m net exceptional and operating exceptional charges in 2003 (2002: £18.3m). £33.5m of these charges related to goodwill and asset write-downs and were of a non cash nature. It is anticipated that a further £5m cash of exceptional charges will be incurred in 2004 in respect of disposal and closure costs for wet coatings.

Future Growth

The focus of the Board is to return the Group to an organic growth path and a number of significant new outsourcing contracts have been won and are currently being negotiated. In addition, the Board have and will continue to consider appropriate bolt on acquisitions, which we believe will strengthen the Group, improve our market position and increase our earning capacity. Net acquisition costs in 2003 were £2.2m. The principal acquisition of 3 test laboratories in the Middle East has been assimilated well and has significantly increased our presence in this growing market. The other acquisition of note was the CoatAlloy® slurry coatings business which is being relocated from Canada to an existing facility in the UK.

Rights Issue

We have taken the decision to strengthen our balance sheet and to give ourselves increased financial flexibility going forward. To this end we have today announced a fully underwritten rights issue which will raise net proceeds of approximately £61.9m. We believe that this issue together with the actions being taken on wet coatings and the rationalisation measures already implemented will significantly strengthen Bodycote's financial position. Full particulars are contained in the prospectus sent to shareholders under separate cover.

Dividend

The Directors are recommending an unchanged final dividend of 3.85p which maintains the total dividend for the year at 6.1p and will be paid on 5 July 2004 to all shareholders on the register at the close of business on 26 March 2004. The new shares, the subject of the rights issue, will not qualify for this final dividend.

Governance

Over the last two years Bodycote has been very proactive in reviewing and implementing changes to its board structure and governance procedures in general. What has emerged, we believe, is a structure appropriate for Bodycote. In keeping with the spirit of the New Combined Code we explain in the Directors' Report in the Annual Report why, for good reasons, we are at variance with the Code in a small number of respects. Our clear focus, going forward, as a Board, is to concentrate on adding economic value to the Group whilst continuing to be transparent and open in our communication with shareholders and the investment community.

Employees

As always we rely upon the dedication and professionalism of our staff which has been clearly demonstrated in what has been another tough year. The additional financial commitment from our shareholders and the prospects for an upturn in our markets will provide them with the opportunity to fully demonstrate their abilities.

Safety, Health and the Environment

The industries we operate in have inherent safety risks from high temperature, high pressure, volatile gases and chemicals. We strive to provide training, equipment and procedures to manage the risks associated with our businesses. In the past year we have enhanced the gathering of detailed safety performance data relating to incidents, frequency and severity rates of accidents and established specific goals. Environmental compliance is part of our good citizenship effort. We now have a group of facilities certified to ISO-14001 environmental standard and are working to certify more locations. We remain committed to continuous improvement.

Current Trading and Prospects

The results for the first two months of the year are in line with our expectations. With the operating improvements that have already been implemented and the actions we are taking on Wet Coatings, we are confident in the financial and trading prospects for the Group in the current year.

Looking further ahead the Group is poised to move forward as market demand recovers. Bodycote has capable people, productive facilities and the systems to deliver exceptional quality and service. The Group will continue to focus on higher value added work, gaining further market share and winning new outsourcing contracts. The Group's medium term strategy is to deliver a pre tax return on capital in the mid teens.

James AS Wallace

James Wallace
9 March 2004

2003 brought no respite from the tough trading conditions we faced since mid 2001 when demand for the Group's services began to decline, particularly in North America. This trend was quickly exacerbated by the events of September 11, political instability and has continued to affect us through 2003. The Group's future can best be served by concentrating on the businesses where we have strong market positions and excellent know how, to enable Bodycote to maximise its return on capital employed.

Sales for the year were up 1.9% over 2002; however, this was aided by some small acquisitions generating growth of 1.8% and favourable currency translation of 1.9%. Pricing pressures remained high, the result of our customers benchmarking manufacturing costs on a global basis and driving their costs down. In response to difficult markets, over capacity in the market and overlapping locations, we closed 13 facilities in 2003, 16 in 2002 and reduced headcount by around 1,100 in this two year period. These actions have primarily targeted Heat Treating and Wet Coatings in the USA, UK, Sweden and France and have slightly improved facility utilisation. Market mix, however, has remained skewed towards lower value added segments with commercial aviation, oil and gas, telecommunications and industrial gas turbine market (IGT) demands remaining low. We have successfully reduced our cost structure by £15m annualised over the past two years, but these gains have been more than offset by unit cost rises for key inputs, most notably our people costs, energy and depreciation. Reflecting all these dynamic forces, operating margins declined in all Strategic Business Units (SBUs) except Materials Testing where they remained steady. We have successfully instituted rigorous controls on capital expenditure and in 2003 generated £30.3m free cash flow (2002: £22.0m) and net cash of £16.1m, after paying the dividend.

Automotive and general engineering end markets have begun to show some signs of recovery in demand while aerospace and power generation markets are stabilising.

We made two significant acquisitions during the year. The first, a patented slurry coating technology developed in Canada which has been relocated to an existing UK facility with development support being provided from one of our laboratories in Canada. The second, a testing group of three laboratories in the Middle East.

We captured new outsourcing business which, when on stream, will equate to over £20m a year of new sales. In addition, as a result of our network capability within each geographical region, we are expecting to see market growth opportunities develop in late 2004 from our technology transfer initiatives.

Our two largest SBUs, Heat Treatment and Materials Testing, are in a good position to capitalise on improving market conditions. Demand for HIP remains subdued as this is more geared to IGT and aerospace markets which are expected to improve later than other sectors.

The Wet Coatings performance, however, continued to decline. With sales in 2003 of £38.0m, it lost £6.0m, had negative EBITDA of £1.8m and over the past two years absorbed £10m of capital investment. The Wet Coatings group was established in the late 1990s through a series of acquisitions designed to create a business which would be synergistic with Bodycote's core heat treatment operations. These synergies, however, have not materialised. After a thorough evaluation we have decided to exit the Wet Coating business sector and aim to do so by divestiture in an orderly and timely fashion so we can focus our resources on core businesses. We estimate that this early action will require a charge of c.£35.0m. This will include non cash asset write downs of approximately £30m charged in the 2003 accounts, of which, £19m relates to tangible fixed assets and £11m to goodwill. The remaining £5m (cash) relates to exit costs such as redundancy, and these will be charged in the 2004 accounts. The exit from this business will remove a cash and profit drain on the Group and will allow us to re-focus attention and develop our core businesses.

In addition to addressing the Wet Coatings issue, which was mentioned in our December 2003 trading statement, we have today announced a fully underwritten Rights Issue. We consider that a combination of equity issuance and asset sales will significantly improve the financial position and flexibility of the Group. Over time, some of the proceeds will be used to support outsourcing, organic growth and to make selective, focused, bolt on acquisitions for our core SBUs. There have been no material acquisitions in the past two years and the few we have made have been in core businesses and delivered well over 20% return on capital. We remain totally committed to improving the Group's return on capital employed and generating cash.

HEAT TREATMENT

Overall sales were flat with margins slipping 1.7 percentage points.

North America

In local currency sales for North America dropped 7.3% year on year with margins slipping 3 percentage points.

We entered 2003 expecting that the decline in the manufacturing economy was about to end and we would benefit from all the cost reductions achieved. Since the downturn started in 2001, we reduced the number of heat treatment locations from 58 to 43 and the number of people employed by around 450. Cost increases in utilities and medical insurance offset a lot of the cost reductions that had been made. Over capacity, and thus pricing pressures, continue to influence the industry. We have been able to increase market share in some areas and have been successful in concluding additional Strategic Partnerships and outsourcing agreements bringing prospects for growth in 2004 and beyond. We increased our emphasis on management training and continued to raise the bar in areas of safety, health and environmental.

The Bodycote Quality System, a systematic approach to delivering quality results, is now installed throughout the organisation and has advanced to become the Bodycote Management System to encompass the new ISO 9001-2000 requirements. Most sites have successfully been accredited to the new ISO standard.

We enter 2004 with a committed and streamlined organisation. Most of the planned consolidation work is now behind us and our base is aligned with market demand. We move forward focused on growth and business development.

Central European Group (CEG)

Germany, Netherlands, Austria, Switzerland, Czech Republic, Hungary and Liechtenstein

In local currency sales for CEG grew 2.0% year on year with stable margins.

Despite difficult market conditions, national strikes and the strong influence of the Iraq war at the beginning of the year, this division was able to deliver a respectable profit margin by tight cost control, a strong sales programme, high profile marketing and turning around loss making plants.

CEG increased market share especially in the high added value sectors of the market. We continued to develop the outsourcing concept and improved capacity utilisation.

Chief Executive's Review

Steps into new technology applications such as: laser heat treating/joining, brazing of fuel cells, diesel exhaust filters and heat treatment of automotive common rail components helped improve our performance.

The Netherlands had a satisfactory performance.

Our international reputation for quality and reliable service has helped us to gain market share with multi-national manufactures in the automotive and tooling markets of the Czech Republic, Hungary and Romania.

Against a background of declining markets and strong competition we managed to maintain our sales in Austria. New low pressure carburizing capacity was installed for diesel engine applications.

Focus will be maintained on our plans to produce better returns in Switzerland and Liechtenstein where declining markets and excess capacity have driven prices down.

In the Central European Group, winning additional outsourcing business remains a focus to increase utilisation of our existing equipment. Our Eastern European expansion programme to support manufacturers will also be a key objective.

France, Belgium, Italy (FBI)

In local currency organic sales for FBI fell 5.4% year on year with margins remaining stable.

A major restructuring plan in 2003 absorbed much management time and energy. Five facilities were closed. As a result our headcount has been reduced by more than 100 people but because of the time consuming process involved in securing government and union agreement, the full benefit will not be seen until 2004. Other rationalisation has involved the merger of all induction heat treatment at Billy Berclau and the return to profitability under new management of the Cluses and Thyez operations. La Talaudière was modified to house additional operations and most of the sales transferred from neighbouring closed facilities. New low-pressure carburising investment will focus on emerging automotive applications.

We now have a good base for growth in Italy, the third largest manufacturing market in Europe, after our acquisition of the Gamma group in 2002.

United Kingdom

Sales in the UK grew 1.1% year on year with margins reducing by 2 percentage points.

The UK heat treatment operations focused on cost control and improvement in return on capital employed. Sales from new automotive contracts and growth in vacuum brazing and electron beam welding offset price pressures in other areas to keep sales level with 2002. Cost increases, however, led to margins declining. The demand for high value work from the commercial aerospace and power generation sectors continued at depressed 2002 levels.

Our new Heat Treatment Centre adjacent to Delphi in Gillingham opened in March 2003 and is performing according to plan. Our relationship with major international manufacturing firms continues to strengthen; offering us opportunities throughout the Western Hemisphere. NADCAP (National Aerospace and Defence Contractors Accreditation Programme) audits to meet our Rolls-Royce commitment started successfully and will be completed during 2004. This establishes Bodycote as the first NADCAP approved source on this side of the Atlantic.

Nordic (Sweden, Denmark and Finland)

In local currency sales for the Nordic Group were at a similar level year on year but margins dropped almost 6 percentage points.

Although sales in Swedish heat treatment were flat, low margin sales predominated.

Sales growth in Finland was slightly positive and with tight cost control, margins were acceptable. Co-operation with our French colleagues and a Finnish customer led to the development of FinNIT, a new process which extends the life of aluminium extrusion dies. We expect to offer this service in other geographies.

Increased competition from a start up company in Denmark has resulted in losses. Costs have been reduced to improve the situation.

MATERIALS TESTING

Organic sales grew 2.6% year on year and margins remained steady.

In very tough economic conditions and market uncertainty, the Materials Testing SBU performed in line with expectations, primarily by diversifying our range of expertise and service offerings. By concentrating on high valued added services the Group won new business and increased market share. A key element to this growth was the formation of a number of cross-border, industry specific technical forums which were able to capitalise on extensive technical know-how and experience, enabling significant opportunities to be grasped. A number of innovative projects, indicating the leading role the Materials Testing SBU places on technologically driven expertise, were initiated in early 2003 and included:

The installation in Sweden of BOMIC, our advanced microcalorimetry testing service, capable of predicting the shelf life of a number of defence munitions systems. This world standard technology has attracted global business and was partly responsible for growth in profits at this facility.

In our Italian facilities we added a unique laboratory specifically designed to investigate the field failure of telecom and associated electronic products by utilising various optical and analytical techniques.

In terms of our geographical market performance, the core UK business suffered in line with UK manufacturing and the effects of globalisation on traditional home produced goods. Our Radiographic and Materials Engineering units performed admirably in difficult IGT/Aerospace markets, and a number of OEM approvals and investment programmes should provide added impetus for 2004. The Health Sciences division posted an improvement in profit. This business unit will be expanded to take advantage of further regulatory compliance monitoring for water quality, asbestos in buildings and integrated pollution, prevention and control (IPPC).

The European division had strong trading performances in Sweden, where our Polymer Piping laboratory won large outsourced testing programmes from North America and the Far East. In the Netherlands the laboratories won work on large tranches of pipeline and associated oil/gas installation work from France, Spain and Indonesia. Similarly, the Italian business captured several significant projects for programmes in Russia, Turkey and Libya.

Our Middle Eastern facilities performed well ahead of expectations following the completion of several significant construction projects in the UAE allied to significant penetration into oil/gas markets in Azerbaijan, Kazakhstan and Iran. This provided the platform for the further expansion, both in service scope and geographically, via the acquisition of the laboratory interests of Carillion plc in Abu Dhabi, Oman, and Dubai. These laboratories are now successfully integrated into the Group and the rationale for the development of the division was fully vindicated by securing the multi-million dollar contract for provision of an on site laboratory for the Dubai Airport extension.

Our North American business Group had mixed fortunes, with the Canadian Group unable to match last year's performance due to price erosion in our Quebec Environmental/Pharmaceutical markets. Our Detroit laboratory which opened an additional facility, enhancing the large scale environmental simulation capability available. New chlorine test cells for Polymer Piping were installed at Melrose Park to meet changes in the US plumbing regulations. Los Angeles continues to be a challenge due to the continuing downturn in the US Aerospace sector, however a number of significant quality approvals from major US/UK engine manufacturers should provide trading stimulus for 2004.

2003 also witnessed a number of advances in our infrastructure support systems with the adoption worldwide of our ISO 17025 quality system; the roll-out of our North American developed LIMS system, which allows clients direct access to their data; and finally the setting up of divisional marketing centres to control enquiry management, co-ordinate web marketing and provide market intelligence to our business development teams.

HIP

Overall sales declined 1% year on year and margins declined 3 percentage points. 2004 will be a year in which we expect to start improving our return on capital employed which remains unacceptably low in this capital intensive SBU.

North America

Aerospace volumes in North America accounted for 54% of our sales (2002: 54%). We saw a halving in IGT sales but this was more than offset by growth in the tooling and electronics markets, which relate to HIPping of powder metal billets and flat screen TV targets.

Equipment installed in 2002, to produce a transparent ceramic material (ALON), experienced slower than budgeted sales increase, but we remain confident that this work will utilise the installed capacity.

Europe

Positive change came from increased sales of near net shaped powder densification projects. Improved welding efficiency in Sweden has reduced operating costs and lead-time for several key customers. The offshore oil and gas business and demand for industrial gas turbines, which is the major market for UK HIP, remained at the levels of 2002 reflecting continued low global demand.

The merger of our Essen facility with Haag, near Munich, helped reduce the cost base. Densal II® adoption by a major automotive customer is assisting in gaining application acceptance.

METALLURGICAL COATINGS

Wet Coatings

The acquisition strategy to grow a wet coatings group synergistic with our heat-treating network failed to benefit the Group. After careful review, we have decided to exit this market in an orderly and timely fashion so we can focus our resources on core businesses.

Specialty Coatings

Specialty coatings consist of processes we believe are synergistic with our heat-treating business. These value added services provide, in the main, functional metallurgical enhancement.

Slurry Coatings

Demand for our ceramic slurry coatings increased during the year in spite of fluctuations in the oil exploration and textile markets. Our emerging market applications are medical suppliers and electronics, the latter requiring an insulating coating currently under development.

Following our success in the UK, we are now penetrating the North American and European steel market. Bodycote is applying K-Tech 17 ceramic densification on galvanising and steel mill furnace rolls, extending their useful life. A collaboration agreement with a leading UK manufacturer to supply tungsten carbide coating and a joint marketing campaign is currently underway in Europe.

In June, we acquired the intellectual property rights and production equipment for the CoatAlloy® range of diffusion bonded metallic slurry coatings from Surface Engineered Products Ltd of Alberta, Canada, as part of our strategy to develop our speciality coating group. These advanced, high temperature, metallic slurry coatings will be applied at our previously surplus facility at Knowsley, UK to a range of oil and gas and petrochemical applications. This coating dramatically improves ethylene process yield and lengthens time between maintenance requirements offering considerable advantages for chemical plant operators and is being marketed through our strategic partnership with Manoir Industries S.A., a specialist tubular manufacturer.

Physical Vapour Deposition (PVD)

In order to cope with the international nature of the PVD customer base and the strong needs to cross link the coating know how, the 10 facilities have been put under one operating structure. Specific regional market knowledge and coating application know-how is being leveraged ‘from centres of excellence’ for global exploitation. PVD operations that have proven competencies in specific niches will support the roll-out of those applications into the geographic network. The Tecate, Mexico operation is supporting marketing and process development for decorative applications, Chassieu, France for tooling and Venlo, Netherlands for tribological coatings applications.

Sherardizing/Sheraplex

Two sites focus on large volume Sherardizing/Sheraplex. Sheraplex has been specified by the designer for European and USA foldaway trailer system for the back of breakdown trailers. Sheraplex is being marketed worldwide as a cost effective coating system for fasteners used on construction projects.

Plasma Spray

New contracts have been won for plasma spray of titanium honeycomb parts for Airbus projects at our French facility.

CURRENT TRADING AND PROSPECTS

The results for the first two months of the year are in line with our expectations. With the operating improvements that have already been implemented and the actions we are taking on Wet Coatings, we are confident in the financial and trading prospects for the Group in the current year.

Looking further ahead the Group is poised to move forward as market demand recovers. Bodycote has capable people, productive facilities and the systems to deliver exceptional quality and service. The Group will continue to focus on higher value added work, gaining further market share and winning new outsourcing contracts. The Group’s medium term strategy is to deliver a pre tax return on capital in the mid teens.

In support of our ongoing needs and future talent requirement for high calibre staff, we have intensified initiatives to nurture interest in a career with Bodycote. Programmes of school visits, distance learning through related discipline colleges, graduate sponsorship schemes at various European and North American universities and ‘Prize Paper Competition’ have enhanced Bodycote’s profile amongst this important talent pool as Bodycote continues to position itself for further growth and development and looks forward to the challenges ahead.

John D. Hubbard

John D. Hubbard
9 March 2004

Finance Director's Report

Sales and Operating Profit

The Group recorded sales of £448.4m, compared to £440.1m in 2002, with difficult trading conditions in essentially all of the Group's end markets continuing. Existing operations accounted for £447.1 m, whilst acquisitions added £1.3 m.

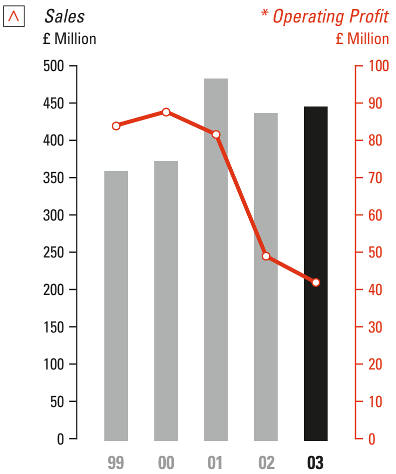
Following a review of the Coatings operations, the Board has concluded that the future development of the Group can best be served by concentrating on the businesses where we have strong market positions and excellent know-how, thereby enabling Bodycote to maximise its return on capital employed.

	Sales		Operating Profit*		Operating Margin*	
	2003	2002	**2003**	2002	**2003**	2002
	£m	£m	**£m**	£m	**%**	%
Continuing Operations						
Heat Treatment	**302.9**	302.7	**31.6**	36.5	**10.4**	12.1
Materials Testing	**61.2**	56.6	**11.4**	10.9	**18.6**	19.3
Hot Isostatic Pressing	**27.6**	28.5	**3.6**	4.5	**13.0**	15.8
Specialty Coatings	**18.7**	16.3	**2.7**	(2.6)	**14.4**	16.0
Head Office	**–**	–	**(1.6)**	(1.3)		
	410.4	404.1	**47.7**	53.2	**11.6**	13.2
Wet Coatings	**38.0**	36.0	**(6.0)**	(3.8)	**(15.8)**	(10.6)
	448.4	440.1	**41.7**	49.4	**9.3**	11.2

**before amortisation of goodwill of £9.1m (2002: £8.7m) and exceptional items of £34.0m (2002: £18.3m)*

The continued weakness in demand for the Group's services during 2003 has resulted in a degree of price pressure which coupled with higher employment and energy costs and operational problems at several wet coatings plants, more than offset the benefits of our reorganisation and cost reduction programme. The effect of this was that despite closing a further 13 facilities and reducing headcount by over 380, (excluding businesses acquired in 2003) operating profit* fell from £49.4m to £41.7m.

Consequently the Board has decided to exit the wet coatings business (electroplating and anodising) in an orderly and timely fashion. This will result in an impairment in the asset values of this business and an exceptional charge in the 2003 accounts of £30m, made up of £11m goodwill and £19m for tangible assets. In addition it is expected that cash costs for this reorganisation will be £5m to be recognised in 2004.



Heat Treatment

The UK heat treatment business recorded sales and profits almost identical in 2003 to 2002, although reported profits in 2003 are lower by £0.3m due to an unanticipated pension charge related to a 1998 acquisition which, if identified at the time, would have been included in purchase consideration. Demand from its key aerospace/IGT markets appear to have bottomed out and market increases are now expected. The Central European Group returned robust results in the face of weak conditions, particularly in Germany, with sales and profits in local currency ahead by 2% and 5% respectively. This reflects good cost control and success at winning new outsourced contracts, particularly in the automotive sector.
The France/Belgium/Italy Group had its operating profit boosted by £0.7m with the inclusion for a full year of the Gamma acquisition in Italy (purchased in September 2002). France, however, proved to be one of our weakest markets in 2003, particularly in the second half, with our large automotive orientated continuous furnace facilities most affected. Progress was also retarded by the very lengthy process required in France to action our reorganisation plan. This caused an eight month delay compared to other parts of the Group. Official sanction to reduce headcount by 8% was finally given in June and the benefits will be achieved in 2004.
The Nordic division had disappointing results given that local currency sales were flat but profits were down £1.1m. This was due to issues regarding employee cost control and high maintenance costs, both of which should be improved in 2004. In addition, results from Denmark were impacted by significant over capacity in the market. Along with France, North America proved to be the most difficult trading environment with sales down, in local currency, over 7% year on year. Aerospace and IGT demand was very weak throughout the year, particularly impacting our West Coast plants. Automotive was hit by a very weak Q3 as component suppliers reacted to the Q2 vehicle production cut back by the Big Three manufacturers. Despite good cost control with a further 173 reduction on headcount, margins were reduced by three percentage points.

Materials Testing

Once again, Materials Testing has delivered increased sales, up 8%, and maintained margins, whilst serving essentially the same markets as our other SBUs. Sales were ahead in all regions, except Canada which was flat, as the division continues to win new business for the Group despite weak end market conditions. In the UK, our traditional engineering focused laboratories were impacted, along with heat treatment and HIP, by weak aerospace and IGT demand but this was compensated for by growth in Health Sciences. The European laboratories performed strongly with new contracts for polymer pipeline testing for the water industry and in steel for the oil and gas sector. The Middle East produced excellent results as it benefited from strong civil engineering related demand in the UAE and our position was significantly enhanced mid year by the acquisition of additional facilities in the region. Canada was held back by price erosion in the Quebec environmental and pharmaceutical laboratories, although this was offset by increased demand for engine testing in Ontario. In the USA, the situation was one of steady growth with the exception of Los Angeles which was impacted by poor aerospace demand.

Hot Isostatic Pressing

The UK saw a further significant decline in HIP demand from its key precision casting customers, who serve the aerospace and IGT markets, which saw sales down 19% year on year. With particularly high fixed costs in HIP, margins were reduced to 11%. The continental European plants fared much better with sales flat in Sweden and ahead in both Germany and Belgium. This reflects a wider spread of business in these markets with powder consolidation and production of near net shapes in addition to casting densification. Densal® sales grew by 64% due to good demand from German automotive manufacturers. Sales in the USA were marginally ahead for the year, with Q4 easily the strongest. Profits were impacted by £0.2m increase in depreciation charges.

Metallurgical Coatings

The results from the Group's coatings plants range from some of the best in the Group to the worst. Margins and profits in the small specialty businesses (slurry and flame spray) were excellent. PVD ranges from satisfactory to very good with sales ahead 21% compared to 2002. We expect this trend to continue in 2004. Along with Materials Testing, this is an area where Bodycote's capacity is being increased. The performance of the anodizing plants (located in Sweden, Finland and Germany) should certainly be better but are not a serious problem. The electroplating results, however, are very poor, as a combination of weak demand and disappointing operational performance at a handful of facilities have resulted in significant losses. Wet coatings in total lost £6.0m. The plants that focus on zinc (in the UK, France and Sweden) have suffered from poor demand. The aerospace facilities (UK and France) should experience a recover in demand in due course. It is taking time to efficiently run the large new highly automated telecoms oriented operation at Gothenburg, Sweden. There has also been a high scrap rate at our chrome on plastic facility at Anderstorp, Sweden. At St Dizier in France, operational performance has been stabilised following a problematic second half of 2002 and first half of 2003 but the plant operates in a small market for chrome on aluminium, which requires further development before satisfactory returns can be achieved.

Information Systems

During the last two years the Group has been moving towards standard information systems solutions as and when businesses need to upgrade. Our Central European Group is close to completing the implementation of the Navision ERP system (a Microsoft solution). As well as offering first class functionality for accounting, sales and purchase order processing and plant scheduling, the system enables electronic customer access to scheduling information, all of which are factors to improve our future market position and margins. Based on our experience in the Central European Group, France, Belgium, Italy, the UK and North American will adopt Navision to replace their legacy systems in 2004.

Profit Before Tax, Goodwill Amortisation and Exceptional Items

Profit before tax, goodwill amortisation (£9.1m) and net exceptional items (£34.0m) was £32.0m compared to £38.2m last year. In 2002 the Group recorded operating exceptional charges of £18.3m relating to reorganisation of the Group designed to bring capacity more into line with reduced demand levels. In 2003 the continuation of this programme saw a further charge of £7.5m, in addition to the £19m provision against wet coatings tangible fixed assets. With the exception of wet coatings, the reorganisation is broadly completed. The initiative has included the closure of 29 facilities over the two years spread throughout the network. Against this, the Group benefited from the settlement of a fully provided loan to its former furnace manufacturing business resulting in an exceptional profit in 2003 of £3.5m. Pre-goodwill amortisation, pre exceptional operating profit declined from 2002 to 2003 by £7.7m, of which £2.2m was due to wet coatings. Foreign exchange movements during the year resulted in a net benefit to operating profit of £0.8m. The effect of applying current exchange rates to the 2003 results would be an adverse impact on operating profit of approximately £1.0m, although this would be partly offset by interest savings on dollar borrowings of c.£0.6m. The Group's interest charge was reduced from £11.2m to £9.7 m reflecting lower borrowings and the benefit of a weaker US dollar. Goodwill amortisation has increased by £0.4m to £9.1m excluding the exceptional write-down of £11m related to wet coatings.

Taxation

The effective tax rate in 2003, before the amortisation of goodwill (which is not generally allowable for tax) was 69% (2002: 24%). The figure is distorted by the significant exceptional charges, particularly related to the disposal of wet coatings, which creates losses, the tax benefit for which has not been assumed in the Group accounts, as their recoverability at the Balance Sheet date is not known. Before exceptional charges and goodwill amortisation, the effective tax rate is 22% (2002: 29%), reflecting the mix of taxable profits and losses and the jurisdictions in which the Group operates.

Finance Director's Report

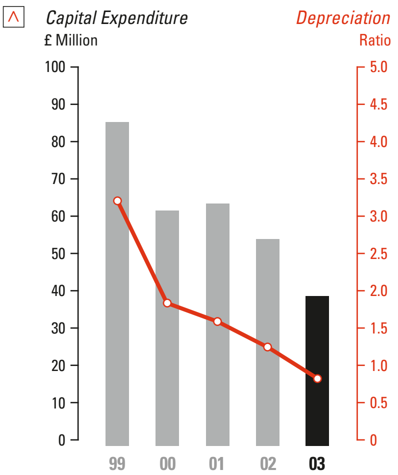
Earnings per share

Headline earnings per share were 9.7p (2002: 10.6p), with basic diluted loss per share being (6.8)p (2002 earnings per share: 2.4p). The Board is recommending a full year dividend of 6.1p (2002: 6.1p) per share. Dividend was covered 1.6 (2002: 1.7) times by headline earnings. Interest was covered 4.3 (2002: 4.4x) times by profit before goodwill and exceptional items.

Capital Expenditure

Net capital expenditure for the year was £38.3m compared to £54.0m in 2002. The multiple of depreciation (net capital expenditure divided by depreciation) has continued to fall, being 0.8 times in 2003 compared to 1.3 times in 2002 as the Group continues to make greater use of previous investments.

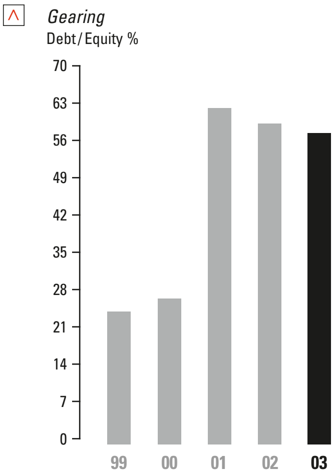
Major projects undertaken during the year included: the consolidation of three facilities into one in St Etienne, France with the establishment of a new service centre focused on nitriding technologies, the installation of additional PVD tribological capacity in Venlo, Netherlands, tooling capacity in Chassieu, France, the addition of low pressure carburizing technologies in Livonia, USA and established an engine testing facility in St Catherine's, Canada.



Cash Flow and Borrowings

In July 2003 a three year £195m syndicated unsecured revolving credit facility was successfully arranged which, along with the existing $80m of senior notes due in December 2009, means that no significant refinancing of borrowings will be required in 2004 or 2005.

There has been continued focus on cash collection, which has seen debtor days reduce from 66 to 64. After allowing for capital expenditure, interest and tax there was free cash flow of £30.3m compared to £22.0m in 2002 even though cash flow from operations decreased from £94.2 m to £83.9 m. Acquisitions resulted in net cash payments of £2.2m, of which the purchase of the Middle East laboratories, from Carillion plc, accounted for £1.4m. Net borrowings ended the year at £210.3m, a reduction in the year of £23.9m; gearing was reduced from 60% to 57%.



Treasury

Treasury is managed centrally covering borrowings and its components, including source, maturity, interest rate and currency. The objective is to minimise risk through a balanced approach. Funds are obtained via privately placed bonds and from banks. The Group aims to have a range of maturities both committed and uncommitted currently ranging from 364 day facilities to the six years remaining on the private placement senior notes.

The Group also aims to have a mix of fixed and floating rate debt to achieve the desired profile and to manage interest rate volatility. During 2003 the balance has been weighted towards floating allowing the Group to benefit from historically low rates. Funding of overseas activities is generally via local currency borrowings so as to provide a partial hedge against the impact of exchange rate volatility on asset values as translated into sterling on consolidation.

Pensions

The Group has elected to adopt the transitional provisions of FRS 17 (Retirement Benefits) and consequently there is no impact on the 2003 figures. If FRS17 had been fully adopted in 2003, the Group would have recorded an additional liability in its balance sheet of £14.3m (2002: £17.0m) relating to defined benefit schemes in the UK, France and USA of which the UK plan accounted for £12.5m (2002: £13.4m). The US plans were inherited with the acquisition of Lindberg. Since last year the largest of these plans has been wound-up, requiring the Group to inject $2.2 m in 2003. The actuaries to the UK scheme have advised that contributions to that plan be increased by £0.1m in 2004.

International Accounting Standards

All European Union listed groups are required to adopt International Accounting Standards (IAS) for their financial statements from 2005, which will include comparative information for 2004. The Group is currently undertaking a detailed review of the impact of IAS on its published financial statements. Although these standards are themselves evolving and undergoing improvements, a preliminary review shows that there is likely to be an impact on the Group's accounts, in relation to accounting for pensions, as the Group has adopted the transitional provisions of FRS 17 and for deferred taxation, where the Group has historically discounted the liability to present value.

David Landless
9 March 2004

Directors' Report

The Directors are pleased to submit their report and the audited financial statements for the year ended 31 December 2003.

PRINCIPAL ACTIVITIES

The Company is a holding company with subsidiaries carrying on business in the fields of materials technology and metal processing. The activities and locations of the principal subsidiary undertakings are set out on pages 48 to 50. The Chief Executive's Review contains a survey of the Group's activities during the year together with an outline of future developments.

TRADING RESULTS

After net exceptional charges of £34.0m (2002: £18.3m) in relation to Group reorganisation, the loss of the Group before taxation was £11.1m (2002: £11.2m profit). The loss attributable to shareholders amounted to £17.4m (2002: £6.3m profit) and, after providing for dividends of £15.6m (2002: £15.6m), both paid and proposed, £33.0m has been set off against reserves (2002: £9.3m).

DIVIDENDS

The Board is recommending a final dividend of 3.85p per share making a total for the year of 6.1p per share (2002: 6.1p). The final dividend, if approved, will be paid on 5 July 2004 to shareholders on the register at the close of business on 26 March 2004.

SHARE CAPITAL

The Company's issued share capital as at 31 December 2003 was £25.7m and during the year the issued ordinary share capital of the Company was increased by the issue of 159,442 shares of 10p each between 27 August and 28 October 2003 for a total consideration of £168,259 pursuant to options granted under the Company's executive share option schemes. The shareholders have authorised the Company to purchase up to 25,647,088 of its own shares, although no purchases have been made. This authority expires at the conclusion of the forthcoming Annual General Meeting to be held on 26 May 2004, at which time a further authority will be sought from shareholders.

On 9 March 2004 the Group announced its intention to raise approximately £61.9m net through a fully underwritten rights issue.

ACQUISITIONS

During 2003 the Group made three acquisitions at a net cost of £2.2m:

On 1 April 2003 Bodycote Materials Testing Limited acquired the business and assets of the UKAS accredited analytical laboratory in Windsor, UK from Eurotest Limited. The facility offers environmental and pharmaceutical testing services.

On 30 June 2003 Bodycote Metallurgical Coatings Limited acquired the intellectual property rights and equipment in respect of CoatAlloy™ from Surface Engineered Products of Canada. The technology and equipment will be located at Knowsley UK and will provide specialist coating services for the petrochemical industries.

On 1 July 2003 Bodycote Materials Testing acquired the laboratory interests of Carillion plc based in Abu Dhabi, Dubai and Oman. The laboratories provide testing services to the construction, oil and gas industries.

Note 23 on page 39 provides the necessary financial disclosures.

DIRECTORS

The present Directors are listed on page 18 and all served throughout the year. Mr T. Bell left the Group and resigned as a Director on 27 March 2003 and Dr Rickinson retired at the Annual General Meeting on 28 May 2003.

Messrs R.T. Scholes and D.F. Landless are retiring by rotation and, in accordance with the articles of association and each being eligible, offer themselves for re-election at the forthcoming Annual General Meeting. The service agreement for Mr Landless is terminable by one year's notice. Mr Scholes does not have a service contract with the Company.

DIRECTORS' INTERESTS

The interests of the Directors in the shares of the Company at 31 December 2003 and 31 December 2002 are set out below:

Beneficial	**2003**	2002
J.A.S. Wallace	**45,830**	45,830
J.D. Hubbard	**900,000**	900,000
D.R. Sleight	**70,000**	70,000
R.T. Scholes	**15,000**	15,000
D.F. Landless	**5,500**	5,500
J. Vogelsang	**–**	–
L.P. Bermejo	**–**	–

Each Executive Director was also technically interested as a potential beneficiary, pursuant to the terms of the Bodycote International Employee Benefit Trust, in 400,000 shares (2002: 400,000) held as trustee by Hill Samuel Offshore Trust Company Limited. No Director has had any dealings in any shares or options in the Company since 31 December 2003. An analysis of Directors' share options is given in the Board Report on Remuneration on page 17. 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.

CORPORATE GOVERNANCE

The Group's mission is:

- *To provide world class companies with metallurgical and testing 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.*
- *To act as a good corporate citizen.*

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

Directors' Report

Compliance with 2003 FRC Combined Code

The Bodycote Board has overseen substantial changes in its board and committee membership in the last three years. All these changes are appropriate to the Company, in accordance with the principles of good corporate governance, and in line with the provisions of The Combined Code on Corporate Governance published by the UK Financial Reporting Council in July 2003 ('the 2003 Code'), save in three areas where the reasons for the variance are:

(i) Performance evaluation (code provision A.6)

The Board believes a rolling programme of assessments is the most practical and effective method of evaluating Bodycote's control structures. During 2003 all Executive Directors, the Chairman, the Senior Independent Non-Executive Director and the Audit Committee all underwent formal self-assessment with the assistance, in the last case, of the auditors. A self-assessment of the Board started in 2003 and was concluded in early 2004. In 2004 there will be an evaluation of the other Non-Executive Directors, the Remuneration Committee and the Nomination Committee as well as the annual appraisal of the Executive Directors. Bodycote will aim to carry out and report on assessments of all relevant personnel, committees and the Board itself within a three-year cycle.

(ii) 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 is available to meet 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. Regular feedback by the Company's advisers on investor meetings and results presentations are circulated to all Directors. Non-Executive Directors are also encouraged to attend one of the results presentations each year. On specific issues, as with the introduction in 2003 of a new incentive scheme, the Chairman will seek the views of Bodycote's leading investors.

(iii) Committee membership (code provisions B.2.1/C.3.1)

The Audit Committee is chaired by the Senior Independent Director, who is financially qualified. Two further members were appointed on 1 January 2003. The Chairman of the Company, who is also financially qualified, has remained on the Audit Committee in order to maintain a balance of experience.

The Chairman is also Chairman of the Remuneration Committee, a position that he has held since 1994. At the time of his appointment as Chairman of the Company the Board decided that he was the most appropriate Non-Executive Director with the time and experience to fill this important role. The terms of reference for this committee precludes, of course, his involvement in setting his own fees.

Apart from these distinct areas, Bodycote will be in compliance with the provisions of the 2003 Code.

Compliance with the 1998 Code

Many of the recommendations of the 1998 Code of Best Practice prescribed by the Listing Rules of the Financial Services Authority have been a feature at Bodycote for some years. Taken together with the Board Report on Remuneration, this statement explains how Bodycote has applied the principles of good corporate governance set out in Section 1 of the Combined Code issued by the Hampel Committee on Corporate Governance in 1998 ('the 1998 Code') during 2003. A report on the work of the Remuneration Committee, pursuant to the Directors' Remuneration Report Regulations 2002, is given on page 14, and a resolution for approval of that report is set out on page 51. The Company complied with the 1998 Code throughout the period.

Leadership

The Board of Directors comprises seven members, of whom three are independent Non-Executive Directors and three are Executive Directors led by the Company's part-time Non-Executive Chairman, Mr J.A.S. Wallace, who also chairs the Nomination and Remuneration Committees. The Chief Executive is Mr J.D. Hubbard and the Senior Independent Non-Executive Director is Mr R.T. Scholes who also chairs the Audit Committee. Brief biographical details of all Directors are given on page 18. The Board meets at least nine times a year and visits are made to UK and overseas facilities. Certain defined issues are reserved for the Board to decide, inter alia:

- *Approval of financial statements & circulars*
- *Capital projects, acquisitions and disposals*
- *Annual budgets*
- *Strategy*
- *Directors' appointments & service agreements*
- *Policies for financial statements, treasury, safety, health and environment, donations*
- *Committee terms of reference*
- *Board and committee membership*
- *Investments*
- *Equity & bank financing*
- *Internal control & risk management*
- *Corporate governance issues*
- *Key external & internal appointments*
- *Pensions & employee incentives*

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 budget and forecasts. They are also supplied with the latest information on safety, health and risk management issues. Where required, a Director may seek independent professional advice at the expense of the Company and all Directors have access to the Company Secretary, and 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, after which the appointment may be extended by mutual agreement. A statement of the Directors' responsibilities is set out on page 13. The Board also operates three committees. These are the Nomination Committee, the Remuneration Committee and the Audit Committee.

Independence of Non-Executive Directors

The Board asserts that Messrs R.T. Scholes, J. Vogelsang and L.P. Bermejo are independent for the purposes of the 2003 Code.

Commitment

All continuing Directors recorded 100% attendance at the ten Board meetings held in the year, including visits to overseas facilities in Sweden, Liechtenstein, Switzerland and the UK.

Performance Evaluation

Performance evaluation of the Chairman, the Senior Independent Non-Executive Director, the Chief Executive and the Finance and Corporate Development Directors was carried out internally during 2003. In February 2004 the Board carried out its own evaluation of the Board as a whole. The Audit Committee assessed its own performance in December 2003 with input from the external auditors, the Chief Executive and the Finance Director.

Nomination Committee

Mr J.A.S. Wallace chairs the Nomination Committee which also comprises Messrs R.T. Scholes, J. Vogelsang, L.P. Bermejo and J.D. Hubbard. All members attended the only committee meeting in 2003, when it determined the policy on external appointments and the nominations for re-election at the 2003 Annual General Meeting.

Proposals for Re-election

Following the performance evaluation carried out by the Chairman in November 2003 in respect of Mr Scholes' service as Senior Independent Non-Executive Director and Audit Committee Chairman, the Board proposes his re-election as Director. His performance was determined to be effective and he has devoted the necessary time and commitment (achieving 100% Board and Audit Committee meeting attendance since appointment in 1998). Following a performance appraisal by the Chief Executive, the Board also proposes the re-election of Mr D.F. Landless as a Director.

Audit Committee

The members of the Audit Committee are Messrs R.T. Scholes (appointed 1998; Chairman from 2002), J.A.S. Wallace (Committee Chairman 1994 to 2001). J. Vogelsang (2003) and L.P. Bermejo (2003). Their appointments to the Committee were made by the Board at the time of their original appointment to the main Board of Bodycote. Their relevant qualifications and experience is given on page 18 and their remuneration on page 16. The Committee Chairman's responsibilities are reflected by additional remuneration for that role as shown on page 16. The Committee met three times during 2003 and has the assistance of the Finance Director, Head of Internal Audit and Company Secretary, who serves as committee secretary. Save for the absence abroad of Mr Bermejo for one meeting, 100% attendance was achieved. The Committee (or its chairman) held meetings with both the external and internal auditors without management in attendance. The Head of Internal Audit has a direct reporting line to the Chairman of the Audit Committee.

In reporting financial results to shareholders, the Committee depends on the skill, objectivity and independence of the auditors. In the year ended 31 December 2003 the Committee obtained confirmation of the auditor's independence. The policy of the Company is not to use the auditor for non-audit services, save for tax compliance, without the prior approval of the Audit Committee. The Committee's areas of activity are set out below.

- *Review financial statements and results announcements*
- *Assess independence of auditors*
- *Approve auditor appointment and fees*
- *Recommend policy on use of auditors for non-audit work*
- *Approve scope of internal and external audits*
- *Approve accounting policies and resources*
- *Approve management representations*
- *Review management improvement letters*
- *Review audit process*
- *Assess internal and external audit effectiveness*
- *Review Committee's own effectiveness*
- *Recommend new terms of reference*
- *Review arrangements for reporting and investigation of employee concerns*
- *Review internal audit reports & monitored effectiveness of internal audit*
- *Review effectiveness of Board's internal controls and risk management process.*

Internal Control

The Board has applied Principle D.2 of the 1998 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. 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's monitoring covers all controls, including financial, operational and compliance controls and risk management. 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 2003, in compliance with provision D.2.1, the Board also performed a specific assessment for the purpose of this annual report.

Directors' 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. These reports were reviewed and commented upon by the Heads of Internal Audit, Safety, Health and Environment and Sales and Marketing functions. Such risks were measured against their own stated objectives. Following the risk management review by each participant at Strategic Business Unit level, a Group level review was prepared for the Directors to assess. No significant previously unidentified risks were uncovered as part of this process.

Prospects

The Board's view on the Group's position and prospects is given by the Chairman, Chief Executive and Finance Director in their respective statements on pages 2 to 8 of this report. Following a review of the Group's results for 2003 and its budgets for 2004, the Directors consider that the Company and the Group have adequate resources to finance their activities for the foreseeable future, and therefore it is appropriate to adopt the going concern basis in preparing the financial statements.

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. Significant enhancements for the benefit of shareholders will be implemented during 2004.

Bodycote's financial advisers, corporate brokers and financial public relations consultants provide 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' presentation at the time of the regular results announcements. As stated on page 10 the Chairman and Senior Independent Non-Executive Director are available to discuss any issues not resolved by the Chief Executive and Finance Director.

CORPORATE SOCIAL RESPONSIBILITY

As part of the general programme of risk management and review of internal controls, Bodycote regularly keeps under review the risks associated with its corporate and social engagement. Where there is significant benefit in terms of shareholder value and or business risk, Bodycote has already developed appropriate policies and procedures for each Strategic Business Unit. The accreditable elements are the subject of both internal and external audit procedures. In areas where Bodycote does not perceive either shareholder value and or business risk, the aim is to develop and implement appropriate policies over time. The areas of significance are safety, health and the environment and the Group's employees.

SAFETY, HEALTH AND THE ENVIRONMENT

The Group has a positive approach to safety, health and environmental matters and is committed to the achievement of the highest practicable standards of safety and health at work for all employees and to the minimisation of adverse effects on the environment. Appropriate safety and health policies and procedures are in force at all strategic business units. During 2003 the Group began collating further data in order better to benchmark performance in subsequent years. From 1 January 2004 the Group commenced reporting its performance in terms of lost time, frequency and severity of accidents in a uniform manner. As a result each Strategic Business Unit will be able to benchmark their health and safety performance and formulate criteria for improvements. Where appropriate the Group will develop and implement environmental management systems consistent with international standards. The Group continues to seek ways to reduce reliance on the use of solvent cleaners. In 2001 the Group began an assessment of the steps required to improve its environmental performance and started seeking environmental accreditation. In 2002 all Strategic Business Units were mandated to obtain ISO14001 accreditation. By the end of 2003 one site in North America, three sites in Sweden, and a further seventeen sites in the UK have been accredited by ISO14001. Three UK sites are in the course of seeking approval during 2004. 43 of the Group's 46 materials testing sites, which have a low environmental profile, operate to the ISO17025 standard and this incorporates environmental management requirements. The three remaining sites are set to achieve the ISO17025 standard during 2004.

EMPLOYMENT

The Group recognises the value that can be added to its future profitability and strength by the efforts of employees. The involvement of employees at all levels 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.

During 2003 each of the Group's employees received a printed copy of "EveryBody", a staff magazine published in nine languages, detailing the Group's activities, performance and some of its personalities. This was succeeded in autumn 2003 by "EveryBody Extra" which is published in nine languages across the Bodycote extranet. Approximately 1,200 Bodycote managers are connected to the Bodycote extranet, which will improve knowledge of Group activities, and assist greatly with technology exchange and co-ordination. This facility became multi-lingual during 2003.

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.

Directors' Report

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. Costs of research and development are written off in the year in which they are incurred.

DONATIONS

Charitable donations during the year net of income tax amounted to £12,000 (2002: £2,000). There were no political contributions.

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 (2002: 45 days).

SHAREHOLDERS

As at the date of this report the following interests of 3% or more in the issued share capital of the Company appeared in the register maintained under the provisions of Section 211 of the Companies Act 1985:

	Number of shares	% of Issued share capital
Sprucegrove Investment Management Limited	19,097,014	7.4
Aegon Asset Management UK plc	16,936,946	6.6
LD Pensions	14,029,660	5.5
Franklin Resources Inc.	10,479,820	4.1
Legal & General Investment Management Limited	8,055,396	3.1
HBOS plc	8,014,221	3.1

An analysis of the Company's shareholders and the shares in issue at 20 February 2004, numbering 3,317 and 256,630,326 respectively is given on page 53.

AUDITORS

On 1 August 2003 Deloitte & Touche transferred their business to Deloitte & Touche LLP, a limited liability partnership incorporated under the Limited Liability Partnerships Act 2000. The Company's consent has been given in relation to treating the appointment of Deloitte & Touche as extending to Deloitte & Touche LLP with effect from 1 August 2003 under the provisions of section 26(5) of the Companies Act 1989. In accordance with the provisions of section 384 of the Companies Act 1985, a resolution for their re-appointment, special notice of which has been given to the Company, is to be proposed at the forthcoming Annual General Meeting.

DIRECTORS' RESPONSIBILITIES

The Directors are required by company law to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group for that year. In preparing the financial statements the Directors are required to:

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

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

They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and Group and to prevent and detect fraud and other irregularities.

ANNUAL GENERAL MEETING

The 2004 Annual General Meeting will be held on 26 May 2004 in accordance with the notice set out on pages 51 and 52.

By order of the Board

J.R. Grime
Secretary
9 March 2004

Hulley Road
Hurdsfield
Macclesfield
Cheshire
SK10 2SG

Board Report on Remuneration

The members of the Remuneration Committee during 2003 were J.A.S. Wallace (Chairman), R.T. Scholes, B.A. Rickinson (until 28 May 2003), J. Vogelsang and L.P Bermejo.

All members are Non-Executive Directors of the Company and have no personal financial interest, other than as shareholders, in the matters to be decided, no potential conflicts of interest arising from cross directorships and no day to day involvement in running the business. The Committee met six times during 2003. 100% attendance was recorded at meetings save for one absence by Mr Scholes and one by Dr Rickinson. The Committee operates under terms of reference approved by the Board in June 2002. These terms (which are available to view on the Group website) will be revised during 2004 following an evaluation of the Committee's performance.

This report for the year ended 31 December 2003 and the recommendations of the Remuneration Committee have been approved in full by the Board for submission to shareholders. In accordance with the requirements of the Companies Act, an ordinary resolution seeking shareholders' approval for the remuneration report will be proposed at the Annual General Meeting. The tables attached to this report disclosing Directors' emoluments, pensions and share options on pages 16 and 17 have been audited, together with the performance criteria and share price information.

POLICY FOR EXECUTIVE DIRECTORS

The Committee makes recommendations to the Board concerning the policy on remuneration for senior executives and the remuneration package for each Executive Director. In determining the remuneration policy the Committee has given full consideration to the provisions on the design of remuneration policies contained in the Combined Code and received input from the Chief Executive. New Bridge Street Consultants (who were appointed by the Committee) provided independent market information and remuneration advice (including advice covering the proposal to adopt a new share incentive scheme) during 2002 and 2003. In addition during 2003 the Company received actuarial and other pensions advice from JLT Benefit Consultants Limited (who were appointed by the Company in 1995) in relation to the pension scheme, of which currently two executive directors are members. Neither organisation provides any other services to, or has any other connection with, the Company.

The Committee aims to provide a remuneration policy consistent with the Group's overall objectives and thereby attract and retain high calibre senior executives, align executive rewards with the creation of shareholder value and motivate executives to achieve and maintain challenging levels of Company and individual performance.

The Committee has used the remuneration practices of UK engineering businesses and other FTSE 250 companies, as well as other North American and European companies in similar trades, as comparables. In order to ensure that a substantial proportion of the overall remuneration package can be linked to performance, there is an annual bonus scheme and an executive share option scheme. Only basic salaries are pensionable.

SALARY AND BONUSES

The basic salary of each Executive Director and senior executive is reviewed annually and is determined by taking into account the responsibilities and performance of the individual, having regard to current market practice. However, for 2003, after consultation with the Chief Executive, it was decided to leave basic salaries unchanged and put more emphasis on the variable elements.

A performance related annual bonus is payable to all Executive Directors and senior executives, based on the Group's earnings before interest and tax, the Group's return on invested capital and other qualitative measurements. For those senior executives with Strategic Business Unit responsibilities, part of the performance-related bonus is based on their relevant sphere of responsibility.

In 2003 the Committee recommended an increase in the total potential bonus for 2003 and 2004 to 60% (2002: 40%) of basic salary if all targets are met and assuming that one-third of the bonus (i.e. up to 20% of salary) is paid in the form of shares in the Company. The shares will be held in trust for three years and will normally be forfeited if executives leave or are dismissed. Executives may request that their entire annual bonus is paid in cash, in which case the maximum bonus would be 50% of salary. This illustrates the increasing importance attached by the committee to the variable elements of remuneration and encouraging long-term shareholding by executives. No bonuses were paid in 2003 to executive directors as targets were not met.

Benefits in kind, which comprise the provision of a company car, private medical insurance for the Director and family and long-term disability insurance, are consistent with industry standards. An analysis of Directors' emoluments is given on page 16.

SHARE OPTION SCHEMES

The Group believes that participation in a share option scheme by Executive Directors and other executives of the Group is important and that it strengthens the link between executives' personal interests and shareholders' interests. Bodycote's Board will encourage Directors to build up a reasonable shareholding in the Company over a period of time. However, it will not be prescriptive since the Directors' ability to do so will depend on a number of factors, not least being their own personal commitments. The remuneration committee governs the granting of share options to Directors and senior executives. Options up to a maximum value of half annual salary were granted in the year and an analysis of all Directors' share options is given on page 17.

Under the rules of the 1994 and 1996 schemes the exercise cost of all options over unissued shares awarded to a Director cannot exceed four times that Director's salary and bonus. Operation of the 1994 and 1996 schemes was extended by using the employee share ownership trust. Share options granted under the 1994 and 1996 schemes are only exercisable if, over any rolling period of three years from the date of the award, the growth in the Group's earnings per share exceeds United Kingdom retail inflation by 6% (10% in respect of those options granted in September 2002).

Following a review and advice in 2003 from New Bridge Street Consultants shareholders approved the establishment of the 2003 Executive share option scheme to replace the 1994 and 1996 schemes, under which no further options will be granted. The elements of the 2003 Scheme, under which 1,230,434 options were granted to executives in September 2003, are:

- The value of shares under options granted to an executive in any year will not normally exceed 1.5 times basic salary.
- No more than 10% of the new issued ordinary share capital may be allocated under all of the Company's share schemes over a ten-year period.
- The exercise of options will be based on the Company's earnings per share growth relative to inflation.
- No awards can be made at a discount to the market price
- The performance targets will be challenging since they will be measured only over three or five years and the following targets will apply

Portion of Option Grant	Applicable Performance Target *(average annual growth in pre-tax EPS)*
Up to 0.5 x salary	RPI + 3% pa
0.5 - 1 x salary	RPI + 3% - 5% pa
1 - 1.5 x salary	RPI + 5% - 10% pa

The Committee believes that the use of growth in pre-tax earnings per share is the most appropriate measure of the Company's financial performance, is transparent (because the performance test relies on publicly available data) and is consistent with market practice. The chairman of the Remuneration Committee verifies that the tests have been met.

Directors made no gains on the exercise of share options during 2002 or 2003. The market price of Bodycote's ordinary shares at 31 December 2003 was 141.75p, the range during 2003 was 65.5p to 181p and the average was 122.4p. The performance conditions for options granted since 1998 have yet to be achieved. The performance conditions attached to the options granted before 1999 and still outstanding at 31 December 2003 have been achieved.

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 either party 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. Legally appropriate factors would be taken into account to mitigate any compensation payment, covering basic salary, annual and long term 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 Hubbard's contract is dated 5 February 2002 and those for Messrs Landless and Sleight are each dated 26 September 2001.

PENSIONS

Pensions for Executive Directors are, as far as allowable, provided for under the Group's UK contributory final salary pension scheme which has a normal retirement age of 65.

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

(a) Pensions from age 65 of 1/60th highest average salary of any consecutive three years out of last ten years prior to retirement (restricted to the earnings cap where it applies) for each year of pensionable service, and with increases in pensionable salary after 31 December 2003 restricted to 4.5% ('the Salary Limit');

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

(c) Spouse or dependent'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) Members' contributions are 6% of basic salary.

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

Arrangements for Mr Hubbard are for a contribution to a defined benefit arrangement of 14% of his basic salary (including any payments being made by the Group into the Group's US 401k retirement plan) from January 2004 onwards.

An analysis of accrued pension entitlements for the three Directors with accruing benefits under the scheme during 2003 is given on page 16. Mr Hubbard, the Chief Executive, is a member of the Group's US 401K retirement plan to which the Group contributed £3,660 (2002: £8,834). Pension contributions for Mr Landless' salary above the earnings cap amounted to £6,684 (2002: £5,684).

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.

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). Non-Executive Directors do not have formal service agreements and are not entitled to any pension or other employment benefits or to participate in any incentive scheme. Payment in respect of Mr Vogelsang's service is made to a company owned by him.

TSR PERFORMANCE

The graph on page 16 illustrates the Company's Total Shareholder Return (TSR) performance since 1998 in accordance with paragraph 4 of the Directors' Remuneration Report Regulations 2002, relative to the FTSE Engineering & Machinery Index, of which the Company is a component part. Accordingly this sector is considered to be the most appropriate comparator group for this purpose.

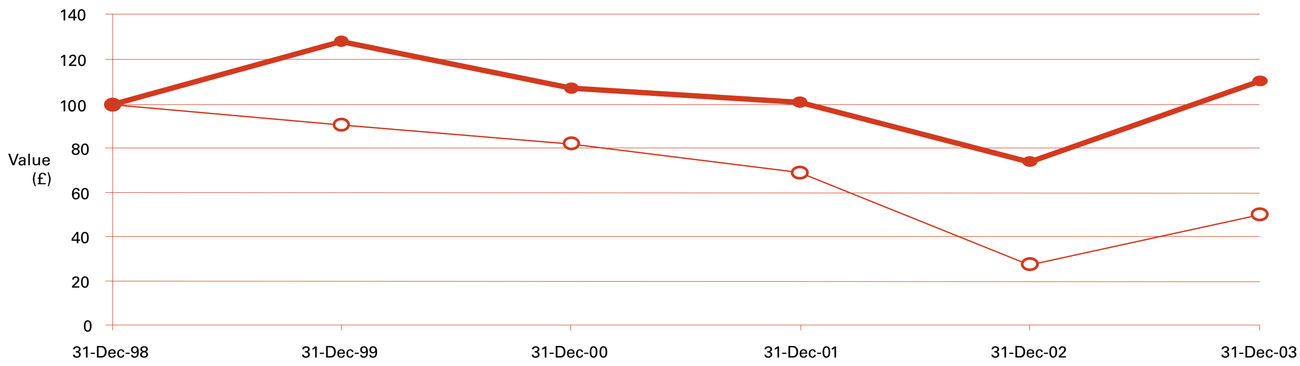
Approved by the Board

James AS Wallace

J. A. S. Wallace
Chairman of the Remuneration Committee
9 March 2004

Board Report on Remuneration

TSR Performance Graph



This graph looks at the value, by 31/12/03, of £100 invested in Bodycote International plc on 31/12/98 compared with that of £100 invested in the FTSE Engineering & Machinery Index. The other points plotted are the values at financial year-ends.

Bodycote International plc — FTSE Engineering & Machinery Index

Source: Datastream

Directors' emoluments

	Salary and fees £000	Benefits £000	**2003 Total £000**	2002 Total £000
Executive				
J. D. Hubbard	250	15	**265**	268
D. R. Sleight	150	13	**163**	157
D. F. Landless	170	14	**184**	183
T. Bell*	50	3	**53**	161
	620	45	**665**	769
Non-Executive				
J. A. S. Wallace	80	–	**80**	80
B. A. Rickinson*	10	–	**10**	24
R. T. Scholes	28	–	**28**	28
J. Vogelsang	25	–	**25**	–
L. P. Bermejo	25	–	**25**	–
	788	45	**833**	901

Directors' pensions

Director	Accrued annual pension at 1 January 2003 £000	Transfer value at 1 January 2003 £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	Increase in transfer value less members' contributions £000	Members' contributions £000	Accrued annual pension at 31/12/03 £000	Transfer value at 31/12/03 £000
D.R. Sleight	43	225	4	1	5	18	169	9	48	403
D.F. Landless	6	26	2	–	2	3	10	6	8	42
T. Bell*	41	131	1	1	2	2	19	2	43	152

Directors' share options

Director	1 January 2003	Options granted (lapsed)	31 December 2003	Option price (pence)	Dates from which exercisable	Expiry (lapse) dates
J. D. Hubbard	41,307	–	41,307	337.35	03/12/2000	03/12/2007
	37,500	–	37,500	396.00	26/04/2002	26/04/2009
	25,000	–	25,000	312.50	14/12/2002	14/12/2009
	12,000	–	12,000	247.50	02/05/2003	02/05/2010
	15,000	–	15,000	217.50	24/04/2004	24/04/2011
	60,000	–	60,000	134.50	16/09/2005	16/09/2012
	–	79,365	79,365	157.50	15/09/2006	15/09/2013
D. R. Sleight	73,202	(73,202)	–	190.57	–	(18/06/2003)
	55,075	–	55,075	258.73	20/05/2000	20/05/2004
	37,500	–	37,500	396.00	26/04/2002	26/04/2009
	30,000	–	30,000	312.50	14/12/2002	14/12/2006
	15,000	–	15,000	247.50	02/05/2003	02/05/2007
	20,000	–	20,000	217.50	24/04/2004	24/04/2008
	40,000	–	40,000	134.50	16/09/2005	16/09/2009
	–	47,619	47,619	157.50	15/09/2006	15/09/2013
D. F. Landless	50,000	–	50,000	396.00	26/04/2002	26/04/2009
	50,000	–	50,000	312.50	14/12/2002	14/12/2006
	15,000	–	15,000	247.50	02/05/2003	02/05/2007
	20,000	–	20,000	217.50	24/04/2004	24/04/2008
	40,000	–	40,000	134.50	16/09/2005	16/09/2009
	–	53,968	53,968	157.50	15/09/2006	15/09/2013
T. Bell*	41,307	(41,307)	–	258.73	–	(27/03/2003)
	37,500	(37,500)	–	396.00	–	(27/03/2003)
	12,000	(12,000)	–	247.50	–	(27/03/2003)
	20,000	(20,000)	–	217.50	–	(27/03/2003)

* Mr Bell left the Group on 27 March 2003 and Dr Rickinson retired at the Annual General Meeting on 28 May 2003.

Board of Directors

EXECUTIVE DIRECTORS

J. D. Hubbard Chief Executive (56) United States
Appointed Chief Executive in January 2002; joined the Board in 2001. Previously served as President of Bodycote's North American Heat Treatment operations from 1996 to 2001. A licensed professional Metallurgical Engineer.

D. R. Sleight Corporate Development Director (54)
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 Materials Testing operations. A Chartered Accountant.

D. F. Landless Finance Director (44)
Appointed Finance Director and joined the Group in 1999. From 1989 to 1997 served as Finance Director in UK and US divisions of Courtaulds Plc. Finance Director of Courtaulds Coatings (Holdings) Limited from 1997 to 1999. A Chartered Management Accountant.

NON-EXECUTIVE DIRECTORS

J. A. S. Wallace Non-Executive Chairman (60)
Appointed a Director in 1994. Non-Executive Chairman of The Lowry Centre Limited (2002) and Non-Executive Director of Holidaybreak Plc (2002). Deputy Chairman of Pifco Holdings plc from 1994 to 2001. Chairman of the Remuneration and Nomination Committees and member of Audit Committee. A Chartered Accountant.

R. T. Scholes Senior Non-Executive Director (58)
Appointed in 1998. Non-Executive Director of Keller Group PLC (2002) Chaucer Holdings PLC, Crest Nicolson Plc and Marshalls PLC (2003) and of British Vita plc (1993 to 2003). Investment banker with Dresdner Kleinwort Wasserstein (1986 to 2001). Chairman of the Audit Committee and member of the Remuneration and Nomination Committees. A Chartered Accountant.

J. Vogelsang (61) Netherlands
Appointed a Director on 1 January 2003. President of Technology at Basell Polyolefins (2001 to 2002), President of Montell Polyolefins Europe (1999 to 2001), Vice-President of Shell Chemicals Europe and Africa (1994 to 1999) and Chief Executive of the Shell Companies in Sweden (1992 to 1994). Member of the Audit, Remuneration and Nomination Committees. A Chemical Engineer.

L.P. Bermejo (44) France
Appointed a Director on 1 January 2003. Chief Executive of Dalkia Plc (UK and Ireland subsidiary of Veolia Environment) from 1999 having previously been Chief Executive of Dalkia in the Czech and Slovak Republics (1995 to 1999) and DEKRA-Veritas Automobile (1993 to 1995), Member of the Audit, Remuneration and Nomination Committees. A Structural Engineer.

SECRETARY AND REGISTERED OFFICE

J. R. Grime
Hulley Road, Hurdsfield, Macclesfield, Cheshire SK10 2SG. Tel: 01625 505300 Fax: 01625 505313. Registered Number 519057 England and Wales.

Advisers

AUDITORS	Deloitte & Touche LLP
PRINCIPAL BANKERS	HSBC Bank plc, Barclays Bank PLC, The Royal Bank of Scotland plc, Svenska Handelsbanken AB, Bank of Scotland and Danske Bank A/S
FINANCIAL ADVISERS	Dresdner Kleinwort Wasserstein Limited
SOLICITORS	Eversheds LLP
BROKERS	Dresdner Kleinwort Wasserstein Securities Limited
REGISTRARS	Capita Registrars Limited, Huddersfield

Independent Auditors' Report
to the Members of Bodycote International Plc

Bodycote

We have audited the financial statements of Bodycote International Plc for the year ended 31 December 2003, which comprise the consolidated profit and loss account, the balance sheets, the consolidated cash flow statement, the consolidated statement of total recognised gains and losses and the related notes 1 to 27 together with the reconciliation of net cash flow to movement in net debt, the reconciliation of movements in Group shareholders' funds and the accounting policies. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the Board Report on Remuneration 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

As described in the statement of Directors' responsibilities, the Company's Directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the annual report, including the Board Report on Remuneration. Our responsibility is to audit the financial statements and the part of the Board Report on Remuneration described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Board Report on Remuneration described as having been audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if 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 transactions with the Company and other members of the Group is not disclosed.

We review whether the corporate governance statement reflects the company's compliance with the seven provisions of the 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 Directors' Report and the other information contained in the annual report for the above year as described in the contents section including the unaudited part of the Board Report on Remuneration and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Board Report on Remuneration described as having been audited. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, 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 financial statements and the part of the Board Report on Remuneration described as having been 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 financial statements and the part of the Board Report on Remuneration described as having been audited.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2003 and of the loss of the Group for the year then ended; and
- the financial statements and part of the Board Report on Remuneration described as having been audited have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants
Registered Auditors

Manchester
9 March 2004

Consolidated Profit and Loss Account
for the year ended 31 December 2003

	2003 £m	2002 £m	Note
Turnover			1
Existing operations	**447.1**	440.1	
Acquisitions	**1.3**	–	
Continuing operations	**448.4**	440.1	
Operating profit			2
Existing operations	**24.9**	22.4	
Acquisitions	**0.2**	–	
Continuing operations	**25.1**	22.4	
Total operations:			
Trading	**41.7**	49.4	
Operating exceptional item arising from restructuring and asset write downs	**(7.5)**	(18.3)	2
Goodwill amortisation	**(9.1)**	(8.7)	
Operating profit	**25.1**	22.4	
Exceptional items			3
Profit on disposal of discontinued operations	**3.5**	–	
Loss on termination of operations	**(30.0)**	–	
(Loss)/profit on ordinary activities before interest and taxation	**(1.4)**	22.4	
Net interest payable	**(9.7)**	(11.2)	4
(Loss)/profit on ordinary activities before taxation	**(11.1)**	11.2	1
Tax on (loss)/profit on ordinary activities	**(6.2)**	(4.8)	6
(Loss)/profit on ordinary activities after taxation	**(17.3)**	6.4	
Minority interests - equity	**(0.1)**	(0.1)	18
(Loss)/profit for the financial year	**(17.4)**	6.3	
Dividends - paid and proposed	**(15.6)**	(15.6)	8
Retained loss for the financial year	**(33.0)**	(9.3)	17
Earnings/(loss) per share			9
Headline	**9.7p**	10.6p	
Headline - diluted	**9.7p**	10.6p	
Basic	**(6.8p)**	2.4p	
Basic - diluted	**(6.8p)**	2.4p	

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

Balance Sheets
as at 31 December 2003

Bodycote

	Group		Company		Note
	2003	2002	**2003**	2002	
		As restated		As restated	12
	£m	£m	**£m**	£m	
Fixed assets					
Intangible assets - goodwill	**137.5**	155.5	**–**	–	10
Tangible assets	**478.7**	498.4	**0.2**	0.2	11
Investments	**0.9**	0.9	**831.6**	830.8	12
	617.1	654.8	**831.8**	831.0	
Current assets					
Stocks	**18.2**	17.7	**–**	–	13
Debtors	**102.7**	111.6	**11.4**	28.3	14
Cash at bank and in hand	**35.2**	43.5	**3.2**	6.3	
	156.1	172.8	**14.6**	34.6	
Creditors					
Amounts falling due within one year	**(119.1)**	(202.8)	**(32.4)**	(99.3)	15
Net current assets/(liabilities)	**37.0**	(30.0)	**(17.8)**	(64.7)	
Total assets less current liabilities	**654.1**	624.8	**814.0**	766.3	
Creditors					
Amounts falling due after more than one year	**(239.5)**	(190.8)	**(493.2)**	(426.1)	15
Provisions for liabilities and charges	**(42.8)**	(44.6)	**–**	–	16
Net assets	**371.8**	389.4	**320.8**	340.2	1
Capital and reserves					17
Called-up share capital	**25.7**	25.6	**25.7**	25.6	
Share premium account	**244.4**	244.2	**244.4**	244.2	
Currency and other reserves	**14.2**	(0.2)	**0.7**	0.6	
Profit and loss account	**86.6**	119.6	**50.0**	69.8	
Shareholders' funds - equity	**370.9**	389.2	**320.8**	340.2	
Minority interests - equity	**0.9**	0.2	**–**	–	18
	371.8	389.4	**320.8**	340.2	

Approved by the Board of Directors on 9 March 2004 and signed on its behalf by:

J. D. Hubbard
D. F. Landless } Directors

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

Consolidated Cash Flow Statement
for the year ended 31 December 2003

	2003 £m	2002 £m	Note
Net cash inflow from operating activities	**83.9**	94.2	20
Returns on investments and servicing of finance	**(10.3)**	(11.0)	21
Taxation	**(4.9)**	(7.2)	
Capital expenditure and financial investment	**(38.3)**	(54.0)	21
Acquisitions and disposals	**1.3**	(10.1)	21
Equity dividends paid	**(15.6)**	(15.6)	
Cash inflow/(outflow) before management of liquid resources and financing	**16.1**	(3.7)	
Management of liquid resources	**5.9**	7.8	21
Financing	**(23.5)**	3.6	21
(Decrease)/increase in cash in the year	**(1.5)**	7.7	

	2003 £m	2002 £m	Note
Reconciliation of net cash flow to movement in net debt			
(Decrease)/increase in cash in the year	**(1.5)**	7.7	
Cash outflow/(inflow) from decrease/(increase) in debt and lease financing	**23.7**	(3.6)	
Cash inflow from movement in liquid resources	**(5.9)**	(7.8)	
Change in net debt resulting from cash flows	**16.3**	(3.7)	
Debt acquired with subsidiaries	**–**	(1.1)	
Currency adjustments	**7.6**	12.6	
Movement in net debt in the year	**23.9**	7.8	
Net debt at 1 January	**(234.2)**	(242.0)	
Net debt at 31 December	**(210.3)**	(234.2)	22

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

Consolidated Statement of Total Recognised Gains and Losses

for the year ended 31 December 2003

	2003	2002
	£m	£m
(Loss)/profit for the financial year	**(17.4)**	6.3
Disposal of revalued property	**–**	(0.6)
Currency adjustments	**14.4**	9.7
Total recognised gains and losses relating to the year	**(3.0)**	15.4

Reconciliation of Movements in Group Shareholders' Funds

for the year ended 31 December 2003

	2003	2002
		As restated
	£m	£m
(Loss)/profit for the financial year	**(17.4)**	6.3
Dividends paid and proposed	**(15.6)**	(15.6)
Retained loss for the financial year	**(33.0)**	(9.3)
Disposal of revalued property	**–**	(0.6)
Currency adjustments	**14.4**	9.7
New shares issued	**0.3**	–
Net movement in shareholders' funds	**(18.3)**	(0.2)
Shareholders' funds at 1 January (as previously stated)	**390.0**	390.2
Prior year adjustment (note 12)	**(0.8)**	(0.8)
Shareholders' funds at 1 January (as restated)	**389.2**	389.4
Shareholders' funds at 31 December	**370.9**	389.2

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

Accounting Policies

ACCOUNTING CONVENTION

The financial statements have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards with the exception of the policy for accounting for employee benefit trusts which is explained in note 12.

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 Group's financial statements.

BASIS OF CONSOLIDATION

The Group financial statements consolidate the accounts of the Company and its subsidiary undertakings, all of which are drawn up to 31 December each year. The acquisition method of accounting has been adopted. The results of subsidiaries acquired or sold during the year are consolidated from or to the date on which control passed.

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.

GOODWILL

Purchased goodwill arising on the acquisitions of subsidiary undertakings before 1 January 1998, when FRS 10 Goodwill and Intangible Assets was adopted, was written off to reserves in the year of acquisition and, as allowed by this Standard, has not been reinstated in the balance sheet.

Purchased goodwill arising on acquisitions since 31 December 1997 has been capitalised and is being amortised in equal instalments over its estimated useful life up to a maximum of twenty years. Provision is made for any impairment.

TURNOVER

Turnover represents amounts receivable for goods and services sold to outside customers, excluding value added tax.

INVESTMENTS

Investments are held at cost less provision for impairment.

STOCK

Stock is valued at the lower of cost and net realisable value. In the case of manufactured products, cost includes the attributable proportion of manufacturing overhead costs. Net realisable value comprises the estimated selling price less all further costs to completion and all costs to be incurred in selling and distribution.

PENSION COSTS

For defined benefit schemes the amount charged to the profit and loss account in respect of pension costs is the estimated regular cost of providing the benefits accrued in the year, adjusted to reflect variations from that cost. For defined contribution schemes the amounts charged are the contributions payable in the year.

LEASES

Assets held under finance leases are capitalised as tangible fixed assets at fair value and the corresponding rental liability is shown net of interest under finance leases within creditors. The capitalised values are written off over the shorter of the period of the lease and the useful life of the asset concerned and finance charges are written off over the period of the lease.

Rental costs under operating leases are charged to the profit and loss account over the period of the lease.

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%

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 Group'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.

FOREIGN CURRENCIES

The results of overseas subsidiaries are translated into sterling using average rates of exchange during the year. Assets and liabilities of overseas subsidiaries are translated at the rates of exchange ruling at the balance sheet date. Exchange differences arising from the translation of investments in subsidiary undertakings at closing rates are taken to reserves, together with exchange differences on foreign currency borrowings which finance a proportion of foreign currency investments.

GOVERNMENT GRANTS

Capital based government grants are included within accruals and deferred income in the balance sheet and credited to the profit and loss account over the estimated useful economic lives of the assets to which they relate. Revenue based government grants are credited to the profit and loss account in the period in which they are receivable.

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.

DERIVATIVES AND FINANCIAL INSTRUMENTS

The Group uses derivatives and financial instruments to reduce exposure to foreign exchange risk. The Group does not hold or issue derivatives or financial instruments for speculative purposes.

For a forward foreign exchange contract to be treated as a hedge, the instrument must be related to actual foreign currency assets or liabilities or to a probable commitment. It must involve the same currency or similar currencies as the hedged item and must also reduce the risk of foreign currency exchange movements on the Group's operations. Gains and losses arising on these contracts are deferred and recognised in the profit and loss account, or as adjustments to the carrying amount of fixed assets, only when the hedged transaction has itself been reflected in the Group's accounts. If an instrument ceases to be accounted for as a hedge, for example, because the underlying hedged position is eliminated, the instrument is marked to market and any resulting profit or loss recognised at that time.

Notes to the Financial Statements
31 December 2003

1. Segmental analysis

By activity	Turnover		Profit		Net assets	
	2003	2002	**2003**	2002	**2003**	2002 As restated
	£m	£m	**£m**	£m	**£m**	£m
Heat treatment	**302.9**	302.7	**31.6**	36.5	**296.9**	288.4
Materials testing	**61.2**	56.6	**11.4**	10.9	**32.6**	25.3
Hot isostatic pressing	**27.6**	28.5	**3.6**	4.5	**66.9**	64.9
Specialty coatings	**18.7**	16.3	**2.7**	2.6	**15.6**	9.9
	410.4	404.1	**49.3**	54.5	**412.0**	388.5
Wet coatings	**38.0**	36.0	**(6.0)**	(3.8)	**(40.2)**	0.9
	448.4	440.1	**43.3**	50.7	**371.8**	389.4
Head office expenses			**(1.6)**	(1.3)		
Operating profit before amortisation of goodwill and exceptional items			**41.7**	49.4		
Net interest payable			**(9.7)**	(11.2)		
Profit on ordinary activities before amortisation of goodwill and exceptional items			**32.0**	38.2		
Amortisation of goodwill			**(9.1)**	(8.7)		
Profit on ordinary activities before exceptional items			**22.9**	29.5		
Operating exceptional item arising from restructuring and asset write downs			**(7.5)**	(18.3)		
Exceptional items			**(26.5)**	–		
(Loss)/profit on ordinary activities before taxation			**(11.1)**	11.2		

By geographical origin	Turnover		Profit before tax		Net assets	
	2003	2002	**2003**	2002	**2003**	2002 As restated
	£m	£m	**£m**	£m	**£m**	£m
United Kingdom	**60.6**	62.2	**(0.9)**	4.5	**2.7**	32.2
Mainland Europe	**229.0**	201.0	**(5.5)**	5.3	**340.1**	261.8
North America	**154.9**	174.6	**4.2**	12.0	**23.7**	91.2
Rest of World	**3.9**	2.3	**0.8**	0.6	**5.3**	4.2
	448.4	440.1	**(1.4)**	22.4	**371.8**	389.4
Net interest payable			**(9.7)**	(11.2)		
Profit on ordinary activities before taxation			**(11.1)**	11.2		

By geographical destination	Turnover	
	2003	2002
	£m	£m
United Kingdom	**58.8**	62.5
Mainland Europe	**224.9**	199.5
North America	**154.9**	174.5
Rest of World	**9.8**	3.6
	448.4	440.1

The segmental disclosure by activity for 2002 has been restated to reflect the transfer of certain businesses from the heat treatment to the metallurgical coatings division.

2. Operating profit

	2003 Existing Operations £m	2003 Acquisitions £m	2003 Total £m	2002 Continuing Operations £m
Turnover	**447.1**	**1.3**	**448.4**	440.1
Cost of sales	**(314.7)**	**(0.7)**	**(315.4)**	(303.4)
Gross profit	**132.4**	**0.6**	**133.0**	136.7
Distribution costs	**(16.3)**	**–**	**(16.3)**	(16.4)
Administrative expenses				
- Other	**(74.7)**	**(0.3)**	**(75.0)**	(70.9)
- Goodwill amortisation	**(9.0)**	**(0.1)**	**(9.1)**	(8.7)
- Operating exceptional items arising from restructuring and asset write downs	**(7.5)**	**–**	**(7.5)**	(18.3)
Operating profit	**24.9**	**0.2**	**25.1**	22.4

	2003 £m	2002 £m
Operating profit is stated after charging/(crediting):		
Depreciation	**45.7**	43.0
Amortisation of goodwill	**9.1**	8.7
Operating lease rentals, plant and machinery	**3.2**	3.3
Operating lease rentals, other	**5.7**	5.6
Auditors' remuneration for audit services	**0.4**	0.3
Government grants receivable	**(0.2)**	(0.4)
Rents receivable	**(0.7)**	(0.6)
Operating exceptional item (see below)	**7.5**	18.3

Amounts payable to Deloitte & Touche LLP and their associates by the Group in respect of non-audit services were £0.4m (2002: £0.8m).

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

	2003 £m	2003 %	2002 £m	2002 %
Audit services				
Statutory audit	**0.4**	**50**	0.3	27
Tax services				
Compliance services	**0.1**	**13**	0.2	18
Advisory services	**0.2**	**25**	0.5	46
	0.3	**38**	0.7	64
Other services				
Other services not covered above	**0.1**	**12**	0.1	9
	0.8	**100**	1.1	100

In addition to the amounts shown above, the auditors received fees of £7,000 (2002: £7,000) for the audit of the Group's UK pension schemes.

A description of the work of the Audit Committee is set out in the Directors' Report on page 11 and includes an explanation of how auditor objectivity and independence is safeguarded when non-audit services are provided by the auditors.

2. Operating profit continued

Operating exceptional item:
A restructuring charge of £7.5m (2002: £18.3m) has been recognised to cover the costs of plant closures, asset write offs and reorganisation of continuing operations. £2.1m (2002: £5.1m) remains as a provision at 31 December 2003 (see note 16).

	Asset write off £m	**Redundancy costs £m**	**Plant closures £m**	**2003 Total £m**	2002 Total £m
Heat treatment	**2.1**	**0.8**	**2.5**	**5.4**	11.9
Hot isostatic pressing	**–**	**–**	**0.1**	**0.1**	0.4
Materials testing	**0.4**	**–**	**0.1**	**0.5**	0.3
Metallurgical coatings	**1.0**	**0.2**	**0.3**	**1.5**	5.7
Total	**3.5**	**1.0**	**3.0**	**7.5**	18.3

3. Exceptional items reported after operating profit

	2003 £m	2002 £m
Receipt of fully provided deferred consideration relating to prior years' disposal	**3.5**	–
Loss on termination of operations (see below)	**(30.0)**	–
	(26.5)	–

	2003 £m	2002 £m
The loss on termination of discontinuing operations comprises		
Goodwill impairment losses (note 10)	**11.1**	–
Tangible fixed assets impairment losses (note 11)	**18.9**	–
	30.0	–

4. Net interest payable

	2003 £m	2002 £m
Interest payable and similar charges - bank loans and overdrafts	**(13.2)**	(14.4)
Bank interest receivable	**3.5**	3.2
	(9.7)	(11.2)

5. Employees

	2003 Number	2002 Number
The average monthly number of persons employed by the Group (including Executive Directors) was:		
Heat treatment	**4,926**	5,239
Materials testing	**1,334**	1,266
Hot isostatic pressing	**269**	266
Metallurgical coatings	**856**	875
	7,385	7,646

	2003 £m	2002 £m
Total employee costs (including Executive Directors) were:		
Wages and salaries	**158.8**	159.9
Social security costs	**38.5**	38.9
Other pension costs (see note 24)	**4.9**	5.5
	202.2	204.3

Details of Directors' emoluments are given on page 16.

6. Tax on (loss)/profit on ordinary activities

	2003 £m	2002 £m
The charge for tax comprises:		
Current tax:		
UK corporation tax	**1.4**	3.5
Overseas tax	**5.0**	6.3
Adjustments in respect of prior years:		
- UK corporation tax	**0.4**	(0.5)
- Overseas tax	**(1.0)**	(2.5)
Total current tax	**5.8**	6.8
Deferred tax:		
Origination and reversal of timing differences	**2.1**	(3.7)
(Increase)/decrease in discount	**(1.7)**	1.7
Total deferred tax (see note 16)	**0.4**	(2.0)
Total tax on (loss)/profit on ordinary activities	**6.2**	4.8
The tax effect of exceptional items comprises:		
Profit on disposal of discontinued operations - overseas	**1.8**	–
Operating exceptional restructuring charges	**(2.7)**	(6.2)
	(0.9)	(6.2)

The loss on termination of operations (note 3) has no tax effect.

The difference between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows.

	2003 £m	2002 £m
Group (loss)/profit on ordinary activities before tax	**(11.1)**	11.2
Tax on Group (loss)/profit on ordinary activities at standard UK corporation tax rate of 30% (2002 - 30%)	**(3.3)**	3.4
Effects of:		
Goodwill amortisation not deductible for tax purposes	**2.7**	2.6
Other expenses not deductible for tax purposes	**0.1**	0.1
Exceptional provision for asset write downs not considered recoverable	**9.0**	–
Adjustments to tax charge in respect of previous periods	**(0.6)**	(3.0)
Origination and reversal of timing differences	**(2.1)**	3.7
Group current tax charge for the year	**5.8**	6.8

A deferred tax asset amounting to £14.2m (2002: £nil) for trading losses has not been recognised because in the opinion of the directors there will be no suitable taxable gains available in the forseeable future.

7. (Loss)/profit for the financial year

The loss for the financial year dealt with in the financial statements of the parent company amounted to £4.2m (2002: £4.0m profit).

8. Dividends - paid and proposed

	2003 £m	2002 £m
Interim - 2.25p per share (2002: 2.25p) on 256,630,326 (2002: 256,470,884) shares paid 6 January 2004 (2002: 2 January 2003)	**5.8**	5.8
Final - 3.85p per share (2002: 3.85p) proposed on 256,630,326 (2002: 256,470,884) shares	**9.8**	9.8
	15.6	15.6

9. Earnings/(loss) per share

	2003 £m	2002 £m
(Loss)/profit for the financial year	**(17.4)**	6.3
Goodwill amortisation charge	**9.1**	8.7
Exceptional items after tax	**33.1**	12.1
Headline earnings	**24.8**	27.1

	Number	Number
Weighted average number of ordinary shares in issue - basic	**256,115,749**	256,052,197
Adjustment in respect of share options	**–**	327,984
Weighted average number of ordinary shares in issue - diluted	**256,115,749**	256,380,181

	2003	2002
Headline	**9.7p**	10.6p
Headline - diluted	**9.7p**	10.6p
Basic	**(6.8p)**	2.4p
Basic - diluted	**(6.8p)**	2.4p

The Directors consider that the headline earnings per share figures more accurately reflect the underlying performance of the Group. The figures for basic and diluted weighted average share capital exclude 400,000 shares in respect of which dividend entitlement has been waived on behalf of the Bodycote International Employee Benefit Trust.

FRS 14 requires presentation of diluted EPS when a company could be called upon to issue shares that would decrease net profit or increase net loss per share. Net loss per share would only be increased by out-of-the-money options. Since it seems inappropriate to assume that option holders would act irrationally, no adjustment has been made to diluted EPS.

10. Intangible fixed assets - Goodwill

Group

Cost	£m
1 January 2003	180.6
Additions (note 23)	2.2
31 December 2003	**182.8**
Amortisation	
1 January 2003	25.1
Charge for the year	9.1
Impairment losses (note 3)	11.1
31 December 2003	**45.3**
Net book value	
31 December 2003	**137.5**
31 December 2002	155.5

11. Tangible fixed assets

	Land and buildings			Plant	Fixtures	
		Long	Short	and	and	
	Freehold	leasehold	leasehold	machinery	fittings	Total
	£m	£m	£m	£m	£m	£m
Group						
Cost						
1 January 2003	163.4	12.4	6.0	526.6	38.9	747.3
Currency adjustments	3.7	0.8	–	12.5	1.9	18.9
Recategorisation	0.7	–	–	(1.5)	0.8	–
Subsidiaries acquired	0.1	–	–	0.6	–	0.7
Additions	3.0	0.2	0.4	33.7	2.6	39.9
Disposals	(3.3)	–	–	(16.9)	(1.9)	(22.1)
31 December 2003	**167.6**	**13.4**	**6.4**	**555.0**	**42.3**	**784.7**
Depreciation						
1 January 2003	18.8	6.3	1.4	196.6	25.8	248.9
Currency adjustments	1.0	0.4	–	6.8	1.3	9.5
Recategorisation	0.3	–	–	(1.3)	1.0	–
Charge for the year	4.2	0.3	0.4	36.0	4.8	45.7
Provision for impairment (note 3)	3.9	–	–	13.6	1.4	18.9
Disposals	(1.1)	–	–	(14.2)	(1.7)	(17.0)
31 December 2003	**27.1**	**7.0**	**1.8**	**237.5**	**32.6**	**306.0**
Net book value						
31 December 2003	**140.5**	**6.4**	**4.6**	**317.5**	**9.7**	**478.7**
31 December 2002	144.6	6.1	4.6	330.0	13.1	498.4

Included in the net book value of fixed assets of £478.7m (2002: £498.4m) is £13.1m (2002: £13.1m) which relates to freehold land not depreciated.

During the year the Group recategorised some of its fixed assets.

In the Directors' opinion the net book value of leased assets is not material.

11. Tangible fixed assets continued

	Fixtures and fittings £m
Company	
Cost	
31 December 2003 and 2002	**0.3**
Depreciation	
31 December 2003 and 2002	**0.1**
Net book value	
31 December 2003 and 2002	**0.2**

12. Investments

	Group Shares £m	Group other investments £m	Group Total £m	Company Shares £m	Company Loans £m	Company Total £m
Cost						
31 December 2002 (as previously stated)	1.4	0.5	1.9	398.3	435.3	833.6
Prior year adjustment (see below)	(0.8)	–	(0.8)	(0.8)	–	(0.8)
1 January 2003 (as restated)	0.6	0.5	1.1	397.5	435.3	832.8
Acquisitions and advances	–	–	–	–	10.3	10.3
Disposals and repayments	–	(0.1)	(0.1)	–	(0.3)	(0.3)
Currency adjustments	–	0.2	0.2	–	(9.2)	(9.2)
31 December 2003	**0.6**	**0.6**	**1.2**	**397.5**	**436.1**	**833.6**
Provision						
1 January 2003	0.2	–	0.2	2.0	–	2.0
Acquisitions	0.1	–	0.1	–	–	–
31 December 2003	**0.3**	**–**	**0.3**	**2.0**	**–**	**2.0**
Net book value						
31 December 2003	**0.3**	**0.6**	**0.9**	**395.5**	**436.1**	**831.6**
31 December 2002 (as restated)	0.4	0.5	0.9	395.5	435.3	830.8

Group investments comprise:

Name of company	Nature of business	Country of incorporation	% Holding of ordinary shares
Traitement Compression Services SA	Hot Isostatic Pressing	France	49
International Heat Treatment Limited	Heat Treatment	Hong Kong	40

Equity accounting has not been applied in respect of these entities as the impact would be immaterial. Details of principal subsidiary undertakings are given on pages 48 to 50.

Prior year adjustment

During the year, the Group adopted the requirements of UITF 38, 'Accounting for ESOP Trusts', as a result of which the policy for accounting for the Group's employee benefit trust was changed. The comparative figures in the primary statements and notes have been restated to reflect the new policy. There is no impact on the results for the year ending 31 December 2003 or 2002. The effects of the change in policy are summarised below:

Balance Sheet

	2003 £m	2002 £m
Investments	**(0.8)**	(0.8)
Decrease in net assets	**(0.8)**	(0.8)

13. Stocks

	Group	
	2003 £m	2002 £m
Raw materials and consumables	**12.0**	12.1
Work in progress	**5.3**	4.9
Finished goods and goods for resale	**0.9**	0.7
	18.2	17.7

There is no material difference between the balance sheet value of stocks and their replacement cost.

14. Debtors

	Group		Company	
	2003 £m	2002 £m	**2003 £m**	2002 £m
Amounts falling due within one year:				
Trade debtors	**86.1**	86.3	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**6.9**	15.4
Other debtors	**6.0**	10.1	**3.5**	8.3
Prepayments and accrued income	**6.9**	7.0	**1.0**	0.1
	99.0	103.4	**11.4**	23.8
Amounts falling due after more than one year:				
Other debtors	**3.7**	8.2	**–**	4.5
	102.7	111.6	**11.4**	28.3

15. Creditors

	Group		Company	
	2003 £m	2002 £m	**2003 £m**	2002 £m
Amounts falling due within one year:				
Bank loans	**9.3**	87.3	**2.9**	80.1
Obligations under finance leases	**1.6**	1.5	**–**	–
Bank overdrafts	**5.4**	6.5	**1.9**	0.5
Trade creditors	**36.1**	34.9	**0.3**	0.7
Amounts owed to subsidiary undertakings	**–**	–	**10.0**	0.3
Corporation tax	**3.2**	1.4	**–**	–
Proposed dividends	**15.6**	15.6	**15.6**	15.6
Other taxes and social security	**14.5**	16.1	**–**	–
Other creditors	**8.6**	9.4	**0.3**	0.3
Accruals and deferred income	**24.8**	30.1	**1.4**	1.8
	119.1	202.8	**32.4**	99.3
Amounts falling due after more than one year:				
Bank loans	**224.9**	177.8	**216.0**	163.2
Obligations under finance leases	**4.3**	4.6	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**277.2**	262.9
Other creditors	**10.3**	8.4	**–**	–
	239.5	190.8	**493.2**	426.1

15. Creditors continued

	Group		Company	
	2003	2002	**2003**	2002
	£m	£m	**£m**	£m
Bank loans are repayable:				
After 5 years	**47.6**	56.8	**44.7**	49.7
Between 2 and 5 years	**165.8**	114.4	**161.3**	109.9
Between 1 and 2 years	**11.5**	6.6	**10.0**	3.6
	224.9	177.8	**216.0**	163.2
On demand or within 12 months	**9.3**	87.3	**2.9**	80.1
	234.2	265.1	**218.9**	243.3
Finance leases are repayable:				
After 5 years	**0.6**	0.8	**–**	–
Between 2 and 5 years	**2.5**	2.6	**–**	–
Between 1 and 2 years	**1.2**	1.2	**–**	–
	4.3	4.6	**–**	–
On demand or within 12 months	**1.6**	1.5	**–**	–
	5.9	6.1	**–**	–

Bank loans are secured by interlocking intra Group guarantees with principal subsidiaries. The bank loans falling due after 5 years bear interest at a weighted average rate of 7.79% (2002: 7.79%).

Finance leases are secured on the assets to which they relate.

16. Provisions for liabilities and charges

	Deferred tax	Restructuring provision	Total
	£m	£m	£m
Group			
1 January 2003	39.5	5.1	44.6
Profit and loss account charge	0.4	7.5	7.9
Currency adjustments	0.8	–	0.8
Utilised in the year	–	(10.5)	(10.5)
31 December 2003	**40.7**	**2.1**	**42.8**

Deferred tax	Group	
	2003	2002
	£m	£m
Deferred tax is provided as follows:		
Accelerated capital allowances	**64.9**	61.8
Other timing differences	**(5.6)**	(5.4)
Undiscounted provision for deferred tax	**59.3**	56.4
Discount	**(18.6)**	(16.9)
Discounted provision for deferred tax	**40.7**	39.5

17. Capital and reserves

Share capital:

	2003	2002
	£m	£m
Authorised 347,060,000 (2002: 347,060,000) ordinary shares of 10p each	**34.7**	34.7
Allotted, called-up and fully paid 256,630,326 (2002: 256,470,884) ordinary shares of 10p each	**25.7**	25.6

An analysis of the shares that were issued is given in the Directors' Report on page 9.

Share options:

During the year options covering 1,230,434 ordinary shares were granted to 68 employees pursuant to the rules of the Bodycote International Executive Share Option Scheme 2003. Options covering 159,442 ordinary shares were exercised and 660,842 options lapsed.

At 31 December 2003 options under the Bodycote International Share Option Schemes 1994, 1996 and 2003 were outstanding in respect of 9,301,081 ordinary shares granted to 475 employees at prices ranging from 105.53p to 509p per share and which expire at dates between 8 January 2004 and 15 September 2013.

Outstanding options

Date of grant		Option price pence	Exercise period	Number of options **2003**	2002
November	1994	105.53	1997-2004	**154,467**	313,909
May	1995	113.73	1998-2005	**46,411**	46,411
October	1995	142.42	1998-2005	**19,027**	19,027
June	1996	190.57	1999-2006	**73,202**	219,606
November	1996	253.58	1999-2003	**–**	43,920
November	1996	251.47	1999-2003	**–**	16,423
December	1996	271.08	1999-2006	**366,238**	404,790
May	1997	258.73	2000-2007	**2,399,805**	2,490,679
December	1997	337.35	2000-2007	**571,372**	605,791
January	1998	377.60	2001-2008	**240,000**	247,500
May	1998	509.00	2001-2008	**38,750**	63,750
October	1998	305.00	2001-2008	**285,000**	326,250
April	1999	396.00	2002-2009	**459,875**	539,875
May	1999	352.00	2002-2009	**15,000**	15,000
December	1999	312.50	2002-2009	**185,000**	185,000
May	2000	247.50	2003-2010	**1,034,000**	1,105,500
April	2001	217.50	2004-2011	**1,184,558**	1,239,558
April*	2001	217.50	2004-2008	**42,942**	42,942
September	2002	134.50	2005-2012	**870,700**	880,700
September*	2002	134.50	2005-2009	**84,300**	84,300
September	2003	157.50	2006-2013	**1,230,434**	–
				9,301,081	8,890,931

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.

17. Capital and reserves continued

Reserves:

	Share premium account £m	Currency and other reserve £m	Profit and loss account £m	Total £m
Group				
31 December 2002 (as previously stated)	244.2	0.6	119.6	364.4
Prior year adjustment (note 12)	–	(0.8)	–	(0.8)
1 January 2003 (as restated)	244.2	(0.2)	119.6	363.6
Currency adjustments	–	14.4	–	14.4
Retained loss for the year	–	–	(33.0)	(33.0)
Premium on shares issued	0.2	–	–	0.2
31 December 2003	**244.4**	**14.2**	**86.6**	**345.2**
Company				
31 December 2002 (as previously stated)	244.2	1.4	69.8	315.4
Prior year adjustment (note 12)	–	(0.8)	–	(0.8)
1 January 2003 (as restated)	244.2	0.6	69.8	314.6
Currency adjustments	–	0.1	–	0.1
Retained loss for the year	–	–	(19.8)	(19.8)
Premium on shares issued	0.2	–	–	0.2
31 December 2003	**244.4**	**0.7**	**50.0**	**295.1**

Cumulative goodwill written off to reserves at 31 December 2003 and 2002 amounted to £122.1m.

18. Minority interests - equity

	Group	
	2003 £m	2002 £m
Equity interest at 1 January	**0.2**	0.7
Share of profits for the period	**0.1**	0.1
Acquisition/(disposal) of subsidiary undertaking	**0.7**	(0.5)
Dividend payable	**(0.1)**	(0.1)
Equity interest at 31 December	**0.9**	0.2

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19. Capital and leasing commitments

	Group	
	2003	2002
	£m	£m
Contracted capital expenditure not provided for in the financial statements:	**12.1**	11.7

The annual commitment for payments in respect of operating leases is:

	Land and buildings		Other	
	2003	2002	**2003**	2002
	£m	£m	**£m**	£m
Expiring:				
Within 12 months	**0.6**	0.3	**1.9**	0.7
Between 1 and 5 years	**1.1**	1.7	**2.2**	2.9
After 5 years	**2.2**	1.3	**0.2**	–
	3.9	3.3	**4.3**	3.6

20. Reconciliation of operating profit to operating cash flows

	2003	2002
	£m	£m
Operating profit	**25.1**	22.4
Depreciation charges	**45.7**	43.0
Amortisation of goodwill	**9.1**	8.7
Loss on sale of tangible fixed assets	**0.1**	–
Fixed assets written off on restructuring	**3.5**	8.4
Decrease in stocks	**–**	0.6
Decrease in debtors	**12.1**	8.7
(Decrease)/increase in creditors and provisions	**(11.7)**	2.4
Net cash inflow from operating activities	**83.9**	94.2

21. Analysis of cash flows

	2003	2002
	£m	£m
Returns on investments and servicing of finance:		
Interest received	**3.6**	3.2
Interest paid	**(13.8)**	(14.1)
Dividend paid to minority shareholder	**(0.1)**	(0.1)
Net cash outflow from returns on investments and servicing of finance	**(10.3)**	(11.0)
Capital expenditure and financial investment:		
Purchase of tangible fixed assets	**(39.9)**	(59.1)
Sale of tangible fixed assets	**1.5**	4.6
Sale of investments	**0.1**	0.5
Net cash outflow from capital expenditure and financial investment	**(38.3)**	(54.0)

Notes to the Financial Statements

21. Analysis of cash flows continued

	2003 **£m**	2002 £m
Acquisitions and disposals:		
Net cash/(overdrafts) acquired with subsidiaries	**0.7**	(0.2)
Purchase of subsidiary undertakings (note 23)	**(2.9)**	(9.4)
Purchase of minority interests	**–**	(0.5)
Sale of discontinued operations (note 3)	**3.5**	–
Net cash inflow/(outflow) from acquisitions and disposals	**1.3**	(10.1)
Management of liquid resources:		
Cash withdrawn from short term deposits	**70.8**	86.1
Cash placed on short term deposits	**(64.9)**	(78.3)
Net cash inflow from management of liquid resources	**5.9**	7.8
Financing:		
Issue of ordinary share capital	**0.2**	–
Repayment of bank loans	**(215.6)**	(30.9)
Additional bank loans	**192.6**	34.2
Repayment of finance leases	**(1.5)**	(0.9)
Additional finance leases	**0.8**	1.2
Net cash (outflow)/inflow from financing	**(23.5)**	3.6

22. Analysis of changes in net debt

	1 Jan 2003 £m	Cash flow £m	Non-cash changes £m	Currency adjustments £m	31 Dec 2003 £m
Cash	36.1	(4.2)	–	1.8	33.7
Short term deposits	7.4	(5.9)	–	–	1.5
Cash at bank and in hand	43.5	(10.1)	–	1.8	35.2
Bank overdrafts	(6.5)	2.7	–	(1.6)	(5.4)
Bank loans due within one year	(87.3)	84.2	(2.5)	(3.7)	(9.3)
Bank loans due after one year	(177.8)	(61.2)	2.5	11.6	(224.9)
Finance leases due within one year	(1.5)	1.3	(1.3)	(0.1)	(1.6)
Finance leases due after one year	(4.6)	(0.6)	1.3	(0.4)	(4.3)
	(234.2)	16.3	–	7.6	(210.3)

23. Acquisition of subsidiary undertakings

Acquisitions were made at a cost of £2.9m. The significant acquisitions in the year are given on page 9 in the Directors' Report. The following table analyses the acquisitions made in the year and adjustments made in respect of acquisitions in prior years. No fair value adjustments were required to be made to the amounts at which the assets and liabilities were recorded in the books of the acquired entities. The fair values below are provisional.

	2003 Book and fair value £m
Tangible fixed assets	**0.7**
Stocks	**0.1**
Debtors	**0.8**
Creditors	**(0.9)**
Total net assets acquired	**0.7**
Goodwill	**2.2**
Cash paid	**2.9**

Of the goodwill arising on the acquisition of subsidiary undertakings, £2.2m was capitalised in the year in accordance with FRS 10. This then resulted in an amortisation charge of £0.1m.

The subsidiary undertakings acquired during the year contributed £0.3m to the Group's net operating cash flow, paid nil in respect of net returns on investments and servicing of finance and utilised £0.5m for capital expenditure.

24. Pension schemes

The Group operated a number of pension schemes during the year. The cost to the Group of these schemes was £4.9m (2002: £5.5m) of which £3.3m (2002: £4.1m) related to overseas arrangements.

UK Schemes

The Group operates a funded defined benefit arrangement for UK employees in which the assets are held in separate trustee administered funds. The pension cost relating to the UK arrangement is assessed in accordance with the advice of qualified actuaries using the projected unit method. The last actuarial assessment of the scheme was performed on 6 April 2002. The assumptions that have the most significant effect on the results of each of the actuarial assessments are those relating to the rate of return on the investments (6.5%), the rate of increase in salaries (4.0%) and the allowance (2.75%) made for pension payment increases of 5% or retail price inflation if less.

At the last actuarial valuation of the scheme, the market value of the assets totalled £26.8m. The actuarial value of these assets represented 83% of the benefits that had accrued to members after allowing for expected future increases in earnings.

At 6 April 2002, there was a surplus of £0.2m on the basis of the minimum funding requirement of the Pensions Act 1995.

The contributions made by the employer over the financial year have been £1,556,000, equivalent to 18% of pensionable pay (after allowing for National Insurance rebates). This contribution rate is to continue until reviewed following the triennial valuation of the scheme due as at 6 April 2005. As the scheme is closed to new entrants, the current service cost as a percentage of pensionable payroll is likely to increase as the membership ages, although it will be applied to a decreasing pensionable payroll.

The transitional arrangements of the new accounting standard FRS 17 require disclosure of assets and liabilities as at 31 December 2003 calculated in accordance with the requirements of FRS 17. They also require disclosure of the items which would appear in the profit and loss account and in the statement of total recognised gains and losses were the full requirements of FRS 17 in place. For the purpose of these financial statements, all of these figures are illustrative only and do not impact on the actual 31 December 2003 balance sheet or on this year's performance statements.

Assumptions

The assets of the scheme have been taken at market value and the liabilities have been calculated using the following principal actuarial assumptions:

	2003	2002	2001
	% p.a.	% p.a.	% p.a.
Inflation	**2.75**	2.50	2.50
Salary increases	**4.00**	3.75	3.75
Rate of discount	**5.75**	5.50	5.75
Allowance for pension increases of 5% per annum or RPI if less in payment or if deferred	**2.75**	2.50	2.50

The fair value of the assets in the scheme, the present value of the liabilities in the scheme and the expected rate of return at each balance sheet date were:

	2003	**2003**	2002	2002	2001	2001
	%	**£m**	%	£m	%	£m
Equities	**7.0**	**18.2**	7.0	14.8	7.0	20.0
Bonds	**4.7**	**2.9**	5.4	2.5	5.4	1.6
Cash	**4.0**	**0.5**	4.0	0.8	–	–
With profits insured policy	**4.7**	**4.5**	5.2	4.6	5.4	4.3
Total fair value of assets		**26.1**		22.7		25.9
Present value of scheme liabilities		**(38.6)**		(36.1)		(30.9)
Deficit in the scheme		**(12.5)**		(13.4)		(5.0)
Related deferred tax asset		**3.8**		4.0		1.5
Net pension liability		**(8.7)**		(9.4)		(3.5)

24. Pension schemes continued

Amounts which would be charged to the profit and loss account over the financial year	2003 £m	2002 £m
Current service cost (charge to operating profit)	**0.7**	0.7
Interest on pension scheme liabilities (charge to net finance costs)	**2.0**	1.8
Expected return on pension scheme assets (credit to net finance costs)	**(1.4)**	(1.8)
Total charge	**1.3**	0.7

Amounts which would be included within the statement of total recognised gains and losses

	2003 £m	2003 % of scheme assets/ liabilities	2002 £m	2002 % of scheme assets/ liabilities
Difference between expected and actual return on assets	**(2.4)**	**9.2**	6.4	28.3
Experience gains and losses arising on the scheme liabilities	**(0.1)**	**0.3**	0.6	1.6
Effects of changes in the demographic and financial assumptions underlying the present value of the scheme liabilities	**1.9**	**4.9**	2.0	5.6
Total (credit)/charge	**(0.6)**		9.0	

Analysis of movements during the year	2003 £m	2002 £m
Deficit at 1 January	**13.4**	5.0
Movement in the year:		
Current service cost	**0.7**	0.7
Net finance charge	**0.6**	–
Contributions	**(1.6)**	(1.3)
Actuarial (gain)/loss	**(0.6)**	9.0
Deficit at 31 December	**12.5**	13.4

Overseas Schemes

The Group operates an unfunded scheme for employees in France. The total liability in respect of benefits is €3.3m (£2.3m) of which €2.4m (£1.7m) has been provided.

The company also sponsors six defined benefit pension arrangements in the USA. These are Lindberg Corporation, Metallurgical Inc. Pension Plan, Lakeside Heat Treating, Lansing (UAW), St Louis Hourly and Supplemental Retirement Plans. During the year the Lindberg Corporation plan was fully bought out through the payment of lump sums and the purchase of annuities with an insurance company. The figures calculated for the purposes of US accounting requirement FASB No 32 as at 31 December 2003 have been obtained and adjusted on an approximate basis for the purpose of illustrating the liabilities for the UK accounting standard FRS17. The disclosures required under the transitional arrangements of FRS 17 in respect of these pension schemes are set out below.

The contributions made by the employer over the financial year have been $2,467,000 (£1,505,000) equivalent to 7% of pensionable pay. The next actuarial valuations for funding purposes are at dates between 1 September 2003 and 1 January 2004.

Assumptions

The assets of the scheme have been taken at market value and the liabilities have been calculated using a discount rate of 5% per annum (5% at 31 December 2002).

24. Pension schemes continued

The fair value of the assets in the scheme, the present value of the liabilities in the scheme and the expected rate of return at each balance sheet date were:

	2003 %	**2003 £m**	**2003 $m**	2002 %	2002 £m	2002 $m	2001 %	2001 £m	2001 $m
Equities	**7.00**	**0.9**	**1.7**	7.00	0.8	1.3	7.00	1.1	1.8
Bonds	**5.00**	**0.5**	**0.9**	5.00	0.6	0.9	6.00	0.6	1.0
Cash	**1.25**	**0.3**	**0.6**	1.25	11.6	18.6	1.75	11.9	19.1
Total fair value of assets		**1.7**	**3.2**		13.0	20.8		13.6	21.9
Present value of scheme liabilities		**(3.0)**	**(5.4)**		(16.0)	(25.8)		(13.4)	(21.6)
(Deficit)/surplus in the scheme		**(1.3)**	**(2.2)**		(3.0)	(5.0)		0.2	0.3
Related deferred tax asset/(liability)		**0.6**	**1.0**		1.3	2.3		(0.1)	(0.1)
Net pension (liability)/asset		**(0.7)**	**(1.2)**		(1.7)	(2.7)		0.1	0.2

Charge to the profit and loss account over the financial year

	2003 £m	**2003 $m**	2002 £m	2002 $m
Current service cost (charge to operating profit)	**0.1**	**0.2**	0.1	0.2
Gain on settlements and curtailments	**(0.6)**	**(1.0)**	–	–
Total operating (credit)/charge	**(0.5)**	**(0.8)**	0.1	0.2
Interest on pension scheme liabilities (charge to net finance costs)	**0.4**	**0.6**	0.9	1.3
Expected return on pension scheme assets (credit to net finance costs)	**(0.1)**	**(0.2)**	(0.3)	(0.5)
Total (credit)/charge	**(0.2)**	**(0.4)**	0.7	1.0

Amounts which would be included within the statement of total recognised gains and losses

	2003 £m	**2003 $m**	**2003 % of scheme assets/ liabilities**	2002 £m	2002 $m	2002 % of scheme assets/ liabilities
Difference between expected and actual return on assets	**–**	**(0.1)**	**3.9**	0.3	0.5	3.1
Experience gains and losses arising on the scheme liabilities	**–**	**0.1**	**1.8**	–	–	–
Effects of changes in the demographic and financial assumptions underlying the present value of the scheme liabilities	**–**	**–**	**–**	2.7	4.0	1.5
Total charge	**–**	**–**		3.0	4.5	

Analysis of movements during the year	**2003 £m**	**2003 $m**	2002 £m	2002 $m
(Deficit)/surplus at 1 January	**(3.0)**	**(5.0)**	0.2	0.3
Movement in the year:				
Current service cost	**(0.1)**	**(0.2)**	(0.1)	(0.2)
Contributions	**1.5**	**2.4**	0.2	0.2
Other finance charges	**(0.2)**	**(0.4)**	(0.5)	(0.8)
Gain on curtailment	**0.5**	**1.0**	–	–
Actuarial loss	**–**	**–**	(2.8)	(4.5)
Deficit at 31 December	**(1.3)**	**(2.2)**	(3.0)	(5.0)

24. Pension schemes continued

The analysis of reserves that would have arisen if FRS17 had been fully implemented is as follows:	**2003 £m**	2002 £m
Profit and loss reserve excluding pension liability	**86.6**	119.6
Amount relating to defined benefit pension liability, net of related deferred tax	**(11.7)**	(12.4)
Profit and loss reserve	**74.9**	107.2

25. Contingent liabilities

The Company has guaranteed bank overdrafts and loans of certain subsidiary undertakings amounting to £2.3m (2002: £3.7m).

26. Derivatives and other financial instruments

The Finance Director's Report on page 8 summarises the objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the period.

The numerical disclosures in this note deal with financial assets and financial liabilities as defined in FRS 13 Derivatives and Other Financial Instruments: Disclosures. Certain financial assets such as investments in subsidiary and associated companies are excluded from the scope of these disclosures.

As permitted by FRS 13, short term debtors and creditors have also been excluded from the disclosures, other than the currency disclosures.

Interest rate profile

Financial assets:

The Group's financial assets are made up of cash deposits which are part of the financing arrangements of the Group. These deposits comprise amounts placed on money market at fixed rates for various durations from call up to one week and are detailed as follows:

	2003 £m	2002 £m
Currency		
Sterling	**3.5**	8.0
US Dollar	**6.7**	11.6
Swedish Krona	**0.2**	–
Norwegian Krone	**0.5**	0.3
Danish Krone	**0.1**	0.1
Euro	**19.9**	18.6
Canadian Dollar	**0.3**	0.9
UAE Dirham	**1.2**	1.7
Swiss Franc	**0.5**	0.9
Czech Koruna	**1.6**	1.4
Omani Rial	**0.2**	–
Mexican Peso	**0.5**	–
Total	**35.2**	43.5

26. Derivatives and other financial instruments continued

Financial liabilities:
After taking into account forward foreign currency contracts entered into by the Group, the interest rate profile of the Group's financial liabilities at 31 December 2003 and 31 December 2002 was as follows:

	Total 2003 £m	**Floating rate 2003 £m**	**Fixed rate 2003 £m**	**Interest free 2003 £m**	Total 2002 £m	Floating rate 2002 £m	Fixed rate 2002 £m	Interest free 2002 £m
Currency								
Sterling	**1.2**	**1.1**	**0.1**	**–**	0.5	0.3	0.2	–
US Dollar	**135.3**	**90.6**	**44.7**	**–**	158.1	107.4	50.7	–
Swedish Krona	**14.9**	**14.9**	**–**	**–**	14.3	14.3	–	–
Danish Krone	**1.5**	**1.5**	**–**	**–**	1.1	1.1	–	–
Euro	**74.7**	**64.5**	**9.9**	**0.3**	82.7	73.2	9.2	0.3
Canadian Dollar	**1.4**	**1.2**	**0.2**	**–**	1.9	1.6	0.3	–
Swiss Franc	**16.1**	**16.1**	**–**	**–**	16.1	14.5	1.6	–
Czech Koruna	**0.4**	**–**	**0.4**	**–**	3.0	2.5	0.5	–
Total	**245.5**	**189.9**	**55.3**	**0.3**	277.7	214.9	62.5	0.3

Further analysis of the interest rate profile at 31 December 2003 and at 31 December 2002 is as follows:

	2003 Fixed rate Weighted average interest rate %	**2003 Fixed rate Weighted average period for which rate is fixed Years**	**2003 Interest free Weighted average period to maturity Years**
Currency:			
Sterling	**12.08**	**0.4**	**–**
US Dollar	**7.79**	**6.0**	**–**
Czech Koruna	**20.00**	**1.3**	**–**
Euro	**4.49**	**3.1**	**2.8**
Swiss Franc	**2.56**	**0.5**	**–**
Canadian Dollar	**7.30**	**0.3**	**1.0**

	2002 Fixed rate Weighted average interest rate %	2002 Fixed rate Weighted average period for which rate is fixed Years	2002 Interest free Weighted average period to maturity Years
Currency:			
Sterling	12.29	1.3	–
US Dollar	7.72	6.9	–
Czech Koruna	20.00	1.7	–
Euro	5.14	2.7	3.6
Swiss Franc	3.71	0.6	–
Canadian Dollar	7.06	1.7	–

The interest on floating rate financial liabilities is based on the relevant national inter-bank rate and is fixed in advance for periods normally between 3 and 12 months.

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26. Derivatives and other financial instruments continued

Currency exposures

The Group's objectives in managing the currency exposures arising from its net investment overseas (in other words, its structural currency exposures) are to maintain a low cost of borrowings and to retain some potential for currency-related appreciation while partially hedging against currency depreciation. Gains and losses arising from these structural currency exposures are recognised in the statement of total recognised gains and losses.

The table below shows the Group's currency exposures; in other words, those transactional (or non-structural) exposures that give rise to the net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the Group that are not denominated in the operating (or "functional") currency of the operating unit involved, other than certain non-sterling borrowings treated as hedges of net investments in overseas operations.

The exposures as at 31 December 2003 were as follows:

	Net foreign currency monetary assets			
	US $ £m	**Euro £m**	**SEK £m**	**Total £m**
Functional currency of Group operation				
Sterling	**1.1**	**1.4**	**0.1**	**2.6**
Swiss Franc	**–**	**0.1**	**–**	**0.1**
Total	**1.1**	**1.5**	**0.1**	**2.7**

The exposures at 31 December 2002 for comparison purposes were as follows:

	Net foreign currency monetary assets			
	US $ £m	Euro £m	SEK £m	Total £m
Functional currency of Group operation				
Sterling	0.2	0.5	–	0.7
Czech Koruna	–	0.1	–	0.1
Swedish Krona	–	0.3	–	0.3
Total	0.2	0.9	–	1.1

The amounts shown in the tables above take into account the effect of any forward contracts and other derivatives entered into to manage these currency exposures.

Maturity of financial liabilities

The maturity profile of the Group's financial liabilities at 31 December 2003 and 31 December 2002 was as follows:

	2003 £m	2002 £m
In one year or less	**16.3**	95.3
In more than one year but not more than two years	**12.7**	7.8
In more than two years but not more than five years	**168.3**	117.0
In more than five years	**48.2**	57.6
Total	**245.5**	277.7

26. Derivatives and other financial instruments continued

Fair values

Set out below is a comparison by category of book values and fair values of the Group's financial assets and liabilities at 31 December 2003 and 31 December 2002.

	2003 Book value £m	2003 Fair value £m	2002 Book value £m	2002 Fair value £m
Primary financial instruments held or issued to finance the Group's operations				
Financial assets	**35.2**	**35.2**	43.5	43.5
Long-term borrowings	**(229.2)**	**(231.4)**	(182.4)	(186.8)
Short-term financial liabilities and current portion of long-term borrowings	**(16.3)**	**(16.3)**	(95.3)	(95.3)

The fair value of forward foreign currency contracts and US Dollar denominated long-term fixed rate debt with a carrying amount of £44.7m (2002: £53.9m) have been calculated by discounting cash flows at prevailing interest rates. All the other fair values shown above have been determined by reference to prices available from the markets on which the instruments involved are traded.

Gains and losses on hedges

The Group enters into forward foreign currency contracts to eliminate the currency exposures that arise on sales and purchases denominated in foreign currencies when those sales or purchases are transacted. Changes in the fair value of instruments used as hedges are not recognised in the financial statements until the hedged position matures. The unrecognised gains and losses were not material either in 2003 or 2002.

Borrowing facilities

The Group had undrawn committed borrowing facilities at 31 December 2003 and 31 December 2002, in respect of which all conditions precedent had been met, as follows:

	2003 £m	2002 £m
Expiring in one year or less	**18.4**	3.9
Expiring in more than two years	**14.5**	3.5
Total	**32.9**	7.4

27. Post balance sheet event

On 9 March 2004 the Group announced its intention to raise approximately £61.9m net through a fully underwritten rights issue.

Five Year Summary

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	2003	2002	2001	2000	1999
		As restated	As restated	As restated	As restated
	£m	£m	£m	£m	£m
Turnover					
Metal technology	**448.4**	440.1	479.4	359.4	322.8
Discontinued operations	**–**	–	–	11.7	32.6
	448.4	440.1	479.4	371.1	355.4
Profits/(Losses)					
Trading profit	**32.6**	40.7	72.1	82.8	81.1
Operating exceptional items	**(7.5)**	(18.3)	–	–	–
Operating profit	**25.1**	22.4	72.1	82.8	81.1
Profit/(loss) on disposal of discontinued operations	**3.5**	–	(1.9)	9.5	11.8
Restructuring costs	**(30.0)**	–	–	–	(5.2)
(Loss)/profit on disposal of fixed assets	**–**	–	(0.8)	–	0.8
Net interest payable	**(9.7)**	(11.2)	(13.9)	(6.9)	(3.3)
(Loss)/profit before taxation	**(11.1)**	11.2	55.5	85.4	85.2
Taxation	**(6.2)**	(4.8)	(18.0)	(21.0)	(27.3)
(Loss)/profit after taxation	**(17.3)**	6.4	37.5	64.4	57.9
Minority interests	**(0.1)**	(0.1)	(0.1)	–	0.1
(Loss)/profit for the financial year	**(17.4)**	6.3	37.4	64.4	58.0
Headline earnings per share (pence)	**9.7**	10.6	18.2	22.6	22.5
Dividend per share (pence)	**6.1**	6.1	6.1	6.0	5.5
Assets employed					
Intangible fixed assets	**137.5**	155.5	154.4	81.6	64.1
Tangible fixed assets	**478.7**	498.4	496.6	410.5	357.4
Other current assets and liabilities	**(34.1)**	(30.3)	(18.5)	(31.1)	(21.9)
	582.1	623.6	632.5	461.0	399.6
Financed by					
Share capital	**25.7**	25.6	25.6	25.6	25.8
Reserves	**345.2**	363.6	364.2	341.7	295.2
Shareholders' funds	**370.9**	389.2	389.8	367.3	321.0
Minority interests	**0.9**	0.2	0.7	0.2	0.2
Net borrowings	**210.3**	234.2	242.0	93.5	78.4
	582.1	623.6	632.5	461.0	399.6
Net assets per share (pence)	**144.5**	151.8	152.0	143.3	124.7
Return on capital employed before exceptional items (%)	**5.4**	6.5	13.2	19.2	22.4
Return on capital employed after exceptional items (%)	**(0.2)**	3.6	12.8	21.4	24.2

Principal Subsidiary Undertakings

Metal Technology

Heat Treatment

		Country of incorporation or registration
*Bodycote Heat Treatments Limited	Aldridge, Broxburn, Cambridge, Chard, Cheltenham, Coventry, Derby, Gillingham, Great Barr, Hazel Grove, Macclesfield, Rotherham, Skelmersdale, Walsall, Willenhall and Woodford	England
Bodycote Wärmebehandlung GmbH	Ebersbach, Eching, Essen, Esslingen, Karben, Köln, Korntal, Landsberg, Langenselbold, Lüdenscheid, Menden, Nürnberg, Remscheid, Sömmerda, Sprockhövel and Wehingen	Germany
Bodycote Hardingscentrum BV	Diemen, Hengelo, Tilburg and Venlo	Netherlands
Bodycote Hardiff BV	Apeldoorn	Netherlands
Bodycote Rheintal Wärmebehandlung AG	Schaan	Liechtenstein
Bodycote Austria Wärmebehandlung GmbH	Kapfenberg, Marchtrenck and Vienna	Austria
Bodycote Switzerland Wärmebehandlung AG	Fallenden and Urdorf	Switzerland
Bodycote Czech Republic Heat Treatment S.r.o.	Modrice, Pilzen, Prague and Pribram	Czech Republic
HT Progres S.r.o.	Brno and Liberec	Czech Republic
Bodycote Hokezelo KFT	Budapest	Hungary
Vide Express Romania (83% owned)	Brasov	Romania
Bodycote IMT Inc.	London OH and Camas WA	USA
Bodycote Thermal Processing, Inc.	Boaz AL, Fremont, San Diego, Santa Fe Springs, Santa Ana, Gardena, Huntington Park, Los Angeles, Rancho Dominguez, Vernon, Walnut, Westminster and Tarzana CA, Berlin, Waterbury and South Windsor CT, Ipswich and Worcester MA, Canton, Lansing, Livonia (under construction) and Grand Rapids MI, Cincinnati and Cleveland OH, Oklahoma City and Tulsa OK, Dallas, Houston and Fort Worth TX, Laconia NH, Melrose Park IL, Indianapolis IN, Eden Prairie MN, St Louis MO, Rochester NY, Lexington TN, Clintonville, Sturtevant and New Berlin WI	USA
Bodycote Thermal Processing Canada, Inc.	Newmarket and Kitchener ON	Canada
Bodycote HIT	Ambazac, Amiens, Beaugency, Brétigny sur Orge, Billy-Berclau, Cernay, Chanteloup les Vignes, Charleville Mézières, Chassieu, Cluses, Condé sur Noireau, Gemenos, Gennevilliers, Lagny sur Marne, La Monnerie Le Montel, La Talaudière, Le Subdray, Neuilly sur Marne, Neuilly en Thelle, Nogent, Pusignan, Serres Castet, St Aubin les Elbeuf, St Dié, St Nicholas d'Aliermont, St Rémy en Mauges, Thyez and Voreppe	France
Bodycote Italia Srl (90% owned)	Gorgonzola	Italy
Bodycote Trattamenti Termici SPA	Flero, Madone and Rodengo	Italy
Bodycote Belge	Brussels and Nivelles	Belgium
Bodycote Värmebehandling AB	Anderstorp, Göteborg, Karlskoga, Linköping, Malmö, Mora, Stockholm, Värnamo and Västerås	Sweden
Bodycote Lämpökäsittely Oy	Pieksämäki, Tampere, Vaasa and Vantaa	Finland
Bodycote Värmebehandling A/S	Århus and Herlev	Denmark

Vacuum and sealed quench and induction heat treatment, carburising, carbonitriding, plasma nitriding, copper, silver and gold brazing, hardening, tempering, kolsterising, electron beam welding and laser processing.

Bodycote

Metal Technology continued

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

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

Materials Testing

Bodycote Materials Testing Limited	Bridgwater, Burton-on-Trent, Daventry, Droitwich, Dudley, Glasgow, Lancaster, Manchester, Middlesbrough, Newcastle, Newbridge, Nuneaton, Poole, Salford, Sheffield, Shotton and Windsor	Scotland
Bodycote Materials Testing BV	Emmen and Spijkenisse	Netherlands
Bodycote Materials Testing A/S	Sandnes	Norway
Bodycote Materials Testing Srl	Milan	Italy
Bodycote CTR Srl	Padua	Italy
Bodycote Materials Testing Services Limited	Abu Dhabi and Al Ain	Guernsey
Al Futtaim Bodycote Materials Testing Services LLC (49% owned)‡	Dubai	Dubai
Bodycote Materials Testing Services Limited Company & LLC (70% owned)‡	Muscat and Sohar	Oman
Bodycote Materials Testing Inc.	Chicago and Melrose Park IL, Houston TX, Los Angeles CA, Detroit MI and Portland OR	USA
Bodycote Materials Testing Canada Inc.	Burlington, Cambridge, Mississauga and Niagara Falls ON, Montreal and Quebec City QC	Canada
Bodycote Polymer AB	Nyköping	Sweden
Bodycote CMK AB	Karlskoga	Sweden
Bodycote Materials Testing s.r.o.	Pilzen	Czech Republic

Testing services for producers and users. Mechanical, corrosion, physical, radiographic and chemical testing of ferrous and non-ferrous alloys, building products, ceramics, composites and plastics and lifetime assessment of polymers. Healthcare testing, microbiological assessment, water analysis, fire, drug, pharmaceutical and food product testing. Automotive engine structural and environmental exposure testing.

Principal Subsidiary Undertakings

Metal Technology continued

Metallurgical Coatings

		Country of incorporation or registration
*Bodycote Metallurgical Coatings Limited	Darlington, Knowsley, Liverpool, Macclesfield, Poole, Rochdale, Uxbridge and Wolverhampton	England
Bodycote Coating Centrum BV	Venlo	Netherlands
Bodycote Metallurgical Coatings, Inc.	Greensboro NC	USA
Bodycote K-Tech, Inc	Hot Springs AR	USA
Bodycote de Mexico SA de CV	Tecate	Mexico
Bodycote Ytbehandling AB	Anderstorp, Göteborg, Gnosjö, Katrineholm, Karlstad, Mullsjö, Solna, Vansbro and Västra Frölunda	Sweden
Bodycote Pintakäsittely Oy	Alajärvi and Espoo	Finland
Bodycote Nussbaum GmbH & Co KG.	Kaufbeuren	Germany
Bodycote HIT	Chassieu, Pau, Neuilly en Thelle and St Dié	France
Procolor	Auterive	France
Europeenne de Chromage	St. Dizier	France

Anti-corrosion processing including sherardizing, mechanical plating, zinc electroplating, organic and metal finishing, vacuum and ceramic and high temperature alloy coating and physical vapour deposition.

Property and General

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

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

Bodycote Property Holdings Inc.	Mississauga ON	Canada
Bodycote MAS Redevelopment Corporation	St Louis MO	USA

Managers of the Group's property interests.

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

Notice of Annual General Meeting

Bodycote

NOTICE IS HEREBY GIVEN that the 51st Annual General Meeting of BODYCOTE INTERNATIONAL PLC will be held at The Stanneylands Hotel, Stanneylands Road, Wilmslow SK9 4EY on Wednesday 26 May 2004, at 1500 hours for the following purposes:

As ordinary business

1. To receive the annual report and statement of accounts for the year ended 31 December 2003.
2. To approve the Board Report on Remuneration.
3. To declare a final dividend.
4. To re-elect Mr R T Scholes as a Director of the Company.
5. To re-elect Mr D F Landless as a Director of the Company.
6. To re-appoint Deloitte & Touche LLP as auditors of the Company and authorise the Directors to fix their remuneration.

As special business

To consider and, if thought fit, to pass the following resolutions which will be proposed as to resolutions 7 and 8 as ordinary resolutions and as to resolutions 9 and 10 as special resolutions:

7. That the authorised share capital of the Company be increased from £34,706,000 divided into 347,060,000 ordinary shares of 10p each to £43,000,000 by the creation of 82,940,000 additional ordinary shares of 10p each.

8. That the Directors be and they are hereby generally and unconditionally authorised pursuant to Section 80 of the Companies Act 1985 to exercise any power of the Company to allot and grant rights to subscribe for or to convert securities into shares of the Company up to a maximum aggregate nominal amount equal to the nominal amount of authorised but unissued share capital immediately following the passing of resolution 7 above PROVIDED THAT the authority hereby given shall expire on the date which is fifteen calendar months after the passing of this resolution unless previously renewed, varied or revoked by the Company in general meeting save that the Directors may, notwithstanding such expiry, allot any shares or grant any such rights under this authority in pursuance of an offer or an agreement so to do made by the Company before the expiry of this authority.

9. That, subject to the passing of the resolution numbered 8, the Directors be and they are hereby empowered pursuant to Section 95 of the Companies Act 1985 to allot equity securities (within the meaning of Section 94 of the Companies Act 1985) for cash pursuant to the authority conferred by the said resolution as if Section 89(1) of the Companies Act 1985 did not apply to any such allotment provided that this power shall be limited:

   (a) to the allotment of equity securities (within the meaning of Section 94 of the Companies Act 1985) in connection with rights issues in favour of ordinary shareholders where the equity securities respectively attributable to the interests of all ordinary shareholders are proportionate (as nearly as may be) to the respective numbers of ordinary shares held by them subject to such exclusions or other arrangements as the Directors consider appropriate, necessary or expedient to deal with any fractional entitlements or with any requirements of any regulatory body or recognised investment exchange or otherwise;

   (b) to the allotment of equity securities pursuant to the terms of the Bodycote International executive share option schemes

   (c) to the allotment (otherwise than pursuant to sub-paragraphs (a) and (b) above) of equity securities up to an aggregate nominal value of £1,603,939 being 5% of the issued share capital of the Company; and

   (d) the authority hereby given shall expire at the close of the next annual general meeting of the Company to be held after the date hereof unless such authority is renewed prior to such time; but a contract of purchase may be made before such expiry which will or may be executed wholly or partly thereafter, and a purchase of shares may be made in pursuance of any such contract.

10. That the Company be and it is hereby generally and unconditionally authorised to make market purchases (within the meaning of Section 163(3) of the Companies Act 1985) of ordinary shares of 10 pence each in the Company provided that:

   (a) the maximum number of shares hereby authorised to be acquired is 32,078,790;

   (b) the maximum price which may be paid for any such share is an amount equal to 105% of the average of the middle market quotations for an ordinary share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the share is contracted to be purchased;

   (c) the minimum price which may be paid for any such share is 10 pence; and

   (d) the authority hereby given shall expire at the close of the next annual general meeting of the Company to be held after the date hereof unless such authority is renewed prior to such time; but a contract of purchase may be made before such expiry which will or may be executed wholly or partly thereafter, and a purchase of shares may be made in pursuance of any such contract.

By order of the Board
J. R. GRIME,
Secretary.

Hulley Road, Hurdsfield,
Macclesfield, Cheshire SK10 2SG
9 March 2004

Notes

1. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the Company specifies that only those shareholders registered in the Register of Members of the Company as at 1700 hours on 24 May 2004 shall be entitled to attend or vote at the Meeting in respect of the number of shares registered in their names at that time. Changes to entries on the Register of Members after 1700 hours on 24 May 2004 shall be disregarded in determining the rights of any person to attend or vote at the Meeting.
2. Every member who is entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and on a poll vote in his/her stead. A proxy need not be a member.
3. Brief biographical details of Directors standing for re-election at the Meeting are set out on page 18.

Recommendation and explanatory notes

Increase in authorised share capital (Resolutions 7).

When the issued share capital of the Company is increased by the rights issue announced on the 9th March 2004, the headroom available for the further issue of new shares pursuant to Section 80 of the Companies Act 1985 will be reduced from 26.1% to 7.6% of authorised share capital, which the Directors consider insufficient. Resolution 7 will increase the authorised share capital by 23.9% and restore the headroom to approximately 25.4%.

Renewal of authority to allot shares (Resolutions 8 and 9).

Under the provisions of Section 80 of the Companies Act 1985 the Directors are not able to allot shares except with the general or specific approval of shareholders. A general authority was granted on 28 May 2003 in respect of the shares then unissued and it is now proposed in resolution number 8 in the notice convening the annual general meeting that this authority be renewed for a period of fifteen months from the date of passing the resolution in respect of unissued share capital immediately following the passing of resolution 7, which will then represent approximately 25.4% of the authorised share capital. No shares are held in treasury.

The Board has no present intention of issuing any further shares nor will any such issue be made which would effectively alter the control of the Company without the prior approval of shareholders in general meeting.

Sections 89 and 95 of the Companies Act 1985 provide that any ordinary shares issued for cash must first be offered to existing shareholders unless their approval is obtained that this stipulation should not be applied. The Directors consider it desirable that they should have the authority to make allotments of ordinary shares for cash, other than by way of rights issues to existing shareholders, up to a maximum nominal value of £1,603,939 being 5% of the issued ordinary share capital immediately following the passing of resolution 7.

Purchase of own Shares (Resolution 10)

Under Article 9 the Company is empowered to purchase its own shares. The Directors consider that the power to make purchases in the market of the Company's own shares should be maintained even in the circumstances of the announcement of a fully underwritten rights issue, and accordingly recommend the approval of the special resolution set out as resolution number 10. The Directors intend to exercise this authority only where, in the light of market conditions prevailing at that time, they believe that the effect of such purchases would be to increase earnings per share, or to deliver shares to participants in the Bodycote International executive share option schemes. Any shares purchased in this way will either be cancelled, in which case the number of shares in issue will be reduced accordingly, or held as treasury shares.

The resolution specifies the maximum and minimum prices at which shares may be bought, and the maximum number of shares which may be bought, this being 10% of the Company's issued ordinary share capital following completion of the rights issue announced on 9 March 2004. As at 31 December 2003 outstanding share options over unissued shares totalled 9,173,839 and this represented 3.6% of the Company's issued share capital. Based on the estimated issued share capital following the rights issue, if the Company utilised the authority proposed by resolution 10 in full, outstanding share options would then represent 3.2% of the consequently reduced share capital.

The Directors consider that the proposals described in this notice are in the best interests of the shareholders as a whole and unanimously recommend shareholders to vote in favour of all the resolutions proposed, as they intend to do in respect of their own beneficial holdings.

A form of proxy is enclosed for those entitled to vote. Instructions are given for electronic proxy voting.

Financial Calendar

Bodycote

Annual general meeting	26 May 2004
Final dividend for 2003	5 July 2004
Interim results for 2004	August 2004
Interim dividend for 2004	January 2005
Results for 2004	March 2005

Shareholder Enquiries

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: 0870-1623131; Fax: 01484-600911; 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.

Shareholder Information

Analysis of share register as at 20 February 2004

Holding range:	Number of shareholders	%	Number of Shares	%
1 to 1,000	1,116	33.65	588,240	0.23
1,001 to 10,000	1,588	47.88	5,725,566	2.23
10,001 to 100,000	435	13.11	12,993,749	5.06
100,001 to 500,000	94	2.83	21,146,078	8.24
500,001 and over	84	2.53	216,176,693	84.24
	3,317	100.00	256,630,326	100.00

Types of shareholders:	% of shareholders	% of total shares
Directors' interests	0.1	0.4
Major institutional and corporate holdings	5.9	91.2
Other shareholdings	94.0	8.4
	100.0	100.0

outsourcing for industry

Bodycote International plc
Hulley Road
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Cheshire
SK10 2SG

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Fax: +44 (0)1625 505313
Email: info@bodycote.com

www.bodycote.com

Heat Treatments
Materials Testing
Hot Isostatic Pressing
Metallurgical Coatings