

Corporate governance statement

Chairman's message

Dear Shareholders

I am pleased to introduce the Group's corporate governance report on behalf of our Board of Directors. The Corporate governance statement provides an insight into how the Board operated during the year and the key issues considered. We are committed to conducting business responsibly whilst maintaining high standards of corporate governance to enhance performance underpinned by our business model. Our approach to governance is set by the Board and our Executive Committee ensures that the approach is effectively implemented across the business.

The main Group-wide governance documents are our Core Values and the Code of Conduct, which set out the values and standards that we expect of our employees. These documents, together with our policies, govern how we conduct our business and set the standards that drive performance. Compliance training helps to enforce this. Board oversight, reviews and audits form part of the monitoring and supervision process. Risk processes are embedded and reviewed on an ongoing basis across the business. The important governance developments at Bodycote over the last year are detailed in the governance reporting section below.

The Board is actively engaged in succession planning for both executive and non-executive directors. This ensures that the Board composition continues to be appropriate and, therefore, effective.

I encourage all shareholders to attend the AGM, which will be held at our Macclesfield head office on 17 May 2017. This event provides an excellent opportunity to meet the executive and independent non-executive directors.

A.M. Thomson

Chairman

Board performance

2016 key actions	2016 achievements	Priorities for 2017
<ul style="list-style-type: none">■ Implement actions from the 2016 strategy review	<ul style="list-style-type: none">■ Accelerated growth from Specialist Technologies and enhanced business processes	<ul style="list-style-type: none">■ Undertake 2017 strategy review
<ul style="list-style-type: none">■ Continued focus on management development and succession planning	<ul style="list-style-type: none">■ The Board and management reviewed management resources during the year	<ul style="list-style-type: none">■ Continue with the refreshment of the Board and succession planning
<ul style="list-style-type: none">■ Appointment of a new Non-Executive Director, a new Senior Independent Director and a new Chief Financial Officer	<ul style="list-style-type: none">■ P. Larmon was appointed as Non-Executive Director and I.B. Duncan as Senior Independent Director. D. Yates was appointed as Chief Financial Officer	<ul style="list-style-type: none">■ Smooth transition following handover of the Chief Financial Officer role from D. Landless to D. Yates
<ul style="list-style-type: none">■ Continued emphasis on external Board training and development	<ul style="list-style-type: none">■ The Board visited plants in the Czech Republic and Belgium during the year and developed the directors' understanding of these businesses and the markets they serve	<ul style="list-style-type: none">■ Use Board visits to meet the French and American teams to promote understanding of markets and the opportunities they offer
<ul style="list-style-type: none">■ Continued review of the risk register, including major programme risks	<ul style="list-style-type: none">■ During the year the Board reviewed the different elements of the Group's risk management framework and how it discharged its responsibilities	<ul style="list-style-type: none">■ The Board will continue to review cyber security protection, the management of risk in major programmes and crisis management

Governance reporting

Board diversity

Bodycote is a global business with operations in 23 countries and diversity is an integral part of how we do business. The Nomination Committee considers diversity when making appointments to the Board, taking into account relevant skills, experience, knowledge, personality, ethnicity and gender. Our prime responsibility, however, is the strength of the Board and our overriding aim in any new appointment must always be to select the best candidate. The Nomination Committee considers capability and capacity to commit the necessary time to the role in its recommendation to the Board. The intention is to appoint the most suitable qualified candidate to complement and balance the current skills, knowledge and experience of the Board and who will be best able to help lead the Company in its long-term strategy. The Nomination Committee is advised by international search companies, who have been briefed on our diversity policy and are required to reflect the policy in the long list submitted to the Committee.

We appointed P. Larmon on 13 September 2016 as part of our Board refreshment. D. Yates was appointed Chief Financial Officer on 2 January 2017, replacing D. Landless, who retired on 1 January 2017. We will address this issue further when we discuss Board succession planning in the coming year. The Board is kept deliberately small and currently comprises two executive directors, three non-executive directors and a non-executive chairman.

Female representation on our Board is currently 17% (2015: 17%) and at manager level it is 25% (2015: 24%). Females represent 18% (2015: 18%) of our total workforce. We believe it is difficult to set targets or timescales for increasing the proportion of women, or any other minority group, on our Board and do not propose to do so. We will increase female representation on the Board if appropriate candidates are available when Board vacancies arise.

The Corporate responsibility and sustainability report contains further details regarding the male and female representation within the Group, including Board representation.

Board evaluation

Following the external Board Evaluation in 2015, the Board agreed to undertake an internal evaluation in 2016. To ensure that all aspects of good governance are covered by the review, the Group Company Secretary distributed a tailored questionnaire to each member of the Board. Questions were framed under the following seven topics:

- Remit and objectives;
- Composition, training and resources;
- Corporate governance/risk management;
- Stakeholder engagement;
- Board meetings and visits;
- Board procedures and administration; and
- Evaluation and effectiveness.

At a meeting of the Nomination Committee in September 2016, the directors assessed the conclusions reached and are in the process of implementing a number of recommendations. Additional emphasis will be placed on risk management, strategy and operational matters. The Board evaluation covered the activities of the Board and each of its Committees. The Board is considered to be functional and working well. Arising from the exercise, the Board concluded that its focus should remain on divisional growth strategies, technology development, risk and sustainability as well as continued training. The overall conclusion is that the Board is performing well and high governance standards have been adopted. The Executive Committee is strongly challenged by the Board when appropriate.

As in previous years, the Chairman has assessed the performance of each Board member by conducting individual interviews and we can confirm that all directors continue to perform effectively and demonstrate commitment to their roles.

E. Lindqvist has several other non-executive director appointments, all with Swedish or Finnish companies. The Board noted that typically board meetings in Nordic companies are no more than four to six times per annum and hence felt that these appointments had no impact on E. Lindqvist's time commitment to Bodycote.

The Executive Directors Messrs S.C. Harris and D. Yates were also appraised in February 2017.

Led by the Senior Independent Director, the directors carried out an evaluation of the Chairman's performance in September 2016. The Board is satisfied with the Chairman's commitment and performance.

Corporate governance statement continued

Induction

All new directors are subject to a tailored induction programme covering a diverse range of topics including trading, investor relations, organisational and legal matters as well as visits to operational sites. They also meet all other directors and senior executives. This facilitates their understanding of the Group and the key drivers of business performance.

Training

The Board receives training via ad hoc presentations and papers from advisers and the Group Company Secretary. External periodic training on important topics takes place and during the year the directors received training on international employment law developments, focusing in particular on the main countries in which we operate. Other opportunities for ongoing development and support are:

- a programme of plant/site visits throughout the year;
- reviews with the Chairman to identify any training and development needs;
- advice on governance, relevant legislative changes affecting the business or their duties from the Group Company Secretary;
- access to independent professional advice at the Company's expense; and
- participation at the training and guidance programme for boards and directors offered at the Deloitte Academy.

Succession planning

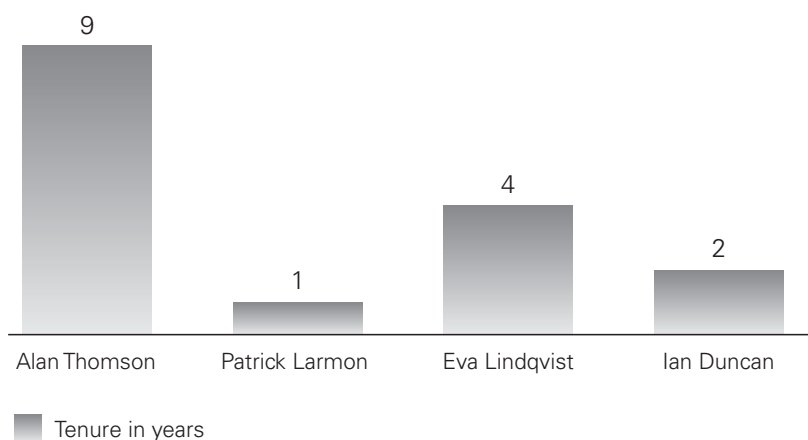
Succession planning ensures that appropriate senior executive leadership resources are in place to achieve Bodycote's strategic objectives. The plans are reviewed annually by the Nomination Committee.

The Board further develops its knowledge and gains greater visibility of executive talent and management succession by visiting the Group's sites and meeting with key talent and senior executives.

Board refreshment will continue over the coming years.

Non-executive tenure

(in years)



Individual roles of the Board

Chairman	Group Chief Executive	Chief Financial Officer
<ul style="list-style-type: none"> ■ operates leadership and governance of the Board and chairs the Nomination Committee ■ Board effectiveness ■ ensures members receive accurate, timely and clear information on Board issues ■ ensures, together with the Group Company Secretary, comprehensive induction of new directors ■ sets Board agenda, style and tone of Board discussions ■ ensures effective communication with shareholders 	<ul style="list-style-type: none"> ■ overall responsibility and leadership of the Group performance ■ stewardship of Group assets ■ plans and executes objectives and strategies ■ maintains a close working relationship with the Chairman, ensuring effective dialogue with investors and stakeholders ■ ensures the leadership and development frameworks are developed to generate a positive pipeline for future opportunities for the Group ■ has overall responsibility for the Group's sustainability performance ■ communicates the vision and values of the Group ■ manages the senior management team 	<ul style="list-style-type: none"> ■ maintains strong financial management and implements effective financial controls ■ provides financial and commercial decision leadership, vision and support ■ ensures the appropriateness of risk management systems ■ oversees all aspects of accounting/finance operations including accounting policies and integrity of financial data and external financial reporting ■ responsible for corporate finance functions, financial planning and budget management ■ supports and advises the senior management team ■ leads the development of investor relations strategy and communications
Senior Independent Director	Non-Executive Directors	Group Company Secretary
<ul style="list-style-type: none"> ■ acts as a sounding board for the Chairman ■ serves as an intermediary for other directors ■ is available to meet shareholders if they have concerns which they have not been able to resolve through the normal channels ■ conducts an annual review of the performance of the Chairman and convenes a meeting of the non-executive directors to discuss the same 	<ul style="list-style-type: none"> ■ provide constructive challenge ■ help develop strategy ■ ensure financial controls and systems of risk management are robust and defensible ■ determine appropriate levels of remuneration for the executive directors ■ monitor reporting of performance ■ scrutinise performance of management ■ are available to meet with major shareholders 	<ul style="list-style-type: none"> ■ secretary to the Board and its committees ■ ensures efficient information flows within the Board and its committees and between senior management and non-executive directors ■ facilitates induction of new directors and assists with training and development needs as required ■ regularly updates the Board on corporate governance matters, legislative changes and regulatory regimes affecting the Group ■ ensures compliance with Board procedures ■ co-ordinates external Board evaluation and conducts internal Board evaluation

Core Values

The Board acknowledges its responsibility for determining and maintaining the Group's values and ensures these are reflected in the business practices. This is monitored by the Board at regular intervals. Further details are available on page 31.

Pre-emption rights

In line with best practice provisions in the Pre-Emption Group Statement of Principles, the Board confirms that it does not intend to issue more than 7.5% of the issued share capital of the Group on a non-pre-emptive basis in any rolling three-year period.

Corporate governance statement continued

Compliance reporting

In respect of the financial year 2016, Bodycote's obligation under the Disclosure and Transparency Rules is to prepare a corporate governance statement with reference to the UK Corporate Governance Code issued by the FRC in September 2014 ("the Code"). The 2016 UK Corporate Governance Code was issued in April 2016 and applies to accounting periods beginning on or after 17 June 2016.

In respect of the year ended 31 December 2016, Bodycote has complied with the provisions of the Code with the exception of provisions E.1.1 and B.1.2. Regarding E.1.1, the Board has, in recent years, taken the view that generally it is the responsibility of the Group Chief Executive and the Chief Financial Officer to manage relationships with institutional investors. The Chairman also meets institutional investors to discuss overall strategy, governance and any concerns that shareholders may have. Only where these more usual channels of communication have failed would the Board expect the Senior Independent Non-Executive Director (SID) or other non-executive directors to become involved, notwithstanding that the Code specifies attendance of the SID at meetings with major shareholders. The SID has contacted major shareholders and offered to facilitate meetings with them should they have any concerns they wish to discuss. Regular feedback from the Group's advisers on investor meetings and results presentations is circulated to all directors. During the year the Chairman met with shareholders to discuss governance matters. During the year there existed a short period where the Group did not comply with provision B.1.2. as R. Rajagopal retired from the Board at the AGM on 27 May 2016 and P. Larmon was appointed as Non-Executive Director on 13 September 2016.

Apart from these distinct areas, Bodycote was in compliance with the provisions of the 2014 and 2016 Code throughout 2016.

Operation of the Code

Taken together with the Report of the Nomination Committee, the Report of the Audit Committee and the Board report on remuneration presented on pages 48 to 73, this statement explains how Bodycote has applied the principles of good corporate governance as set out in the Code.

Leadership

The Board is responsible to shareholders for good corporate governance, setting the Group's strategic objectives, values and standards, and ensuring the necessary resources are in place to achieve the objectives.

The Board met on eight occasions during 2016, including a specific meeting to review and update the Group's long-term strategy. The Board of Directors comprises six members, of whom four are non-executive directors and two are executive directors, led by the Group's part-time Non-Executive Chairman, A.M. Thomson, who also chairs the Nomination Committee. The Group Chief Executive is S.C. Harris and the Senior Independent Non-Executive Director is I.B. Duncan, who also chairs the Audit Committee. E. Lindqvist is Chair of the Remuneration Committee. Brief biographical details of all directors are given on pages 36 to 37. During the year the Board visited a number of UK and overseas facilities, including sites in the Czech Republic and Belgium. Such events involved meetings with local management and the unit workforce to understand more clearly technical and operational performance in countries where Bodycote has a significant presence.

Matters reserved for the Board were reviewed during the year and updated where required. Certain defined powers and issues reserved for the Board to decide are, inter alia:

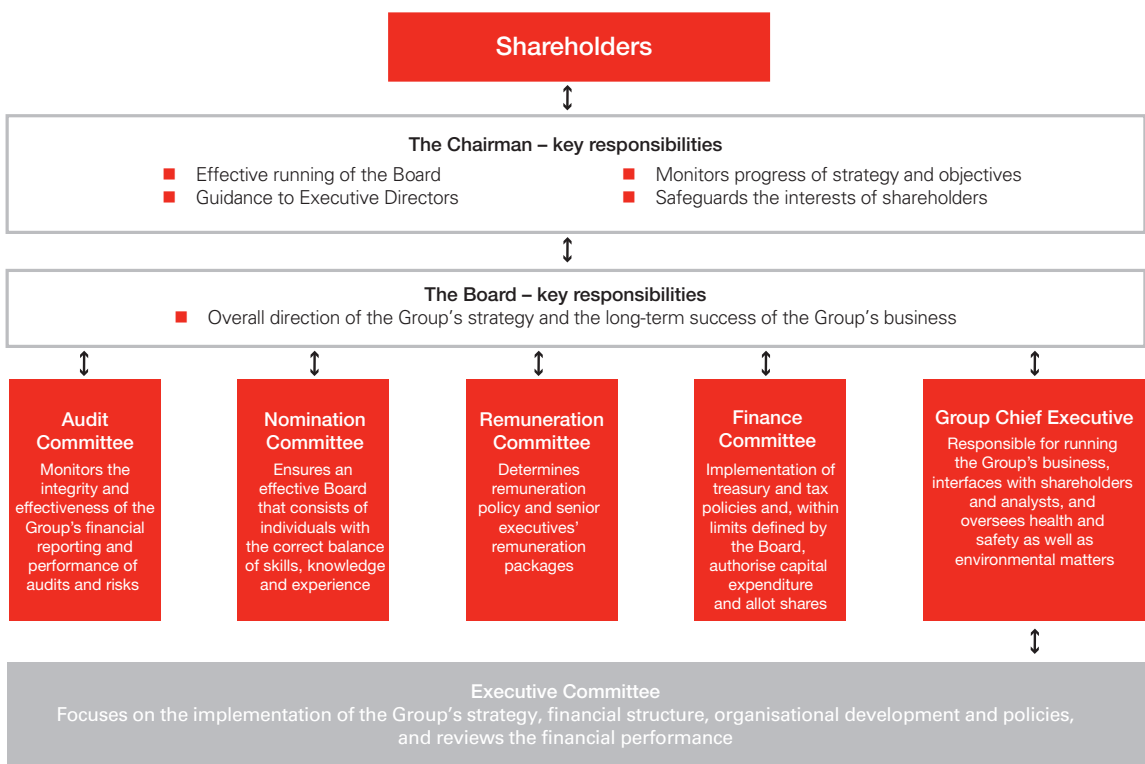
- Strategy;
- Approval of financial statements and circulars;
- Capital projects, acquisitions and disposals;
- Annual budgets;
- Directors' appointments, service agreements, remuneration and succession planning;
- Policies for financial statements, treasury, safety, health and environment, donations;
- Committees' terms of reference;
- Board and committee chairmen and membership;
- Investments;
- Equity and bank financing;
- Internal control and risk management;
- Corporate governance;
- Key external and internal appointments; and
- Employee share incentives and pension arrangements.

In advance of Board meetings, directors are supplied with up-to-date information regarding the trading performance of each operating division and sub-division, in addition to the Group's overall financial position and its achievement against prior year results, budgets and forecasts. They are also supplied with the latest available information on safety, health and environmental and risk management issues and details of the safety and health performance of the Group, and each division, in terms of severity and frequency rates for accidents at work. Senior management from across the Group and advisers attend some of the meetings to provide updates. The exposure to members of senior management from across the Group helps enhance the Board's understanding of the business, the implementation of strategy and the changing dynamics of the markets in which the Group operates.

Where required, a director may seek independent professional advice, the cost of which is reimbursed by the Group. All directors have access to the Group Company Secretary and they may also address specific issues with the SID. In accordance with the Articles of Association, all newly appointed directors must submit themselves for election. All directors stand for yearly re-election. Non-executive directors, including the Chairman, are appointed for fixed terms not exceeding three years from the date of first election by shareholders, after which the appointment may be extended by mutual agreement. A statement of the directors' responsibilities is set out on page 74. The Board also operates three committees. These are the Nomination Committee, the Remuneration Committee and the Audit Committee. All non-executive directors serve on each Board Committee.

In accordance with the recommendations of the Code, Board members serve for a period of six years, which will only be extended in certain circumstances. If letters of appointment are extended beyond six years, the fixed term is reduced to one year.

In order that necessary actions can be taken promptly, a finance sub-committee, comprising the Chairman (or failing him, any other non-executive director), the Group Chief Executive and the Chief Financial Officer operates between the dates of scheduled Board meetings and is authorised to make decisions, within limits defined by the Board, in respect of certain finance, treasury, tax or investment matters.



Corporate governance statement continued

Independence of non-executive directors

The Board considers that P. Larmon, E. Lindqvist and I.B. Duncan are all independent for the purposes of the Code. The Chairman was considered independent upon appointment.

Commitment

Attendance of directors at regular scheduled meetings of the Board and its Committees is shown in the table below:

Director	Full Board		Audit Committee		Remuneration Committee		Nomination Committee	
	Eligible	Attended	Eligible	Attended	Eligible	Attended	Eligible	Attended
A.M. Thomson	8	8	–	–	7	7	7	7
S.C. Harris	8	8	–	–	–	–	7	7
R. Rajagopal ¹	3	3	2	1	5	5	3	1
E. Lindqvist	8	8	4	4	7	7	7	7
D.F. Landless	8	8	–	–	–	–	–	–
I.B. Duncan	8	8	4	4	7	7	7	7
P. Larmon ²	3	3	1	1	2	2	2	2
D. Yates ²	1	1	–	–	–	–	–	–

1. R. Rajagopal retired after the AGM in May 2016.

2. P. Larmon was appointed on 13 September 2016 and D. Yates on 1 November 2016.

All directors, with the exception of R. Rajagopal, attended the maximum number of Audit, Remuneration and Nomination Committee meetings that they were scheduled to attend. R. Rajagopal's non-attendance was due to ill health. In addition, non-members Messrs A.M. Thomson, S.C. Harris and D.F. Landless attended by invitation some parts of the meetings of the Audit, Nomination and Remuneration Committees.

Proposals for re-election

The Board decided, in line with the Code, that all directors will retire annually and, other than in the case of any director who has decided to stand down from the Board, will offer themselves for re-election at the AGM. Accordingly A.M. Thomson, S.C. Harris, E. Lindqvist and I.B. Duncan will stand for re-election at the AGM in May 2017. Having been appointed since the last AGM, P. Larmon and D. Yates will stand for election.

The Board recommends to shareholders that they re-elect (or elect) all the directors. In accordance with the recommendations of the Code, Board members will serve for a period of six years which may be extended in certain circumstances.

The performance of each director was evaluated as indicated above and the Board confirms in respect of each that their performance continues to be effective and that each continues to demonstrate commitment to his or her respective role.

Internal control and risk management

The Board is responsible for the Group's system of internal controls and risk management policies and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. The Board has applied Principle C.2 of the Code by establishing a continuous process for identifying, evaluating and managing the Group's significant risks, including risks arising out of Bodycote's corporate and social engagement. The Board's monitoring covers all controls, including financial, operational and compliance controls and risk management systems. It is based principally on reviewing reports from management and from internal audit to consider whether any significant weaknesses are promptly remedied or indicate a need for more extensive monitoring. The Audit Committee assists the Board in discharging these review responsibilities.

The Board believes that the Group maintains an effective system of internal controls which is in accordance with the FRC's guidance entitled 'Internal Control: Revised Guidance for Directors' (formerly referred to as the Turnbull Report guidance) and, in the view of the Board, no significant deficiencies have been identified in the system. The system was in operation throughout 2016 and continues to operate up to the date of the approval of this report. Key elements of the Group's system of internal control are as follows:

- The Group prepares a comprehensive annual budget which is closely monitored and updated quarterly. The Group's authority matrix clearly sets out authority limits for those with delegated responsibility and specifies what can only be decided with central approval.
- The Board, with the assistance of E&Y, who provide Internal Audit services, monitors the Group's internal financial control system. Internal audit reviews are conducted on the basis of a risk-based plan approved annually by the Audit Committee. The findings and recommendations from internal audit are reported on a regular basis to the Executive and Audit Committees.
- An annual internal control self-assessment, with management certification, is undertaken by every Bodycote site. The assessment covers the effectiveness of key financial and compliance controls. The results are validated by internal audit through spot checks and are reported to the Executive and Audit Committees.
- Group policies (including the Code of Conduct, Group authority matrix and finance policies) are documented and are available to all employees via the Group's intranet system.
- The Chief Financial Officer, Group Financial Controller, President and Vice President of Finance for each division sign a letter of representation annually. This is to confirm the adequacy of their systems of internal controls, their compliance with Group policies, relevant laws and regulations, and that they have reported any control weaknesses through the Group's assurance processes.
- A Group-wide risk register is maintained throughout the year to identify the Group's key strategic and operational risks. Any changes to these risks during the year are promptly reported to the Executive Committee and the Board.

During 2016, in compliance with provision C.2.1 of the Code, management performed a specific assessment for the purpose of this Annual Report. Management's assessment, which has been reviewed by the Audit Committee and the Board, included a review of the Group's key strategic and operational risks, which is summarised from work performed by the Group Head of Risk and the Group's Risk Committee to identify risks (by means of workshops, interviews and investigations, and by reviewing departmental or divisional risk registers). Further information regarding the ways in which the principal business risks and uncertainties affecting the Group are managed is shown on pages 24 to 27. No new significant risks were identified as part of this process, and the necessary actions have been or are being taken to remedy any significant failings or weaknesses identified as part of the reviews.

Investor relations

The Group Chief Executive and Chief Financial Officer 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 and operating performance. In addition, internet users are able to view up-to-date news on the Group and its share price via the Bodycote website at www.bodycote.com. Users of the website can access recent announcements and copies of results presentations and can enrol to hear live presentations. On a regular basis, Bodycote's financial advisers, corporate brokers and financial public relations consultants provide the directors with opinion surveys from analysts and investing institutions following visits and meetings with the Group Chief Executive and Chief Financial Officer. The Chairman and SID are available to discuss any issues not resolved by the Group Chief Executive and Chief Financial Officer. On specific issues, such as the review of remuneration packages, the Group has sought, and will continue to seek, the views of leading investors.

By order of the Board:

U.S. Ball

Group Company Secretary
28 February 2017

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