Independent auditor's report

To the Members of Bodycote plc

Opinion on financial statements of Bodycote plc

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2016 and of the Group's and the Parent Company's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including FRS 101 Reduced Disclosure Framework; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The financial statements that we have audited comprise:

- the Consolidated Income Statement;
- the Consolidated Statement of Comprehensive Income;
- the Consolidated and Parent Company Statement of Financial Position;
- the Consolidated Cash Flow Statement;
- the Consolidated and Parent Company Statement of Changes in Equity;
- the Group and Company Accounting Policies;
- the related notes 1 to 31 to the Group financial statements; and
- the related notes 1 to 12 to the Parent Company financial statements.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the Parent Company financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 101 Reduced Disclosure Framework.

Summary of our audit approach

Key risks	The key risks that we identified in the current year were: ■ Impairment of tangible and intangible fixed assets ■ Completeness and accuracy of environmental remediation provisions ■ Taxation accounting – adequacy of tax provisions ■ Pensions – defined benefit UK scheme liability assumptions
Materiality	The materiality that we used in the current year was £4.6m which was determined on the basis of 5% of pre-tax profit.
Scoping	As a consequence of the audit scope determined, we achieved coverage of approximately 86% (2015: 86%) of revenue, 92% (2015: 99%) of profit before tax and 90% (2015: 91%) of net assets.
Significant changes in our approach	Our approach is consistent with the previous year with the exception of the removal of restructuring provisions as a key risk for the 2016 audit report, and refinements made to the remaining risks as described in more detail below.

Independent auditor's report continued

To the Members of Bodycote plc

Going concern and the directors' assessment of the principal risks that would threaten the solvency or liquidity of the Group

As required by the Listing Rules we have reviewed the directors' statement regarding the appropriateness of the going concern basis of accounting on page 23 to the financial statements and the directors' statement on the longer-term viability of the Group on page 27.

We are required to state whether we have anything material to add or draw attention to in relation to:

- the directors' confirmation on page 24 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;
- the disclosures on pages 24 to 26 that describe those risks and explain how they are being managed or mitigated;
- the directors' statement on page 23 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements; and
- the directors' explanation on page 23 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We confirm that we have nothing material to add or draw attention to in respect of these matters.

We agreed with the directors' adoption of the going concern basis of accounting and we did not identify any material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Independence

We are required to comply with the Financial Reporting Council's Ethical Standards for Auditors and confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards.

We confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards. We also confirm we have not provided any of the prohibited non-audit services referred to in those standards.

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.

In 2015 we identified a risk relating to restructuring provisions as a result of a significant global restructuring programme in the year. As no such programme has been initiated in the current year, we have not identified a key risk in this area in our 2016 audit report.

We have also refined our key risk regarding taxation accounting to focus on the adequacy of tax provisions in place at the year-end, whereas we identified a further risk in the prior year in relation to deferred tax assets. We have also refined our risk in relation to environmental remediation provisions to focus primarily on the provisions held in the US as this is from where the majority of the balance emanates. All risks below are also referred to in the Report of the Audit Committee as areas of focus as shown on page 51.

Impairment of tangible and intangible fixed assets

Risk description

The Group has a significant non-current asset base including tangible fixed assets of £509.0m and intangible assets (including goodwill) of £206.7m as shown in notes 11, 12 and 13. Current macro-economic uncertainties result in a risk regarding the carrying value of these assets. Performing an impairment review of these non-current assets requires the exercise of judgement regarding future growth rates, discount rates and sensitivity assumptions, as described in note 11, and represents a key source of estimation uncertainty for the Group as described in the Group's accounting policies.

How the scope of our audit responded to the risk

We challenged the assumptions used in the impairment model for intangible and tangible assets. As part of our procedures we:

- considered the appropriateness of the growth rate assumptions by comparing them to historical trading performance and World Bank historical GDP data across the Group's geographical and market segments;
- considered the impact of the sensitivities performed by management in assessing whether it reflects a reasonable possible change;
- assessed the appropriateness of the assumptions concerning inputs to the discount rate against latest market expectations. In performing our procedures, we used our internal valuation specialists and third party evidence to assess the individual inputs to the discount rates of between 13.4% and 14.4% applied; and
- considered management's assertions of the future utilisation of assets supporting their carrying value by reviewing the strategic plan for the business by cash generating unit.

Key observations

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

Completeness and accuracy of environmental remediation provisions

Risk description

Given the nature of the Group's operations and potential environmental contamination which could have arisen historically, a risk arises in connection with the appropriateness and completeness of the £13.8m environmental remediation provisions as described in note 23. The risk specifically applies to the level of judgement involved in calculating the provisions required and to the likely period of utilisation. As the majority of the balance resides in the US, we have focused our work on the provisions held in the US businesses.

How the scope of our audit responded to the risk

We evaluated the environmental provisions by undertaking the following testing:

- assessing the completion and accuracy of the provision recognised; and
- challenging the status and utilisation of provisions.

As part of our audit procedures we reviewed the available third party evidence collated by management's experts and assumptions detailing the assessment of environmental liabilities for the Group together with correspondence from the Group's internal environmental remediation team.

We considered the appropriateness of the qualifications of management's experts and have benchmarked the Group's accounting policy against comparator companies. We have also considered the requirement to discount the balance should the impact of doing so be material and audited management's calculation for this assessment.

Key observations

Based on the results of work carried out we concur that the provision recognised by management is appropriate.

Taxation accounting – adequacy of tax provisions

Risk description

The tax risk concerns the judgements and estimates applied in the determination of provisions for liabilities attributed to specific uncertain tax positions linked to the Group's corporate arrangements as described in note 8.

How the scope of our audit responded to the risk

In conjunction with our taxation audit specialists, we have assessed the assumptions and judgements concerning the adequacy of tax provisions for uncertain tax positions by viewing the latest correspondence from the various tax authorities and drawing on the experience of our tax specialists in respect of similar situations.

Key observations

From the work performed above we are satisfied that the assumptions applied in respect of the carrying value of amounts held on the balance sheet for uncertain tax positions are reasonable.

Pensions – defined benefit UK scheme liability assumptions

Risk description	This risk concerns the appropriateness of the actuarial assumptions applied in calculating the Group's UK scheme defined benefit liability of £126.6m (2015: £99.9m) within the net UK defined benefit liability of £3.6m (2015: £2.7m) as shown in note 31. The valuation of the Group's IAS 19 liability involves significant judgement in the choice of discount rate used and in the key sources of estimation uncertainty, in particular in relation to the inflation assumptions, as described in the Group's accounting policies.
How the scope of our audit responded to the risk	We have assessed the appropriateness of the assumptions underpinning the valuation of the scheme liabilities. Specifically we challenged the discount rate, inflation and mortality assumptions applied in the calculation by using our internal pension specialists to benchmark the assumptions applied against comparable third party data and assessed the appropriateness of the assumptions in the context of the Group's own position.
Key observations	From the work performed we are satisfied that the assumptions applied in respect of the valuation of the Group's IAS 19 liabilities are materially correct. We consider the assumptions to be towards the prudent end of our benchmarked range.

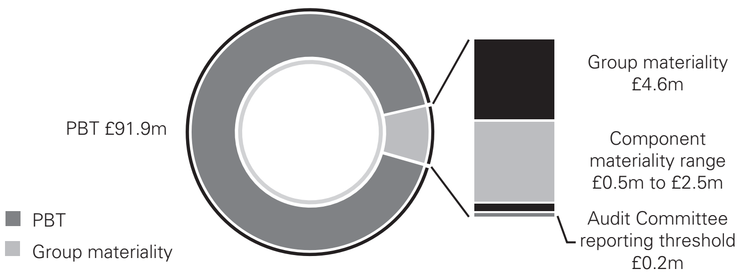
These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Group materiality	£4.6m (2015: £4.8m)
Basis for determining materiality	5% of pre-tax profit (2015: 5% pre-tax profit adjusted for the add-back of £20.0m of exceptional restructuring costs).
Rationale for the benchmark applied	Pre-tax profit is determined to be the most stable basis of underlying business performance.



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.2m (2015: £0.15m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level.

Based on this assessment, we focused our Group audit scope primarily on the audit work at 12 countries, being USA, UK, France, Italy, Germany, Poland, Sweden, Netherlands, Czech Republic, Turkey, China and Mexico. Consistent with the prior year and as agreed with the Audit Committee. Singapore has been removed from audit scope following its disposal in 2016.

In 2016 we continued to have direct Group oversight, leadership and control over the components of the Group accounted for in the US Shared Service Centre ('SSC') and in conjunction with our Czech component audit team we jointly audited the components of the Group accounted for at the Prague SSC.

As a consequence of the audit scope determined, we achieved coverage of approximately 86% (2015: 86%) of revenue, 92% (2015: 99%) of profit before tax and 90% (2015: 91%) of net assets. Our audit work at each location was executed at levels of materiality applicable to each individual entity which was lower than Group materiality. Component materiality ranged from £0.5m to £2.5m (2015: £0.5m to £2.5m).

The Group audit team continued to follow a programme of planned visits that has been designed so that a senior member of the Group audit team visits each of the significant locations included as full scope for the Group audit at least once every three years. During the year, senior members of the Group audit team have visited the US, UK, France and the Prague Shared Service Centre.

In years when we do not visit a significant component we include the component audit team in our team briefing, discuss their risk assessment, attend close meetings by conference call and review documentation of the findings from their work.

At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

Revenue

Full audit scope 86%
Review at Group level 14%

Profit before tax

Full audit scope 92%
Review at Group level 8%

Net assets

Full audit scope 90%
Review at Group level 10%

Opinion on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006;
- the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic report and the Directors' report have been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic report and the Directors' report.

Independent auditor's report continued

To the Members of Bodycote plc

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion: ■ we have not received all the information and explanations we require for our audit; or ■ adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or ■ the Parent Company financial statements are not in agreement with the accounting records and returns.	We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns.	We have nothing to report arising from these matters.

Corporate governance statement

Under the Listing Rules we are also required to review part of the Corporate governance statement relating to the Company's compliance with certain provisions of the UK Corporate Governance Code.	We have nothing to report arising from our review.

Our duty to read other information in the Annual Report

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is: ■ materially inconsistent with the information in the audited financial statements; or ■ apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or ■ otherwise misleading. In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed.	We confirm that we have not identified any such inconsistencies or misleading statements.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Mark Mullins FCA (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
28 February 2017