

# Principal risks and uncertainties

Effective management of risks is essential to the delivery of the Group's objective of creating superior shareholder returns. The Board is responsible for the Group's risk management and the review of financial risk has been delegated to the Audit Committee. Under the leadership of the Group Head of Risk, Bodycote has developed the risk management framework to identify, report and manage its business critical risks. The Risk Committee, established in 2012, continued to meet during the year attended by senior managers from each of the operating divisions. The role of the Risk Committee is to embed risk management and facilitate the implementation of risk management measures throughout the Group.

A variety of approaches are used to identify and report risks, which are aggregated first at a sub-divisional level and then at Group level. For each business critical risk, assurance activities have been documented in risk assurance maps and this is used to direct assurance activity.

The Group Head of Risk provides an update to the Audit Committee on the Group's risk activities at every meeting and a comprehensive review of the Group's business critical risks is presented in December. In addition, the Board examines a specific risk topic at each Board meeting.

The table below highlights the major risks that may affect Bodycote's ability to deliver the strategy, as laid out on page 7. Details of the Group's financial risks (funding, foreign exchange, interest rate and counterparty risks), which are managed by the Group's treasury function are provided in note 18 to the financial statements. The mitigating activities described below will help to reduce the impact or likelihood of the major risk occurring, although the Board recognises that it will not be possible to eliminate these risks entirely. Furthermore, there could be risks that may be unknown or that may be judged to be insignificant at present, but may later prove to be significant. For this reason business continuity plans have been prepared for all plants to provide for situations where specific risks have the potential to severely impact the business.

## Risk Description and Impact

## Mitigation

### Market and Customer Risks

#### Markets

Bodycote's exposure to macroeconomic performance means that it suffers from a certain level of sales volatility. A substantial proportion of Bodycote's sales are closely linked to the economic cycle. Sales in the markets served by the AGI businesses (64% of the total Group) tend mainly to develop in line with or ahead of the economic cycle, whereas ADE sales (36%) tend to track behind the economic cycle. Sales can also be impacted by energy prices which in turn can be affected by general economic activity. The high proportion of fixed costs in the business means that a drop in sales may have a significant impact on profitability. However Bodycote's presence in 26 countries in a wide variety of end-markets acts as a natural hedge to neutralise localised economic volatility. Nevertheless, the Board is mindful of the potential impact on demand for the Group's services.

- Implement strategic plan with medium-term objective of "above-market" sales growth, a focus on targeted premium growth business segments and a more balanced geographic spread.
- Maintain flexibility of cost base for example, by ensuring that a proportion of the workforce is employed on temporary contracts.
- Respond quickly to changes in customer demand on a local or a Group-wide level.
- Wide geographical and market sector spread of Group sales.

#### Loss of key customers

Bodycote benefits from many long-term relationships with key customers. Damage to, or loss of, any of these relationships would be detrimental to Group results and could affect the viability of one or more of Bodycote's facilities. However, the Board believes this is unlikely as Bodycote strives to provide a high level of customer service and the Group's network of strategically located facilities ensures that it is the supplier of choice to these major manufacturers. Furthermore there is no significant customer dependency, with the Group's top ten customers accounting for less than 13% of sales and the balance made up by many thousands of customers.

- Continued focus on customer service and quality processes to maintain excellent relationships with major customers. Use key account management to monitor customer satisfaction with the Group's service levels.
- Ensure there is no significant customer dependency.

### Corporate and Community Risks

#### Human resources

Bodycote is reliant on its ability to attract, develop and retain staff of the right calibre to support its growth strategy. Competition for capable resources is high and there is a risk that Bodycote may not be able to attract or retain skilled individuals. As a market leader Bodycote is seen as a source of talent by competitors, while the Group competes with employers from a wide range of sectors to attract staff into the business.

- Continue the implementation of the HR strategy to address the long-term development and retention of staff.
- Develop succession plans.
- Ensure performance management processes are properly implemented and used effectively.

## Risk Description and Impact

## Mitigation

### Corporate and Community Risks (continued)

#### Safety and health

Bodycote is committed to providing a safe work environment for its employees. The nature of Bodycote's activities presents safety and health risks which can have a significant impact on individual employees. Furthermore poor safety and health practices could lead to disruption of business, financial penalties and loss of reputation.

- Group-wide health and safety policies set by the Chief Executive.
- Bodycote SHE management system standard, being implemented based on OHSAS 18001 and ISO 14001.
- Programme in place to focus on reduction of incidents which could have a high impact.
- Safety compliance audits at all plants at least every two years.
- Oversight of safety and health framework provided by the Group SHE Committee.

#### Environment

Bodycote is committed to providing the highest level of protection to the environment. Environmental contamination could lead to health risks, disruption of business, financial costs and loss of reputation.

Historical use of chlorinated solvents and other hazardous chemicals by plants operated by Bodycote or by plants acquired by Bodycote could have led to ground contamination. The environmental regulations in many of the jurisdictions in which Bodycote operates impose actual or potential obligations on Bodycote to remediate contaminated sites. Bodycote incurs costs annually (2013: £1.6m) in meeting its obligations and has a provision of £13.2m at 31 December 2013 in respect of required environmental remediation costs. If the provision is insufficient to meet the cost of remediation, then this could have an impact on the Group's results. Some of the Group's heat treatment plants continue to use chlorinated solvents and hazardous chemicals in small quantities.

- Remediation of contaminated sites as required by local legislation.
- Reduction in the use of hazardous substances, such as chlorinated solvents.
- Environmental procedures and measures in place conforming to ISO 14001 (2013: 85% of plants).
- Environmental due diligence of businesses for acquisition.

### Operational Risks

#### Service quality

The Bodycote brand is reliant on the repeatable delivery of parts to agreed specification to an agreed time. Deterioration in quality or service levels could cause serious long-term damage to Bodycote's reputation with financial consequences such as the loss of a customer and the cost of damages or litigation. Work that is released into use which is not in compliance with specification could arise as a result of system or human failure. Bodycote has stringent quality systems in place managed by qualified staff. Where necessary, plants have relevant accreditations such as ISO 9001, Nadcap and TS 16949.

- Maintain industry relevant accreditations.
- Quality systems and processes operated at plant level, supervised by divisional quality teams.
- All plants subjected to internal and external quality audits and inspections at least once a year.

#### Major disruption at a facility

Bodycote's business processes have inherent risks and there is a possibility that a major fire or utility outage could lead to closure of a facility's operation. In addition a number of sites are exposed to natural hazards, such as earthquakes, flooding and storms. As a result there is a possibility that service to Bodycote's customers from the affected site could be disrupted. However Bodycote's global network of over 190 plants creates a framework to provide backup capability for any affected facility.

- OHSAS 18001 and ISO 14001 compliant SHE management systems being used by Group Head of Safety, Health and Environment with support of divisional safety and health teams.
- Programmed equipment maintenance and inspections.
- Independent insurer inspections to assess hazard and business interruption risks.
- Business continuity plans developed for all plants.

#### Information technology systems

The efficient operation of the Group will rely increasingly on the proper development and operation of its IT systems. Bodycote is currently undergoing a Group-wide implementation of a new ERP system. The impact of the re-engineered business process will have significant long-term benefits on Bodycote's operational effectiveness. However, failure to manage the implementation programme successfully could result in cost overruns and potentially, disruption to the business.

- Defined disaster recovery planning and data backup procedures.
- Project approval and progress subject to Board review.
- Project teams made up of skilled subject matter experts supplemented with third party advisers.
- Best practice project management processes in place with assurance provided by third parties.

### Regulatory Risks

#### Regulatory and legislative compliance

The global nature of Bodycote's operations means that the Group has to comply with a wide range of local and international legislative requirements, including anti-bribery and anti-competition legislation, taxation legislation, employment law and import and export controls. Failure to comply with legislation could lead to substantial financial penalties, disruption to business, diversion of management time, personal and corporate liability and loss of reputation.

- Establish business processes supported by HR policies and the Group Code of Conduct.
- The "Open Door Line" whistleblower facility which is managed by a third party.
- Training and awareness programmes.
- Engagement of local specialists to support Bodycote at local, divisional and Group level.
- Regular audit of the effectiveness of implemented procedures.