

# the directors' remuneration report

The Board presents the following report on directors' remuneration and the operation of the Remuneration Committee.

## THE REMUNERATION COMMITTEE

This Committee has been established for many years and operates under terms of reference agreed by the Board.

Messrs. E. Lindh, C. G. Sneath, M. Townsend (Chairman) and W. H. Whiteley were members of the Committee during the year when the Committee was considering matters relating to directors' remuneration. Mr. Sneath served on the Committee until his retirement on 26th July 2002. Mr. Whiteley commenced membership of the Committee on his appointment as an independent non-executive director on 26th July 2002.

The Committee is responsible for determining, on behalf of the Board, the Company's remuneration policy and for determining the employment conditions and remuneration packages of the Chairman and individual executive directors. The Committee also administers and determines the grant of options under the Group's share option schemes for executive directors and other senior employees.

The Committee obtains independent professional advice from Towers Perrin to ensure that the Company's remuneration policies are appropriate and competitive. Towers Perrin was appointed by the Committee and has not provided other services to the Company during the year. Mr. T. B. Fortune, the Company Chairman, and Mr. M. J. D. Steel, the Chief Executive, attend meetings at the invitation of the Committee to provide information requested by it. However, they do not participate in any discussions involving their own remuneration.

The Company has throughout the year complied with the code of best practice set out under the Combined Code with regard to directors' remuneration. The Committee has given full consideration to the Combined Code in establishing the remuneration policy and packages for directors.

## POLICY ON EXECUTIVE DIRECTORS' REMUNERATION

The Company's policy is to reward directors competitively and on the broad principle that their remuneration should be comparable with remuneration in other similar public companies. The total remuneration package is appropriate and necessary to attract, retain and motivate directors of the calibre required to take the Company forward.

In order to align the interests of directors and shareholders, the Committee has structured the total remuneration package to provide a material performance-related element, this portion being increased with effect from 1st January 2002 when further non-pensionable elements were added to the performance-related bonus.

The structure of directors' remuneration packages, which was established in 1989 and confirmed following a specific review in 1995, has been amended for appointments of executive directors after 1st January 1998 to provide normally for a 12 month, rather than for a 24 month, notice period in the service contract. The Remuneration Committee considers that as the length of service contracts complied with normal practice at the time the contracts were entered into it is inappropriate to change existing terms and conditions. The service contracts provide for a normal retirement age of 62½ for each executive director.

The Remuneration Committee establishes the remuneration package for the executive directors having regard to pay and conditions elsewhere in the Group and in particular to those senior executives who are not Board members.

The following table shows the number of executives at differing levels of basic pay and bonus.

<b>Remuneration £pa</b>	<b>No. of Senior Executives</b>
100,000 - 150,000	9
150,001 - 200,000	2
200,001 - 250,000	1

The Committee currently has no plans to change the Company's policy on directors' remuneration or the structure of their remuneration packages during this year or subsequent years. However this position will be kept under review to ensure the directors' overall packages remain properly competitive and shareholders will be informed of any resulting change.

The remuneration packages comprise the following:-

### Basic Salary

The Committee obtains independent professional advice using published information for comparable public companies. Salaries are reviewed annually on 1st January taking into account the experience, responsibility and performance of the individual.

## **Annual Bonus**

The Company operates an annual bonus scheme for executive directors. The bonus is paid as a percentage of salary. This percentage is the sum of:-

- (i) 33% of the percentage increase in pre-tax profit for the year over the average pre-tax profit for the previous three years;
- (ii) 67% of the percentage increase in earnings per share for the year over the average earnings per share for the previous three years;

additionally from 1st January 2002:-

- (iii) cash generation (expressed as a percentage of profit) will carry a maximum of 30% bonus. Where cash inflow, as determined from the Accounts, is less than 100% of profit for the financial year, no bonus will be earned; where cash generated equals or exceeds 140%, the full 30% will accrue with proportionate bonus being earned between 100% and 140% of profit; and
- (iv) gross margin percentage will be compared with that for the previous year. Where the gross margin has deteriorated by 0.5 percentage points or more, no bonus will accrue; where there has been an improvement of 1.5 percentage points or more, the full allocation of 20% will accrue with proportionate bonus being earned between these limits, provided always that the percentage is above the required minimum.

There is a contractual maximum bonus payment equal to basic salary. The bonus forms an integral and regular part of the executive directors' remuneration and elements (i) and (ii) have been and are pensionable. Elements (iii) and (iv) are not pensionable. The non-executive directors do not participate in the bonus scheme.

## **Options**

### **Spirax-Sarco Engineering 1992 UK & Global Share Option Schemes and Spirax-Sarco Engineering Approved & Global Share Option Schemes**

The Company operates share option schemes for executive directors and senior management which are administered by the Committee which determines the grant of options under the schemes usually once per year. These are designed to align the longer term interests of directors and senior management with those of shareholders by giving an incentive linked to added shareholder value. The policy is to phase options over the ten year life of the share option schemes. Options granted to each director are subject to performance criteria which are set out below.

The exercise of any option granted to any director under the Company's share option schemes since 1995 (and any discounted option granted before 1994 when the granting of discounted options ceased) is subject to the satisfaction of performance criteria.

In accordance with market practice, options granted are normally specified to be exercisable between three and ten years from the date of grant and, for grants from 1995 and up to and including 2001, only if specified performance criteria are satisfied. In line with the then established market practice, these performance criteria require an increase in earnings per share of more than 6% greater than the increase in the UK retail prices index over a period of three consecutive years between grant and exercise. For options granted from and including 2002 the performance criteria require an increase in earnings per share of more than 9% greater than the increase in the UK retail prices index over a period of three consecutive years between grant and exercise. The same performance criteria apply to each director. The performance criteria chosen were considered appropriate because it ensured increases in the share price were achieved having taken account of UK inflation. In assessing whether the chosen performance criteria are met the Committee arranges for the auditor to confirm the calculations made. This method of assessment is considered appropriate to confirm compliance with the criteria. The performance condition requires a comparison with a factor external to the Company, namely the growth in the UK retail prices index over the performance period.

The exercise of options granted before 1995 (other than discounted options) is not subject to any performance criteria being met. This is in line with market practice at the time of grant of those options.

The discounted options granted are exercisable between five and ten years from date of grant at an alternate exercise price which reflects a 15% discount to the market price at the time of grant. These require an increase in earnings per share of more than 10% greater than the increase in the UK retail prices index over a period of five consecutive years between grant and exercise.

Details of total share options issued are set out on page 46. The above performance criteria also apply to other relevant options granted to participants in the share option schemes.

### **Spirax-Sarco Engineering plc Employee Share Ownership Plan**

The executive directors participate in the Employee Share Ownership Plan, as described on page 29. Participation in the Employee Share Ownership Plan is open to all eligible UK employees. No employee's entitlement under the Employee Share Ownership Plan is subject to performance conditions. This is because the aim is to encourage increased shareholding in the Company by all eligible UK employees.

There are no other long term incentives provided to directors.

# the directors' remuneration report *(continued)*

## Pensions

The executive directors are members of an Inland Revenue approved non-contributory defined benefit pension scheme based on 1/60th of pensionable salary, for each year of pensionable service. The maximum pension is two-thirds of pensionable salary. The executive directors accrue pro-rata additional service at a rate which gives a further two and a half years of service at their normal retirement age of 62½. Additionally Mr. G. P. Marchand accrues pro-rata additional service at a rate which gives a further nine years of service at age 60.

The scheme provides lump sum death in service benefit of four times pensionable salary. Spouses' pensions are payable where death occurs in service or in retirement. No executive director is affected by the Inland Revenue earnings cap and there are no unapproved pension arrangements in respect of directors.

## Non-Executive Directors

The remuneration of non-executive directors is approved by the full Board within the limits set out in the Company's articles of association. Their remuneration reflects the amount of time spent on the Company's business. The non-executive directors do not participate in the bonus, share option or share ownership schemes and their appointments are non-pensionable.

## Service Contracts

In determining the amount of compensation payable on termination of a service contract, it is the Committee's policy to apply normal principles of mitigation which, in its opinion, confer greater flexibility to deal with individual circumstances than seeking to include in directors' service contracts a fixed compensation payment. Poor performance will not be rewarded.

The executive directors have service contracts as follows:-

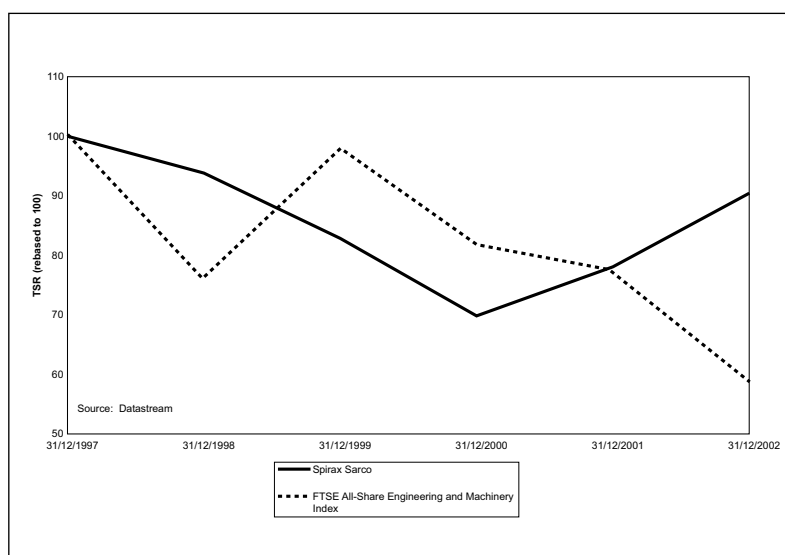
	<b>Date of Contract</b>	<b>Notice Period</b>
M.J.D. Steel	30.12.92	24 months
C.J. Ball	26.11.92	24 months
A.D.H. Black	18.11.98	12 months
G.P. Marchand	30.12.92	24 months
D.J. Meredith	30.12.92	24 months
P.A. Smith	24.12.92	24 months
P.M. Smith	01.09.98	12 months

The Committee believes it is appropriate to retain the 24 months' notice period for Messrs. M. J. D. Steel, C. J. Ball, G. P. Marchand, D. J. Meredith and P. A. Smith, being the established practice at the date of their appointment. As a result of a specific review, the Committee, recognising the subsequent change in practice, has determined that in normal circumstances appointments of executive directors made after 1st January 1998 would be on a 12 months' notice basis. Messrs. A. D. H. Black and P. M. Smith have service contracts which are subject to 12 months' notice.

The non-executive directors, including the Chairman, Mr. T. B. Fortune, do not have service contracts. They have appointment letters, normally for three year periods, and re-appointment is not automatic.

## TOTAL SHAREHOLDER RETURN

The performance graph illustrated shows the Company's total cumulative shareholder return for the five year period ended 31st December 2002 compared with the total cumulative shareholder return for the FTSE All-Share Engineering and Machinery Index. This comparison is selected as being the most appropriate sector for the Company's operations as the comparison automatically takes account of the impact on the Company's shares of the market's view of the engineering industry generally.



## DETAILS OF INDIVIDUAL EMOLUMENTS

The auditor is required to report on the information contained in this section of the Report.

	Basic Salary/ Fees	Benefits (1)	Annual performance related bonus	Total emoluments excluding pension	
	£	£	£	2002 Total £	2001 Total £
T. B. Fortune (2)	70,000	349	-	70,349	68,947
M.J.D. Steel	270,000	15,124	135,648	420,772	291,155
C.J. Ball	158,000	18,504	79,379	255,883	177,931
A.D.H. Black	150,000	14,861	75,360	240,221	172,845
G.P. Marchand	162,000	10,481	81,389	253,870	178,498
D.J. Meredith	175,000	10,958	87,920	273,878	196,581
P.A. Smith	125,000	7,684	62,800	195,484	140,273
P.M. Smith	150,000	15,699	75,360	241,059	173,560
E.Lindh (2)	20,000	-	-	20,000	19,100
C.G. Sneath (2) (3)	11,667	-	-	11,667	19,100
M.Townsend (2)	26,500	-	-	26,500	25,400
W.H. Whiteley (2) (4)	8,641	-	-	8,641	-
	1,326,808	93,660	597,856	2,018,324	1,463,390

(1) Benefits arising from employment by the Company, which relate in the main to the provision of a company car.

(2) Non-executive director.

(3) Mr. C. G. Sneath retired from the Board on 26th July 2002.

(4) Mr. W.H. Whiteley was appointed to the Board on 26th July 2002.

## Long Term Incentives

(i) Spirax-Sarco Engineering 1992 UK & Global Share Option Schemes  
and Spirax-Sarco Engineering Global Share Option Scheme

The interests of directors are set out below:-

		31.12.01 (1)	Granted during year to 31.12.02 No. (2)	Exercised in year No. (3)	31.12.02 No.	Average exercise price per share pence (4)	Date from which exercisable	Expiry date
M.J.D. Steel	A	25,000	-	-	25,000	319.2	17.03.03	08.04.08
	B	160,000	30,000	-	190,000	492.7	10.10.97	08.04.08
		185,000	30,000	-	215,000			
C.J. Ball	A	15,000	-	-	15,000	319.2	17.03.03	29.09.05
	B	110,000	17,500	-	127,500	521.2	10.10.97	29.09.05
		125,000	17,500	-	142,500			
A.D.H. Black	A	15,000	-	-	15,000	319.2	17.03.03	17.03.10
	B	55,000	17,500	-	72,500	439.4	16.09.01	22.03.12
	C	7,569	-	5,046	2,523	341.8	07.10.96	07.10.03
	D	12,500	-	-	12,500	648.6	10.10.97	16.09.07
		90,069	17,500	5,046	102,523			
G.P. Marchand	A	30,137	-	-	30,137	330.5	07.10.96	24.12.07
	B	110,000	17,500	-	127,500	521.2	10.10.97	24.12.07
		140,137	17,500	-	157,637			
D.J. Meredith	A	42,752	-	27,752	15,000	319.2	17.03.03	17.03.10
	B	120,000	17,500	-	137,500	527.7	10.10.97	22.03.12
		162,752	17,500	27,752	152,500			
P.A. Smith	A	15,000	-	-	15,000	319.2	17.03.03	17.03.10
	B	80,000	17,500	-	97,500	522.1	18.09.98	18.08.10
	C	37,845	-	25,230	12,615	344.2	07.10.96	07.10.03
	D	12,500	-	-	12,500	427.0	10.10.97	10.10.04
		145,345	17,500	25,230	137,615			
P.M. Smith	A	15,000	-	-	15,000	319.2	17.03.03	21.09.05
	B	55,000	17,500	-	72,500	439.4	16.09.01	21.09.05
	C	7,568	-	-	7,568	340.0	07.10.96	07.10.03
	D	35,000	-	-	35,000	624.7	10.10.94	21.09.05
		112,568	17,500	-	130,068			

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## Notes

1. Options shown on lines A and B relate to options granted to members of the Board, whereas options shown on lines C and D relate to options granted to individuals prior to their appointment to the Board.

Options shown on lines A and C are those where the exercise prices are lower than the middle market price of the Company's ordinary shares on 31st December 2002. Options shown on lines B and D are those where the exercise prices are higher than the middle market price on that date.

2. Options were granted to directors during the year over 135,000 ordinary shares at 436.0p per share under the Spirax-Sarco Engineering Global Share Option Scheme, which is unapproved. Mr. M. J. D. Steel was granted 30,000 options and each of the remaining executive directors were granted 17,500 options.

	Options exercised	Option exercise price	Market price on the date options exercised	2002 Gain arising on exercise	2001 Gain arising on exercise
	No.	pence	pence	£	£
T.B. Fortune					59,317.87
A.D.H. Black	3,154 1,892	233.03216 } 274.15490 }	433.5	9,337.57	
P.A. Smith	13,608 11,622	233.03216 } 274.15490 }	438.5	47,060.25	
D.J. Meredith	12,615 3,784 11,353	233.03216 } 301.81416 } 355.07554 }	456.0	45,419.74	
<b>Aggregate of gains arising on exercise</b>				101,817.56	59,317.87

4. These are the weighted averages of the exercise prices for ordinary shares under option at 31st December 2002.

The market price of the ordinary shares on 31st December 2002 was 414p. During the period from 1st January 2002 to 31st December 2002, the ordinary share price ranged between 473.5p and 341p.

Within the number of options set out in the table above, the outstanding discounted options held by executive directors as at 31st December 2002 are as follows:-

	No. of discounted options	Discounted price pence	Expiry date
A.D.H. Black	631	301.81416	07.10.03
G.P. Marchand	3,784	301.81416	07.10.03
P.A. Smith	2,587	301.81416	07.10.03
P.M. Smith	2,144	301.81416	07.10.03

The Register of Directors' Interests (which is open to inspection) contains full details of directors' shareholdings and options to subscribe.

There have been no changes in the number of shares held or share options granted as shown above since 31st December 2002.

(ii) Spirax-Sarco Engineering plc Employee Share Ownership Plan

The Company operated an employee share ownership plan in which all the executive directors are eligible to participate on the same basis as all other eligible UK employees. For the Plan period the individual director's contributions are limited to a maximum of £1,500 per annum under Inland Revenue Rules.

	<b>Interest as at 01.01.02</b>	<b>Vested No.</b>	<b>Interest as at 31.12.02 No.</b>	<b>Period of qualifying conditions</b>
M.J.D. Steel	-	949	949	3 years
C.J. Ball	-	949	949	3 years
A.D.H. Black	-	949	949	3 years
G.P. Marchand	-	949	949	3 years
D.J. Meredith	-	949	949	3 years
P.A. Smith	-	949	949	3 years
P.M. Smith	-	949	949	3 years

### DIRECTORS' PENSIONS

The Director's Remuneration Report Regulations 2002 require disclosure of directors' defined benefit pensions arrangements on a different basis from that specified in the Combined Code. Details on both bases are shown below.

	<b>Age attained at 31.12.02</b>	<b>Accrued pension at 31.12.01 £pa</b>	<b>Accrued pension at 31.12.02 £pa</b>	<b>Change in accrued pension during the year £pa</b>	<b>Change in accrued pension during the year* £pa</b>	<b>Transfer value of change in accrued pension £</b>	<b>Transfer value of value of accrued pension at 31.12.01 £</b>	<b>Transfer value of value of accrued pension at 31.12.02 £</b>	<b>Change in total transfer value £</b>
M.J.D. Steel	57	136,570	151,310	14,740	12,418	153,000	1,694,000	1,699,000	5,000
C.J. Ball	59	98,997	107,861	8,864	7,181	109,000	1,378,000	1,466,000	88,000
A.D.H. Black	45	53,398	59,291	5,893	4,985	30,000	399,000	340,000	-59,000
G.P. Marchand	57	79,614	89,881	10,267	8,914	113,000	1,101,000	1,131,000	30,000
D.J. Meredith	43	49,048	54,763	5,715	4,881	27,000	351,000	299,000	-52,000
P.A. Smith	54	59,905	65,334	5,429	4,411	47,000	691,000	633,000	-58,000
P.M. Smith	59	54,664	60,614	5,950	5,021	77,000	835,000	901,000	66,000

\* net of deferred pension revaluation at a rate of 1.7%

Note: Accrued pension means pension payable at normal retirement age assuming no further pensionable service.

The following is additional information relating to directors' pensions:

(i) Dependant's pensions

On the death of a director in service, a spouse's pension equal to one-half of the director's pension based on pensionable service to the date of death is payable.

On the death of a director after payment of the pension commences, a spouse's pension of one-half of the director's pension entitlement at the date of death, ignoring commutation and any early retirement actuarial reduction, is payable; in addition directors' pensions are guaranteed to be paid for five years from retirement.

(ii) Early retirement rights

After leaving the service of the Company, a director has the right to draw his accrued pension at any time after his 60th birthday with no reduction.

(iii) Pension increases

All pensions are subject to contractual annual increases in line with the annual rise in the RPI subject to a maximum of 5% per annum. The Trustees and the Company have the discretion to apply a greater increase.

# the directors' remuneration report *(continued)*

(iv) Transfer values

The changes in transfer values stated above do not represent a sum paid or payable to the individual director. Instead they represent a potential liability of the pension scheme.

(v) Other discretionary benefits

There are no discretionary practices which are taken into account in calculating transfer values on leaving service.

Signed by

**T. B. Fortune** *Chairman*  
on behalf of the Board

## statement of directors' responsibilities

Company law requires the directors to prepare accounts 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 for that period. In preparing those accounts, the directors are required to:

- (i) Select suitable accounting policies and then apply them consistently.
- (ii) Make judgements and estimates that are reasonable and prudent.
- (iii) State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.
- (iv) Prepare the accounts on a 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 to enable them to ensure that the accounts comply with the requirements of the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.