

notes to the accounts

1 ACCOUNTING POLICIES

Basis of preparation

The consolidated accounts are prepared under the historical cost convention, supplemented by the revaluation of certain assets in prior years, and in accordance with applicable accounting standards. The following principal accounting policies have been applied consistently in dealing with items which are considered material in relation to the Group's accounts.

Basis of consolidation

The Group accounts include the accounts of the company and its subsidiary undertakings made up to 31st December 2003. Unless otherwise stated, the acquisition method of accounting has been adopted. Under this method, the results of subsidiary undertakings acquired or disposed of in the year are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

Under section 230(4) of the Companies Act 1985 the company is exempt from the requirement to present its own profit and loss account.

Goodwill

Purchased goodwill arising on consolidation in respect of acquisitions before 1 January 1998, when FRS 10 - Goodwill and Intangible Assets was adopted, was written off to reserves in the year of acquisition. When a subsequent disposal occurs any related goodwill previously written off to reserves is written back through the profit and loss account as part of the profit or loss on disposal.

Purchased goodwill (representing the excess of the fair value of the consideration given and associated costs over the fair value of the separable net assets acquired) arising on consolidation in respect of acquisitions since 1 January 1998 is capitalised. Positive goodwill is amortised to nil by equal annual instalments over its estimated useful life, normally 20 years. Should the value of this goodwill become recognised as impaired, an impairment charge would be made against operating profit.

On the subsequent disposal or termination of a business acquired since 1 January 1998, the profit or loss on disposal or termination is calculated after charging the unamortised amount of any related goodwill.

In the company's financial statements investment in subsidiary undertakings is stated at cost less any impairment in value.

Turnover

Turnover comprises net sales to external customers.

Turnover is recorded when the risks and rewards of ownership have passed to the purchaser.

Depreciation

Depreciation is calculated on cost or valuation on a straight line basis at rates which write down the value of the assets to their residual values over their estimated useful lives. The principal rates are as follows:

Freehold land	nil	Office equipment	12.5 - 20%
Freehold buildings	1.5%	Motor vehicles	20%
Plant and machinery	10-12.5%	Tooling and patterns	10%
Office furniture and fittings	10%		

Leasehold properties are amortised over the life of the lease.

Stocks

Stocks and work in progress are valued at the lower of cost, including overheads where appropriate, and estimated net realisable value.

Cash and liquid resources

Cash, for the purpose of the cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand. Liquid resources are current asset investments which are disposable without curtailing or disrupting the business and are either readily convertible into known amounts of cash at or close to their carrying values or traded in an active market.

Research and development expenditure

Research and development expenditure is charged against profits as incurred.

1 ACCOUNTING POLICIES (continued)

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19 - Deferred Tax.

Foreign currency translation

Foreign currency assets and liabilities are translated into sterling at rates of exchange ruling at 31st December. Trading results of overseas subsidiary undertakings have been translated into sterling at average rates of exchange ruling during the year.

Differences arising from the changes in rates of exchange are treated as part of the trading profit where they relate to items of a trading nature. Exchange differences arising from the retranslation of the opening net investment in overseas subsidiary undertakings, borrowings to hedge those net investments and between the profits for the year translated at average and closing rates, are disclosed as movements on reserves.

Leases

Where the company enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a finance lease.

Assets acquired under finance leases are capitalised and the outstanding future lease obligations are shown in creditors.

Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

Pensions and other post-retirement benefits

Pension schemes are operated by the Company and subsidiary undertakings which employ the majority of Group employees. Contributions to the schemes are charged to the consolidated profit and loss account such that the cost is spread over the estimated working lives of employees of the Group. The Group has adopted the transitional requirements of FRS 17 - Retirement Benefits as reported in note 28.

The costs of providing post-retirement benefits other than pensions, principally healthcare, are charged to the profit and loss account on a consistent basis over the average service lives of employees. Such costs are assessed in accordance with the advice of independent qualified actuaries.

2 TURNOVER

The analysis of turnover by reference to the geographical location of customers is as follows:

	2003 £000	2002 £000
United Kingdom	39,215	38,928
Continental Europe	117,390	106,490
The Americas	84,207	85,385
Asia, Australasia and Africa	73,275	65,560
	314,087	296,363

The analysis of turnover by reference to the geographical location of the Group's operations is as follows:

	2003 £000	2002 £000
United Kingdom	92,370	89,435
Continental Europe	146,408	127,403
The Americas	87,962	89,768
Asia, Australasia and Africa	67,145	58,843
	393,885	365,449
Intra-group sales	(79,798)	(69,086)
Sales to third parties	314,087	296,363

There were no discontinued operations in 2003 or 2002.

The Group operates in one business segment which is the control of fluids.

notes to the accounts (continued)

3 OPERATING COSTS

	2003 £000	2002 £000
Change in stocks of finished goods and work in progress	(1,764)	2,615
Raw materials and consumables	84,070	75,946
Staff costs (<i>note 4</i>)	118,968	109,681
Depreciation	13,155	11,935
Amortisation of goodwill	669	557
Other operating charges	53,239	52,955
	268,337	253,689

4 STAFF COSTS AND NUMBERS

The aggregate payroll costs of persons employed by the Group were as follows:

	2003 £000	2002 £000
Wages and salaries	94,884	87,936
Social security costs	15,715	14,907
Other pension costs	8,369	6,838
	118,968	109,681

The average number of persons employed by the Group (including directors) during the year was as follows:

	Number	Number
United Kingdom	1,098	1,099
Overseas	2,957	2,899
	4,055	3,998

5 OPERATING PROFIT

The analysis of operating profit by reference to the geographical location of the Group's operations is as follows:

	2003 £000	2002 £000
United Kingdom	8,021	8,014
Continental Europe	16,439	13,561
The Americas	10,335	11,336
Asia, Australasia and Africa	10,955	9,763
	45,750	42,674

6 NET INTEREST PAYABLE

		2003	2002
		£000	£000
Interest payable:	Bank loans and overdrafts	1,653	1,823
	Other loans	644	906
		2,297	2,729
Interest receivable		(1,111)	(748)
		1,186	1,981

7 PROFIT BEFORE TAXATION

Profit before taxation is shown after charging:

		2003	2002
		£000	£000
Depreciation of tangible fixed assets held under finance leases		178	160
Audit fees (Spirax-Sarco Engineering plc £100,000 (2002: £90,000))		696	635
Hire of plant and machinery		288	310
Other operating leases		2,667	2,670
Research and development		4,878	4,411
Share Ownership Plan contributions		413	393

Fees paid to the auditors of the parent company and their associates for services other than statutory audits supplied to the Company and the rest of the Group worldwide amounted to £313,000 (2002: £520,000), including amounts paid to the auditors of overseas companies of £212,000 (2002: £227,000). Fees were paid mainly in respect of taxation services.

8 DIRECTORS' EMOLUMENTS

Details of directors' emoluments, share options and pension benefits are shown in The Directors' Remuneration Report on pages 26 to 33.

9 TAXATION

		2003	2002
		£000	£000
Analysis of charge in period			
UK corporation tax			
Current tax on income for the period		10,152	8,059
Adjustments in respect of prior periods		(137)	60
		10,015	8,119
Double taxation relief		(7,393)	(5,244)
		2,622	2,875
Foreign tax			
Current tax on income for the period		12,810	11,357
Adjustments in respect of prior periods		(360)	(243)
		12,450	11,114
Total current tax charge		15,072	13,989
Deferred tax		66	(102)
Tax on profit on ordinary activities		15,138	13,887

notes to the accounts (continued)

9 TAXATION (continued)

Current tax reconciliation

Profit on ordinary activities before tax	44,564	40,693
Current tax at 30% (2002: 30%)	13,369	12,208
Higher tax rates on overseas earnings	1,883	1,911
Non-deductible expenses, provisions and accruals	826	1,413
Pension prepayment	(356)	(132)
Accelerated capital allowances	183	(734)
Adjustment to tax in respect of previous periods	(409)	(183)
Other	(424)	(494)
Total current tax charge (see above)	15,072	13,989

Factors that may affect the future tax charges:

The Group's tax charge in future years is likely to be affected by the proportion of profits arising and the effective tax rates in the various territories in which the Group operates. No UK tax (after double tax relief for underlying tax) is expected to be payable on the future remittance of the retained earnings of overseas subsidiaries. No provision has been made for deferred tax on property revaluations: the total amount unprovided is £448,000 and it is not envisaged that the tax will become payable in the foreseeable future.

10 PROFIT FOR THE FINANCIAL YEAR ATTRIBUTABLE TO SHAREHOLDERS

Profit dealt with in the accounts of Spirax-Sarco Engineering plc was £19,274,000 (2002: £25,117,000). Included in this amount are dividends from subsidiary undertakings of £19,457,000 (2002: £25,803,000).

11 DIVIDENDS

			2003	2002
			£000	£000
Interim paid	6.0p	(2002: 5.8p) per share	4,487	4,319
Final proposed	14.1p	(2002: 13.5p) per share	10,541	10,031
	20.1p	(2002: 19.3p) per share	15,028	14,350

12 EARNINGS PER SHARE

The calculation of earnings per share (basic) is based on earnings of £28,638,000 (2002: £26,125,000) as shown in the Group profit and loss account, divided by the weighted average number of shares in issue during the year of 74,432,975 (2002: 74,072,923). The calculation of earnings per share (diluted) is based on the earnings shown above and the weighted average number of shares in issue diluted by 521,701 (2002: 121,943) to 74,954,676 (2002: 74,194,866). The dilution is in respect of unexercised share options.

13 FIXED ASSETS: INTANGIBLE ASSETS

	THE GROUP
	Goodwill £000
Cost:	
At 1st January 2003	12,169
Exchange adjustments	361
	12,530
Additions (<i>note 31</i>)	1,093
At 31st December 2003	13,623
Amortisation:	
At 1st January 2003	1,785
Exchange adjustments	50
	1,835
Charged in year	665
At 31st December 2003	2,500
Net book value:	
At 31st December 2003	11,123
At 31st December 2002	10,384

14 FIXED ASSETS: TANGIBLE ASSETS

	THE GROUP				
	Land and buildings			Fixtures, fittings, tools and equipment	
	Freehold £000	Short leasehold £000	Plant and machinery £000	£000	Total £000
Cost or valuation:					
At 1st January 2003	48,008	1,513	77,383	50,315	177,219
Exchange adjustments	711	(121)	196	3	789
	48,719	1,392	77,579	50,318	178,008
Additions	1,207	57	7,586	3,507	12,357
Disposals	(48)	(4)	(3,381)	(1,841)	(5,274)
At 31st December 2003	49,878	1,445	81,784	51,984	185,091
Depreciation:					
At 1st January 2003	6,327	266	46,597	35,436	88,626
Exchange adjustments	81	(15)	48	(149)	(35)
	6,408	251	46,645	35,287	88,591
Charged in year	986	45	7,339	4,263	12,633
Disposals	(37)	-	(2,718)	(1,467)	(4,222)
At 31st December 2003	7,357	296	51,266	38,083	97,002
Net book value:					
At 31st December 2003	42,521	1,149	30,518	13,901	88,089
At 31st December 2002	41,681	1,247	30,786	14,879	88,593

notes to the accounts (continued)

14 FIXED ASSETS: TANGIBLE ASSETS (continued)

Freehold land and buildings at cost or valuation on the basis of open market values for existing use comprises:

		2003 £000	2002 £000
Valuation	1976	76	63
	1986	7,090	6,939
	1991	1,974	2,195
Cost		40,738	38,811
		49,878	48,008

The historic cost net book value of freehold land and buildings at 31st December 2003 was £45,482,000.

Freehold land of £7,949,000 is not depreciated.

Included in the above are finance leases with net book value of £1,950,000 (2002: £1,917,000).

Fixed assets are stated at cost, except that as permitted under the provisions of FRS 15 - Tangible Fixed Assets, on adoption of that standard in 2000 the then book amounts of revalued land and buildings were retained. These book values are based on the previous revaluations shown above and have not subsequently been revalued.

15 FIXED ASSETS: INVESTMENTS

	PARENT COMPANY		
	Shares in subsidiary undertakings £000	Loans to subsidiary undertakings £000	Total £000
Cost:			
At 1st January 2003	46,354	11,155	57,509
Exchange adjustments	-	99	99
	46,354	11,254	57,608
Loan	-	963	963
Repayments	-	(837)	(837)
At 31st December 2003	46,354	11,380	57,734
Amounts written off:			
At 1st January 2003 and 31st December 2003	994	1,042	2,036
Net book value:			
At 31st December 2003	45,360	10,338	55,698
At 31st December 2002	45,360	10,113	55,473

Investments are stated at cost less provisions for any impairment in value.

Details relating to subsidiary undertakings are given on pages 14 and 15. Except where stated on those pages all classes of shares were 100% owned by the Group at 31st December 2003. The country of incorporation of the principal Group companies is the same as the country of operation with the exception of companies operating in the United Kingdom which are incorporated in Great Britain. All are in the fluid control business except Spirax-Sarco Investments Ltd., Spirax-Sarco Overseas Ltd., Sarco International Corp., Watson-Marlow Bredel Holdings B.V., Spirax-Sarco Engineering S.L., Spirax-Sarco Engineering B.V. and Spirax-Sarco Investments B.V. which are investment holding companies.

Spirax-Marshall Limited, in which the Group has a 40% interest, and Spirax-Sarco Mexicana S.A., in which the Group has a 49% interest, have been consolidated as subsidiaries because the Group has participating interests in them and exercises a dominant influence over them. The dominant influence is on the basis that the operating and financial policies of these companies are set in accordance with the wishes of the Group and for the Group's benefit.

16 STOCKS

	THE GROUP	
	2003 £000	2002 £000
Raw materials and consumables	20,194	19,062
Work in progress	11,163	9,636
Finished goods and goods for resale	29,338	28,890
	60,695	57,588

17 DEBTORS

	THE GROUP		PARENT COMPANY	
	2003 £000	2002 £000	2003 £000	2002 £000
Trade debtors	71,064	70,139	-	-
Amounts owed by subsidiary undertakings	-	-	19,584	18,515
Other debtors	10,570	9,802	116	112
Prepayments and accrued income	3,147	2,927	261	74
Taxation recoverable	1,635	884	27	59
Deferred tax	4,099	3,378	-	-
	90,515	87,130	19,988	18,760

Other debtors in the Group balance sheet include prepaid pension costs of £7,221,000 (2002: £5,942,000) chargeable to the profit and loss account after more than one year.

18 CASH DEPOSITS AND SHORT-TERM INVESTMENTS

Cash deposits and short-term investments in the Group balance sheet comprise investments and money market deposits of £38,197,000 (2002: £31,796,000) and £20,000,000 (2002: £16,500,000) in the parent company, all with major banks, all of which have a maturity of three months or less from inception.

19 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	THE GROUP		PARENT COMPANY	
	2003 £000	2002 £000	2003 £000	2002 £000
Bank loans and overdrafts				
Overdrafts	12,602	6,794	-	-
Other loans	19,714	12,542	-	-
Trade creditors	14,220	14,396	-	-
Bills of exchange payable	993	834	-	-
Obligations under finance leases (<i>note 21</i>)	380	349	-	-
Amount owing to subsidiary undertakings	-	-	69	-
Corporation tax	1,587	2,032	54	-
Overseas tax	5,589	5,341	-	-
Social security	2,437	2,129	-	-
Other creditors	7,696	8,795	1	-
Accruals	10,968	10,616	609	856
Proposed dividend	10,541	10,031	10,541	10,031
	86,727	73,859	11,274	10,887

Bank loans and overdrafts amounting to £1,000 (2002: £155,000) are secured on current assets of certain Group companies.

notes to the accounts (continued)

20 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	THE GROUP		PARENT COMPANY	
	2003 £000	2002 £000	2003 £000	2002 £000
Bank and other loans - Repayable between 1 and 2 years	3,280	19,545	-	-
- Repayable between 2 and 5 years	20,706	18,946	-	-
Obligations under finance leases (<i>note 21</i>)	849	1,168	-	-
Amount owed to subsidiary undertakings	-	-	941	1,398
Tax payable	-	27	-	-
Accruals	541	1,349	-	-
	25,376	41,035	941	1,398

The Company together with other Group companies has jointly and severally guaranteed loans granted to subsidiary undertakings amounting to £54,637,000 at 31st December 2003 (2002: £56,940,000).

21 OBLIGATIONS UNDER FINANCE LEASES

	THE GROUP	
	2003 £000	2002 £000
Aggregate amounts repayable:		
Over 5 years	282	326
between 2 and 5 years	183	473
between 1 and 2 years	384	369
	849	1,168
in 1 year or less	380	349
	1,229	1,517

22 PROVISIONS FOR LIABILITIES AND CHARGES

	THE GROUP			
	Deferred taxation provisions £000	Post retirement benefits £000	Warranty and other provisions £000	Total £000
Provisions at 1st January 2003	5,936	9,925	325	16,186
Exchange adjustments	(127)	403	-	276
	5,809	10,328	325	16,462
Charge for the year	708	2,139	123	2,970
Utilised during the year	-	(1,755)	-	(1,755)
Provisions at 31st December 2003	6,517	10,712	448	17,677

An analysis of deferred taxation is set out below.

	THE GROUP	
	Provided	
	2003	2002
	£000	£000
Accelerated capital allowances	3,821	3,614
Provisions disallowed	(3,575)	(3,452)
Other timing differences	2,172	2,396
	2,418	2,558
Deferred tax liabilities	6,517	5,936
Deferred tax asset (<i>note 17</i>)	4,099	3,378
	2,418	2,558

23 NET ASSETS

The analysis of net assets by reference to the geographical location of the Group's operations is as follows:

	THE GROUP	
	2003	2002
	£000	£000
United Kingdom	47,575	47,178
Continental Europe	60,901	61,271
The Americas	35,868	33,909
Asia, Australasia and Africa	38,806	34,483
	183,150	176,841
Cash at bank and in hand	(4,977)	(4,882)
	178,173	171,959
Net debt	(14,357)	(22,666)
Net assets	163,816	149,293

24 CALLED UP SHARE CAPITAL

	THE GROUP		PARENT COMPANY	
	2003	2002	2003	2002
	£000	£000	£000	£000
Ordinary shares of 25p each:				
Authorised 120,000,000	30,000	30,000	30,000	30,000
Allotted, called up and fully paid 74,759,941	18,690	18,575	18,690	18,575

234,251 ordinary shares, having an aggregate nominal value of £58,563, were issued pursuant to the Spirax-Sarco Engineering plc Employee Share Ownership Plan on 8th October 2003 for a consideration of £839,399 received by the Company. 11,455 ordinary shares, having an aggregate nominal value of £2,864, were issued pursuant to the Spirax-Sarco Engineering plc Employee Share Ownership Plan in lieu of dividends of £57,906. 213,613 ordinary shares, having an aggregate nominal value of £53,403, were issued during the year pursuant to the Spirax-Sarco Engineering Share Option Schemes for a consideration of £816,415 received by the Company.

notes to the accounts (continued)

24 CALLED UP SHARE CAPITAL *(continued)*

Directors and 112 other senior employees and former employees of the Group have been granted options to purchase 3,004,500 ordinary shares with an aggregate nominal value of £751,125. Options are exercisable as follows:

	Number of shares	Price to be paid per share
Between 1997 and 2004	2,838	363.0p
Between 1997 and 2004	162,162	427.0p
Between 1998 and 2005	217,500	611.0p
Between 1999 and 2006	263,500	739.0p
Between 2000 and 2007	252,500	669.0p
Between 2001 and 2008	265,500	420.0p
Between 2002 and 2009	280,000	525.0p
Between 2003 and 2010	352,500	319.2p
Between 2004 and 2011	433,500	397.7p
Between 2005 and 2012	363,500	436.0p
Between 2006 and 2013	411,000	394.5p
	3,004,500	

Where relevant these figures reflect adjustments made to the options as a result of the Company's bonus issue.

The performance criteria applicable to directors' share options set out on page 27 also apply to these options.

25 RESERVES

	THE GROUP				
	Share premium account £000	Revaluation reserve £000	Capital redemption reserve £000	Profit and loss account £000	Total £000
Balance at 1st January 2003	34,380	4,216	1,832	87,328	127,756
Effect of exchange rate adjustments	-	134	-	(1,156)	(1,022)
	34,380	4,350	1,832	86,172	126,734
Retained profit for the financial year	-	-	-	13,610	13,610
Premium on the issue of shares	1,616	-	-	-	1,616
Balance at 31st December 2003	35,996	4,350	1,832	99,782	141,960

The cumulative amount of goodwill resulting from acquisitions prior to 1998 (less goodwill on disposals) deducted from reserves amounted to £67,322,000 (2002: £67,322,000).

	PARENT COMPANY				
	Share premium account £000	Revaluation reserve £000	Capital redemption reserve £000	Profit and loss account £000	Total £000
Balance at 1st January 2003	34,380	-	1,832	23,767	59,979
Retained profit for the financial year	-	-	-	4,246	4,246
Premium on the issue of shares	1,616	-	-	-	1,616
Balance at 31st December 2003	35,996	-	1,832	28,013	65,841

26 CAPITAL COMMITMENTS

	THE GROUP		PARENT COMPANY	
	2003 £000	2002 £000	2003 £000	2002 £000
Capital expenditure contracted for but not provided	1,028	1,201	-	-

27 LEASE OBLIGATIONS

	THE GROUP			
	Buildings		Other operating leases	
	2003 £000	2002 £000	2003 £000	2002 £000
Rental payments due in 2004 are under current operating leases terminating in the following years:				
2004	274	653	271	730
2005 to 2008	608	772	532	891
2009 onwards	299	636	5	1
	1,181	2,061	808	1,622

28 PENSIONS AND OTHER POST-RETIREMENT BENEFITS

The total pension charge for the Group this year was £8,369,000 (2002: £6,838,000) of which £4,238,000 (2002: £2,782,000) relates to the overseas schemes. £5,347,000 of the total pension charge was in respect of defined benefit schemes and £3,022,000 for defined contribution schemes.

The Group operates three defined benefit schemes in the UK and one defined contribution scheme. Two of the defined benefit schemes were closed to new entrants during 2001. The defined contribution scheme was established in 2001 to provide pension benefits to new employees. The cost of the UK defined benefit pension schemes was determined using the projected unit and attained age methods following the advice of a qualified actuary. The cost of the defined contribution scheme is equal to the contributions paid.

The most recent actuarial valuations of the UK schemes were carried out at either 31st December 2001 or 5th April 2002. The valuations show that the market value of the assets was £109,700,000 and was sufficient to cover 98 per cent of the benefits that had accrued to members, after allowing for expected future increases in earnings. This shortfall should be eliminated within the average working lifetime of the employees in the UK.

The most important assumptions used in the valuations for accounting purposes concern the rate of return on investments and the rates of increases in salary and pensions. It was assumed that investment returns would exceed salary increases by an average of 2.9 per cent per annum and pension increases by an average of 3.9 per cent per annum.

Included in other debtors in the Group balance sheet are prepaid pension costs of £7,221,000 (2002: £5,942,000).

In respect of certain overseas schemes the excess of £10,132,000 (2002: £9,323,000) of the accumulated pension cost over the amount funded is provided in the accounts (note 22). Part of this provision relates to the unfunded German defined benefit scheme.

The charge for post-retirement benefits other than pensions for the Group in 2003 was £90,000 (2002: £107,000) and related to health care. Provisions for the benefit obligations at 31st December 2003 amounted to £580,000 (2002: £602,000) and are included in provisions for post retirement benefits (note 22). The future costs of benefits are assessed in accordance with the advice of independent qualified actuaries and are based on assumed discount rates of 6.25%.

Financial Reporting Standard 17 disclosures

Whilst the Group continues to account for pension costs in accordance with Statement of Standard Accounting Practice 24 - Accounting for Pension Costs, under FRS 17 - Retirement Benefits the following transitional disclosures are required:

The actuarial valuations of the Group's defined benefit schemes were carried out at various dates between 31st December 2001 and 31st December 2003. The results produced at earlier valuation dates were updated to the 31st December 2003 by independent qualified actuaries.

notes to the accounts (continued)

28 PENSIONS AND OTHER POST-RETIREMENT BENEFITS (continued)

The financial assumptions used at 31st December were:

Assumptions weighted by value of liabilities % per annum

	UK pensions			Overseas pensions and medical		
	2003	2002	2001	2003	2002	2001
Rate of increase in salaries	3.5	3.3	3.5	3.4	3.4	4.2
Rate of increase in pensions	2.5	2.3	2.5	1.8	1.8	2.0
Discount rate	5.5	5.6	5.8	5.8	6.2	6.5
Rate of price inflation	2.5	2.3	2.5	2.2	2.2	2.6
Medical trend rate				5.0	5.0	6.0

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice.

Assumptions weighted by market value of assets % per annum

	UK pensions			Overseas pensions and medical		
	2003	2002	2001	2003	2002	2001
Expected rate of return on assets (aggregate)	7.5	7.5	7.0	7.8	7.6	8.2
Bonds	4.9	5.0	5.1	5.9	6.0	6.8
Equities	8.2	8.2	7.8	9.0	9.0	8.5
Other	5.5	5.9	5.3	3.9	2.7	3.8

The market value of the schemes' assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised and the present value of the schemes' liabilities, which are derived from cash flow projections over long periods and thus inherently uncertain, at 31st December 2003 were:

	UK pensions			Overseas pensions and medical			Total		
	2003 £000	2002 £000	2001 £000	2003 £000	2002 £000	2001 £000	2003 £000	2002 £000	2001 £000
Total market value in aggregate	110,700	91,100	109,600	14,700	11,900	16,700	125,400	103,000	126,300
Bonds	17,800	15,900	22,900	4,000	3,800	500	21,800	19,700	23,400
Equities	86,200	70,100	77,800	9,800	7,300	14,400	96,000	77,400	92,200
Other	6,700	5,100	8,900	900	800	1,800	7,600	5,900	10,700

	UK pensions			Overseas pensions and medical			Total		
	2003 £000	2002 £000	2001 £000	2003 £000	2002 £000	2001 £000	2003 £000	2002 £000	2001 £000
Total market value of schemes' assets	110,700	91,100	109,600	14,700	11,900	16,700	125,400	103,000	126,300
Present value of the schemes' liabilities	(140,000)	(124,400)	(116,600)	(27,500)	(27,300)	(28,200)	(167,500)	(151,700)	(144,800)
Deficit in the schemes	(29,300)	(33,300)	(7,000)	(12,800)	(15,400)	(11,500)	(42,100)	(48,700)	(18,500)
Related deferred tax asset	8,800	10,000	2,100	2,200	3,300	2,220	11,000	13,300	4,320
Net pension liability	(20,500)	(23,300)	(4,900)	(10,600)	(12,100)	(9,280)	(31,100)	(35,400)	(14,180)

28 PENSIONS AND OTHER POST-RETIREMENT BENEFITS (continued)

The movement in deficits in the schemes during the year were:

	UK pensions		Overseas pensions and medical		Total	
	2003 £000	2002 £000	2003 £000	2002 £000	2003 £000	2002 £000
Net pension liability at beginning of year	(23,300)	(4,900)	(12,100)	(9,280)	(35,400)	(14,180)
Contributions paid	5,300	4,500	1,300	1,000	6,600	5,500
Current service cost	(5,000)	(5,100)	(900)	(850)	(5,900)	(5,950)
Other finance income/(charge)	-	1,000	(700)	(450)	(700)	550
Actuarial gain/(loss)	3,700	(26,700)	2,900	(3,600)	6,600	(30,300)
Adjustment to deferred tax asset	(1,200)	7,900	(1,100)	1,080	(2,300)	8,980
Net pension liability at end of year	(20,500)	(23,300)	(10,600)	(12,100)	(31,100)	(35,400)

The components for the defined benefit cost for the year ended 31st December 2003 under FRS 17 were:

	UK pensions		Overseas pensions and medical		Total	
	2003 £000	2002 £000	2003 £000	2002 £000	2003 £000	2002 £000
Current service cost	(5,000)	(5,100)	(900)	(850)	(5,900)	(5,950)
Past service cost	-	-	-	-	-	-
Total charge to operating profit	(5,000)	(5,100)	(900)	(850)	(5,900)	(5,950)
Interest on pension scheme liabilities	(6,900)	(6,700)	(1,500)	(1,550)	(8,400)	(8,250)
Expected return on assets in the pension scheme	6,900	7,700	800	1,100	7,700	8,800
Net (charge)/credit to other finance income	-	1,000	(700)	(450)	(700)	550
Total charge before tax	(5,000)	(4,100)	(1,600)	(1,300)	(6,600)	(5,400)

The amounts to be recognised in the Group statement of total recognised gains and losses (STRGL) were:

	UK pensions		Overseas pensions and medical		Total	
	2003 £000	2002 £000	2003 £000	2002 £000	2003 £000	2002 £000
Gain/(loss) on assets	10,800	(27,700)	1,800	(1,700)	12,600	(29,400)
Experience gain/(loss) on liabilities	1,500	500	1,400	(1,500)	2,900	(1,000)
Gain/(loss) on change of assumptions (financial and demographic)	(8,600)	500	(300)	(400)	(8,900)	100
Total gain/(loss) recognised in STRGL before adjustment for tax	3,700	(26,700)	2,900	(3,600)	6,600	(30,300)

The history of experience gains and losses was:

	UK pensions		Overseas pensions and medical		Total	
	2003 £000	2002 £000	2003 £000	2002 £000	2003 £000	2002 £000
Gain/(loss) on assets	10,800	(27,700)	1,800	(1,700)	12,600	(29,400)
% of schemes' assets at end of year	9.8%	(30.4%)	12.3%	(14.3%)	10.1%	(28.5%)
Experience gain/(loss) on liabilities	1,500	500	1,400	(1,500)	2,900	(1,000)
% of schemes' liabilities at end of year	1.1%	0.4%	4.9%	(5.5%)	1.7%	(0.7%)
Total gain/(loss) recognised in STRGL	3,700	(26,700)	2,900	(3,600)	6,600	(30,300)
% of schemes' liabilities at end of year	2.6%	(21.5%)	10.5%	(13.2%)	3.9%	(20.0%)

notes to the accounts (continued)

28 PENSIONS AND OTHER POST-RETIREMENT BENEFITS (continued)

If the above amounts had been recognised in the accounts, the Group's net assets and profit and loss account reserve at 31st December 2003 would be as follows:

	£000
Net assets (page 37)	163,816
Unprovided pension liability*	(29,900)
Adjusted net assets including pension liability	133,916
Profit and loss account reserve (page 37)	99,782
Unprovided pension liability*	(29,900)
Adjusted profit and loss account reserve	69,882

* The net pension liability of £31,100,000 calculated in accordance with FRS 17 compares with the net pension provision currently recorded of £1,200,000.

29 ANALYSIS OF CASH FLOWS FOR HEADINGS NETTED IN THE CASH FLOW STATEMENT

	THE GROUP	
	2003 £000	2002 £000
Returns on investments and servicing of finance		
Interest received	1,110	748
Interest paid	(2,185)	(2,553)
Interest element of finance lease rental payments	(106)	(109)
Dividends paid by subsidiary undertakings to minority interests	(312)	(527)
Net cash outflow for returns on investments and servicing of finance	(1,493)	(2,441)
Capital expenditure		
Purchase of tangible fixed assets	(12,571)	(11,684)
Sales of tangible fixed assets	659	345
Net cash outflow for capital expenditure	(11,912)	(11,339)
Acquisitions and disposals		
Purchase of subsidiary undertakings	(1,909)	(1,687)
Net cash and overdrafts acquired with subsidiary	-	170
Sale of subsidiary undertakings	-	131
Net cash outflow for acquisitions	(1,909)	(1,386)
Management of liquid resources*		
Net cash placed on deposit	(6,012)	(15,918)
Net cash outflow from management of liquid resources	(6,012)	(15,918)
Financing		
Issue of ordinary share capital	1,731	1,144
Debt due within a year: net increase in short term borrowings	7,119	(5,581)
Debt due beyond a year: net decrease in long term borrowings	(15,481)	1,342
Capital element of finance lease rental payments	(397)	(253)
Decrease in debt	(8,759)	(4,492)
Net cash outflow from financing	(7,028)	(3,348)

* Spirax-Sarco Engineering plc includes as liquid resources term deposits of less than a year.

30 ANALYSIS OF CHANGES IN NET DEBT

	At 1st Jan 2003	Cash flow	Exchange movement	At 31st Dec 2003
	£000	£000	£000	£000
Cash in hand and at bank	4,882	(83)	178	4,977
Overdrafts	(6,794)	(5,631)	(177)	(12,602)
		(5,714)		
Debt due within a year	(12,542)	(7,119)	(53)	(19,714)
Debt due beyond a year	(38,491)	15,481	(976)	(23,986)
Finance leases	(1,517)	397	(109)	(1,229)
		8,759		
Current asset investments	31,796	6,012	389	38,197
Total	(22,666)	9,057	(748)	(14,357)

31 PURCHASE OF SUBSIDIARY UNDERTAKINGS

		Watson Marlow Bredel South Africa			
		Book value	Accounting policy adjustments	Fair value	Other
		£000	£000	£000	£000
Current assets	Stock	311	(50)	261	
Current liabilities	Trade creditors	(352)	-	(352)	
Total net liabilities		(41)	(50)	(91)	
Goodwill				1,330	(237)
Purchase consideration				1,239	
Satisfied by	Cash paid			1,024	
	Acquisition expenses			215	
				1,239	
Analysis of net flow of cash and cash equivalents in respect of purchase of subsidiaries					
Cash consideration				1,157	752
Net cash outflow				1,157	752
					1,909

The acquisition of the Watson-Marlow Bredel peristaltic pump distributorships in South Africa from Walter Becker South Africa (Pty.) Ltd was completed on 1st April 2003. The acquisition was accounted for by the acquisition method of accounting. Consideration of £1,024,000 was paid on completion. The book value of stock has been adjusted to reflect Spirax Sarco's accounting policies in order to arrive at its fair value.

The total profits after tax of the business acquired in the period in 2003 prior to acquisition was £83,000. The total profit for 2002 of the business acquired was £176,000.

In addition there was an adjustment to goodwill of £237,000 in respect of acquisitions in previous years as a result of reassessment of past fair values.

notes to the accounts (continued)

32 DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

The Group does not enter into significant derivative transactions. The Group's principal financial instruments comprise bank loans, guaranteed senior notes, cash and short-term deposits. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial instruments such as trade debtors and trade creditors, which arise directly from its operations. It is, and has been throughout the period under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are interest rate risk, liquidity risk and foreign currency risk. The board reviews and agrees policies for managing each of these risks and they are summarised below. These policies have remained fundamentally unchanged since the beginning of 2000.

Interest rate risk

The Group borrows in desired currencies at both fixed and floating rates of interest as appropriate to the purposes of the borrowing depending on which gives best value. At the year-end 14% of the Group's debts were at fixed rates.

Liquidity risk

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of overdrafts, loans and finance leases as appropriate.

Foreign currency risk

The Group has operations around the world and therefore its balance sheet can be affected significantly by movements in the rate of exchange between sterling and various other currencies particularly the US dollar and euro. The Group seeks to mitigate the effect of this structural currency exposure by borrowing in these currencies where appropriate while maintaining a low cost of debt. At 31st December 2003 the percentage of debt to net assets, excluding debt, was 57% (2002: 63%) for the euro and 45% (2002: 48%) for the US dollar.

The Group also has transactional currency exposures principally as a result of trading between Group companies. Such exposures arise from sales or purchases by an operating unit in currencies other than the unit's functional currency. Net cash flows between any two currencies of less than £1m per annum would not usually be considered sufficiently material to warrant forward cover. Forward cover is not taken out more than twelve months in advance or for more than 80% of the forecast exposure.

The disclosures below exclude short-term debtors and creditors.

Interest rate risk profile of financial liabilities

The interest rate profile of the financial liabilities of the Group as at 31st December was as follows:

	Total	Fixed rate financial liabilities	Floating rate financial liabilities	Financial liabilities on which no interest is paid
	£000	£000	£000	£000
2003				
Euro	36,639	1,095	35,003	541
US dollar	10,017	6,690	3,327	-
Other	11,416	56	11,360	-
	58,072	7,841	49,690	541
2002				
Euro	39,481	1,524	36,608	1,349
US dollar	11,870	9,908	1,962	-
Other	9,342	98	9,244	-
	60,693	11,530	47,814	1,349

In respect of fixed rate financial liabilities the interest rate for euro financial liabilities is 4.4% fixed for 2.5 years (2002: 3.3 years). The interest rate for US dollar financial liabilities is 6.7% fixed for 2.1 years (2002: 3.1 years).

The benchmark rates for the floating rate financial liabilities are as follows:

Canadian dollar	}	LIBOR
Japanese yen		
US dollar		
Euro		LIBOR/EURIBOR

32 DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS (continued)

Interest rate risk profile of financial assets

The interest rate profile of the financial assets of the Group as at 31st December was as follows:

	Total £000	Floating rate financial assets £000	Financial assets on which no interest is earned £000
2003			
Sterling	21,301	20,166	1,135
Other	21,873	18,031	3,842
	43,174	38,197	4,977
2002			
Sterling	16,606	16,500	106
Other	20,072	15,296	4,776
	36,678	31,796	4,882

Floating rate financial assets comprise cash placed on money market deposit mainly at call and three month rates.

Currency exposures

As explained above, 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 debt while partially hedging against currency depreciation. All gains and losses arising from these structural currency exposures are dealt with in the statement of total recognised gains and losses.

Transactional (or non-structural) exposures give rise to net currency gains and losses that are recognised in the profit and loss account. Such exposures include the monetary assets and monetary liabilities in the Group balance sheet that are not denominated in the operating (or 'functional') currency of the operating unit involved. At 31st December the currency exposures in respect of the euro was a net monetary liability of £81,000 (2002: £273,000 net monetary asset) and in respect of the US dollar a net monetary asset of £744,000 (2002: £1,032,000).

Foreign exchange contracts

There were no significant forward exchange contracts outstanding at 31st December 2003.

Maturity of financial liabilities

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

	2003 £000	2002 £000
In one year or less, or on demand	32,696	19,685
In more than one year but no more than two	4,204	20,757
In more than two years but no more than five	20,890	19,925
In more than five years	282	326
	58,072	60,693

Borrowing Facilities

The Group has various borrowing facilities available to it. The undrawn committed facilities available at 31st December in respect of which all conditions precedent had been met at that date were as follows:

	2003 £000	2002 £000
Expiring in one year or less	16,343	17,872

Fair values of financial assets and financial liabilities

A US dollar loan with a book value of £6,690,000 (2002: £9,908,000) had a fair value at 31st December of £7,014,000 (2002: £10,525,000). Apart from this loan, fair values of financial assets and liabilities at that date were not considered to be materially different from book values due to their size or the fact that they were at short term rates of interest.