

# 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.

The Committee members are Messrs. E. Lindh, M. Townsend (Chairman) and W. H. Whiteley, each of whom is an independent non-executive director.

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 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 - Principles of Good Governance and Code of Best Practice 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.

The structure of the directors' remuneration package has been established subject to appropriate modifications for many years and has regard to pay and conditions elsewhere in the Group.

The remuneration package comprises:-

### **Basic Salary**

The Committee obtains independent professional advice from Towers Perrin 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;
- (iii) cash generation (expressed as a percentage of profit for the financial year) will carry a maximum of 20% bonus. Where cash inflow, as determined from the Accounts, is less than 100% of profit, no bonus will be earned under this element; where cash generated equals or exceeds 160% of profit, the full 20% will accrue with proportionate bonus being earned between 100% and 160% of profit; and

(iv) an amount derived from the change in gross margin percentage compared with that for the previous year. Where the gross margin has deteriorated by 0.5 percentage points or more, no bonus will be earned under this element; 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 gross margin percentage is above a required minimum.

Element (iii) of the bonus has been amended during the year.

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) are pensionable. Elements (iii) and (iv) are not pensionable.

In 2004, the Committee intends to review, with assistance from its professional advisers, the pension arrangements for executive directors taking into account the proposal to introduce a lifetime limit for tax favoured pension savings and the inclusion of elements (i) and (ii) of the annual bonus (described above) for pension purposes.

The Company's policy on directors' remuneration and the structure of their remuneration package are kept under review to ensure the directors' overall package remains properly competitive and shareholders will be informed of any resulting change.

## **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, senior executives and 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 executive directors, senior executives and 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 since 1995 are subject to performance criteria which are described below.

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, only if specified performance criteria are satisfied. In line with the then established market practice, the performance criteria for options granted from 1995 up to 2001 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 they ensured increases in the earnings per share were achieved having taken account of UK inflation. In assessing whether the chosen performance criteria are met the Committee arranges for the auditors 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 is not subject to any performance criteria being met. This is in line with market practice at the time of grant of those options.

Details of total share options issued are set out on page 50. The above performance criteria apply to other relevant options granted to all participants in the share option schemes.

In 2004, the Committee intends to review, with assistance from its professional advisers, the long term incentive arrangements for executive directors, senior executives and management, including the ongoing operation of the Company's share option schemes and the performance conditions to be attached to options granted under those schemes.

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

The executive directors participate in the Employee Share Ownership Plan, as described on pages 31 and 32. 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.

As noted above, the Committee intends to review the Company's pension arrangements for executive 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

It is the Company's policy for new executive directors to have notice periods of 12 months or less. The notice periods for the executive directors are set out below. Four executive directors who previously had notice periods of 24 months agreed to reduce them to 12 months during 2003, with no compensation being paid. The position for Mr. C. J. Ball is explained below. The service contracts provide for a normal retirement age of 62½ for each executive director.

The executive directors have service contracts as follows:-

	<b>Date of Contract</b>	<b>Notice Period</b>
M.J.D. Steel	30.12.92	12 months
A.D.H. Black	18.11.98	12 months
N.H. Daws	28.05.03	12 months
G.P. Marchand	30.12.92	12 months
D.J. Meredith	30.12.92	12 months
P.A. Smith	24.12.92	12 months

Mr. C. J. Ball reaches his normal retirement age of 62½ on 29th September 2005. His contract refers to a 24 months notice period but the contract provides for automatic termination at normal retirement age. In view of this reducing notice period the Remuneration Committee has accepted that it is appropriate to retain the existing agreement in Mr. C. J. Ball's case.

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.

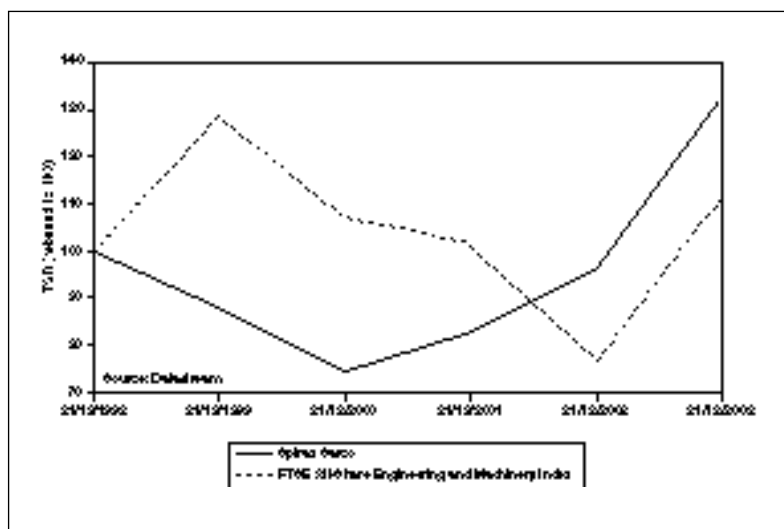
## POLICY ON SENIOR EXECUTIVE REMUNERATION

The Committee determines the philosophy, principles and policy of remuneration which shall apply to the Group's senior executives. The responsibility of determining the precise package to meet local practice and performance lies with the Chief Executive and the responsible executive director.

## TOTAL SHAREHOLDER RETURN

The performance graph illustrated shows the Company's total cumulative shareholder return for the five year period ended 31st December 2003 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.

The auditors are required to report on the information contained in the remaining sections of the Report.



## DETAILS OF INDIVIDUAL EMOLUMENTS

	Basic Salary/ Fees	Benefits (1)	Annual performance related bonus	Total emoluments excluding pension	
				2003 Total	2002 Total
	£	£	£	£	£
T. B. Fortune (2)	73,500	349	-	73,849	70,349
M. J. D. Steel	290,000	14,918	81,548	386,466	420,772
C. J. Ball	167,000	15,869	46,961*	229,830	255,883
A. D. H. Black	160,000	15,957	44,992	220,949	240,221
N. H. Daws (4)	77,000	7,079	21,652	105,731	-
G. P. Marchand	171,000	11,082	48,085	230,167	253,870
D. J. Meredith	185,000	10,938	52,022	247,960	273,878
P. A. Smith	132,000	7,733	37,118	176,851	195,484
P. M. Smith (3)	66,667	6,915	18,747	92,329	241,059
E. Lindh (2)	22,000	-	-	22,000	20,000
C. G. Sneath (5)	-	-	-	-	11,667
M. Townsend (2)	29,750	-	-	29,750	26,500
W. H. Whiteley (2)	22,000	-	-	22,000	8,641
	1,395,917	90,840	351,125	1,837,882	2,018,324

\* Mr. C.J. Ball's annual bonus of £46,961 includes an amount of £29,292 which Mr. C.J. Ball has waived. The Company is contributing £29,292 to a defined contribution executive pension plan for Mr. C.J. Ball set up on independent financial advice.

- (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. P. M. Smith retired from the Board on 31st May 2003.  
(4) Mr. N. H. Daws was appointed to the Board on 1st June 2003 and his emoluments in the above table are calculated from this date. Total emoluments for the full year 2003 were £148,258.  
(5) Mr. C. G. Sneath retired from the Board on 26th July 2002.

# the directors' remuneration report (continued)

## 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:-

		31.12.02 or date of appointment*	Granted during year to 31.12.03 (2) No.	Exercised in year (3) No.	31.12.03 or date of retirement** No.	Average exercise price per share (4) pence	Date from which exercisable	Expiry date
M.J.D. Steel	A	170,000	35,000	-	205,000	415.2	10.10.97	08.04.08
	B	45,000	-	-	45,000	673.0	18.09.98	08.04.08
		215,000	35,000	-	250,000			
C.J. Ball	A	97,500	-	-	97,500	420.0	10.10.97	29.09.05
	B	45,000	-	-	45,000	673.0	18.09.98	18.09.05
		142,500	-	-	142,500			
A.D.H. Black	A	80,358	20,000	-	100,358	413.9	16.09.01	14.03.13
	C	12,165	-	5,023	7,142	420.0	16.09.01	16.09.08
	D	10,000	-	-	10,000	704.0	24.09.99	16.09.07
		102,523	20,000	5,023	117,500			
N.H. Daws* (Note 2a)	C	46,500	-	-	46,500	411.0	10.10.97	14.03.13
	D	22,500	-	-	22,500	693.7	18.09.98	16.09.07
		69,000	-	-	69,000			
G.P. Marchand	A	112,637	20,000	30,137	102,500	414.0	16.09.01	24.12.07
	B	45,000	-	-	45,000	673.0	18.09.98	16.09.07
		157,637	20,000	30,137	147,500			
D.J. Meredith	A	97,500	20,000	-	117,500	415.7	10.10.97	14.03.13
	B	55,000	-	-	55,000	661.7	18.09.98	16.09.07
		152,500	20,000	-	172,500			
P.A. Smith	A	77,500	20,000	-	97,500	413.7	16.09.01	18.08.10
	B	35,000	-	-	35,000	664.1	18.09.98	16.09.07
	C	25,115	-	12,615	12,500	427.0	10.10.97	10.10.04
		137,615	20,000	12,615	145,000			
P.M. Smith**	A	95,000	-	-	95,000	419.5	10.10.97	31.05.04
	B	27,500	-	-	27,500	678.6	18.09.98	31.05.04
	C	7,568	-	7,568	0	-	-	-
		130,068	-	7,568	122,500			

## 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 2003. 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 130,000 ordinary shares at 394.5p per share under the Spirax-Sarco Engineering Global Share Option Scheme, which is not approved by the Inland Revenue. Mr. M. J. D. Steel was granted an option over 35,000 shares, Mr. N. H. Daws was granted an option over 15,000 shares and each of the remaining executive directors, with the exception of Mr. C. J. Ball and Mr. P. M. Smith, were granted options over 20,000 shares.

(2a) An option over 15,000 shares granted to Mr. N. H. Daws in the year to 31.12.03 and options over 2,523 shares exercised by Mr. N. H. Daws in the year to 31.12.03 were granted and exercised respectively during the year but prior to Mr. N.H. Daws' appointment to the Board.

(3)	2003	Option	Market	2003	2002
	Options	exercise	price on	Gain arising	Gain arising
	exercised	price	the date	on exercise	on exercise
	No.	pence	options	£	£
			exercised		
			pence		
A.D.H. Black	-	-	-	-	9,337.57
	631	301.81416 }			
	1,892	355.07554 }	550.0	8,329.02	-
	2,500	427.00000 }			
N. H. Daws	631	301.81416 }	470.0	3,235.62	-
	1,892	355.07554 }			
G. P. Marchand	3,784	301.81416 }			
	11,353	355.07554 }	544.0	48,162.90	-
	15,000	427.00000 }			
D. J. Meredith	-	-	-	-	45,419.74
P.A. Smith	-	-	-	-	47,060.25
	2,587	301.81416 }	420.0	3,057.47	-
	10,028	355.07554 }	550.0	19,547.03	-
P.M. Smith	2,144	301.81416 }	472.0	9,990.76	-
	5,424	355.07554 }			
<b>Aggregate of gains arising on exercise</b>				<b>92,322.80</b>	<b>101,817.56</b>

(4) These are the weighted averages of the exercise prices for ordinary shares under option at 31st December 2003.

The market price of the ordinary shares on 31st December 2003 was 540p. During the period from 1st January 2003 to 31st December 2003 the ordinary share price ranged between 365p and 586.5p.

Within the number of options set out in the table above, there are no outstanding discounted options held by executive directors as at 31st December 2003.

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 2003.

(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. The Company provides a matching share for each share purchased under the Plan by the director.

# the directors' remuneration report (continued)

	Interest as at 31.12.02 (or date of appointment*)	Vested	Interest as at 31.12.03 (or date of retirement**)	Period of qualifying conditions
M.J.D. Steel	949	883	1,832	3 years
C.J. Ball	949	883	1,832	3 years
A.D.H. Black	949	855	1,804	3 years
N.H. Daws*	976	856	1,832	3 years
G.P. Marchand	949	883	1,832	3 years
D.J. Meredith	949	883	1,832	3 years
P.A. Smith	949	883	1,832	3 years
P.M. Smith**	949	27	976	-

## DIRECTORS' PENSIONS

The directors are members of defined benefit pension arrangements. The information below is consistent with the presentation used last year and sets out the disclosures under the Stock Exchange Listing Rules and the 2002 Directors' Remuneration Report Regulations.

	Age attained at 31.12.03	Accrued pension at 31.12.02	Accrued pension at 31.12.03	Change in accrued pension during the year	Change in accrued pension during the year*	Transfer value of accrued pension	Transfer value of accrued pension at 31.12.02	Transfer value of accrued pension at 31.12.03	Change in total transfer value
		£pa	£pa	£pa	£pa	£	£	£	£
M.J.D. Steel	58	151,310	170,864	19,554	15,317	210,730	1,699,000	2,268,000	569,000
C.J. Ball	60	107,861	118,420	10,559	7,539	118,748	1,466,000	1,866,000	400,000
A.D.H. Black	46	59,291	67,281	7,990	6,330	43,225	340,000	455,000	115,000
N.H. Daws	41	34,656 <sup>(1)</sup>	41,238	6,582	6,100	33,321	166,000 <sup>(1)</sup>	225,000	59,000
G.P. Marchand	58	89,881	101,231	11,350	8,833	125,481	1,131,000	1,479,000	348,000
D.J. Meredith	44	54,763	62,232	7,469	5,936	36,867	299,000	397,000	98,000
P.A. Smith	55	65,334	72,726	7,392	5,563	66,365	633,000	841,000	208,000
P.M. Smith	60	60,614	63,995 <sup>(2)</sup>	3,381	2,538	47,700	901,000	1,197,000 <sup>(2)</sup>	296,000

\* net of deferred pension revaluation at a rate of 2.8%

(1) At 1st June 2003 when Mr. N. H. Daws became a director.

(2) At 31st May 2003 when Mr. P. M. Smith retired from active service.

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**

Pensions are subject to 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.

**(iv) Transfer values**

In 2003, in order to comply with professional actuarial guidance governing the calculation of transfer values, an adjustment was made to the way in which transfer values were calculated. This results in an additional 7% being included in the 31st December 2003 transfer values shown above. This adjustment did not apply to transfer values as at the 31st December 2002, but does apply to Mr. N. H. Daws' calculation at 1st June 2003.

**(v) Other discretionary benefits**

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

**(vi) Defined contribution executive pension plan**

The defined contribution executive pension plan for Mr. C. J. Ball is explained on page 29.

Signed by

**T. B. Fortune** *Chairman*

on behalf of the Board