

chief executive's review



M.J.D. Steel, *Chief Executive*

The two businesses have achieved their market leading positions by developing a network of over 40 sales companies serving all the world's major industrial economies. This network supports over 1,000 sales and service engineers, whose task is to advise and help an increasing number of industrial users to improve the efficiency of their systems or the quality of their end product. Both businesses serve a broad range of industries including food, beverages, pharmaceuticals, electronics, biotechnology, oil, chemicals, pulp and paper, rubber, plastics, water treatment and many others. This very broad spread of users means that no industrial sector accounts for more than 10% of our sales and no single customer accounts for more than 1% of our sales; this diversity provides stability to our business.

Watson-Marlow Bredel has, through selective acquisition, product development and geographical expansion, grown rapidly to lead the world market for peristaltic pumps. This is the fastest growing segment of the world pumping market. The peristaltic principle

I am pleased that in 2004 we increased the sales and profits of our industrial steam and pumping businesses; both businesses are world leaders in their respective niche markets. 88% of our sales were outside the UK and we grew organic global sales by 8% which translates to an increase of 4% in sterling. Operating profits increased by 12% despite adverse exchange rate movements of £3.75 million, although the profit increase included the non-repeat of the factory closure costs (£1.5 million) in 2003. The pre-tax profit rose by 14%, a good overall result.

enables sensitive, abrasive, corrosive or valuable media to be pumped safely, quietly and without contamination. These attributes are required in an increasing number of industrial and commercial applications and the steady expansion of its product range, in terms of flow rates and pressure bands, allows Watson-Marlow Bredel to address a widening market.

The Spirax Sarco business has, through focused attention on its chosen market, built its strong position in the steam-using industries in both the long established and the newly developing and thus more dynamic economies of the world. There are also significant parts of the product range which are relatively recent additions and which offer further growth potential.

Steam is a highly effective medium for the transfer of large amounts of heat energy in a wide variety of industrial processes. The essence of the Spirax Sarco business is to know and understand the customers' steam "loop", from the application of raw heat to water

in the boiler, through distributing the steam to the point where it gives up its heat to the process, to recycling of the hot condensate to the boiler. The steam system can therefore be made to operate at maximum efficiency, thereby giving the customer increased throughput through their process, or lower costs, or better product quality, or a combination of all three. The use of steam is evolving, for example with increasing hygiene regulations, global warming controls and deregulation of the power generation industry; all enhance steam's attraction compared with other heat transfer media.

The sales and marketing philosophies of our peristaltic pumping and steam businesses are shared and are founded on our detailed and specialist technical knowledge, both of the product itself and of its application in detail in the end user's plant. It follows that education and training of both our own engineers and our customers' staff is central to our success. We run extensive training programmes and have 35 training centres worldwide dedicated to this objective. The websites of Watson-Marlow Bredel (www.watson-marlow.com) and Spirax Sarco (www.spiraxsarco.com) provide ample evidence of our ability to provide significant benefits to our customers and hence long term growth for the Group.

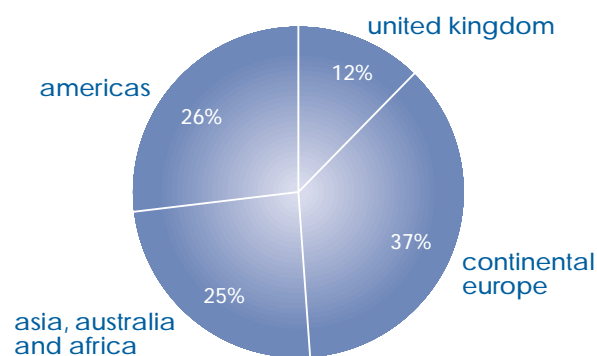
trading

The second half of 2004 continued the good growth experienced in the first half. The market background against which we have been operating has, for the most part, been positive. The North American economies were buoyant despite pre-election caution in the USA, and the South American markets followed suit. The Continental European markets were, by contrast, generally weak, being negatively affected by the major economies of France, Germany and Italy, although there were some bright spots elsewhere. The UK continued to be a dull market with the manufacturing base weakening and little sign of any change for the better, other than from continued government spending, particularly on the National Health Service. The Asian economies mostly continued their strong growth, with China still growing fast despite the government's measures to take the heat out of the economy.

Exchange rates have again moved against sterling based businesses such as Spirax with over 80% of turnover

and operating profits earned outside the UK. Our manufacturing base is well spread across the world but, despite this, the transaction impact and the translation impact together reduced operating profit by £3.75 million; the adverse translation effect on sales was £13 million (4%). This came from the roughly 10% devaluation in 2004 of the US dollar and related weakness in the South American and some Asian currencies. Also, sterling was slightly stronger against the euro.

Turnover increased to £326 million from £314 million in 2003, an increase of 4% (organic growth of 8% at constant exchange rates). This was a robust underlying performance in which we gained market share. The organic growth in sales was achieved in all geographic regions but the main gains were in Asia and the Americas, which is a continuation of the trends from 2003. We continued the gradual increase in the number of sales and service engineers. The programme of product developments also enhanced the offering to customers as well as challenging our competitors.



geographical analysis of turnover

The Group's operating profit increased by 12% in 2004 from £45.8 million in 2003 to £51.1 million, a record figure. The 2003 operating profit included a charge of £1.5 million for the closure of a small factory in Spain; on the other hand, the 2004 operating profit is reached after taking the £3.75 million adverse exchange movement effect which is mentioned above. So, the underlying operating profit increase was 16%. This came partly from the sales increases (in the Americas, Asia and, to a lesser extent, in Continental Europe and the UK) and partly from active cost control, including raw material resourcing which counteracted the steel price increases that came through in 2004. We also improved productivity in the Group as a whole.

chief executive's review *(continued)*

The operating profit margin increased from 14.6% in 2003 to 15.7% in 2004, a stronger increase than in the previous two years. In October 2004, we completed the acquisition of Eirdata Environmental Services for an initial consideration of €1.2 million. This is a small company based in the Republic of Ireland providing system and utility auditing and servicing for the pharmaceutical industry and which will boost our steam system service presence in both the Republic of Ireland and the UK.



Watson-Marlow 520U/R2 pump

united kingdom

Operating profit

2004	£8,732
2003	£8,021

Turnover

2004	£97,419
2003	£92,370

Turnover includes intra-group sales, see page 45.

Turnover in the UK domestic market grew by 2% in 2004 to £39.9 million. The UK industrial and commercial steam using and pumping markets remained weak, with some customers closing or consolidating plants. Our sales teams focused on areas of opportunity such as OEMs, turnkey projects, steam system management, prefabricated units and silicone tubing. Demand on the UK factories, which are suppliers to our sales companies worldwide as well as to the domestic market, was constrained as a result of our stock reduction activities in the steam business, but was well ahead in Watson-Marlow as a result of the good demand for the new pump range and expanding tubing sales.

Operating profits in the UK were £8.7 million, up 9% on 2003.



DIVA flowmeter

continental europe

Operating profit

2004	£18,866
2003	£16,439

Turnover

2004	£149,334
2003	£146,408

Turnover includes intra-group sales, see page 45.

Sales to third party customers in Continental Europe increased by 3% from £117.4 million in 2003 to £121.2 million in 2004; at constant exchange rates the increase was 5%, which was achieved in spite of the subdued state of the major continental markets. The major economies are not showing consistent signs of returning to growth and probably will not do so until the restrictive regulatory systems impacting on business are reduced. In these difficult conditions, our sales teams did well to increase demand through focused sales management, concentrating on the Group-wide sales initiatives and local actions such as targeting the OEM, oil and petrochemicals, and pulp and paper markets.

The sales growth in Continental Europe was relatively widely spread. In Germany, despite the difficult conditions, the Spirax Sarco business gained market share. Norway and Sweden grew strongly, particularly through heat exchanger sales. We also made gains in Denmark, Poland, Portugal and Switzerland.

Hygromatik, M&M and Bredel in Europe all did well although the Spirax Sarco Italian sales were flat and French sales were only slightly up, a creditable position in lacklustre markets. The main reductions were in the Czech Republic, where the sales were good but below an exceptional pre-EU accession year in 2003, and in Spain and Finland where the markets were difficult and sales were down.

The factories in France and the Netherlands saw good demand, particularly from Asia and the Americas, and increased their profits.

Operating profits in Continental Europe were £18.9 million in 2004 which represents an increase of 15% on 2003. The 2003 figure included the £1.5 million charge for closure costs of the small Spanish factory; the profit increase excluding this charge would have been 5%, and, at constant exchange rates, would have been 8%. The operating profit margin improved to 12.6% from 11.2% in 2003.



Engineered Systems, UK

chief executive's review *(continued)*

asia, australasia and africa

Operating profit

2004	£12,201
2003	£10,955

Turnover

2004	£73,161
2003	£67,145

Turnover includes intra-group sales, see page 45.

The economies in Asia and Australasia continued their recent growth record and trading conditions through 2004 were positive despite the high oil price and the Chinese government's measures to slow the economy down. Our sales companies achieved good sales and profits growth based on both the market activity and our own sales development actions. Third party sales were £80.2 million, up from £73.3 million in 2003, an increase of 9%. The weakness of the Asian currencies has undermined the sterling results from this part of the world and the sales at constant exchange were ahead by 15%. The growth in sales was broadly spread across the region, with China and India producing the biggest increases, and Japan also growing well, which was the result of strategic actions taken by the management team. Korean sales were ahead as a

result of successes with sales initiatives and some good project wins. Elsewhere, there were good sales increases in Australia, New Zealand, Taiwan and UK exports, particularly to the Middle East.

Operating profit for the region was £12.2 million, which compares with £11.0 million last year, an increase of 11%. The effect of the adverse exchange rate movements (both transaction and translation) significantly reduced the sterling value of the profit, which at constant exchange would have given an increase of 23% over 2003, a strong result. The operating profit margin in 2004 was 16.7%, more or less unchanged from 2003, the benefit of the extra volumes having been largely offset by the adverse effect of exchange rate movements on the gross margin.

americas

Operating profit

2004	£11,301
2003	£10,335

Turnover

2004	£88,578
2003	£87,962

Turnover includes intra-group sales, see page 45.

Turnover in the Americas increased in 2004 over 2003 by 10% at constant currency, a good increase, which was, however, almost totally eliminated by the weakness of the US dollar and the other Americas currencies, so the sterling result does not reflect the hard work and success of our companies in the year. All the markets in the Americas were busy, although there are some concerns, particularly in Latin America, that the current levels of activity might not be sustained.

Our businesses in the USA both performed well. The Spirax Sarco company built up sales in steam system services, prefabricated units and exports to Latin America, and like for like profits were well ahead. The Watson-Marlow Bredel business produced solid

underlying growth, and some good OEM and project orders partially compensated for the large project orders received in 2003; the profit was adversely affected by the weak dollar.

Canada produced a very good result and our Mexican joint venture improved sales and profits following the management changes.

The operating profit for the Americas was £11.3 million, up 9% from £10.3 million in 2003 despite a significant exchange hit. The operating profit margin improved to 12.8% in 2004 from 11.7%, the increased sales and overhead controls more than compensating for the exchange hit on the gross margin.

balance sheet and cash flow

We finished 2004 with capital employed (net assets excluding net cash/debt and goodwill) of £167 million, which was virtually unchanged from a year earlier despite the 8% underlying increase in business levels. Total working capital continued to be closely controlled, in particular stock values were marginally lower representing a good improvement compared with the increased sales which were reflected in higher debtors. There was only a small increase in net fixed assets. The overall return on capital employed improved again from 28% to 31% during the year, reflecting the increased operating profit and broadly unchanged capital employed, a pleasing outcome for the year.

Cash flow for the year was also good. The cash inflow from operating activities rose to £63.2 million (2003: £53.4 million). Net capital expenditure increased to £14.1 million (2003: £11.9 million) and taxation payments were higher, reflecting the profit increase. There was a small outflow of £0.8 million in respect of acquisitions. During the year, the opening net debt of £14.4 million was eliminated due to the good trading cash flows and we finished 2004 with a small net cash balance of £2.9 million.

International Financial Reporting Standards will apply for 2005, with comparative figures for 2004 restated onto the new basis. We have been working to prepare for these changes and we are well on target to meet the required timetable. The adoption of IFRS will have some impact on the presentation of the primary financial statements but does not change the economics, risk profile or cash flows of the business. The main areas affected will be share-based payments, pensions, goodwill, R&D and consolidation of subsidiaries (which affects the presentation of our minority investments in Mexico and India).

looking ahead

The markets which are served by the Spirax Sarco steam business are very diverse both geographically and industrially and, although we are the leading specialists in the world in this focused market, we still have a relatively small market share. In addition, some of the current trends such as greater regulation of environmental issues, health, safety and hygiene, increasing outsourcing and slimming down by customers are all tending to increase demand for the knowledge, service and support that we provide. There are also markets, both geographical and industrial, where we are not as strong as we could be. All of which means that the long term growth of the past has the potential to continue into the future.

The Watson-Marlow Bredel peristaltic pumping business has a high share of the focused industrial and laboratory markets but the technology of the pumps,

tubes and hoses is advancing and our talented and expert team of sales engineers are successfully converting users of other pump types to the peristaltic principle. So the market is expanding, hence the continuing growth prospects.

We will also continue to improve the way we organise ourselves from a sales structure and management point of view, as well as production and product development. The advances in communications and IT also open up opportunities for us to improve our product development processes and production efficiency, and build on the effectiveness of the global sales organisation which is unique to our Group and which is in touch with the large number of end user customers.

These opportunities, either in the form of sales and marketing openings or improving internal efficiencies, will allow us to achieve long term growth organically and by suitable acquisitions as and when appropriate opportunities arise. In the short term we are aware that there are doubts regarding the strength of some of the world economies as evidenced by the recent downturn in the OECD leading indicators.

chairman's retirement

Finally, in the Chairman's statement, Tim Fortune confirms that he will be retiring from the Board on 12th May after 27 years with the Group. Tim started as Production Director in the Cheltenham operating company. In 1983 he joined the main Board as Group Manufacturing Director, he became Chief Executive in 1992 and then Chairman in 1998. Throughout this time with Spirax, Tim's hallmark has been his energetic and enthusiastic questioning of everything, allied to a constant quest for improvement. He has nurtured the Group's vision and clarity of purpose. Under his stewardship the Group has made great strides and we thank him for the good shape in which he leaves Spirax.



M.J.D. Steel, *Chief Executive*

investing in people

At Spirax Sarco we pride ourselves on having a highly trained workforce. Our employees are our most important asset and we seek to ensure that we support that statement with our actions.

In the UK we operate an apprenticeship scheme which is an excellent way to recruit and train young people. The company retains two thirds of its apprentices, which is double the national average retention rate.

Spirax Sarco has obtained the UK Investors in People award. This is a national standard awarded to organisations that place the development of people at the heart of their business strategy. It is based on the view that organisations that train and develop their staff are best equipped for success.

Many of our companies offer funded further education for employees to develop their knowledge and skill base. In the USA many employees are taking the opportunity of preparing themselves for future opportunities by pursuing a higher level of education through an Educational Assistance Program. The plan covers technical school training, four-year degrees at university and advanced degrees, such as MBAs.

- in-house training
- apprenticeships
- funded further education
- postgraduate professional development

Local and international training programmes have also been set up to train both technical and sales people. These internal courses provide not only the tools for the employees to do their jobs more effectively but provide a great forum for exchanging experiences and knowledge.

We also invest in the education of our customers by providing training for them at their own premises, at one of our 35 training centres worldwide, or on our website.

Our sales company in Korea has also recently opened a new training centre to provide a wider range of courses to meet with customer requirements.



Training Centre, Allentown, USA.

an employee's view

I joined Spirax Sarco eight years ago on an Engineering Advanced Modern Apprenticeship Scheme. Through a sponsored training programme I am now a qualified engineer, working in the business development department based at the Steam Trap Product Unit in the UK.

I chose the modern apprenticeship route because the combination of training offered me good long-term benefits, in a practical training environment, which could lead straight to a permanent job.

Throughout my apprenticeship I was given a lot of support. This gave me confidence in learning about the many aspects of the business and how these interrelated, something which has since proved invaluable.

'Spirax Sarco has given me the opportunities to develop my key competencies and focus on what I am good at.'

After successfully completing my apprenticeship, the Company supported me through University. I studied Engineering Product Design and Management, and gained a BSc (Hons) degree.

Following my degree I was offered the job as assistant marketing engineer, at the Steam Trap Product Unit. I am now responsible for creating product specifications, new product releases and technical support, reviewing statistics, supporting product quality and providing training.

Spirax Sarco has given me the opportunities to develop my key competencies and focus on what I am good at. What's more I am still learning and hope to continue developing my career with the Company.



Michelle Leggett
assistant marketing engineer,
Steam Trap Product Unit, UK.

investing in manufacturing

With major manufacturing facilities in the UK, France, USA, Italy and Argentina, Spirax Sarco is committed to a programme of continuous improvement in its manufacturing processes. It is essential that products are made to the highest quality standards in an efficient and productive environment ensuring that cost targets are met.

Manufacturing costs have been reduced at the controls and metering product unit, with the recent installation of robot spraying for the pressure reducing valves and safety valves. The robot automatically senses the product identification on the conveyor line, selects the robotic program and the appropriate paint colour is applied. The new paint booths have reduced solvent emissions and improved working conditions. The booths are certified to operate within strict emission regulations, which means over 99% of all over-spray is contained and not emitted to atmosphere. The water-based paint is designed to give excellent levels of adhesion and colour retention, whilst offering good temperature resistance.

In order to meet increased demand for our safety valve business, investment has been made in a new valve test facility. This is used to set large safety valves on air and steam as well as providing a dedicated test facility for the development of new products.

Reduced costs and increased productivity have been achieved in the USA through investment in new machinery.

Global sourcing of raw materials, including China and India, has allowed us to take advantage of the lower costs in those countries.

- reduced manufacturing costs
- increased productivity
- labour saving
- reduced emissions

The ball valve product unit, based in Argentina, recently underwent an expansion project to increase the factory space by 1,220 m². This extra space allowed the factory layout to be modified, reducing the movement of parts and improving efficiency.

New CNC machine tools have been installed and automatic testing machines are to be incorporated in the assembly process.

Part of the new area is now allocated to the production of EasiHeat heat exchanger units and engineered systems, which will allow us to meet increased demand.



The ball valve product unit, Argentina.

engineered systems

In response to sales growth in the packaged system business, Spirax Sarco has invested in a substantial new manufacturing and engineering facility. The well-equipped UK-based factory offers a flexible approach to the design and fabrication of a wide range of engineered systems.

These include heat exchange packages, condensate return systems, reducing valve stations, humidifiers and manifold units, all of which incorporate many individual Spirax Sarco products. The units are designed to comply with international standards.

‘This investment has enabled quicker responses to quotation enquiries and shorter order lead-times.’



The new 2,000 m² factory has facilities to house a fully integrated team including design, material procurement and manufacturing.

The extra space and material handling equipment will allow larger and more complex packages to be built.

Engineered system,
manufactured in the UK.

This investment has enabled quicker responses to quotation enquiries and shorter order lead-times. This coupled with in-house control of quality and conformity to international standards from a flexible and competent team, means there is now great potential to gain further business.

A similar production facility has also been developed at our Italian manufacturing plant.

investing in product and service development

To maintain our position in the market it is important for us to invest in the development of new products and services. Through a combination of research, development and acquisition we have added to our existing product ranges, and introduced higher levels of service around the Group.

Watson-Marlow has designed an entirely new generation of peristaltic pumps. This innovative design has enabled production costs to be reduced and pump capabilities to be increased. Improvements in quality and reliability have resulted in reduced warranty costs. The new range has allowed product rationalisation to take place with the benefit of reduced lead times.

Spirax Sarco Brazil has developed a new automatic rotary strainer that incorporates a rotating helical scraper plate for continuous cleaning of the strainer surface. The design provides constantly high standards of filtration, reducing the risk of product contamination. The automatic operation allows increases in productivity to be made and the strainer complies with international health and safety requirements.

The Spirax Sarco Group information centre website has been developed as a source of steam engineering expertise. It contains technical information on our product range and distance learning material. Currently there are over 8,500 pages of information available.

Spirax Sarco has continued to introduce steam system services around the world. Each level of service provides the customer with an appropriate level of support, from straightforward steam system audits to more comprehensive contracts.

- increasing capabilities
- innovative design
- exacting performance
- sharing expertise

As part of an ongoing development both to grow our controls product range and to respond better to the needs of our customers, Spirax Sarco has developed the new SteriTrol hygienic valve.

This is a two-port, stainless steel control valve for a wide range of clean service applications in the pharmaceutical, biotechnology, food, beverage and brewing industries. It is suitable for a range of fluids including various grades of clean steam and purified water.

Our close relationships with customers in these industries gives us a unique knowledge of their special requirements. This allows us to develop products with highly marketable features, such as the ability to open, clean and inspect valves quickly and easily.



SteriTrol hygienic valve.

gas meter success

Spirax Sarco has been working closely with a major supplier of gas in SE Asia on the development of a meter for use on natural gas for small (2,000 kg/h) boilers.

Spirax Sarco entered into discussions regarding the company's requirements at an early stage. The product requirement from the gas company was such that they agreed to work with us and be actively involved with the development of the product.

As the development had to be fast tracked we based the new product on existing technology. We established a winning combination that used one of our existing meter bodies with our latest design of electronics.

'The release of Flowin has given us a very good cost effective meter for gas, as well as the basis for a meter to measure compressed air flow.'



Flowin meter

Field trials were conducted in conjunction with the gas company during the latter part of 2003 and early 2004, resulting in the release of the Flowin meter.

The Flowin meter provides the accuracy of flow measurement across a wide range of flowrates as originally specified by our customer.

The product is targeted at boiler manufacturers and companies using gas fired industrial boilers.

The release of Flowin has given us a very good cost effective meter for gas, as well as the basis for a meter to measure compressed air flow.

investing in marketing for sales growth

The Group's main focus continues to be the application of our products and services to meet the diverse needs of the manufacturing and service industries that use steam for process and heating.

Our evaluation of the Group's overall worldwide market share within the steam market tells us that sales growth is achievable in both our mature and developing markets. Our customers have become more demanding in all areas of product quality, delivery, price and after-sales services. Our investments in manufacturing, products, services and people are all targeted at satisfying customer expectations, that will open up the opportunity for sales growth.

The Group has also invested in a number of worldwide market research projects all aimed at delivering the necessary input to our overall marketing strategy for continued growth.

- geographical expansion
- increased market share from existing products
- market penetration from new products
- focus on key industrial segments with growth potential

Recent market investigations covering the expanding use of clean steam within the food processing, pharmaceuticals, electronics and some service industries including hospitals, identified the need to improve the quality of the end product or to reduce the possibility of infection. Clean and pure steam systems are becoming more widely used in these industries and we have identified a wide range of new products for development over the next 12 to 24 months to meet the needs of these customers.

The launch of these products will not only demonstrate to customers the expertise of Spirax Sarco in the design and use of clean steam systems but will also open up the opportunity to achieve sales growth in a market segment where public demand for improved levels of health care will drive a wider use of clean manufacturing processes.



Clean steam environment

condensate management

The Group also investigated the condensate pumping market and identified specific needs of our customers across Europe, Asia and the Americas resulting in the continued development of two existing products to meet these customer requirements.

For our Americas markets, a completely new design of pump has been developed to reduce and simplify maintenance requirements and to meet with customer expectations for an extended service life. This new pump, named Pivotrol, has been launched with a 3-year operational warranty.

'The introduction of these new products will ensure Spirax Sarco retains its global leadership in the use of mechanical pumps for the pumping of hot condensate.'



Pivotrol condensate pump

The MFP14 condensate pump has been redesigned to meet with customer expectations in Europe and Asia for extended service life and increased capacity. Other design improvements have resulted in the product being re-released with a 3-year operational warranty.

The introduction of these new products will ensure Spirax Sarco retains its global leadership in the use of mechanical pumps for the pumping of hot condensate.

Other market investigations covering control valves, steam traps and the oil and petrochemical industries are being developed to provide the marketing strategies necessary for the Group to deliver continued sales growth.