

## Directors' report

The directors present their report and accounts for the year ended 31 December 2004.

### Principal activities

Spectris is engaged in the development and marketing of precision instrumentation and controls. For 2004 reporting purposes, the businesses were grouped into three sectors: electronic controls, in-line instrumentation and process technology. Further details of the trading companies can be found in the Chief Executive's review (page 14). Developments in the group's business activities are discussed in the Chairman's statement (page 12), Chief Executive's review (page 14) and financial review (page 18).

### Acquisitions

During the year, a number of small, bolt-on acquisitions were made for which the consideration was £10.4 million, including acquisition expenses.

### Disposals

There were no disposals during the year.

### Share capital

The issued share capital at the year end consisted of 124,301,513 5p ordinary shares.

At the 2005 Annual General Meeting resolutions will be proposed for the renewal of the authorities granted to the directors to allot shares, to allot shares on a non pre-emptive basis for cash and to purchase the company's own shares (either to be cancelled or to be held in treasury), all within specified limits.

At 14 March 2005 interests notified to the company in accordance with Part VI of the Companies Act 1985 comprised:

Legal & General Investment Management Limited  
8,728,413 shares (7.02% material interest)

Aegon Asset Management (UK)  
5,234,182 shares (4.21% material interest)

Liberty Wanger Asset Management LP  
4,910,500 shares (3.95% material interest)

Prudential plc  
3,989,203 shares (3.21% material interest)

Morley Fund Management Limited  
4,564,444 shares (3.67% material interest)

### Dividends

Results for the group are set out in the profit and loss account on page 39 and in the supporting notes. A final dividend of 10.25p per ordinary share is proposed for the year to 31 December 2004 (2003: 9.3p). With the interim dividend, this makes a total for the year of 14.5p (2003: 13.35p). The final dividend will be paid on 10 June 2005 to shareholders on the register on 20 May 2005.

The terms of the Spectris plc Employee Benefit Trust provide that dividends payable on shares held within the Trust are waived to 0.01p.

### Research and development

Expenditure committed to research and development is focused on new product development and to a lesser extent applications engineering and process integration. Costs are expensed as incurred (except to the extent funded by customers) and totalled £34.9 million in the year to 31 December 2004 (2003: £34.1 million).

### Fixed assets

Whilst the market values of some properties differ from book values, the directors believe that the differences are not material.

### Payment of suppliers

The group's policy on payment of suppliers is to ensure that terms of payment accord with contractual and legal obligations. The company had £0.2 million of trade creditors at the year end (2003: £nil).

### Directors

The directors at 31 December 2004 are named on pages 22 and 23. Anthony Reading was appointed to the Board on 10 March 2004 and Steve Hare was appointed to the Board on 1 December 2004. Graham Zacharias resigned from the Board on 13 September 2004 and Paul Boughton resigned from the Board on 4 October 2004.

Andrew Given, Leo Murray and Hans Nilsson retire from the Board by rotation in accordance with the Articles of Association and, being eligible, offer themselves for re-election. Steve Hare, having been appointed since the last AGM, retires from the Board under the terms of the Articles of Association and, being eligible, offers himself for election.

The directors' total remuneration for the year and their interests in the shares of the company and its subsidiaries at 31 December 2004 are disclosed in the directors' remuneration report on pages 28 to 34.

### Auditors

Separate resolutions to re-appoint KPMG Audit Plc as auditors and to authorise the directors to agree their remuneration will be proposed at the Annual General Meeting.

### Annual General Meeting

The Notice of Annual General Meeting to be held at the company's offices on Wednesday 11 May 2005 at 11.30 a.m. is contained in a separate letter from the Chairman accompanying this report.

### Corporate governance

**Combined Code statement of compliance** Spectris plc is subject to the Combined Code on Corporate Governance ("the Combined Code") that is appended to the Listing Rules of the UK Listing Authority. The Combined Code sets out principles and provisions relating to the good governance of companies.

The Combined Code has been subject to review, resulting in the publication of a new Combined Code applicable to the 2004 financial year.

Corporate governance has been and remains the responsibility of the whole Board. This statement describes how the company applied the principles and complied with the provisions of the Combined Code during 2004.

The Board considers that it was throughout the year and continues to be in full compliance with the provisions set out in section 1 of the Combined Code, save that:

- a majority of the members of the nomination committee are not independent non-executive directors, as required by provision A4.1. The committee consists of the Chairman, the senior independent director and the Chief Executive and the Board considers this to be the most appropriate composition for the sensitive issues addressed by the committee;
- the audit committee does not consist exclusively of independent non-executive directors, as required by provision C3.1. The Chairman, John Poulter, continues to serve as a member of the committee and the Board believes this to be essential both to enable the Chairman properly to discharge his responsibilities and to assist the work of the committee given the Chairman's extensive knowledge of the group's operations; and
- until 13 September 2004, at least half the Board, excluding the Chairman, did not comprise independent non-executive directors, as required by provision A3.2.

**Board composition and procedures** The Board meets formally nine times each year to consider developments in relation to the company's strategy and long-term objectives and to review trading results and operational and business issues. In particular it deals with those matters reserved to it for decision, including the acquisition and disposal of businesses, major capital expenditure, the appointment and, where necessary, removal of directors and Board and senior management succession planning. Usually, two meetings each year are held at operating locations and encompass a detailed review of the relevant business. Operational decisions are delegated by the Board to senior management at trading company level over which the Business Group Directors exercise supervision. All directors receive detailed progress reports one week prior to each Board meeting.

The Board currently comprises the Chairman, four executive directors and four non-executive directors. The Board considers all its non-executive directors (Andrew Given, Martin Lamb, Leo Murray and Anthony Reading) to be independent. The positions of Chairman, Chief Executive and senior independent director are held by separate individuals and the Board has adopted written profiles for each of the positions of Chairman, Chief Executive and non-executive director. The non-executive directors have all had senior experience in other organisations and offer independent judgement on Board matters. The Chairman's other significant interests are as a non-executive director of RAC plc, Smaller Companies Value Trust plc and certain private companies. The Board believes that the Chairman's obligations to the company are unaffected by these directorships.

There are procedures for individual Board members to receive induction and training as appropriate and to solicit independent professional advice at the group's expense where specific expertise is required in the course of exercising their duties. All Board directors have access to the company secretary, who is responsible for ensuring compliance with appropriate statutes and regulations.

All directors are subject to re-election by shareholders at the first opportunity after their appointment and thereafter at intervals of no more than three years, with one third of directors being required to submit for re-election by rotation each year. If adopted, the proposed new Articles of Association of the company, will simply require all directors to submit themselves for election by shareholders at the first Annual General Meeting after their appointment and for re-election thereafter at intervals of no more than three years.

The Board delegates specific responsibilities to Board committees, notably the nomination, remuneration and audit committees. The terms of reference of these committees are published on the company's website and the following additional documents are available to shareholders on application to the company secretary:

- schedule of matters reserved for decision by the Board;
- responsibilities of the Chairman, the Chief Executive and the non-executive directors;
- relations with shareholders;
- performance evaluation;
- procedure for taking independent professional advice.

#### Board and committee meeting attendance 2004

	Board	Remuneration committee	Audit committee	Nomination committee
Total meetings during year	9	5	4	2
J W Poulter (Chairman)	9	N/A	4	2
A F Given (senior independent director)	7	5	4	2
M J Lamb	8	5	4	N/A
L G Murray	8	4	4	N/A
A J Reading	6	3	2	N/A
H D Nilsson (Chief Executive)	9	N/A	N/A	2
S Hare	1	N/A	N/A	N/A
S C Harris	9	N/A	N/A	N/A
J C Webster	9	N/A	N/A	N/A
P V Boughton	5	N/A	N/A	N/A
J G Zacharias	6	N/A	N/A	N/A

S Hare, A J Reading, P V Boughton and J G Zacharias held office for part of the year only. S Hare attended the sole Board meeting which he was eligible to attend. A J Reading attended six of the seven Board meetings which he was eligible to attend. P V Boughton attended five of the seven Board meetings which he was eligible to attend. J G Zacharias attended six of the seven Board meetings which he was eligible to attend.

**Board appointments and performance evaluation** The nomination committee consists of the Chairman, the senior independent director and the Chief Executive and is chaired by the Chairman, save in the event of discussions relating to his succession when the senior independent director would take the chair.

Following a decision of the Board that the appointment of a new director is appropriate, the duty of the committee is to present for Board consideration suitably qualified candidate(s). In making such recommendations, the committee evaluates the balance of skills, knowledge and experience on the Board and develops a description of the role and required capabilities. Candidates are then identified for interview through the appointment of an external search consultant. The committee also makes recommendations to the Board regarding the re-election and/or re-appointment of any director. Similar selection processes would apply for the appointment of a successor chairman.

The nomination committee meets as the need arises. Its terms of reference can be found on the company's website.

The operation of the Board and its committees is evaluated by the Board as a whole annually. The executive directors' and company secretary's performances are appraised annually against objectives established for the prior year. The contributions of the Chairman and non-executive directors are reviewed in advance of the conclusion of the initial three-year term, by the senior independent director and the Chairman respectively, prior to their being proposed to shareholders for re-election. Additionally, the Chairman holds periodic meetings with the non-executive directors only and, led by the senior independent director, the non-executives meet at least annually without the Chairman present.

The Board has appointed an external moderator to assist in the evaluation of its operation and performance, scheduled to be completed during the first half year in 2005.

**Shareholder relations** Spectris conducts regular dialogue with institutional shareholders and divulges such information as is permitted within the guidelines of the Listing Rules. The content of presentations made after results announcements may be accessed by individual investors on the group website, [www.spectris.com](http://www.spectris.com).

All shareholders are invited to participate in the Annual General Meeting, where the Chairman, the Chief Executive and the chairmen of the audit, remuneration and nomination committees will be available to answer questions. The results of proxy votes are declared at the Annual General Meeting after each resolution has been dealt with on a show of hands.

The Board is kept informed of the views of major shareholders through periodic reports from the Chief Executive, the company's broker Merrill Lynch and the company's shareholder relations adviser Makinson Cowell. The Chairman and non-executive directors have the opportunity to attend the bi-annual analyst presentations.

Shareholders representing in excess of 3% of the company's issued share capital receive a standing invitation to meet with the Chairman, the senior independent director or new non-executive directors. Such meetings would supplement if necessary, but not replace, the regular meetings with the Chief Executive and group finance director.

**Audit committee** The audit committee comprises the non-executive directors and the Chairman. It is chaired by Andrew Given, who has recent and relevant financial experience as the former group finance director of Logica plc. The committee meets at least three times each year to consider the effectiveness of the group's internal controls, policies and procedures, the process of internal audit and the outcome of the external audit. Its meetings are normally attended by the Chief Executive, the group finance director, the company secretary and the external auditor. The committee regularly confers with the auditor without the attendance of executive directors. Its terms of reference can be found on the company's website.

The committee is responsible for making recommendations to the Board in relation to the appointment of the external auditor and then for approving the external auditor's remuneration, terms of engagement and scope of work.

The committee has also adopted procedures governing and restricting the appointment of the external auditor for non-audit services. The following services are precluded:

- book-keeping or other services related to the accounting records or financial statements of Spectris plc;
- financial information systems design and implementation;
- appraisal or valuation services, fairness opinions or contribution in kind reports;
- actuarial services;
- internal audit outsourcing services;
- management functions or human resources;
- broker or dealer, investment adviser or investment banking services;
- legal services and expert services unrelated to the audit.

A cumulative annual cap of £200,000 is established for all other non-audit services (save for acquisition due diligence and taxation services) above which all engagements are subject to prior approval by the audit committee.

The group employs an internal control and risk manager who performs internal control reviews across the group according to a work programme agreed by the committee. The group internal control and risk manager is assisted in this by other group finance personnel. The nature and scope of the group's internal control review resources is reviewed by the audit committee annually. The audit committee receives reports twice a year on the results of internal control reviews. The group internal control and risk manager has direct access to the chairman of the audit committee and may meet with him in the absence of executive management.

**Internal controls** The Board is ultimately responsible for the group's system of internal controls and for reviewing its effectiveness. However, such a system is designed to manage rather than eliminate risk of failure to meet business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss.

Following publication of the guidance for directors on internal control ("Internal Control: Guidance for Directors on the Combined Code"), the Board confirms that there is an ongoing process for identifying, evaluating and managing any significant risks faced by the group, that this has been in place for the year under review and up to the date of approval of the annual report and accounts, that this process has been reviewed by the Board during the year and that the group accords with the guidance.

The processes which the Board and the audit committee have applied in reviewing the effectiveness of the group's system of internal controls are summarised below:

- risk assessment and evaluation for each business unit takes place as an integral part of the annual strategic planning cycle. Having identified the principal risks to achievement of their strategic business objectives, each business unit is required to document the management and mitigating actions in place and proposed;
- the principal risks identified during the annual strategic planning cycle and the effectiveness of the management and mitigating actions in place are reviewed regularly by the executive directors and twice yearly by the audit committee;
- additionally, the executive directors consider those risks to the group's strategic objectives which are not addressed within the business units and develop appropriate approaches to managing and mitigating these risks;
- annual financial plans for each business unit, significant capital investments or contractual commitments and major acquisitions or divestments are all subject to review and approval by the Board;
- there is a Group Accounting and Policies Manual which sets out the minimum standards and procedures to be applied in relation to those risk areas which are regarded as significant in a group context;
- a process of self assessment of compliance with the Manual and reporting thereon has been established, providing for a documented trail of accountability from business unit presidents and finance directors to the audit committee. Planned corrective actions are monitored for timely completion;
- the executive directors report to the Board on changes in the business and external environment which present significant risks. The group finance director provides the Board with monthly financial information which includes key performance and risk indicators. Regular reports on significant legal issues and insurance matters are received from the company secretary.

#### Going concern

Having reviewed the group's plans and available financial facilities, the Board has a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. For this reason it continues to adopt the going concern basis in preparing the group's accounts.

#### Directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the group and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company and the group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

By order of the Board



**Roger Stephens** Secretary  
15 March 2005