

# Summary directors' remuneration report

## Remuneration policies

In 2002 the Remuneration Committee (the 'Committee') positioned executive directors' salaries and non-executive directors' fees at the market median in the light of independent assessment of market practices, and has done so in respect of directors appointed subsequently. The Committee adopted a policy that executive directors' salaries (assuming no change in responsibilities) would be increased annually in line with inflation, subject to total pay being benchmarked against the market every three years and intended that over time the proportion of executive directors' total remuneration that is dependent upon performance would become greater.

In 2003 executive directors salaries were generally increased in line with inflation, but the salaries of Messrs. Bateman and Dodd were increased with effect from 1st December 2003 when Mr Bateman assumed responsibility for HR in addition to his existing responsibility for operations, and Mr Dodd, the chief financial officer, also assumed responsibility for property, to reflect those additional responsibilities.

The Committee has now determined that it is appropriate to undertake a thorough review of executive directors' remuneration, including bonus and incentive schemes, with a view to taking any proposals that require shareholder consent to the 2005 AGM. In the meanwhile the Committee decided, pending the outcome of that review, to make as few changes as possible to the executive directors bonus and incentive schemes in 2004/05. Accordingly, with one exception in respect of the Executive Share Option Plan the Committee decided to operate the bonus and incentive schemes on a similar basis to that operated in 2003/04.

Bonus schemes provide an opportunity for executive directors and senior managers to receive additional rewards, if and only if, personal and business performance meets specified objectives and targets. The way that business performance is measured for bonus and share option schemes for executive directors and senior managers flows from, and is consistent with, business strategy, and with the board's governing objective of maximising the value of the company for the benefit of shareholders and is described below.

The short term executive bonus scheme rewards executive directors for achieving operating efficiencies and profitable growth in the relevant year by reference to challenging but achievable forecasts derived at the beginning of the year from strategic plans, and also rewards personal performance. The maximum short term bonus that can be earned is (in the case of the chief executive) 100% of base salary, and (for all other executive directors) 75%. One third of the available bonus depends on individual performance against personal targets, and two thirds depends upon business performance targets for operating profit (one-third of the available bonus), sales and return on capital (one-sixth each). The business targets have been chosen for their relevance in driving short term performance of the business.

The Long Term Bonus Scheme provides executive directors with a maximum potential bonus award (MPBA) worth up to 125% of base salary, and provides a direct link between the pay of executive directors and the creation of value for shareholders by rewarding directors for the company's performance in terms of total shareholder return (TSR) over a three or four-year performance period relative to a peer group of ten other leading companies which the Committee consider to be appropriate comparators by virtue of their size and markets in which they operate. TSR was chosen as the appropriate performance measure for the LTBS as it aligns the interests of the executive with the actual return received by shareholders.

Under the Executive Share Option Plan executive directors (and other employees) can be granted options to subscribe for ordinary shares in the company.

The Executive Share Option Plan aligns returns to shareholders with reward to executives but only if share price growth is achieved and if a performance target is met. The value of the options is directly linked to share price movement. The condition imposed in respect of all options granted to date is average annual growth in earnings per share (EPS) over the relevant period at least equal to the increase in the index of retail prices plus 3% calculated as follows: Base EPS is the EPS for the financial year preceding the performance cycle. An EPS target is calculated each year by applying the following formula: Base EPS x (100 + increase in RPI + y) where y is 3 in year one, 6 in year two and 9 in year three and so on. Target EPS for the performance cycle is determined by taking the average of the annual EPS targets during that cycle. In previous years the performance target was tested at the end of year three and retested if necessary at the end of year four, five and six until options vested or lapsed. For options granted in 2004, however, there will be only one possible retest at the end of year five. Executive directors are usually granted options having an exercise price of once the annual salary of the director. Mr Baker, as part of his joining arrangements, received in 2003 options under the Plan and under a personal arrangement made under Listing Rules having an exercise price of three times his initial annual salary.

Share ownership provides an effective way to align the interests of shareholders and executives. For all performance periods commencing on or after 1st April 2002 the whole of an executive director's long term bonus is payable in shares of the company; the executive directors participate in a share option plan, and the Committee has adopted a policy of requiring executive directors over time to achieve a holding in the company's shares having a value equivalent to their base salary.

The Committee believes that performance-related pay should form a significant proportion of the executive directors' remuneration. In broad terms, if the group meets its target levels of performance then performance-related pay is likely to account for approximately 55% of the chief executive's remuneration (approximately 60% initially due to the grant of options of three times annual salary) and 51% of that of the other executive directors. For top decile performance, performance-related pay is likely to account for a greater percentage – up to 75% for the chief executive and 73% for the other executive directors, depending on share price growth from the start of the performance period to the end. The actual benefit enjoyed by directors under the LTBS and under the Executive Share Option Plan will depend upon the company's share price, and cannot therefore be determined in advance.

Non-executive directors do not participate in any bonus or share option schemes.

It is the practice of the board to maintain contact where appropriate with its major shareholders about remuneration issues.

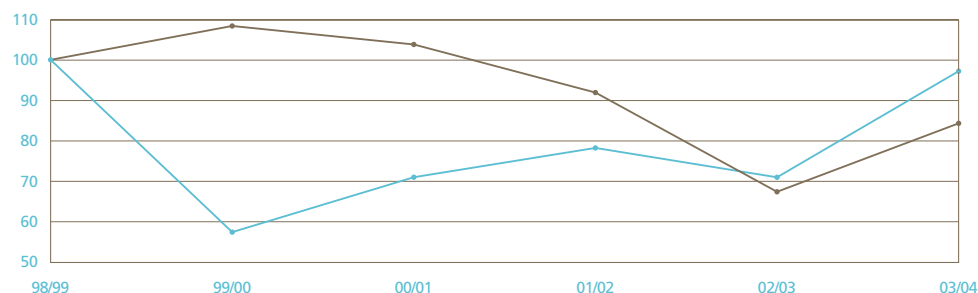
## Contracts of service

With the exception of Mr R A Baker all executive directors' service contracts are terminable by the company on one years notice and the Committee has determined that one years notice is the appropriate period of notice to be given to an executive director. Exceptionally, however, in circumstances such as the appointment of a chief executive from outside the company, the Committee may consider an initial period of greater security to be appropriate and agree that the one years notice should not be given before the first anniversary of appointment. The Committee took this view in respect of the appointment of Mr R A Baker, who joined the company as chief executive on 15th September 2003. Mr Baker's contract will be terminable on one years notice from 15th September 2004.

## Performance graph

The following graph, required by the Directors' Remuneration Report Regulations 2002, shows the total shareholder return over the five-year period to 31st March 2004 for the company's shares and the FTSE100 index. The FTSE100 is considered to be an appropriate index for comparison as the company forms part of that index, investors in the company are likely to regard other FTSE100 companies as alternative investments, and investors are familiar with it.

Total cumulative shareholder return for the five-year period to 31st March 2004 %



## Components of emoluments

**Salaries and fees** Salaries and fees paid to directors are shown in the table opposite.

**Short term executive bonus scheme** Performance against business and personal targets during the year was such that a bonus equal to 80.26% of salary was earned by Mr Baker, and 56.45% of salary was earned by Messrs Bateman and Dodd.

**Other benefits** Executive directors receive other benefits including a company car, or payment in lieu, sick pay and holidays, which overall provide a reasonably competitive package comparable with that provided by other major companies.

## Analysis of directors' emoluments

Full details of directors' emoluments are set out in the directors remuneration report contained in the 2004 Annual Report and Accounts, copies of which are available on request. The cash elements of the remuneration for the year to 31st March 2004 is set out in the table below:

£000	Salaries and fees	Short term bonuses	Other benefits	Compensation for loss of office	Commutation of accrued unapproved pension entitlements	Other payments on termination	Total 2004	Total 2003
R A Baker (from 15th September 2003)	341	273	472 <sup>1</sup>	–	–	–	1,086	–
P Bateman	317	179	82 <sup>2</sup>	–	–	–	578	355
J Bennink	35	–	–	–	–	–	35	32
G N Dawson (from 15th September 2003)	28	–	–	–	–	–	28	–
H Dodd	373	211	17	–	–	–	601	446
T C Parker (from 28th January 2004)	7	–	–	–	–	–	7	–
H Ploix	37	–	–	–	–	–	37	32
Dr M P Read	37	–	–	–	–	–	37	32
Sir Nigel Rudd (deputy chairman until appointed chairman on 15th September 2003)	181	–	–	–	–	–	181	55
Dr J G S Buchanan (resigned 24th July 2003)	17	–	–	–	–	–	17	34
B Clare (resigned 31st January 2003)	–	–	–	–	–	–	–	2,142 <sup>3</sup>
F M Harrison (resigned 6th November 2002)	–	–	–	–	–	–	–	19
J B McGrath (chairman until retirement from the board on 15th September 2003)	375	–	2	–	–	–	377	251
K S Piggott <sup>4</sup> (retired from the board on 31st December 2002)	–	–	–	–	–	–	–	361
S G Russell (resigned 31st May 2003)	206	–	7	758	–	131 <sup>5</sup>	1,102	786
A P Smith <sup>6</sup> (resigned 31st October 2003)	166	–	11	526	353	46	1,102	369
	2,120	663	591	1,284	353	177	5,188	4,914

<sup>1</sup>Mr R A Baker's other benefits include £200,000 and £244,375 compensation for the loss of his part vested Asda share options and short term bonus respectively, and £17,422 being the cost of legal advice met by the company. He will also receive a further £200,000 compensation for loss of part vested Asda share options in 2004/05.

<sup>2</sup>Mr P Bateman's other benefits include £60,000 in respect of relocation expenses relating to the sale of his former home in Brussels.

<sup>3</sup>Mr B Clare's salary for 2003 Included nine months salary in lieu of notice and £67,500 in respect of short term bonus. He and certain of his dependants surrendered their entitlements under the unfunded unapproved retirement benefit scheme, and received a total of £1.2m being the actuarial value of these benefits. The company also met the cost of certain legal and financial advice given to Mr B Clare.

<sup>4</sup>Mr K S Piggott remained an employee of the company until 31st December 2003 and received, in addition to the sums stated in this table, a salary of £135,938 and short term bonus of £38,579 in respect of the period from 1st April 2003 to 31st December 2003, and a salary of £45,313 and short term bonus of £11,328 in respect of the period from 1st January 2003 to 31st March 2003.

<sup>5</sup>Mr S G Russell's other payments on termination include accrued holiday pay of £71,308, a retirement payment of £42,792, and £16,500 being the cost of legal advice met by the company. Mr Russell was credited with one years additional service in his pension arrangements, and will participate (pro rata where appropriate) in LTBS performance periods ending on or before 31st March 2005.

<sup>6</sup>Mr A P Smith's compensation for loss of office included redundancy payment, ten months salary in lieu of notice and 201,167 in respect of short term bonus. His pension arrangements were credited with ten months additional service, and he and certain of his dependants surrendered their entitlements under the unfunded unapproved retirement benefit scheme, and received a total of £352,512 being the actuarial value of these benefits. He will participate (pro rata where appropriate) in LTBS performance periods ending on or before 31st March 2005. The company also met the cost of certain legal, outplacement and financial advice given to Mr A P Smith and of ten months life cover.

The aggregate of directors' emoluments before compensation for loss of office, commutation of pension entitlements and other payments on termination was £3,375,000 (2003 £3,493,000).

### Long Term Bonus Scheme ('LTBS')

#### Outcome of the 2000/04 performance cycle

For this cycle, the company achieved position five in the league table. Accordingly, the long term bonus units earned by executive directors including amounts relating to periods of service before appointment to the board and service after retiring from the board are set out in the following table and will be paid in June 2004. For serving directors, half will be paid in cash and the remaining half will be paid as a grant of a share award as shown below:

2003/04 Number of shares	MPBA 2000/04	MPBA 1999/03	Earned Units 2000/04	Earned Units 1999/03	Share award 2000/04	Share award 1999/03	Cash 2000/04 £000	Cash 1999/03 £000
R A Baker	–	–	–	–	–	–	–	–
P Bateman	33,107	10,580	11,919	–	5,960	–	42	–
H Dodd	42,476	11,799	15,291	–	7,646	–	54	–
S G Russell	121,359	50,566	43,689	–	–	–	311	–
A P Smith	38,653	12,716	13,915	–	–	–	99	–
	235,595	85,661	84,814	–	13,606	–	506	–

During the year, Mr K S Piggott, a former executive director, earned 26,213 long term bonus units. The award will be paid wholly in cash in June 2004, amounting to £186,213.

### Share awards in respect of prior periods

The value of share awards in respect of prior periods which have vested and been exercised in the year is shown in the table below:

	Date interest awarded	Share value at date of award	Share value at vesting 2004	Share value at exercise 2004	Value received 2004 £000	Value received 2003 £000
R A Baker	–	–	–	–	–	–
P Bateman	–	–	–	–	–	–
H Dodd	–	–	–	–	–	–
S G Russell	1st April 1996	599p	626p	664.5p	119	73
A P Smith	1st April 1996	599p	626p	645.5p	20	9
					139	82

The value of the shares received is based on the middle market price on the date of exercise of the share awards, and is the value upon which liability to income tax and National Insurance is calculated.

During the year, Mr Clare, Mr Piggott and Mr Thompson, all former directors, exercised share awards of 7,757, 7,058 and 18,140 respectively. The value received at the exercise date was £55,075, £44,944 and £121,175 respectively.

### Pension entitlement

All executive directors in office at 31st March 2004 receive pension entitlements from the company's principal UK defined benefit pension scheme and supplementary pension arrangements which provide additional benefits aimed at producing a pension of two-thirds final base salary at normal retirement age, subject to completing 20 years service and subject to revenue limits. Non-executive directors are not members of any company pension arrangements. Pension entitlement is calculated only on the salary element of remuneration.

Those directors who are subject to the earnings cap are also members of an unfunded unapproved pension arrangement which provides similar benefits on basic salary in excess of the earnings cap.