

Chief executive's review



Jeff Harris Chief Executive

2000 has proved another busy and successful year for Alliance UniChem, and I am once again pleased to be able to report to you significant progress on all of our strategic priorities. While some of our activities have been heavily focused on the strategic development of the Group in the medium to long term, others have benefited the 2000 results, and I will therefore begin my review by looking at the financial performance of the Group in the year.

Results

On a constant currency basis, and before goodwill amortisation and exceptional items, we increased our turnover by 7 per cent, our operating profits by 11 per cent, and our profit before tax by 12 per cent. Also on this basis, Group earnings per share increased by 14 per cent. In Euro terms and on the same bases, our increases in performance are stronger; our turnover is up by 10 per cent, our operating profits by 16 per cent, our profits before tax are up by 17 per cent, and our diluted earnings per share by 19 per cent. This strong performance has been achieved despite average interest rates in the Euro zone rising by almost half compared to 1999, which clearly had an adverse impact on our interest costs.

We have again demonstrated our ability to outperform our core market, which has grown by an average 6 per cent during 2000.

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Group Development

The Group has made good progress on all of its main strategic aims during the year. We have expanded our wholesale coverage geographically and have continued to grow our retail business. Considerable advances have been made in technology development and, perhaps most significantly, we have continued to improve service levels and the efficiency of our core businesses, which is reflected in the improvements in overall Group operating margin.

To take each of these areas in turn:

Geographical Expansion - Wholesale

In the latter part of the year we agreed two key investments in businesses which brought us significant market positions in Holland and Turkey, both new territories for the Group.

In December we bought Interpharm, the fastest growing wholesaler in Holland, an innovative and highly regarded business which has built an impressive presence in the Dutch market under its excellent management team and dedicated employees. Interpharm is now number two in its market, with over 22 per cent market share. We have already started working with Interpharm to develop further their business and to create synergy benefits.

Towards the end of 2000 we also announced a strategic investment in Hedef, the leading pharmaceutical wholesaler and distributor in Turkey with over 40 per cent market share. Our investment gives us 25 per cent of Hedef, with an option to acquire a further 25 per cent at any time in the next 30 months. Our investment in Turkey offers us the opportunity to participate in a large and growing market. Pharmaceutical prices in Turkey are in part related to the Dollar and Euro prices of those products in their markets of origin, giving a degree of protection against currency fluctuations between the Turkish Lira and our reporting currencies. Turkey's stated aim of entry into the European Union will accelerate its market growth as it increases spending on healthcare to align more closely with the existing EU countries. In addition we are working with the management of Hedef to accelerate their plans for international expansion in their region. We view Hedef both as an important investment in its own right and also as a gateway to new territories for the Group.



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We also acquired smaller wholesaling businesses in Italy, Portugal and Spain to expand our regional coverage and market share. These acquisitions help us achieve our business model for wholesaling businesses, which comprises: operating as number one or two in each market with a significant market share; the most efficient distribution infrastructure; and the broadest and most profitable range of added value services.

Retail Expansion

Our retail chain in the UK, Moss Pharmacy, has continued to expand with the acquisition of a net 77 shops in the UK during 2000, bringing the UK chain to a total of 712 units at the end of the year. In addition, we acquired the 57-strong Scholl footcare chain. We are still seeing many good quality pharmacies available for us to buy despite the continued competition for the larger businesses.

Expansion of our retail activities in Holland and Switzerland is continuing through our international retail division, AURI. We currently have 16 shops in Holland and 30 in Switzerland. Elsewhere, goodwill prices remain uneconomically high for pharmacies in both Ireland and Italy. However, we are continuing to monitor the situation and bid reasonable prices where appropriate.

During the year a number of European countries began reviews of their regulations governing the ownership of pharmacies and, as expected, some movement towards the easing of these restrictions on ownership is occurring. The first country to lift restrictions on pharmacy ownership has been Norway. In advance of this we have actively entered the market, taking out options to acquire pharmacies. We have begun converting these options and, once this process has been completed, will have more than 15 per cent of the Norwegian retail market. At the same time the government of Norway has approved 30 new pharmacies, of which we have been awarded 7 licenses.

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Technology

In 2000, Alliance UniChem launched a new strategy aimed at delivering enhanced benefits to its customers through their use of technology and raising the profitability and value of our own technology activities. The main component of this strategy comprises accelerated development of system solutions for use in pharmacies and the launch of *pharmacy.com*, a pharmacy internet portal. To support this strategy we sought strategic relationships with technology-based companies with specific skills and expertise.

System Solutions

Work has continued to update many of our existing systems used by pharmacists, and to exploit technology to improve efficiency, raise service levels and create a source of valuable data. This work has involved entering into an agreement with Cegedim S.A., a French technology and data exploitation specialist, to provide us with the benefit of their skills and experience and to ensure we continue to offer leading-edge system solutions to our customers. As part of this agreement with Cegedim, which is listed on the French 2nd Marché, we have sold a portfolio of our technology businesses to Cegedim in return for 10 per cent of the equity of that business valued at £29 million / €47 million.

A core client-facing project in 2000 was the development of the next generation of pharmacy management software for the UK market. We already own the rights to Mediphase, the market leader, with an installed base of 3,800 pharmacies. We have been working with Enigma Health Limited, a company founded by the original developers of Mediphase, to update this system for internet connectivity and offer a wide range of enhanced services for pharmacists.

I am pleased to report that since the year end we have taken a 60 per cent stake in Enigma in a deal that joins Mediphase and Enigma to form a single business focused on the development of an updated pharmacy management system. The new protocols built into Enigma will also allow an enhanced level of integration between it and *pharmacy.com* and provide our customers and their patients with the technological tools to accommodate e-prescribing and enhanced management of repeat prescriptions.

pharmacy.com

pharmacy.com launched its first website in France in January 2001, following beta testing of the service and considerable input from pharmacists and manufacturers across Europe. It is now being rolled out in France and the UK, and we are currently determining the programme for its launch in other European markets. Following the feedback from customer testing in the UK, *pharmacy.com*'s UK website will be integrated with our new pharmacy management system later this year, to offer pharmacists a single integrated pharmacy system, incorporating both pharmacy management and internet-based interactive services.

The adoption of internet technology is fundamental to the future development of our business, not because of any fear of disintermediation but because this technology will give us competitive advantage in the future. We are in a unique position to use technology to link together the disparate businesses in the healthcare supply chain, facilitating information flows. To appreciate and understand quickly the skills required we invested in Rx.com, a US internet pharmacy trading in B2B and B2C markets, since that market was much further advanced than Europe. The knowledge gained considerably accelerated the overall development of *pharmacy.com*.

Right: The provision of advice and information is at the heart of our retail business.



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While the US online pharmacy market has consolidated rapidly, Rx.com has built a platform for future expansion and is the only independent company in this marketplace to have successfully automated online order-taking with automated prescription fulfilment.

The management of Rx.com believes that to secure its future it will need to work with other established healthcare companies, and it is in discussions with potential partners.

We believe that any value arising from such a transaction will only be realised in the future and accordingly have deemed it prudent to write down our investment.

This, together with the gain on the Cegedim transaction, has meant that the Group recorded a net exceptional loss of £9.7 million / €15.9 million this year as part of the development of the e-business division.

Operating Efficiency

Our success is founded on a drive to improve efficiency, which continued in 2000. Each national marketplace dictates individual service levels for our businesses and therefore the required infrastructure. However, we continue to drive all our businesses towards the highly efficient and effective structures we have in our more developed operations.

In 2000 we closed one depot each in Spain, Italy, Portugal and France, helping to reduce our cost-base in each of these areas and improve the efficiency of our remaining units in these regions by increasing the volume through them. Since the year end we have also announced the closure of one of our UK depots and 5 more depots in France to be closed by 2003, and we continue to work on streamlining our structures across the entire Group. These programmes are driven by the continuing need to raise wholesaling efficiencies, particularly at a time of significant rises in healthcare taxes in France.



These actions, coupled with the wide range of programmes we have in place to share best practice across the Group, and the use of technology to enhance our efficiency, have enabled us to improve Group operating margins from 2.38 per cent before goodwill amortisation in 1999 to 2.51 per cent in 2000, and will provide us with further improvements to margins in the future.

Outlook

Our emphasis on business growth and customer service will continue to deliver benefits for shareholders, customers and employees alike.

Long-term trend of growth in our markets averages between 5 and 10 per cent per annum, driven by increases in average age of the population, the continued launch of new drug therapies, greater consumer expectation of the healthcare system, and the growing trend towards using drug treatments as an alternative or preventative to hospitalisation.

This combination of market growth, continued focus on driving the best performance from our businesses while harnessing new concepts and technology to drive out costs, and our cautious yet persistent expansion of the Group through strategic acquisition and investment, gives us a firm platform from which to continue to deliver growth.

A handwritten signature in blue ink that reads "Jeff Harris". The signature is fluid and cursive.

Jeff Harris
Chief Executive
20 March 2001

Right: Our businesses continue to win new customers based on a service-led offering rather than price discounting.

