

Report of the Directors

The information constituting or despatched with the 2001 Annual Report is material to an appreciation of the business of the Company and of the Group and as such forms part of this report of the Directors.

Corporate governance

Principles and provisions of good governance for companies are set out in the Combined Code as published in June 1998 by the Committee on Corporate Governance. The way the Company has applied the principles of the Combined Code is explained in this report. Other than where detailed in this report, the Company has throughout the financial year complied with the code provisions set out in section 1 of the Combined Code.

Directors

The Company is led and controlled by the Board, currently consisting of the following directors:

executive directors

Ornella Barra	southern Europe
Geoff Cooper	deputy chief executive
Chris Etherington	northern Europe
Jeff Harris	executive chairman
Stefano Pessina	chief executive

non-executive directors

Claude Berretti	
Ken Clarke	independent and senior non-executive
Neil Cross	independent
Etienne Jornod	
Patrick Ponsolle	independent

On 31 January 2002, the Company announced that George Fairweather will be joining the Board as Finance Director with effect from 2 April 2002.

During the year the following individuals were appointed as, or ceased to be, directors:

appointed	none	
ceased	Barry Andrews	23 May 2001
	Antonin De Bono	18 September 2001

In the rest of this report details given on Barry Andrews and Antonin De Bono will be for the period that they were a director.

Each of the Directors is subject to retirement by rotation at least every three years.

All directors have access to the advice and services of Adrian Goodenough, the Company Secretary, and are entitled, through him and at the expense of the Company, to obtain independent professional advice of their choice, where they believe it is essential to the effective discharge of their corporate duties.

The Board met formally on seven occasions during 2001 and the five standing committees of the Board met in accordance with their terms of reference, as detailed below. Three other committees were established in 2001 to undertake specific tasks, which have been completed. Members of the Board and committees receive appropriate notice of each meeting, accompanied by an agenda and relevant papers, so that the members may discharge their duty effectively. Where decisions of the Board or committees are relevant, they are detailed in the pertinent section of the 2001 Annual Report.

The audit committee met four times in 2001. Its main purposes are: to provide a conduit for the interface between the Company and the auditors; to review the financial statements of the Company, focusing particularly on compliance with legal, regulatory and accounting standard requirements and the going concern assumption; and to review the Group's system of internal controls.

The executive committee is constituted so that the Company can function day to day by taking care of routine matters not requiring the consideration of the Board as a whole. Under the terms of reference, parameters have been established which limit its authority to act without consulting the Board as a whole. The executive committee has delegated some of its authority to a number of sub-committees in order to facilitate the decision making process. These sub-committees cover consideration of acquisitions and treasury matters and have their own terms of reference with relevant parameters to their authority.

The management board has the responsibility to plan, implement and deliver the internal strategy of the Group and is accountable to the Board for the achievement of financial performance. While each business unit has its own board of directors with responsibility for their business, individual members of the management board have line responsibility for the financial performance of all business units, Group functions, associates and synergy activities.

The nomination committee met once in 2001. Its role is to recommend to the Board any appointment as a director and to review whether non-executive directors should be proposed for re-election upon their retirement by rotation.

The remuneration committee met five times in 2001 and is authorised by the Board to determine the remuneration of the executive directors and to grant options under the discretionary share option schemes. The Board determines the fees of the non-executive directors.

Membership of the main committees of the Board

	Audit	Executive	Management board	Nomination	Remuneration
Frequency of meetings					
monthly and as required	–	–	*	–	–
minimum number of times per year as required	2	–	–	–	1
	–	*	–	*	–
Committee members:					
non-executive directors					
Claude Berretti	M	–	–	–	–
Ken Clarke	–	–	–	C	C
Neil Cross	C	–	–	M	M
Patrick Ponsolle	M	–	–	M	M
executive directors					
Ornella Barra	–	M	M	–	–
Geoff Cooper	–	M	C	–	–
Chris Etherington	–	M	M	–	–
George Fairweather (upon his appointment)	A	M	M	–	–
Jeff Harris	–	M	–	M	A
Stefano Pessina	–	C	M	M	A
company executives					
Gerhard Aalders managing director, Interpharm	–	–	M	–	–
Manuel Deleers internal auditor Europe	A	–	–	–	–
Steve Duncan managing director, Moss Pharmacy	–	–	M	–	–
Adrian Goodenough company secretary	A	A	A	A	A
Jean-Louis Méry president, Alliance Santé	–	–	M	–	–
Steve Sampson director of financial structuring	A	–	–	–	–
external					
auditor's representative	A	–	–	–	–

'A' indicates an attendee of the committee

'C' indicates the chairman of the committee and

'M' indicates a member of the committee.

Directors' remuneration

The remuneration committee, the current members of which are detailed above, takes decisions on executive directors' remuneration.

In reaching conclusions on remuneration, the remuneration committee took into consideration the remuneration policy of the Group, a number of comparative remuneration surveys and increases in salary given to employees of the Group.

The remuneration policy of the Group is structured to recruit, motivate and retain personnel of the highest calibre so that the position of the Group in the European healthcare sector is maximised. This is achieved by a combination of fixed and variable payments, benefits, incentive plans and share option schemes. These are detailed below.

Report of the Directors (continued)

Emoluments

The emoluments of the Directors for the financial year ended 31 December 2001 were:

Director	Fees £000	Salary and other cash £000	Non-cash benefits £000	Bonus payments £000	Total emoluments	
					2001 £000	2000 £000
B.M. Andrews	–	109	7	–	116	367
O. Barra	–	230	–	35	265	270
C. Berretti	25	–	–	–	25	25
K.H. Clarke	125	–	–	–	125	125
G.I. Cooper	–	284	19	58	361	406
N.E. Cross	30	–	–	–	30	30
A. De Bono	–	220	–	–	220	303
C. Etherington	–	230	15	81	326	295
J.F. Harris	–	450	17	93	560	623
S. Pessina	–	294	–	61	355	393
P. Ponsolle	25	–	–	–	25	25
Total	205	1,817	58	328	2,408	2,862

Etienne Jornod waived his entitlement to a director's fee of £25,000.

Executive directors are rewarded with bonus payments if the Group and/or their Division achieves the annual budgeted performance, after allowing for the cost of the bonuses, and/or the relevant executive has achieved a satisfactory personal performance. The maximum bonus payable in respect of 2001 was 50 per cent of an individual's salary.

Long-term incentive plan

The Share Incentive Plan is a discretionary scheme under which allocations are made to directors. Each allocation takes the form of a non-binding statement of intent to make an award of a stated maximum amount following the end of a specified performance period. The Directors' allocations under the Scheme are:

Director	Allocation 1	Allocation 2	Allocation 3	Allocation 4
O. Barra	100,000	143,333	153,333	160,666
G.I. Cooper	120,000	176,667	189,000	206,666
C. Etherington	100,000	143,333	153,333	160,666
J.F. Harris	192,500	280,000	299,667	308,666
S. Pessina	125,000	183,333	196,167	216,666

The performance periods for the allocations are:

Allocation	Period start	Period end
1	1 January 1999	31 December 2001
2	1 January 2000	31 December 2002
3	1 January 2001	31 December 2003
4	1 January 2002	31 December 2004

The amount of the award will depend on achieving certain performance measures during the performance period:

Performance measure	Achievement	% awarded
Total shareholder return	below median	–
	median	50%
	+ 1%	12.5%
	upper quartile	75%
Earnings per share	RPI-x	–
	<+ 3%	5.0%
	+ 3%	+ 4.5%
	>+ 4%	50.0%

Total shareholder return measures the total return to shareholders in terms of share price growth and dividends reinvested in the shares of the Company over the performance period. The performance will be compared with the same measure of performance for companies in the FTSE 250. Earnings per share are defined as the diluted pre-exceptional figure as reported for a full accounting year. RPI-x is the index of retail prices for all items excluding mortgage payments as published by the UK Government.

The award takes the form of a right to acquire ordinary shares in the Company for a nominal sum within a period of ten years from the date of the award. The number of shares will be determined by the market price of the Company's shares at the date of the award. The remuneration committee has the discretion to withhold or reduce awards to any extent it considers appropriate, having regard to the Company's underlying financial performance and irrespective of the level of attainment of the performance targets.

During 2001, awards were made on allocations with the performance period 1 January 1998 to 31 December 2000. During the performance period, the Company was in the 87.9th percentile of the comparator group on total shareholder return and the increase in earnings per share was in excess of RPI-x +4 per cent. On this basis, awards equivalent to 100 per cent of the allocations were made:

Director	Allocation	Award
O. Barra	66,667	11,261
G.I. Cooper	80,000	13,513
C. Etherington	66,667	11,261
J.F. Harris	108,333	18,299
S. Pessina	83,333	14,076

The awards are further detailed in the table of interests in options over shares below.

Following the end of the performance period for allocation 1 detailed above, the remuneration committee has recommended to the Employee Share Trust that awards equivalent to 50 per cent of the allocation are made.

Pensions

The pension benefits earned by the Directors during 2001 were:

Director	Age at year end	Increase in accrued pension during the year £000	Total accrued pension at year end £000	Salary supplement paid during the year £000	Additional money purchase contributions	
					2001 £000	2000 £000
B.M. Andrews	57	19	164	–	–	–
O. Barra	48	–	–	–	69	34
G.I. Cooper	47	3	25	10	62	14
C. Etherington	49	3	34	26	56	34
J.F. Harris	53	55	273	–	–	–

The accrued pension is a benefit of the defined benefit plan of the Company's Pension Scheme. The increase in accrued pension during the year is net of the increase resulting from inflation. For Barry Andrews, who retired on 1 June 2001, the accrued pension is at the date of his retirement. The accrued pension at the end of 2000 for Jeff Harris, the highest paid director, was £211,000. The Company pays the additional money purchase contributions into separate schemes with no additional contributions from the Directors. Any additional voluntary contributions paid by the Directors, and the benefit arising from such contributions, are excluded from the above table.

Under the arrangements of the Pension Scheme the normal retirement age of the Directors is 60; Jeff Harris, on leaving service, is entitled to receive an unreduced pension from age 55; directors are required to pay a contribution of 5 per cent of basic salary; a spouse's pension of one half of the Director's pension is payable on death after retirement; a statutory minimum pension for the legal widow and the Director's accumulated contributions are payable on death after leaving service but before retirement; directors' pensions are automatically increased each year after retirement in line with inflation; additional increases may be payable at the discretion of the Trustee of the scheme, subject to the approval of the Company; and no allowance is made for discretionary benefits within transfer values.

Report of the Directors (continued)

Directors' interests

Interests in fully paid shares

The interests of the Directors and their immediate families, all of which are beneficial, in the ten pence ordinary shares of the Company are detailed below:

Director	1 January 2001	Acquired in the year	Disposed in the year	31 December 2001	Acquired in the period	Disposed in the period	19 March 2002
O. Barra	–	11,261	–	11,261	–	–	11,261
K.H. Clarke	3,878	38	–	3,916	–	–	3,916
G.I. Cooper	68,466	4,645	3,886	69,225	13,513	–	82,738
N.E. Cross	5,000	–	–	5,000	–	–	5,000
C. Etherington	12,678	41,624	39,361	14,941	–	–	14,941
J.F. Harris	339,135	8,223	–	347,358	–	–	347,358
S. Pessina	105,099,503	14,211	–	105,113,714	–	–	105,113,714
P. Ponsolle	500	–	–	500	–	–	500
Total	105,529,160	80,002	43,247	105,565,915	13,513	–	105,579,428

The Employee Share Trust held 3,678,348 shares at 31 December 2001. The Trust transferred 339,985 shares during the year and a further 13,513 shares during the period 1 January 2002 and 19 March 2002 to option holders exercising their options. There were no other changes to this holding between 1 January 2001 and 19 March 2002. All employees and the executive directors are eligible to benefit from the Trust.

105,099,503 shares of the interest of Stefano Pessina are held by Alliance Santé Participations S.A.. Stefano Pessina indirectly wholly owns the Company, registered in Luxembourg, and the Directors include Stefano Pessina and Ornella Barra. Ornella Barra holds no other interests in the fully paid shares of the Company except as detailed above.

Interests in options over shares

The Directors' options over ten pence ordinary shares of the Company are detailed below:

Director	Option	1 January 2001	Granted/ (exercised) in the year	31 December 2001	Granted/ (exercised) in the period	19 March 2002	Exercise price (p)	Mid-market price on exercise (p)	Notional gain £000
O. Barra	6	186,263	–	186,263	–	186,263	429.50	–	–
	7	63,737	–	63,737	–	63,737	435.00	–	–
	11	–	11,261 (11,261)	–	–	–	100.00	540.0	61
		250,000	–	250,000	–	250,000			61
G.I. Cooper	3	372	–	372	–	372	269.00	–	–
	4	36,872	–	36,872	–	36,872	268.50	–	–
	6	45,000	–	45,000	–	45,000	429.50	–	–
	8	9,154	–	9,154	–	9,154	213.00	–	–
	11	–	13,513	13,513	(13,513)	–	100.00	530.0	72
		91,398	13,513	104,911	(13,513)	91,398			72
C. Etherington	2	30,000	(30,000)	–	–	–	260.00	556.0	89
	6	45,000	–	45,000	–	45,000	429.50	–	–
	9	3,194	–	3,194	–	3,194	324.00	–	–
	10	1,757	–	1,757	–	1,757	384.00	–	–
	11	–	11,261 (11,261)	–	–	–	100.00	534.0	60
		79,951	(30,000)	49,951	–	49,951			149

Director	Option	1 January 2001	Granted/ (exercised) in the year	31 December 2001	Granted/ (exercised) in the period	19 March 2002	Exercise price (p)	Mid-market price on exercise (p)	Notional gain £000
J.F. Harris	1	45,000	–	45,000	–	45,000	253.99	–	–
	2	45,000	–	45,000	–	45,000	260.00	–	–
	5	4,791	(4,791)	–	–	–	216.00	541.5	16
	6	45,000	–	45,000	–	45,000	429.50	–	–
	10	1,757	–	1,757	–	1,757	384.00	–	–
	11	–	18,299	18,299	–	18,299	100.00	–	–
		141,548	13,508	155,056	–	155,056			16
S. Pessina	11	–	14,076 (14,076)	–	–	–	100.00	568.0	80
Total		562,897	(2,979)	559,918	(13,513)	546,405			377

No options lapsed during the financial year or between 1 January 2001 and 19 March 2002. The mid-market price of shares of the Company ranged during 2001 between 478 pence on 19 September and 594 pence on 21 August and at 31 December was 518 pence. The exercise price for options with an exercise price of 100 pence is the exercise price for the whole option and not for each share.

The options above may be exercised:

Option	Type	First exercisable	Exercisable until	Performance criteria
1	discretionary	1 November 1996	30 October 2003	–
2	discretionary	21 October 1997	20 October 2004	–
3	discretionary	18 October 1998	17 October 2005	–
4	discretionary	13 June 2000	12 June 2004	yes
5	savings related	1 December 2000	30 May 2001	–
6	discretionary	7 May 2001	6 May 2005	yes
7	discretionary	27 May 2002	26 May 2006	yes
8	savings related	1 July 2002	30 December 2002	–
9	savings related	1 August 2003	30 January 2004	–
10	savings related	1 July 2004	30 December 2004	–
11	long-term incentive	6 April 2001	5 April 2011	–

The discretionary options granted to O. Barra formed part of the arrangements of the merger with Alliance Santé S.A.

The options shown above as requiring performance criteria are exercisable if, at any time during the exercise period, earnings per share growth of the Company in the period from the grant of the option was greater than the increase in RPI-x plus 4 per cent compound. Earnings per share are defined as the diluted pre-exceptional figure as reported for a full accounting year. RPI-x is the index of retail prices for all items excluding mortgage payments as published by the UK Government. The remuneration committee may change the target parameters should circumstances warrant it. The performance criteria in respect of all of the above options have been passed.

Employment agreements

Geoff Cooper and Chris Etherington have employment agreements that can be terminated by either party on twelve months' notice. George Fairweather has entered into a similar agreement effective from when he joins the Company. Jeff Harris has an employment agreement that can be terminated by the Company on twelve months' notice or by him on six months' notice. There are provisions in the service agreements for pay in lieu of current salary for the unexpired period of appointment or to cover the required notice period. No other director has a service contract with the Company.

Other interests

Save for the interests mentioned in this report no director was materially interested in any contract during the financial year which is or was significant to the business of the Company or subsidiary undertakings.

Report of the Directors (continued)

Shareholders

The chairman and finance director of the Company have regular meetings with institutional shareholders to discuss the overall strategy of the Group.

The notice convening the 2002 annual general meeting has been despatched with this Annual Report. Shareholders, whether they can attend the meeting or not, are encouraged to ask questions of the Board. It is the intention of all of the Directors to be present at the annual general meeting.

Employees

The Group aims to employ the best qualified personnel and to provide equal opportunity in the selection and advancement of employees regardless of age, race, colour, national origin, religious persuasion, sex or marital status.

Full and fair consideration is also given to disabled applicants for employment, having regard to their particular aptitudes and abilities. If any employee becomes disabled, the objective is the continued provision of suitable employment either in the same or an alternative position with appropriate training if necessary.

The Company communicates with all employees through regular staff briefings. All Group employees will be receiving a summary of the Annual Report, which will include comments on their individual business units. Subject to practical and commercial considerations, employees are consulted and involved in decisions that affect their employment or future prospects. The constitution of a European works council has been agreed and it is expected that this will meet for the first time in 2002.

Other matters

Health and safety

It is the policy of the Group that each business maintains the high standards necessary to safeguard the health, safety and welfare of its employees, customers and the public.

Creditors

It is the policy of the Group to abide by the payment terms negotiated with each of its suppliers whenever it is satisfied that the invoiced goods or services have been ordered and have been supplied in accordance with agreed terms and conditions. Alliance UniChem is a holding company and has no trade creditors.

Political and charitable gifts

Charitable donations of £21,500 were made during 2001. No political gifts were made during the financial year.

Animal testing

It is the policy of the Group that only skin care products that have not been tested on animals will be introduced to the Group's own brand ranges and that wherever possible the pharmacies owned by the Group will only stock other brands with the same policy.

Environment

Each business unit is responsible for maintaining the delivery of healthcare to its market. In maintaining this responsibility, each business is mindful of the impact their operation has on the local environment and works to ensure that such impact is kept to a minimum. In addition, the Group insists that all local regulations and laws are adhered to. Costs or savings associated with this work and compliance have not been separately identified by the operating businesses and are absorbed within internal operating expenses.

Internal controls

Guidance for companies on compliance with the internal control requirements of the Combined Code is set out in the publication Internal Control: Guidance for Directors on the Combined Code. The Company has throughout the financial year and up to the date of approval of the financial statements complied with this guidance.

The Board is responsible for the Group's internal control system. This system can only provide reasonable and not absolute assurance against material misstatement or loss.

The Company has a continuous process for identifying, evaluating and managing key risks faced by the Group and the Board has regularly reviewed this process.

The Board has also reviewed the effectiveness of the Group's internal control system. The audit committee has reported to the Board its review of summaries of the effectiveness of the Group's internal control system. The review covered all controls, including financial, operational and compliance controls and risk management. The review also considered reports by the Group internal audit function on material internal risks in three of the business units and on post investment audits that were carried out to evaluate the performance in the first full year of major investments made in 2000.

The Group's internal control system is designed to regulate the processing of transactions, preserve related data on files and safeguard assets from inappropriate use or from fraud. This system is described under the following four headings.

- (1) Risk management – Risk management is a continuous process whereby market, regulatory and operational risks that the Group may face over a three-year period are identified, evaluated and managed. Controls over financial risks are regularly assessed and contingency plans are made against major failures.
- (2) Processing transactions and safeguarding assets – Where the Board has not reserved matters for its sole consideration, limits are placed on transactions and activities that employees either acting individually or as a group can undertake. There is also a division between those who authorise, process, record and handle the related assets of any transaction or activity.
- (3) Adherence to managerial policies – All personnel are trained on joining the Group and thereafter on proper adherence to the control systems relevant to their role within the Group.
- (4) Financial reporting – Each operating unit prepares monthly results, with a comparison against the budget, the latest forecast and the previous year, which the Board reviews for the Group as a whole and on which it determines appropriate action.

Directors' responsibility statement

This statement, which should be read in conjunction with the Auditors' Report, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the auditors in relation to the financial statements.

The Directors are required by legislation to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss for the financial year.

The Directors consider that the Company has adequate resources to continue in operational existence for the foreseeable future and therefore have continued to adopt the going concern basis in preparing the financial statements.

The Directors also consider that, in preparing the financial statements on pages 48 to 73, appropriate accounting policies have been used, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider to be applicable have been followed.

The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy the financial position of the Company at any time and which enable them to ensure that the financial statements comply with legislation.

The Directors also 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.

Approved by the Board of Directors and signed on their behalf

A J Goodenough
Company Secretary
19 March 2002