Financial review

Accounting policies

The principal accounting policies adopted by the Group are unchanged, with the exception of the early adoption in full of FRS 17 "Retirement Benefits" and a change to the accounting policy on turnover following the issuance of an Application Note to FRS 5 "Reporting the Substance of Transactions" in December 2003. Comparable figures have been restated to reflect these changes. A prior year adjustment of £19.6 million (€30.1 million) has been made for FRS 17 in the 31 December 2002 balance sheet, reducing shareholders' funds. Profit before taxation in 2003 is £2.0 million (€2.9 million) higher as a result of the implementation of FRS 17, the restated figures for 2002 being £1.0 million higher. The principal impact of the Application Note to FRS 5 in 2003 has been a reclassification of £312.4 million (€450.8 million) of customer discounts and other operating income to turnover. All customer discounts are now offset against turnover, rather than forming part of cost of sales. Following changes in UK legislation and subsequent amendments to UK GAAP, the investment in own shares via the Employee Share Ownership Plan Trust has been reclassified in the balance sheet.

The Group is well advanced in determining the likely impact of International Accounting Standards on its future financial statements. An impact analysis was completed during 2003 and a detailed implementation programme is underway.

Results for the year

Group turnover increased by 13.2% on a comparable basis to £8,799.3 million (€12,697.4 million). This compares with Group turnover of £9,111.7 million (€13,148.2 million) on the previous accounting basis.

Group operating profit before amortisation of intangible assets increased by 10.1% to £226.6 million (€327.0 million). The share of operating profit in associated undertakings before amortisation of intangible assets grew by 71.2% to £36.8 million (€53.1 million), resulting in total operating profit before amortisation of intangible assets growing by 15.8% to £263.4 million (€380.1 million). Amortisation of intangible assets increased by 7.9% to £13.6 million (€19.6 million), largely as a result of the increased shareholdings in associated undertakings. Total operating profit increased by 16.3% to £249.8 million (€360.5 million).

Net interest payable was £53.5 million (€77.2 million), a year on year increase of 14.1%. On a constant currency basis, net interest payable increased by 3.2%, principally reflecting acquisition funding costs and higher interest margins applicable on longer maturity borrowings, partially offset by the effect of the share placing in September 2002 and lower interest rates, to the extent that interest was not previously hedged. Included in net interest payable is a charge of £1.0 million (€1.4 million) being the difference between the expected return on pension scheme assets and the interest on pension scheme liabilities in accordance with FRS 17; this compares to £nil in 2002. Interest cover, calculated before the amortisation of intangible assets, was 4.9 times, equivalent to 5.0 times on a pre- FRS 17 basis.

Profit on ordinary activities before taxation and amortisation of intangible assets increased by 16.3% to £209.9 million (€302.9 million), and profit on ordinary activities before taxation increased by 16.9% to £196.3 million (€283.3 million).

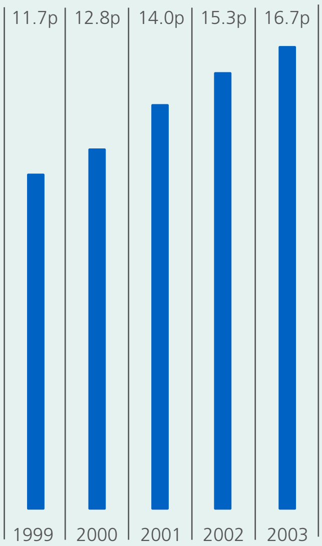
Taxation

The Group's effective rate of tax, based on profit on ordinary activities before taxation and amortisation of intangible assets, was 32.0% (2002 32.1%), which is just above the weighted average standard tax rate of 31.8% (2002 32.5%). The weighted average standard tax rate is higher than the UK standard rate of 30% due to higher rates on non-UK profits.

Shareholders' return and dividends

Diluted earnings per share before amortisation of intangible assets were 41.2 pence (59.5 cents), up 11.7% on the previous year. After amortisation of intangible assets, diluted earnings were 37.3 pence (53.8 cents), a year on year increase of 12.7%. The Board is recommending a final dividend of 11.0 pence per share, making a total dividend for the year of 16.7 pence per share (24.1 cents). The proposed final dividend is 8.9% higher than the final dividend in 2002, the total dividend for the year being 9.2% higher than the total dividend for 2002. The total dividend is covered 2.5 times by basic earnings per share before amortisation of intangible assets and 2.3 times after amortisation.

Dividends per share



Financial review (continued)

Cash flow

for the year ended 31 December 2003

£million	2003	2002
Operating cash flow	**322.3**	200.6
Interest and dividends	**(78.2)**	(86.0)
Tax	**(46.2)**	(51.9)
Maintenance capital expenditure	**(24.1)**	(28.9)
Free cash flow	**173.8**	33.8
Growth capital expenditure and financial investment	**(65.5)**	(146.6)
Cash flow before financing	**108.3**	(112.8)
Financing	**1.3**	73.6
Translation differences	**(56.6)**	(59.6)
Decrease/ (increase) in net borrowings	**53.0**	(98.8)

Cash flow and investment in the business

The Group continues its well established track record of generating free cash flow to fund investment in wholesale acquisitions and new pharmacies.

Net cash inflow from operating activities was particularly strong at £322.3 million (€465.1 million). This compared to £200.6 million (€319.6 million) in 2002, which included £94.2 million (€150.0 million) inflow from the Italian securitisation programme, partially offset by a £37.0 million (€58.9 million) non-recurring variance on the timing of UK securitisation receipts at the end of 2001. Working capital net inflow was £68.6 million (€99.0 million), all key year end working capital ratios improving compared to the start of the year and working capital reductions being achieved in all wholesale businesses. Cash outflow on stocks was £39.4 million (€56.9 million), with stock levels decreasing by close to one day over the course of the year. Stock levels were higher than at the end of the first half due to attractive buying opportunities towards the end of the year, which resulted in a corresponding increase in creditors. Cash outflow from debtors was £60.3 million (€87.0 million), reflecting increased sales, partially offset by close to a two day reduction in trade debtor days. Cash inflow from higher creditors was £168.3 million (€242.9 million), reflecting higher cost of sales, increased stock purchases towards the end of the year and an extra day's credit.

Net capital expenditure on tangible fixed assets was £38.0 million (€54.8 million), including £24.1 million (€34.8 million) of gross expenditure on replacement fixed assets. Total cash paid for acquisitions was £59.2 million (€85.4 million). This expenditure was mainly on the purchase of retail pharmacies. In addition, £1.2 million (€1.7 million) was incurred in the further purchase of shares in associated undertakings. The Group has also continued to buy out minority interests in its businesses in France, Spain and the UK.

Shareholders' funds
Shareholders' funds at the year end were £929.8 million (€1,319.4 million), an increase of £108.8 million, principally reflecting £71.4 million (€103.0 million) of retained profit and £25.0 million (€36.1 million) of shares issued.

Financial position
At 31 December 2003, net borrowings were £827.2 million (€1,173.8 million) compared to £880.2 million at the end of 2002. This decrease was primarily due to a higher net cash inflow from operating activities, partially offset by a £56.6 million (€81.7 million) currency translation difference on borrowings hedging continental European assets.

Treasury policy
The Group's treasury policy seeks to ensure that appropriate financial resources are available for the development of the Group whilst managing currency, interest rate and counterparty risks. The Group treasury department acts as a service centre operating within clearly defined parameters approved by the Board. The Group's policy is to not engage in speculative transactions.

The Group seeks to maintain levels of interest cover that are commensurate with an implied investment grade debt rating; to achieve this it targets a long-term interest cover of around five times total operating profit before amortisation of intangible assets. This level may temporarily fall where the Group has undertaken a strategically important investment in any year.

Liquidity and funding
During the year £100 million of committed borrowing facilities were renewed for a further year and £40 million of new facilities were introduced. These facilities mature on 31 October 2004, although at the Group's election the term may be extended for a further two years. In addition, the Group has £97 million of five-year committed borrowing facilities that mature in 2007 and £40 million of other committed borrowing facilities that mature between 2004 and 2006.

At the year end, 54% of gross borrowings were repayable in more than five years compared to 51% at the end of 2002. Undrawn committed borrowing facilities at the year end totalled £173.7 million (€246.5 million) compared to £105.3 million at the end of 2002.

Interest rate risk management
The Board's policy is to partially protect itself against adverse movements in interest rates by hedging up to 60% of average projected borrowings over a three-year horizon, with borrowings beyond that period on a floating rate basis. The Group borrows on both a fixed and floating interest rate basis and manages its exposure through the use of interest rate swaps and caps.

Currency risk management
The Group has significant assets in continental Europe, which it partly hedges with borrowings denominated in the same currency, either directly or through the use of cross currency swaps. At 31 December 2003, 69% of the Group's gross borrowings were in Euros and 13% were in Sterling.

Approximately 43% of the Group's earnings generated in 2003 was earned in currencies other than Sterling, of which around 53% was in Euros. Although the translation of Euro denominated profits into Sterling was beneficial for reporting, due to the comparative strength of the Euro, this was largely offset by its negative impact on margins on certain UK product segments.

The Group has a policy of hedging foreign currency denominated transactions by entering into forward foreign exchange sale and purchase contracts where these transaction exposures arise.

Counterparty risk
The Group monitors the distribution of its cash assets, borrowings and other financial instruments against pre-determined limits so as to control exposure to any country or institution.

Pensions
FRS 17 "Retirement Benefits" was adopted early in full in the year. Under FRS 17, the net pension liability reflected in the balance sheet was £34.3 million (€48.7 million) at the year end compared to £23.8 million restated at the end of December 2002. The year end balance comprises deficits of £37.4 million for the UK defined benefit pension scheme, £11.1 million for other European defined benefit pension schemes, and £0.8 million for other pension schemes, partially offset by a £15.0 million deferred tax asset. The movement in liability is principally accounted for by an actuarial loss arising from a revision of actuarial assumptions, partially offset by deferred tax thereon. The total pension charge against profit before taxation was £14.0 million (€20.2 million) compared to £11.5 million, restated, last year. This compares to £16.0 million (2002 £12.5 million) had the previous accounting policy been applied for the year.

Share price
The Company's share price ranged from a low of 375.0 pence to a high of 555.0 pence during the financial year. On 31 December 2003 the mid market price was 519.0 pence, giving a market capitalisation of approximately £1.8 billion.