

## Operating review

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## Divisional highlights

for the year ended 31 December 2003

	Turnover £million	Operating profit* £million	Year on year growth	
			Turnover %	Operating profit* %
Wholesale – Northern Europe	2,899.8	84.3	12.7	8.9
– Southern Europe	5,618.9	74.4	15.1	–
	8,518.7	158.7	14.3	4.5
Retail – Europe	1,107.4	79.3	13.7	20.5
Corporate	–	(11.4)	–	–
Intra-group	(826.8)	–	–	–
Group	8,799.3	226.6	13.2	10.1
Share of operating profit of associates	–	36.8	–	71.2
<b>Total</b>	<b>8,799.3</b>	<b>263.4</b>	<b>13.2</b>	<b>15.8</b>

\* before amortisation of intangible assets.

Figures for turnover reflect a change in accounting policy resulting from the amendment in December 2003 to the accounting standard FRS 5. Operating profit reflects the early adoption in full of FRS 17 on retirement benefits. Operating margins reflect these changes. Year on year growth rates are on a comparable basis.

Total operating profit before amortisation of intangibles increased by 15.8% year on year

## Markets

The wholesale markets in which our businesses operate grew, we estimate, by 6% year on year, weighted on the basis of our wholesale turnover, which is ahead of our forecast at the beginning of 2003. The principal factors determining market growth rates in individual countries continue to be regulatory actions and demographics.

Generic prescribing continues to increase, reducing wholesale market growth as more expensive brands come off patent and are replaced by cheaper generic medicines which typically offer higher trading margins to us.

The growth of parallel trade slowed during the year as a result of efforts to curtail it through the restriction of product supply in certain markets, patent expiry of some high volume products, the implementation by manufacturers of quota systems on products and the strengthening of the Euro against Sterling.

## Operating review (continued)



### Warehousing best practice

Best practice, our Group-wide benchmarking initiative for warehouse layout, operating procedures and warehouse technology, brings together the knowledge and experience of logistic specialists across the Group to create an optimised operational model for our wholesale businesses.

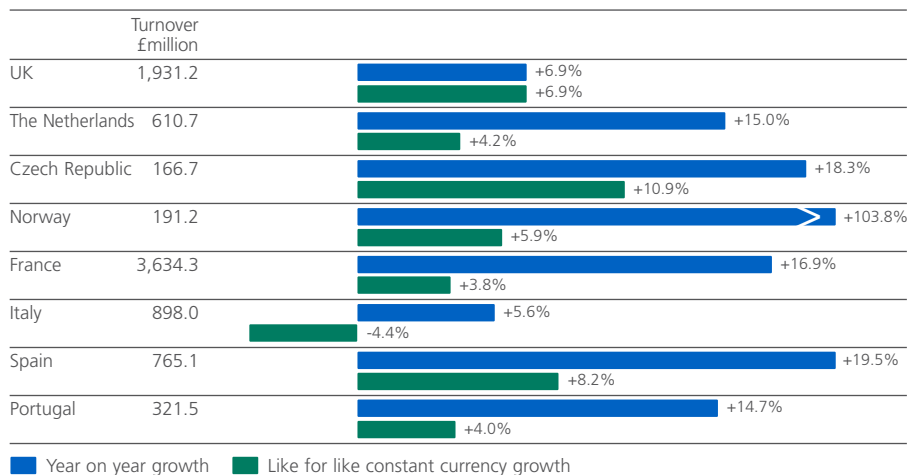
Re-laid warehouses are showing substantial improvements in customer service, productivity and operational efficiency, realising significant cost savings, avoiding the need to relocate to larger premises. For example, by the end of 2003 our customers at Hinckley in the UK, the first of the re-lay projects, were enjoying a 1.7% higher service level, and costs per line handled had reduced by 15.7%. Capacity increased by around 25% at the same time.

Over the last two years, four UK warehouses have been re-laid in compliance with best practice and two built in the Netherlands, one of which is shown here. We continue to roll out the best practice model across our network.

# Best practice warehouse design improves productivity and customer service and reduces stock investment

## Wholesale

year ended 31 December 2003



## Wholesale

### Northern Europe

Operating profit before amortisation of intangible assets was £84.3 million (€121.6 million), an increase of 8.9% on the previous year, on turnover up 12.7% to £2,899.8 million (€4,184.4 million). Overall market growth was better than predicted primarily as a result of higher growth in the UK. Like for like sales were up 6.5% on a constant currency basis, reflecting an overall increase in market share. Operating margins decreased by ten basis points to 2.91% due to the impact of opening and closing warehouses in The Netherlands as part of our warehouse rationalisation programme, underlying margins improving in all countries. Operating profit before amortisation of intangible assets in the second half was £44.7 million, an increase of 4.2% on the second half of 2002 on turnover up 9.7%.

In the UK, turnover increased by 6.9% to £1,931.2 million (€2,786.7 million), reflecting further gains in market share, with estimated market growth of 5% being higher than we had predicted at the start of the year. A continuing strong commercial focus, together with productivity gains, resulted in higher operating margins and good profit growth, despite competitive discounting and the strong Euro squeezing margins on certain product segments.

## Operating review (continued)

# Almus generics appeal to both pharmacists and patients

### Wholesale

#### Northern Europe (continued)

In April, we launched a range of generic drugs, branded "Almus", following research carried out amongst pharmacists and a commercial programme we initiated involving manufacturers, licence holders and packaging designers. Reaction from pharmacists and patients has been very positive, the range having been expanded to 70 products by the year end.

We continue to build on the success of our portfolio of added value services and industry acclaimed loyalty schemes to independent community pharmacies. Our work in medicines management was nationally recognised when Pharmacy Alliance, our virtual chain organisation, was awarded the Pharmaceutical Care Award by The Pharmaceutical Journal.

Following the successful re-laying of the Hinckley warehouse in 2002, as part of the Group-wide benchmarking initiative designed to increase warehouse productivity, the Croydon warehouse was completed in 2003, with the Preston and Livingston warehouses completed in February 2004.

In The Netherlands, turnover increased by 15.0% to £610.7 million (€881.2 million), up 4.2% on a constant currency basis, with estimated market growth slowing to just below 4%. Underlying operating margins were higher than last year, regulatory developments having less impact on

performance than we had expected, although reported operating profits and margins were lower due to our warehouse rationalisation programme.

A new warehouse in Almere was successfully opened in January 2003, replacing outdated facilities, the layout of which incorporates benefits derived from the Group-wide benchmarking initiative. Customers will in future be serviced from four modern facilities in The Netherlands, with the fifth, smaller, warehouse in Rotterdam being scheduled to close in March 2004.

In the Czech Republic, turnover increased by 18.3% to £166.7 million (€240.6 million), up 10.9% on a constant currency basis, compared to a market which we estimate grew by 11%. Operating profits in local currency increased, higher sales and improved productivity more than offsetting gross margin pressures. Two warehouses were closed during the year, following the extension of the principal facility in Prague in late 2002.

In Norway, turnover increased by 103.8% to £191.2 million (€275.9 million), the business having been acquired at the end of June 2002. Like for like sales growth for the second half of the year was 5.9% on a constant currency basis, with profitability higher. Market growth for the full year is estimated at 3%.

#### Southern Europe

Operating profit before amortisation of intangible assets was £74.4 million (€107.4 million), unchanged from the previous year, on turnover up 15.1% to £5,618.9 million (€8,108.1 million). Like for like sales growth was 3.1% on a constant currency basis. Operating margins decreased by 20 basis points to 1.32%, mainly as a result of lower gross margins in France. Second half operating profit before amortisation of intangible assets was £40.5 million, an increase of 4.4% on the second half of 2002 on turnover up 15.0%.

Market growth was higher than we had predicted in all countries, growth being particularly strong in Spain. These markets remained challenging nevertheless, government action to reduce drug expenditure impacting trading performance, most notably in France. In response to these pressures, we took further action to reduce costs and offer enhanced services to customers.



### Almus

In April 2003 we launched an exclusive range of generic drugs in the UK, branded Almus, following research carried out amongst pharmacists and a commercial programme we initiated between manufacturers, licence holders and packaging designers.

Almus's innovative colour-coded packaging helps pharmacists avoid dispensing errors. Patients also appreciate Almus's easily recognisable packaging with clear, concise instructions for use. Those patients who are on repeat prescriptions benefit from greater continuity in dispensing, as our competitive prices encourage pharmacists to choose Almus, time and again, over other generics. For manufacturers, Almus represents an attractive additional sales route to sell their products.

Almus has quickly become a great success; in 2003 we launched 70 products, making it already an important generics brand in the UK. The range received an industry accolade, with generic Almus Metformin, winning "Pharmacy Business Generic Product of the Year 2003" at the UK Pharmacy Business Awards.



## Operating review (continued)



### Alphega

Virtual chains allow our pharmacist customers in the UK, Holland, France and Italy to enjoy some of the financial and operational benefits of chain membership whilst maintaining their independence. In France, 182 independent pharmacists have chosen to join our newest virtual branded chain, Alphega, shown here, and Alphega has recently been launched in Italy.

The Alphega format offers pharmacists a wide range of tools to help them develop and grow their businesses. Merchandising and marketing support enables pharmacists to optimise investment decisions, enhance selling space and anticipate patient needs. Consultation tools aid dispensing, while Alphega's literature provides easily accessible information on treatment and prevention.

In total, 1,181 pharmacies are members of our virtual chains.

# Increasing numbers of independent pharmacists are choosing to join our virtual retail chains

## Wholesale

### Southern Europe (continued)

In France, turnover increased by 16.9% to £3,634.3 million (€5,244.3 million), the high growth rate reflecting the acquisition of Ouest Répartition Pharmaceutique in the second half of 2002 and the strengthening of the Euro against Sterling. Like for like sales growth was 3.8% on a constant currency basis, compared to estimated market growth in the wholesaling segment of 5%, competition from co-operatives being more aggressive in the latter part of the year. We estimate that the total market grew in value by 6.5% with the proportion of products which manufacturers distribute direct to pharmacies rapidly increasing. This reflects the growing importance of generic products, partially as a result of the new reference pricing system. We are working closely with a number of generics manufacturers to increase our market share in this category.

Operating margins were lower than in 2002, due to higher ACOSS healthcare taxes, the full year impact of owning the lower margin Ouest Répartition Pharmaceutique business and non recurring costs. These included a £1.6 million additional charge for a failed appeal against a 2001 competition fine. This fine related to discounting in the early 1990s by wholesalers, one of whom was a company subsequently acquired by the Group. The closure of one warehouse completed the rationalisation plan begun

in 2001. Following the successful launch in 2002 of Alphega, a virtual pharmacy network concept which independent pharmacies can join, the number of pharmacies in the programme rose during the year by 72 to 182.

In Italy, turnover increased by 5.6% to £898.0 million (€1,295.9 million), a decrease of 4.4% on a constant currency basis. This compares with a market which we estimate grew by 3%. Our sales reduction reflected the final stage of our programmed withdrawal from heavily discounted and unprofitable supplies to a number of municipal pharmacy chains as long-term contracts expire, together with the impact of aggressive competition, particularly in southern Italy.

Underlying operating profitability improved year on year, reflecting the benefits of swift action taken in 2002 and a continuing focus on gross margin management and cost control in what has recently been a more stable market environment. Reported operating profitability was, however, lower than in 2002, due to the impact of our debtors' securitisation programme launched in June 2002, which increased operating costs but gave us a corresponding reduction in interest charges. Minor restructuring charges were incurred in the first half of the year. We continue our review of operational strategy in Italy to determine how best to improve longer-term business performance.

In Spain, turnover increased by 19.5% to £765.1 million (€1,104.0 million), up 8.2% on a constant currency basis, domestic sales growth of 11.7% more than offsetting a decline in export business. We continue to gain market share with domestic market growth estimated at 11%. Underlying profitability increased year on year, reported operating profits and margins being adversely impacted by minor restructuring charges to streamline the management structure.

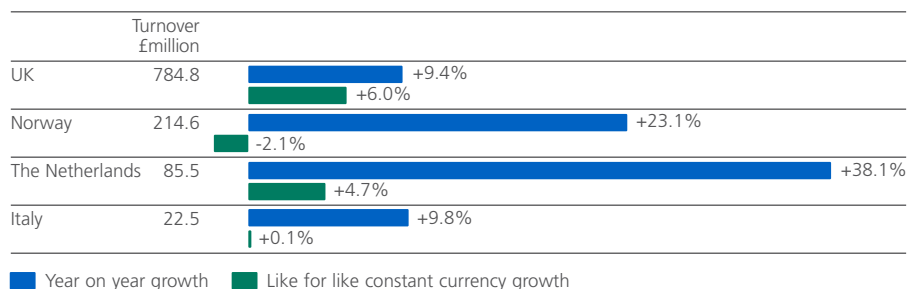
Turnover in Portugal increased by 14.7% to £321.5 million (€463.9 million), up 4.0% on a constant currency basis, compared to an estimated market growth rate of 3.5%. Year on year profitability increased with operating margins being slightly higher. One warehouse was closed during the period.

## Operating review (continued)

# Community pharmacy is a key part of the primary care network

### Retail

year ended 31 December 2003



### Retail

Operating profit before amortisation of intangible assets was £79.3 million (€114.4 million), an increase of 20.5% on the previous year on turnover up 13.7% to £1,107.4 million (€1,598.0 million). In the second half, operating profit before amortisation of intangible assets was £43.2 million, an increase of 24.1% on the second half of 2002 on turnover up 13.6%. Like for like sales on a constant currency basis increased by 4.2% year on year. Overall retail operating margins at 7.16% were 40 basis points higher than in 2002 as a result of operating margin improvements in all countries other than Italy.

In the UK, turnover increased by 9.4% to £784.8 million (€1,132.5 million), with like for like sales growing by 6.0%. Our National Health Service prescription income increased by 11.0%. Operating margins were higher as a result of increased incomes from professional services and operational efficiencies. During the year, one new pharmacy was opened adjacent to a health centre and 33 pharmacies were acquired, the majority in the second half. The total UK chain, as at 31 December 2003, comprised 816 pharmacies and 55 other healthcare related retail outlets. During the year, 67 branches were refitted and eight pharmacies were relocated, five to new healthcare developments. Contracts to supply and dispense medicines to a further four prisons were won during the year, and a pilot scheme is underway to offer help and support to patients at home provided by trained care workers.



Moss  
PHARMACY



### Moss Pharmacy

The cornerstone of the Group's retail strategy is our belief that the pharmacy is a key part of the primary care network. Our pharmacies are typically located in communities, usually close to doctors' surgeries and health centres, which is convenient for patients obtaining prescriptions and facilitates the development of close working relationships with general practitioners and other local healthcare professionals.

In the UK, over half our pharmacies are within 100 metres of a main doctor's surgery or health centre with over 75% within 250 metres. Here in Send, the Moss Pharmacy is actually attached to the local health centre. The pharmacy benefits from a significant share of the centre's prescriptions and repeat prescriptions, and works closely with the practice nurses as part of the local Primary Care Trust's bulk dressing supply service. Other services provided include weight management, advice to care homes and lifestyle checks related to a wider cardiac risk assessment programme.

## Operating review (continued)



### Kring

Pharmacists from Kring, our virtual chain in The Netherlands, recently undertook a study to identify the frequency, nature and causes of potential drug related problems in elderly patients who frequently take more than one medication at a time.

Over the course of a year, Kring pharmacists screened 196 patients, each taking on average 8.7 prescriptions. The study concluded that elderly patients are vulnerable to frequent drug-related problems. Through pharmacist screening the number of medications taken can be reduced, alternative medications substituted, compliance monitored and side-effects better managed.

For pharmacists involved in the study, the screening also resulted in enhanced relationships with elderly patients and their doctors and new service related revenues were gained (for each patient screened, pharmacists were paid a fee by a Dutch insurer).

KRING APOTHEEK

# Pharmacy practice is increasingly focused on improving patient care

## Retail (continued)

In January 2003, the Office of Fair Trading published recommendations to fully deregulate the National Health Service contract system for pharmacies. These recommendations were rejected by the governing bodies in Scotland, Wales and Northern Ireland. In July 2003, the Department of Trade and Industry countered these recommendations for England, proposing instead further changes to pharmacy regulation which recognise the vital role that community pharmacies, such as those operated by Moss Pharmacy, play in providing primary care and patient services. This concept, endorsed by government in all regions of the United Kingdom, is entirely consistent with the way we have developed our UK pharmacy business. Moss Pharmacy has, for some time, led the community pharmacy sector in the development of professional services, continuing education and development of pharmacists and integration with other healthcare professionals. The 12 week Department of Health consultation period ended on 21 November 2003, and we await the detailed procedures that will implement the government's policy.

The vision developed by Moss Pharmacy, "Leading at the Heart of Healthcare", defines our ambition to be at the forefront of future changes to the role of pharmacies in the UK through the development of services on offer beyond the core dispensing activity. This presents a compelling and attractive environment to pharmacists, and we continue to attract, develop and retain excellent patient-orientated professional pharmacists.

An investment is underway to install advanced branch EPOS and pharmacy management systems, linked into new head office systems. This investment, which will be completed in 2005, will facilitate the delivery of new pharmacy services and enable us to manage the business even more effectively.

In Norway, turnover increased by 23.1% to £214.6 million (€309.7 million), up 19.1% on a constant currency basis, reflecting the continued expansion programme. Like for like sales decreased by 2.1% because of an increase in the total number of Norwegian pharmacies. Our reduction was lower than that of the market as a whole, reflecting the inherent quality of our pharmacies. 14 pharmacies were acquired during the year and six opened, bringing the total chain to 109 at 31 December 2003. Operating margins continued to grow as the business benefits from increased scale, both in terms of commercial and cost leverage. As a result, operating profits before amortisation of intangibles more than doubled.

In The Netherlands, turnover increased by 38.1% to £85.5 million (€123.4 million), up 25.2% on a constant currency basis, reflecting the expansion of the chain. Like for like sales increased by 4.7%. During the year, seven pharmacies were purchased, increasing the chain size to 46. As in Norway, operating margins increased as the business increased its scale, resulting in substantially higher operating profits.

In Italy, turnover increased by 9.8% to £22.5 million (€32.4 million), an increase of 0.1% on a constant currency like for like basis. No pharmacies were acquired during the year, leaving a total of 28 at the year end, including eight in associate businesses. Operating margins and profit were lower due to costs incurred in strengthening the management team.

Through other associate retail businesses the Group operated 93 pharmacies and seven other retail outlets at 31 December 2003 with seven pharmacies being acquired during the year and three opened.

## Operating review (continued)

# Associates can provide a relatively low risk point of entry into new, fast-growing markets

### Corporate

Net corporate costs totalled £11.4 million (€16.5 million), a £0.3 million reduction on 2002, primarily due to lower pharmacology.com costs, as a result of operating companies assuming responsibility for pharmacology service delivery and marketing, and also following the completion of the bulk of the software development work. Included in corporate costs was income from the sale of 30% of the Alloga prewholesaling associate, which was almost completely offset by costs for the settlement of litigation relating to the Group's former investment in Rx.com and other internet technology businesses.

### Associates

Associates contributed £36.8 million (€53.1 million) to total operating profit before amortisation of intangible assets, a 71.2% increase year on year.

Hedef Alliance in Turkey contributed £20.4 million (€29.4 million), compared to £6.9 million in 2002. Business operating profits before amortisation of intangible assets increased by 97.3% on an inflation adjusted basis, reflecting the efforts made by joint teams of executives from Alliance UniChem and Hedef on key business drivers, leading to strong sales and gross margin growth. The balance of the increase in contribution from Hedef Alliance reflects the purchase of the second 25% shareholding in the business in September 2002 and a strengthening of the Turkish Lira against Sterling. The balance of the consideration for this additional shareholding is expected to be settled in the first half of 2004, based on Hedef Alliance's financial performance for the two years ended 31 December 2003.

Contributions from other associates increased by 12.3% in total to £16.4 million (€23.7 million), an increase of 1.7% on a like for like constant currency basis. In June 2003, the Group reduced its direct investment in its Alloga prewholesaling associate from 50% to 20%, the shares being sold to our partner, Galenica, which is in turn 25.5% owned by the Group.



### Hedef Alliance

In 2001 we entered the Turkish market via a 25% investment in Hedef (now Hedef Alliance), the largest wholesaler in Turkey, subsequently increasing our stake to 50%. Through this very successful associate investment, we have accessed the rapid growth of a large emerging market.

Since our relationship began, we have worked in partnership with our Turkish colleagues, sharing skills and experience. Hedef Alliance participates in our warehouse best practice programme and will implement our next-generation wholesale computer systems.

We view our associates as partners with whom to develop our common interests in new regions. In keeping with this strategy, we supported Hedef Alliance in 2003 to expand beyond its borders through the purchase of a 40% stake in UCP, the joint market leader in the Egyptian pharmaceutical wholesaling market.