

Board report on corporate governance

The Board is committed to meeting the standards of good corporate governance set out in the Combined Code on corporate governance published by the Financial Reporting Council in July 2003 (the "Code"), which replaced the previous code for financial periods beginning on or after 1 November 2003. This report, together with the audit committee report on pages 42 and 43 and the Board report on remuneration on pages 44 to 54, describes how the Board applied the Code during the year under review.

The Board

The Board currently comprises the Chairman, six executive Directors and seven non-executive Directors. The names of the Directors together with their biographical details are set out on pages 30 and 31. As part of the Company's management succession programme, Ian Meakins was appointed Chief Executive of the Group in place of Stefano Pessina, who returned to his previous role as executive Deputy Chairman. Both changes were effective from 1 December 2004. Geoff Cooper, Deputy Chief Executive, resigned from the Board on 29 July 2004 when the decision to appoint Ian Meakins was finalised, and he left the Company at the end of the year. The roles of the Chairman, Chief Executive and Executive Deputy Chairman have been set out in writing and approved by the Board. The executive Directors' service contracts and the letters setting out the terms of appointment of the non-executive Directors are available for inspection by any person at the Company's registered office during normal business hours and at the AGM.

Chairman

Jeff Harris, who is responsible for the operation of the Board, was appointed Chairman in September 2001. In April 2003 he retired as a full time executive continuing as Chairman in a non-executive capacity. He was appointed to the Board in 1986 and held the position of Chief Executive from 1992 to 2001. The Directors are of the opinion that his extensive industry and business specific knowledge and experience, gained during 17 years as an executive director, have been extremely beneficial to the Board and that his Chairmanship provided valuable continuity to develop the business in the best interests of shareholders and customers. Jeff Harris will step down as Chairman of the Company and retire from the Board at the conclusion of the 2005 AGM. Paolo Scaroni, who was appointed to the Board as an independent non-executive Director on 10 December 2002, will replace him as Chairman of the Company with effect from the same date.

Chief Executive

Ian Meakins is responsible for leading the Group's businesses and managing the Group on a day-to-day basis within the authorities delegated by the Board.

Executive Deputy Chairman

Stefano Pessina, in addition to his role as executive Deputy Chairman, has operational responsibility for strategic development, including acquisitions.

Operation of the Board

The Board met eight times in 2004, including a meeting at the headquarters of the Group's Swiss associate, Galenica, in Berne and a meeting at Moss Pharmacy's headquarters in the UK. In addition, the Board held a strategy meeting in June. The Board is scheduled to meet eight times in 2005, with additional meetings held as required. The attendance record for Board and Committee meetings, including the AGM, is set out on page 41.

The Board has adopted principles of good boardroom practice. These principles ensure that the Directors can perform their role effectively and are given the means and information necessary for them to make informed decisions. The principles include details of:

- the legal responsibilities of Directors;
- the role and appointment of non-executive Directors;
- the procedure by which Directors are given and can obtain information, training and independent advice;
- the procedure for the provision of notices, agendas, papers and minutes for meetings of the Board and Board committees; and
- how meetings of the Board and Board committees are conducted.

The Board is collectively responsible for promoting the success of the Group by directing and supervising the Group's affairs. There is a schedule of matters reserved for approval by the Board, which ensures that it takes all major strategy, policy and investment decisions affecting the Group. This schedule is reviewed annually and includes specific matters under the categories of legal, stock exchange, strategic management control, risk management, Board membership, Board committees, capital and revenue commitments, financing, advisers and employees. At each scheduled meeting, the Board receives a report on current trading and major business issues and

annually approves a three year forward plan and a budget for the following financial year. The Board monitors the Group's overall system of internal controls, governance and compliance and has approved formal delegated powers giving the executive committee day-to-day management of the Group.

Director's and officers insurance

The Company maintains an appropriate level of Directors' and officers' insurance in respect of legal action against Directors.

Board balance and independence

The Board has reviewed the independence of all the non-executive Directors and determined that of the eight non-executive Directors, six are independent. Two are considered to be non independent:

- the Chairman, Jeff Harris, who will be stepping down as Chairman of the Company and retiring from the Board at the conclusion of the 2005 AGM, has previously been an executive Director of the Company; and
- Etienne Jornod is Chairman and Managing Director of Galenica, an associate company. Galenica is entitled, as long as the associate agreement exists between it and the Company, to designate one Director for appointment to the Board of the Company, subject to the approval of the Company's shareholders.

Throughout the year, the Company has not complied with the Code requirement that at least half of the Board, excluding the Chairman, should comprise non-executive Directors determined by the Board to be independent. However, there is a broad pool of independent non-executive Directors who can serve on committees, such that undue reliance is not placed on particular individuals. It is considered that the Board has the balance of skills and experience appropriate for the requirements of the business and that no individual or group of individuals dominates the Board's decision making.

The senior independent non-executive Director is Ken Clarke. The role's terms of reference provide that he is available to shareholders if they have a concern which would make contact through the normal channels of Chairman or Chief Executive inappropriate, or which have not been resolved by such contact. The senior independent non-executive Director periodically holds meetings with the other non-executive Directors without the executive Directors present.

A procedure is in place for Directors, if they wish, to receive independent professional advice in respect of their duties. They also have access to the advice and services of the Company Secretary who is charged with ensuring that Board procedures are followed and that good corporate governance and compliance is implemented throughout the Group. The Company Secretary attends all meetings of the Board and Board committees. The appointment and removal of the Company Secretary is a matter reserved for the Board. The Board and its committees are supplied with full and timely information which enables them to discharge their responsibilities. In addition to the papers circulated to the Board in advance of Board and Committee meetings, reports are sent to the Directors in months when the Board is not scheduled to meet. The Company Secretary ensures good information flows within the Board and its Committees and between the non-executive Directors and management. New Directors receive appropriate induction training on joining the Board, including site visits and meetings with senior management.

Performance evaluation

During the year, the Board formally evaluated its own performance and that of the Board Committees, which included a "follow up" of matters raised in the evaluation carried out by an independent firm of management consultants a year ago. This process was in the form of a questionnaire, supplemented by one to one meetings between the Chairman and each of the Directors, where individual performance was discussed. It is the intention of the Board to undertake further reviews by an independent firm at least every three years. The non-executive Directors met separately to discuss the performance of the Chairman. Issues arising from the self assessment evaluation were presented to the Board by the Chairman with an action plan to ensure continuous improvement in the operation of the Board and its committees. The evaluation of the personal performance of the executive Directors was based on a 360-degree appraisal process.

Re-election of Directors

All Directors are required to be elected by shareholders at the AGM following their appointment by the Board and then re-elected at least once every three years. In accordance with the Articles of Association of the Company, one third of the Directors (excluding new appointments) must stand for re-election at each AGM. Non-executive Directors are normally appointed for an initial term of three years which is then renewed and

extended for not more than two further three year terms. Prior to recommending the re-election of non-executive Directors to the Board, the nomination committee reviews their effectiveness. The review process in 2004 concluded that all Directors continue to contribute effectively and with proper commitment, devoting adequate time to carry out their duties. The notice of this year's AGM confirms that the performance of the Directors being proposed for re-appointment continues to be effective.

The Code requires that the performance and the commitment of any Director being proposed for re-election for a term beyond six years should be subject to a particularly rigorous review. Such a review was conducted for Neil Cross who is being proposed for re-election at the AGM to be held on 22 April 2005.

There is a policy that non-executive Directors will not normally be invited to stand for re-election after serving nine years on the Board. Neil Cross who was appointed to the Board in 1997 will, subject to re-election at the 2005 AGM, retire from the Board at the conclusion of the 2006 AGM. The other Directors coming up for re-election at the 2005 AGM are Stefano Pessina, Steve Duncan and Paolo Scaroni. Ian Meakins, who was appointed to the Board since the last AGM, will retire from the Board at the 2005 AGM and, being eligible, will offer himself for election.

Board committees

The Board has established four committees, the nomination, remuneration, audit and executive committees. Each committee has terms of reference, agreed by both the committee and the Board, which were reviewed during the year, and are published on the corporate website at www.alliance-unichem.com. Regular reports of committee business and activities are given to the Board.

Nomination committee

The nomination committee consists of four independent non-executive Directors, Ken Clarke (Committee Chairman), Neil Cross, Patrick Ponsolle and Paolo Scaroni, and three other Directors, Jeff Harris, Ian Meakins and Stefano Pessina. Ian Meakins and Paolo Scaroni were appointed to the committee in December 2004. The majority of the members of the committee are independent non-executive Directors as required by the Code. The Committee met twice in 2004, the attendance record of members being shown in the table on page 41.

The duties of the nomination committee are to:

- regularly review the structure, size and composition of the Board;
- regularly review the skills, knowledge and experience of the Board and make recommendations to the Board with regard to any adjustments that are considered necessary;
- ensure succession plans are in existence for Directors; and
- keep under review the leadership needs of the Group.

Ian Meakins' appointment to the Board was made in accordance with the Code principles. A search was conducted by an executive search firm specialising in Board level appointments to identify external candidates on a national and international basis to be considered alongside internal candidates. A shortlist of candidates was interviewed by each member of the nomination committee as well as by other non-executive Directors, prior to the committee recommending the appointment of Ian Meakins as Chief Executive.

As part of the ongoing review of succession, the committee has instructed external consultants to identify candidates for a number of positions as independent non-executive Directors. This process will involve an evaluation of the skills and experience required, including the need for at least one new independent non-executive Director to have recent and relevant financial experience. The committee will also consider whether candidates have sufficient time to fulfil the roles.

The committee and the Board also recognise that the Code requires the Chairman of the Board to be an independent non-executive Director. As stated above, Jeff Harris will step down as Chairman of the Company and retire from the Board at the conclusion of the 2005 AGM. Paolo Scaroni, who was appointed to the Board as an independent non-executive Director on 10 December 2002, will replace him as Chairman of the Board with effect from the same date. Paolo Scaroni was seen as a potential candidate for the position of Chairman of the Company when he was first appointed to the Board.

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Remuneration committee

The remuneration committee consists of four independent non-executive Directors, Ken Clarke (Committee Chairman), Neil Cross, Adrian Loader, and Patrick Ponsolle. The Chairman, the Chief Executive and the Executive Deputy Chairman are invited to attend meetings as appropriate but are not present when their own remuneration is discussed. The committee met four times in 2004, the attendance record of members being shown in the table on page 41. The role of the committee and details of how it applied the principles of the Code and the Directors Remuneration Report Regulations 2002 are set out in the Board report on remuneration on pages 44 to 54.

Audit committee

The audit committee consists of five independent non-executive Directors, Neil Cross (Committee Chairman), Adrian Loader, Patrick Ponsolle, Paolo Scaroni and Manfred Stach. The role of the Committee and details of how it carried out its duties are set out in the audit committee report on pages 42 and 43.

Executive committee

The executive committee consists of the executive Directors and is chaired by Ian Meakins. The executive committee met 12 times in 2004.

The duties of the executive committee are to:

- oversee the operation of the Group;
- implement decisions of the Board;
- attend to all matters not reserved for approval by the Board or delegated by the Board to other Board committees; and
- attend to all matters delegated to it.

Relations with shareholders

The Company organises a programme of formal and informal events, investor meetings, and presentations which take place throughout the year. This programme is led by the Chief Executive and the Finance Director and involves other members of the executive committee and the Director of Investor Relations. Meetings are held with institutional investors and analysts to discuss information made public by the Group and any questions that may arise. The Company ensures that no price-sensitive information is disclosed in these meetings. To ensure the Board is effectively informed of shareholders' views, the Company's brokers and the Director of Investor Relations monitor those views and provide regular feedback to the Board.

The non-executive Directors are offered the opportunity to attend meetings with major shareholders and shareholder events. They also make themselves available to investors upon request. In addition to the programme described above, the Company's website provides financial and other information about the Group. Preliminary and interim results, as well as all announcements to the London Stock Exchange are published on the Company's corporate website.

All shareholders have the opportunity to attend the Company's AGM and to question the Directors on any issue relating to the Company. The Chairmen of the nomination, remuneration and audit committees are also present at the meeting to answer questions.

In accordance with best practice:

- the notice of the AGM is circulated to all shareholders at least 20 working days before the AGM;
- the proxy votes for and against each resolution, as well as abstentions, are made available at the meeting after shareholders have voted on each resolution on a show of hands, with the exception of the resolution in connection with the waiver of the obligations of Rule 9 of the City Code on Takeovers and Mergers, which is voted on by a poll; and
- separate resolutions are proposed at the AGM on each substantially separate issue.

Internal controls

The Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness. The system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can provide only reasonable, and not absolute, assurances against material misstatement or loss. The Board considers risk assessment and control to be fundamental to the Company achieving its corporate objectives within an acceptable risk/reward profile and confirms that there is an ongoing process to identify, evaluate and manage significant risks in the Group's system of internal controls. The effectiveness of the internal control system is reviewed annually by the audit committee on behalf of the Board. Throughout 2004 and up until the date of this report the internal controls systems comply with the Turnbull guidance for directors as required by the Code.

Key elements of the Group's system of internal controls are as follows:

- regular Board meetings with a formal schedule of matters reserved by the Board for decision;
- Board approval of business strategies, three year forward plans and annual budgets;
- an annual risk review by the audit committee, based on a detailed self-assessment by management of business risks in terms of impact, likelihood and control strength;
- clearly defined organisational structures and appropriate delegated authorities for the Group's businesses;
- monthly review by the executive committee of key performance indicators to assess progress towards objectives, with action being taken as required;
- continuous monitoring of regulatory developments;
- procedures for planning, approving and monitoring business acquisitions, divestments and capital expenditure projects, supplemented by post-investment performance reviews;
- dispensing and professional pharmacy protocols;
- procedures for security and specialist handling of certain drug classes;
- a rolling programme of surveys by the Group's insurance brokers to advise on physical risks;
- centralised treasury operations operating within defined limits and subject to regular reporting requirements;
- an internal audit function providing independent scrutiny of internal control systems and risk management procedures;
- regular monitoring of risks and control systems throughout the year by operating businesses;
- a self-certification process, whereby operating businesses are required to confirm in writing that the system of internal control is operating effectively;
- the Director of Internal Audit has the right of direct access to the audit committee and the Chairman of the Company;
- continuous monitoring by the Group legal function of claims and litigation throughout the Group; and
- a requirement for specialist legal, financial, and other professional advice to be obtained as part of the Group's business activities.

Meeting attendance record

	AGM	Board	Executive committee	Audit committee	Remuneration committee	Nomination committee
Number of meetings in 2004	1	8	12	4	4	2
Director						
J. F. Harris	1	8	–	–	–	2
I. K. Meakins ⁽¹⁾	–	1	1	–	–	–
S. Pessina	1	8	12	–	–	2
G. R. Fairweather	1	8	12	–	–	–
O. Barra	1	8	12	–	–	–
P. Utnegaard	1	8	12	–	–	–
S. W. J. Duncan	1	8	12	–	–	–
G. I. Cooper ⁽²⁾	1	4	7	–	–	–
K. H. Clarke	1	7	–	–	4	2
N. E. Cross	1	8	–	4	4	2
W. A. Loader	1	5	–	2	2	–
P. Ponsolle	1	6	–	2	4	1
P. Scaroni	1	7	–	4	–	–
M. Stach	1	4	–	0	–	–
E. Jornod	1	8	–	–	–	–
C. J. S. Berretti ⁽³⁾	1	3	–	–	–	–

(1) appointed to the Board in December 2004; one Board meeting and one executive committee meeting were held after his appointment

(2) resigned from the Board in July 2004; four Board meetings and seven executive committee meetings were held before his resignation

(3) retired from the Board in April 2004; three Board meetings were held before his retirement

Compliance statement

The Company applied the principles of the Code throughout the year under review with the following exceptions:

- Code provision A.2.2 – Prior to his appointment as Chairman, Jeff Harris held the position of Chief Executive of the Company. He will step down as Chairman of the Company and retire from the Board at the conclusion of the 2005 AGM. Paolo Scaroni, who was appointed to the Board as an independent non-executive director on 10 December 2002, will replace him as Chairman of the Company with effect from the same date;
- Code provision A.3.2 – Six of the 14 Directors on the Board are considered to be independent. The Board recognises that the Code specifies that at least half of the members on the Board (excluding the Chairman) should be independent non-executive Directors. The Board is working towards achieving the necessary balance; and
- Code Provisions A.4.1/B.2.1/C.3.3 – The terms of reference of the nomination, remuneration and audit committees were updated during the year to comply with the requirements of the new Code. Although the terms of reference for each committee were available to the public on request, they were not put on the Company's website until February 2005.