

Financial review



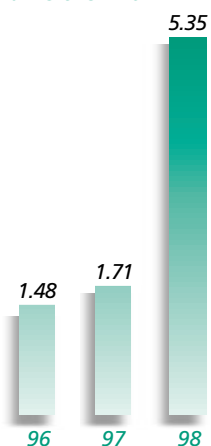
Geoff Cooper
Finance Director

Group turnover increased by 11 per cent and comparable Group operating profits by 8 per cent. After allowing for securitisation charges, the reclassification of associates' interest costs and at actual average exchange rates, net interest costs decreased by £4.3 million and interest cover was 5.4 times (1997 pro-forma: 3.9 times). This reduction in interest costs reflects a fall in base rates across Europe, financing synergies in the form of better borrowing margins, and lower average borrowings from improved working capital management, less the financing of working capital in acquired businesses. Profit before tax increased by 15 per cent and profits after tax grew by 16 per cent. The overall tax rate for 1998 was 33.8 per cent. Diluted earnings per share increased by 10 per cent, and the 10 per cent increase in the full year dividend to 10.65 pence per share gives dividend cover of 2.3 times, level with last year on a per share basis.

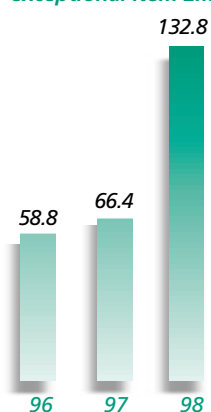
Group Results

The results for 1998 represent the first year of trading for the combined UniChem and Alliance Santé businesses. Comparisons in the text with 1997 are, unless stated, made using pro-forma figures for the merged Group published with the 1997 UniChem results and use 1997 exchange rates for both years.

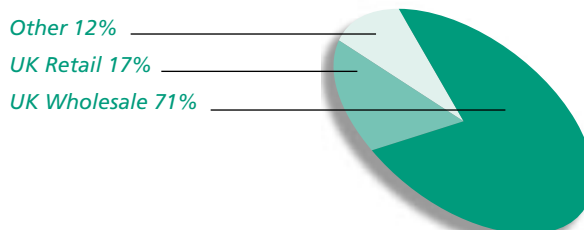
Total turnover for all the divisions - £bn.



Total operating profit for all divisions, pre-exceptional item £m.



Turnover by division 1997



Turnover by division 1998



Cash Flow

With continuing strong cash flow from our core businesses, average borrowings remained broadly level with 1997 through most of 1998, but increased during the fourth quarter to end the year with net debt of £493 million (€730 million), mainly due to acquisitions and the full consolidation of Safa. Average net working capital investment is about 11 per cent of sales and organic sales growth would have required around £35 million of extra working capital investment. However, the growth in working capital only consumed £23 million (€34 million). The net cash outflow from tax and interest payments and dividends was in line with our expectations, giving free cash flow of £57 million (€84 million). We spent a net £33 million (€49 million) on capital expenditure, of which £14 million (€21 million) relates to expansion of our warehouse network across Europe. Expenditure on acquisitions in the year was £89 million (€132 million). The majority of this outflow fell into the second half-year, and as a result year end gearing was 126 per cent, level with 1997.

Receivables Securitisation

The wholesale market in France requires a higher level of working capital investment since pharmacists have traditionally used their wholesaler as a source of funds. However, ASF experiences low bad debt levels, since cashflows are effectively underwritten by the French Government and pharmacy values are protected since pharmacy numbers are generally controlled. The high quality of pharmacy receivables has enabled Alliance Santé France to set up a securitisation programme through an A1 / P1 rated conduit which, subject to a retention, means the receivables are sold on a non-recourse basis. At the year end, the non-recourse value of receivables outstanding amounted to FFr 1,800 million (£193.8 million / €287.0 million). The effect of the securitisation programme is to reduce debtors and borrowings by the non-recourse amount and to reduce interest charges and increase operating costs by an equal amount. The retention amount is included within trade debtors.

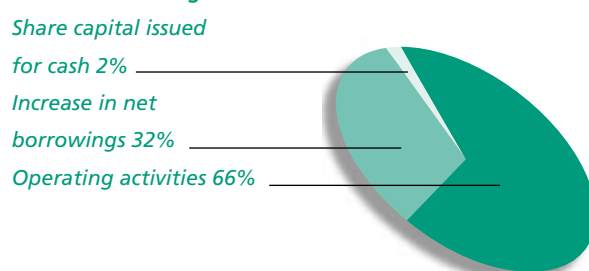
Operating profit by division 1997



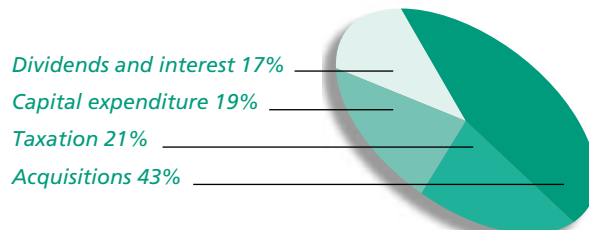
Operating profit by division 1998



Sources of funding



Application of funds



Financial review

Funding

A major review of treasury policies and funding requirements was completed in 1998 which recommended actions to ensure the longer term financing needs of the Group are met. So far, two significant recommendations have been implemented.

We have established some £290 million (€429 million) of both short and medium term committed facilities with a "club" of nine banks, representing those with whom we have key relationships in all but one of our major operating territories.

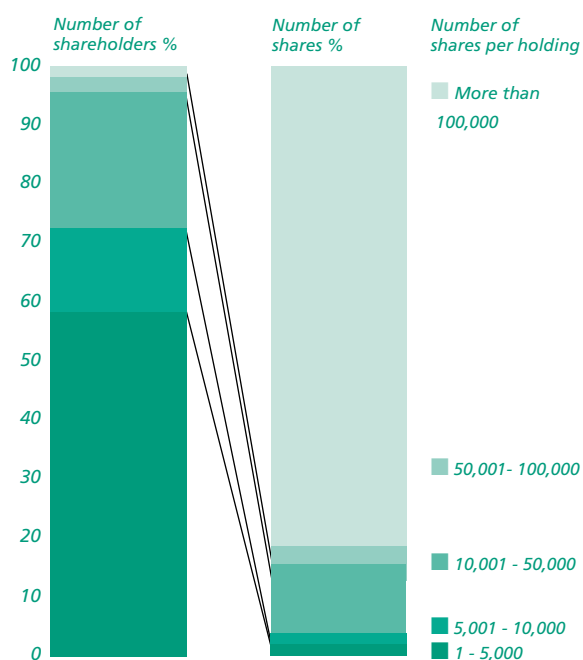
We also successfully issued US\$170 million of 9 and 10 year loan notes to private investors in March 1999. This was a significant achievement as it demonstrates the Group's ability to access funding from different financial markets, whereas historically the Group has relied exclusively on the banking market to meet its needs. All of the principal and interest due under this financing were swapped into Euros. These arrangements, together with the receivables securitisation conduit, give us a sound financial platform for the future, with committed facilities expected to remain at 70 per cent of average borrowings and 40 per cent of total facilities.

Financial Risk Management

The treasury review also set out to address financial risk management issues. This largely reaffirmed the Group's policy to date, that financial risks are to be managed in relation to underlying business needs and that any derivative financial instruments used in this context require Board approval. However, the preferred degree of protection against financial risk is to be increased, in view of higher gearing post-merger, to a target level of about 60 per cent of average borrowings, having regard to the prevailing interest rate environment.

The Group currently has arrangements in place, including swaps, caps and fixed rate borrowings that give protection against volatility in interest rates. These measures cover over 50 per cent of the current average borrowings of the enlarged Group. The extent of protection diminishes gradually to about 30 per cent of average borrowings by the end of 2001, but this will be managed in line with Group policy as opportunities allow.

Analysis of shareholders at 31 March 1998.



"A major review of treasury policies and funding requirements was completed in 1998."

Currently, non-sterling denominated debts approximately match non-sterling denominated assets, minimising any balance sheet translation exposure. Transaction exposure is also minimal since the values of cross border trade outside the Group are very small and in these cases appropriate foreign currency contracts are taken out.

Accounting Policies

During the year the Group has adapted its accounting policies to reflect changing best practice. New guidance has been issued and adopted in respect of the treatment of goodwill, associates and earnings per share calculations.

Goodwill arising on acquisitions is now capitalised in the balance sheet and amortised over the shorter of its useful economic life and 20 years. The effect of this change, which has been implemented from the beginning of 1998, is to depress profits for the year by £0.4m.

Until this year's results, the share of profit before tax for associates has been shown in the profit & loss account. This year, the share of results from associates disclosed in the profit & loss account shows separately the share of operating profit, and the share of interest that has been included in the interest charge and identified in the appropriate note. The comparatives and five year summary have been amended accordingly.

Diluted earnings per share are now calculated by making allowance for the potential number of bonus shares that could be issued in respect of the various options outstanding over the Company's shares. Past best practice required the calculation of notional earnings after adding interest on the proceeds from the options to earnings and adding the total outstanding options to the number of shares. The effect of this change is to show a diluted earnings per share figure for 1997 which is 0.2 pence higher than the previously published fully diluted figure. The comparatives and the numbers incorporated in the five year summary have been adjusted accordingly.

As a Company dedicated to building a strong pan-European business, we have published in our financial statements comparable Euro figures in addition to the usual sterling presentation. The Euro figures have been prepared using published ECU rates for each month for the Profit and Loss Account and the fixed 31 December Euro rate for the Balance Sheet.

Alliance UniChem Plc

On 1 July 1998 Alliance UniChem transferred its UK wholesaling business to UniChem Limited, a newly incorporated company. The effect of this is to remove all but the holding company activities from the Alliance UniChem Plc balance sheet and explains the large movements in the parent company balance sheet included on page 45.