→ Our governing objective is to maximise the value of the company for the benefit of its shareholders

Performance We seek to achieve our governing objective by a decision making process which targets value maximising strategies for the company. We then invest in our current and new business streams in order to generate strong cash flows and superior long term returns.

Shareholder return In our opinion the best overall measure of group performance is total return to shareholders. This measure has been successfully utilised within the group for over ten years. It is calculated from the movement in the share price and the value of dividends as if reinvested in the company when paid. We monitor our performance on a rolling five year basis against ten peer companies. From time to time changes in our competitors cause us to review the peer group. This year Alliance UniChem replaced Sears. This year was a turbulent one on the stock market, with our share price under significant downward pressure, dropping from 895p at the end of last year to 537p on 31st March 2000. The price ranged from a high of 884p to a low of 457p.

These pressures on share price, including the switch away from the more traditional 'value' shares into new technology during the year, have also depressed our peer companies' share prices. The returns for the current year are shown in the following table. We ended the year at number six in the table with a return in the five year period of 33.6%.

Shareholder returns of The Boots Company compared with peer companies
Returns are calculated using average listed share prices over the three months to 31st March

Five years to 31st March 2000		%
1	SmithKline Beecham	246.8
2	Kingfisher	176.4
3	Tesco	145.0
4	Alliance UniChem	71.3
5	Smith & Nephew	39.3
6	**Boots**	**33.6**
7	Reckitt Benckiser	9.9
8	W H Smith	(1.1)
9	J Sainsbury	(15.2)
10	GUS	(16.0)
11	Marks & Spencer	(20.8)

Long term bonuses for the executive directors and other senior management are also tied to total shareholder return measured on a rolling four year basis.

Dividend The board has proposed a final dividend of 17.7p. This brings the total dividend for the year to 25.2p, an increase of 5.9% over last year.

Economic profit We determine the level of investment in our businesses not by sales growth or operating profits, but by 'economic profit'. This is the present value return we expect to make for shareholders after charging an appropriate amount for the capital invested. Currently, this cost of capital for most of the group is 8.5%, after tax and after discounting separately for specific risk.

Turnover Sales from continuing businesses, including joint ventures' turnover of £2.4m, increased by 5.6% to £5,189.4m.

Profit Operating profit from continuing operations before qualifying employee share ownership trust (QUEST) costs, exceptional items and share of operating loss of joint ventures increased by 3.9% (2.1% after charging QUEST) to £583.1m (£573.3m after QUEST). Profit before tax, exceptionals and QUEST rose 4.8% (1.8% after QUEST) to £587.4m (£570.8m after QUEST).

Exchange impact Exchange rate movements during the year adversely impacted operating profits by around £2m.

Interest Net interest receivable for the year was £5.9m compared with £1.8m net payable in 1999, largely as a result of a £192m improvement in net cash flow compared to last year.

Taxation The effective tax rate, before exceptional items, for the group was 29.6%, compared with 30.3% last year.

Cash flow The maximisation of cash flow is the key factor in value creation and cash management is one of the key performance measures used by the company to monitor its businesses, and to determine the level of reward to senior management through the short term bonus scheme. The following summary of cash flow demonstrates the company's ability consistently to generate a healthy free cash flow that is defined as the cash flow available to all the providers of capital.

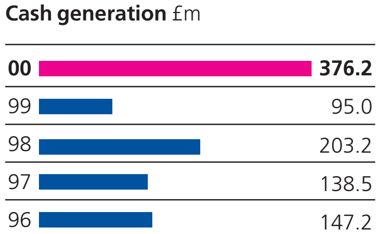
Summary of cash flows	**£m 2000**	£m 1999
Operating cash flows before exceptionals	**773**	616
Exceptional operating cash flows	**(19)**	(14)
Acquisition/disposal of businesses	**(3)**	55
Purchase of fixed assets	**(266)**	(372)
Purchase of own shares	**(58)**	(160)
Disposal of fixed assets	**93**	74
Disposal of own shares	**10**	–
Taxation paid	**(154)**	(112)
Other items	**–**	8
Free cash flow	**376**	95
Repurchase of shares	**(95)**	–
Dividends paid	**(216)**	(207)
Net interest	**(10)**	(25)
Net cash flow	**55**	(137)

The group generated cash from operating activities before exceptionals of £773m, an increase of £157m on last year.

Following last year's high levels of investment in the business, and particularly record levels of spend on BTC stores, investment in fixed assets was down by £106m to £266m. £95m was spent on repurchasing shares this year but £97m less was spent on purchasing shares for the QUEST following last year's £148m expenditure on acquiring the backlog of shares for the trust.

The following chart shows the amounts of free cash flow generated by the group for each of the last five years.

Cash generation £m



Structure There were no significant acquisitions or disposals of businesses during the year.

QUEST The QUEST was established by the company in 1999 in connection with its existing SAYE share scheme, which is open to all UK employees. The QUEST enables the company to use existing shares to satisfy options. This is more tax efficient than issuing new shares, and avoids diluting existing shareholdings.

However, using existing shares requires the cost of the SAYE scheme to be charged against profits. If new shares are used a charge against profits is avoided. Most other companies therefore issue new shares. Accounting standards are gradually moving towards ending this anomaly.

The QUEST has bought in the market 5.7m shares (1999 16.9m) at an average price of 783p (1999 909p) to satisfy options granted during the year (the 1999 purchase covered options granted that year and all the outstanding options relating to prior years). The purchase of shares resulted in a charge to operating profit of £9.8m that has been charged to the businesses (1999 £59.7m to establish the QUEST was treated as an exceptional item at the group level). These costs are the difference between the market value of the shares bought by the QUEST and the option price payable by employees. In addition interest of £6.8m on borrowings to finance the shares in the QUEST has also been charged to the businesses.

Pensions The result of the actuarial valuation, based on market values of liabilities and assets, at 1st April 1998, is shown in note 26. While this shows that accrued liabilities were covered 1.2 times by the market value of assets, as a matter of prudence, the company has recommenced contributions to the pension scheme at the rate of 10% of pensionable salaries. This recognises that the substantial pension scheme surpluses previously generated by the fund are expected to be progressively eliminated by the year 2002. The cash contributions, which recommenced in November 1999, will amount to around £50m a year. We have included a charge of £5m in the profit and loss account for the year. The next actuarial valuation is on 1st April 2001.

Treasury policy and controls Boots has substantial borrowing capacity due to its strong credit ratings.

Treasury focus is primarily on the balance sheet, including items such as property lease commitments, which are economic assets and liabilities, but which current accounting convention does not recognise.

Note 19 on pages 63 and 64 shows further details under the disclosure requirements of Financial Reporting Standard (FRS) 13 'Derivates and Other Financial Instruments: Disclosures'.

Controls Controls seek to prevent fraud and other unauthorised transactions as well as counterparty risk. The effective operation of key controls is reviewed annually by the group's risk assurance and audit staff. Strict guidelines for cash investments apply worldwide, with cash held only in high quality bank deposits and commercial paper. Swaps, which the company uses to manage interest rates, are strictly controlled and monitored, with each transaction specifically authorised by the deputy chief executive and finance director.

Liquidity and funding The company has good access to the capital markets due to its strong credit ratings from Moody's and Standard and Poor's (P1/A1 and A1/A+). It is policy to maintain credit ratings that give good access to the capital markets.

The group has ten identical credit facilities, totalling £600m, which mature in 2004. These facilities remained undrawn during the year, with short term needs being met from uncommitted bank lines.

The proceeds from the £300m ten year eurobond that closed in May 1999 were used partly to refinance short term debt.

Lease liabilities In common with other UK retailers, the group has liabilities through its obligations to pay rents under property leases. Rent commitments on property leases are the economic equivalent of fixed rate debt. The following table shows the capitalised value of the committed after tax rents payable at 31st March 2000, excluding any likely increase in rents at rent reviews, discounted at the group's after tax cost of borrowing of 4.5% (6.4% gross).

Maturity of commitment	Rent commitment at 31st March 2000 £m	Capitalised value £m
1 to 10 years	54.4	186
10 to 20 years	102.1	773
20 to 30 years	25.0	248
Over 30 years	5.2	70
Total	186.7	1,277

The split of rent payable at the year end for businesses is:

	Rent payable £m	%
Boots The Chemists	125.2	67
Halfords	46.7	25
Other	14.8	8
Total	186.7	100

Interest Policy is to maintain a balance between debt, including leases, at fixed and floating rates, but we do not hedge against the impact of short term interest rate movements.

The total value of lease-related swaps at the year end was £1.1bn, with an average maturity of eight years and a weighted average fixed rate receipt of 7.4%. The company's other fixed rate borrowings have all been swapped into floating rate.

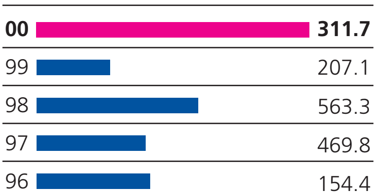
Given the overall cash, borrowing and interest rate swap position, each 1% increase or decrease in short term interest rate changes the net interest figure by about £13m.

Currency exposure The company has no currency debt to match the value of its overseas businesses. When the cash flows from these businesses become more substantial, policy will be reviewed. Modest sales and purchases are made from the UK in a range of currencies but hedging them into sterling does not add value.

Capital structure Value can be achieved for shareholders by managing capital structure. Increasing debt lowers the after tax cost of capital, and since 1994 we have exploited this by distributing £1.3bn to shareholders in the form of share repurchases and special dividends in addition to normal dividend payments. A balance has to be struck, however, between the advantages of debt and the resulting reduction in financial flexibility. As with other financial assets, we do not take positions on the company's share price, which is determined by the market with access to all relevant information. Our wish to repurchase shares is driven only by the intent to maintain an efficient capital structure.

In September 1999, we announced our intention to use powers granted at the AGM to buy back up to 91.5m shares, about 10% of the issued share capital. By the year end £95.4m had been spent buying 16.0 million shares, at a weighted average price of 593p. The continued decline in the share price since announcing the repurchase programme has meant that our financial flexibility has declined. We have therefore made only limited purchases.

Payment to shareholders £m



2000 and 1997 include share repurchase of £95.4m and £300m respectively. 1998 includes the special divedend of £400.5m.

Year 2000 Our comprehensive work programme to achieve Year 2000 compliance was completed on schedule and the date transition was accomplished successfully with no material errors.

The project was completed within the original budget estimate of £14m and we expect no further costs.

The success of this project was assured by thorough planning, a timely start and rigorous project management.

Economic and Monetary Union (EMU) We continue to prepare for EMU in our businesses in the first wave countries and to handle a low level of euro transactions. This reflects the experience of the majority of European businesses. We are in a position to deal with increasing transaction volumes as we move closer to the introduction of notes and coins.

The continued action and planning across all businesses has ensured that we are on target with our euro preparations. Many of our businesses are now able to report internally in euros and our retail customers in the Republic of Ireland can already see the euro equivalent total on till receipts. Further work on the introduction of dual pricing in the Republic of Ireland and the Netherlands will continue during 2000/01. Detailed work following the initial impact analysis has confirmed the initial cost predictions of around 1% of turnover, which remains in line with predictions from other retailers.

Planning in the UK for EMU remains difficult due to the continued uncertainty over the question of UK entry. The Government's Second National Changeover Plan outlines the next steps for overall UK preparation. In particular we support the core principles for the draft Consumers Code of Practice and the moves to address the logistical challenges from the first wave will be key to a smooth UK transition both for our business and for the UK Government. We welcome the recognition of this issue in the Plan.

Accounting standards The company fully supports the objectives of the Accounting Standards Board (ASB) in its aim to improve the quality and consistency of financial statements.

Current UK accounting ignores the material economic costs and liabilities of operating leases, pensions and employee share options, all of which the group's internal management accounting attempts to recognise. We are pleased to note that each of these is currently under consideration by the ASB, albeit at different stages of development. We have made robust representations to the ASB during the year on accounting for both pensions and leases.

During the year the ASB issued Financial Reporting Standards (FRS) 15 'Tangible Fixed Assets' and FRS16 'Current Tax'. The effects of these have been reflected in this year's accounts and include an additional £2.1m depreciation charge this year on freehold shop properties.

David Thompson
Deputy Chief Executive and
Finance Director