



**Boots The Chemists (BTC)**

Managing director	Ken Piggott
Sales £m	3,991.5
Increase %	0.3
Profit £m (before exceptionals)	526.1
Increase %	7.0
<b>Sales split</b>	<b>%</b>
Health and beauty	80.9
Photo, food and baby	14.7
Non-core categories	4.4
www.wellbeing.com	

**BTC made further good progress, with operating profit before exceptional items up 7.0% to £526.1m. This was primarily the result of good margin growth led by a change in mix and effective cost control. Turnover was virtually flat at £3,991.5m but, crucially, the core health and beauty business continued to gain sales – up 3.4%, or 2.1% on a like for like basis – and built market share in a number of key areas. This was offset by the managed exit from unprofitable leisure merchandise, which allows us to release the space we require for health and beauty related products and services. Free cash flow grew by more than 20%, with profit growth supplemented by improvements in working capital – notably a 7.2% improvement in stock efficiency.**

**Strategy**

BTC’s customer appeal is founded on the trust and heritage of the Boots brand, our product range, innovative own brands and exclusives, and expert service and advice. Building on our unrivalled understanding of consumers’ health and beauty needs, reinforced by analysis of Advantage Card data, our strategy is to focus increasingly on leadership in health and beauty. Our authoritative brand and product offer are complemented by a growing range of related services including Dentalcare, Footcare and our new Health & Beauty Experience stores.

**Sales and margin**

Sales in health and beauty were up 3.4% (2.1% like for like), while overall sales declined 0.2% on a like for like basis. The decline was driven by the planned withdrawal from leisure categories, which reduced sales by 2.0% over the year and 3.2% in the second half. These lost sales will be replaced over time as we introduce health and beauty products and services in the space vacated by leisure categories. Sales intensity in stores where this has occurred grew by more than 7% in the final quarter.

We have been successful in building the differentiated position of our beauty offer. We enjoyed good growth in haircare, despite a declining market, driven by our investment in exclusive and fashion designer brands. Our premium cosmetics business grew by



**Left** N°7 cosmetics, the UK’s retail market leader for many years, increased sales by an impressive 16% during the year and broke through the £100m barrier for the first time.

**Right** Creating exclusive ranges in association with leading names in fashion and hairdressing has helped BTC to maintain its health and beauty market share against supermarket competition.



23.2%, with our premium offer now in 100 stores. In skincare we have been working with suppliers to support key new ranges, such as Olay Total Effects, alongside our own power brands. Our fragrance and electrical beauty product businesses grew by 6.8% and 12.5% respectively.

Our photo business has benefited from the rollout of digital minilabs and the launch of bootsphoto.com, the web service which allows customers to view and print their photos via the internet, leading to a market share gain of 0.9 percentage points.

We have continued to provide competitive promotional offers. At the same time, through careful management of our product mix and an increasing focus on our exclusive and Boots brands we have sustained and grown gross margins.

**Advantage Card**

Advantage Card, the world's largest smartcard loyalty scheme, has now stabilised with close on 13 million members. It has become an integral part of our customer offer: today, over 50% of sales are linked to the card.

We have achieved this by using Advantage Card data to understand customers better, identify their individual needs in health and beauty, and focus marketing activity. As a result, we enjoy increasing average transaction values among higher-spending customers.

Allied to the Advantage Card,

we have launched a number of initiatives:

- Our *health & beauty* magazine is now being mailed to the top-spending 3 million Advantage Card holders, and is Britain's biggest magazine in its sector. We see this as an important and cost effective element of our communication with our most valuable customers.
- We launched the Advantage Credit Card powered by Egg, the first combined loyalty and credit smartcard, which offers points against most purchases for redemption in Boots stores.
- We joined with the Department of Health to enable Advantage Card holders to register with the NHS Organ Donor Scheme and carry Advantage Cards featuring the scheme logo. This provides another link with customers, in a unique contribution to the nation's healthcare.

**Products and services**

BTC has been successful in maintaining its health and beauty market share against supermarket competition. One key is our ability to develop own ranges that become brands in their own right, and to create exclusive ranges in association with leading names in fashion and hairdressing.

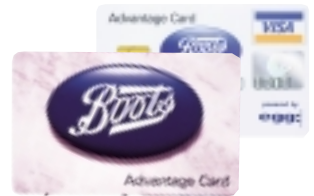
Among the brands launched during the year, we had particular success with Liz Collinge cosmetics, fuk® toiletries, TONI&GUY haircare, and glitter babes products for pre-teen girls. The relaunch of Botanics toiletries in January 2000

**3m** top spending Advantage Card holders receive our *health & beauty* magazine, making it Britain's biggest magazine in its sector.

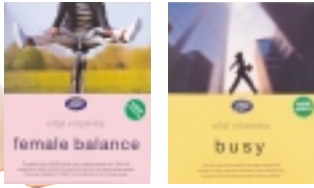
**13m** people now hold an Advantage Card, making it the world's largest smartcard loyalty scheme.

**52%** of sales are linked to the card.

**First** The Advantage Credit Card was the first combined loyalty and smartcard.



06/Review of operations



dramatically revitalised the brand – sales have since doubled – and we are launching a Botanics cosmetics range this year.

Our more traditional brands also performed well, supported by continuing product innovation. N°7, the UK's leading retail cosmetics brand, increased sales by an impressive 15.7% during the year and sales broke through the £100m barrier for the first time.

We continue to scale-down our offer in leisure goods. We have eliminated unprofitable ranges (including music, video, stationery and clothing for children aged four and over) and substantially reduced distribution and space allocated to the remainder. Over 3,500 stock lines have been discontinued. As a result, the proportion of sales represented by leisure merchandise fell 2.1% as predicted.

**Store development**

We opened 16 new edge of town stores, bringing our total edge of town representation to 70. We also relocated seven stores and closed nine others. We are continuing to pursue good sites for building edge of town stores.

We remain committed to town centres, and high street locations generally, and are actively developing and focusing our customer offer to keep it in step with what our customers expect in those locations.

We continue to invest in improved store layouts and to experiment with

new ideas. These include a programme designed to transform the way our people instore relate to customers, and a new trial format is on offer in 15 stores. This builds on the introduction of services and the leisure exit programme to create an authoritative health and beauty offer and a more inspiring shopping experience. In the third quarter we also realigned space across all our larger stores to give more prominence to our core offer and exclusive brands. Initiatives like these are helping to improve sales intensities, enhance the cosmetics and fragrance share of our business and allow our exclusive brands to flourish.

**Cost management**

One of the keys to our profit growth is continued success in reducing costs at both central and store level. Since the cost management programme began two years ago, we have reduced BTC senior management by over 40% and cut total headcount by the equivalent of 2,000 full-time jobs. We met our targets in 2000/01 and expect this progress to continue.

**Outlook**

The expected economic slowdown will inevitably impact on consumer spending although the health and beauty market has proved relatively robust in past downturns. Our continuing withdrawal from unprofitable non-core areas will also affect sales, although margins will

benefit from the improvement in the sales mix as we continue to build our presence in premium beauty products, differentiated brands and wellbeing services.

We were well prepared for the abolition of Resale Price Maintenance on over the counter medicines. We are responding vigorously to competitive activity and expect to increase market share in an expanded market in the medium term. In the short term, abolition is expected to reduce BTC profits in a full year by between £15-20m.

Over the longer term, all the demographic trends point to a bright future for the health and beauty market, and Boots is well placed to benefit.



**Left and above** In our own brand ranges we continue to develop new products that suit contemporary tastes and lifestyles.



**16** new edge of town stores were opened during the year, bringing the total edge of town representation to 70.

---

**+16%** sales increase for N°7, the UK market leader for many years.

---

**+113%** sales growth for Botanics following its relaunch in January 2000.

---

08/Review of operations

**Boots Retail International (BRI)**

Managing director	William Cotton
Sales £m	42.1
Increase %	29.5
Loss £m (before exceptionals)	(43.9)
Decrease %	(32.6)
<b>Sales split</b>	<b>%</b>
Thailand	57.2
Netherlands	20.9
Japan (share of joint venture)	14.8
Taiwan	7.1
www.boots.co.jp	
www.bootsretail.com.tw	

**Although our retail international business had a difficult year, we are learning important lessons that will help us to build a profitable business. We are now testing several encouraging new approaches – and in the Netherlands, we have switched from our own stores to a third-party retailer.**

**BRI's sales rose 29.5% to £42.1m as it grew from 69 stores to 80. However, like for like sales fell 5.3% and the operating loss before exceptional items rose 32.6% to £43.9m. There was an exceptional non-operating loss of £20.3m on the disposal of the Netherlands stores and an exceptional operating loss of £2.8m for restructuring costs.**

**Strategy**

We are currently reappraising our business model in the light of our experience to date. Our aim is to develop more profitable alternatives to the initial model – fully owned units with a full drugstore offering – by adopting a more flexible, less capital intensive approach.

This will involve shifting from a broad range of proprietary brands towards a more focused Boots brand offer, where margins are stronger and differentiation is sharper. We will move towards smaller units, typically under 200m<sup>2</sup>, from the current 300-500m<sup>2</sup>. Rather than opening our own standalone stores we will favour a small store format in other retailers' stores.

These have the advantages of established footfall, lower upfront investment costs and sales-based rent.

**Thailand**

Our Thailand operation made an encouraging start, and we opened 18 more stores in the first part of the year to make a total of 68. However, sales were hit by the rapid emergence of new low-price hypermarkets. In September we suspended the new store opening programme while we addressed this issue. Keener pricing has helped to improve our competitiveness and sales have been recovering since December.

**Netherlands**

After reviewing the operation early in the year, we withdrew from retailing in favour of distributing Boots branded products through an established local retailer. In August we sold our 17 stores to Etos, one of the country's leading drugstore chains. This deal will provide distribution in the majority of Etos' 412-store chain for some of our most popular brand ranges – including N°7, 17 and Ruby & Millie cosmetics, Tricologie haircare and Botanics toiletries. This model has potential elsewhere, and we are currently pursuing similar opportunities in Europe and Asia.

**Japan**

Our joint venture with Mitsubishi Corporation achieved sales of £6.2m during the year. As elsewhere, the challenge is to ensure profitability. We are encouraged by our fourth store, opened in Yokohama in September. It is within a major department store and its rent is sales-based. We are opening further smaller units this year within larger stores, offering Boots and exclusive products, to test the concept – and will continue to refine our customer offer for Japan.

**Taiwan**

In Taiwan we are trialling a new format in line with our current strategic thinking. Of the eight stores now open, five are small store formats of only 40-80m<sup>2</sup>, and their customer offer is

focused on Boots brands. The locations have been chosen to capitalise on existing customer footfall and they can be set up quickly with relatively low capital outlays. All the Taiwan units are so far delivering encouraging performance.

**Outlook**

The emphasis now is on improving the business model. We are managing costs hard while at the same time trialling our latest thinking. Many of our existing stores now look oversized and we expect to downsize some and close others. We will open new units in Taiwan and Japan to test the revised strategy, and expect to make further decisions on future direction in the second half of the year. Although it will inevitably take some time, we remain confident that we can develop international retailing profitably.

**Boots Opticians**

Managing director	Stephan Murray
Sales £m	196.1
Increase %	0.2
Profit £m	4.0
Decrease %	(64.3)
<b>Sales split</b>	<b>%</b>
Spectacles	72.1
Contact lenses	15.5
Other	12.4
www.bootsopticians.co.uk	
www.bootsopticianslask.co.uk	
www.bootshearingcare.co.uk	

**Results continue to disappoint. The optical market remains fiercely competitive and market growth has been low. With higher levels of discounting, advertising and promotion, and investment, and with significant improvements in service levels, sales were marginally up on the previous year.**

**Strategy**

To succeed in the highly competitive optics market, it is vital to differentiate the offer clearly. We have been investing in a number of initiatives to develop a unique offer based on superior customer service, and to enhance customer relationship



**Far left** Boots brands repackaged for the Japanese market.

**Left and below** Xiao Ya, our first Taiwanese store located in central Taipei, and a new small store format in a Warner Village Complex.



09/Review of operations

management using the new store IT system. Over time, we believe effective differentiation will help us reduce our reliance on price promotion, which has been the principal weapon employed by the major optics chains. We have also been investing in the supply chain to ensure 'right first time' delivery of products and services, which will reduce costs and has already increased customer satisfaction.

**Differentiation**

Following last year's significant investment in the new store system, we are now focusing on our customer-facing operation. Research has indicated an opportunity to distinguish Boots Opticians from competitors by offering a more personalised service that fits customers' expectations of the Boots brand.

In response, we have developed a new trading format, currently being refined in five stores. It provides a new environment and sales process designed to be particularly attractive to more affluent customers seeking high service standards. In the pilot stores, customer satisfaction ratings have risen at twice the rate of our conventional stores. Sales growth has been seven percentage points higher, through better conversion rates and higher transaction values. We plan to take the format nationally over the next two years.

**New products and services**

PrismiQ spectacle lenses (manufactured instore) were launched nationally. The system delivers high quality lenses, raising average transaction values and enhancing margins on lens sales.

Two further innovations – LASIK laser clinics and Hearingcare – will radically change the business this year.

We opened our first LASIK clinic in London's Regent Street in December. Using advanced laser technology to provide outpatient eyesight correction, LASIK has proved highly successful in the US. Trading at our store in Regent Street is ahead of expectations and we plan further openings this year.

In March 2001 we opened the first

two Boots Hearingcare Centres in Birmingham and Manchester. These supply the revolutionary Songbird disposable hearing aid to which Boots has exclusive UK rights. The high quality device costs £22 a month and offers similar performance to hearing aids costing around £1,500. We plan to open 45 centres in the next six months.

The launch of Near and Far varifocal contact lenses in May 2000 was an important innovation and we are now the world's leading supplier of these products.

**Store portfolio**

We opened one new store in Uxbridge and amalgamated two in Birmingham: the total number of stores remained unchanged at 298.

**Outlook**

For the past three years profitability has been affected by heavy investment. In the year ahead we will begin to benefit from this spending as we meet the needs of customers more effectively. Substantial growth will come from the LASIK and Hearingcare businesses.

**First** Our first LASIK clinic opened in London in December and is trading ahead of expectations



**6 more** LASIK clinics are due to open this year

**45** Hearingcare Centres will open in the next six months, and a total of 150 will be trading by March 2004.

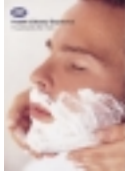
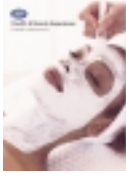
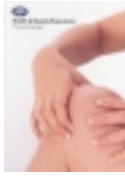
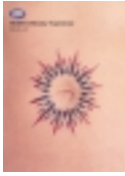
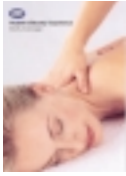


**Above and right** A new trading format, currently being refined in five stores, provides a new environment and sales process designed to be particularly attractive to more affluent customers seeking high service standards.

**Main picture** The revolutionary Songbird disposable hearing aid.



10/Review of operations



**Left and above right**  
Health & Beauty Experience stores combine sales of health and beauty products with a wide range of treatments including facials, nailcare, hydrotherapy, physiotherapy, osteopathy and stress management.

**Right** Shared reception area for Dentalcare and Footcare practices.



**Wellbeing Services**

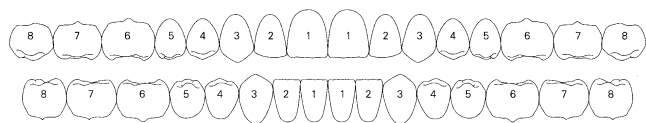
Managing director	Phil Douty
Sales £m	8.5
Operating loss £m	(20.7)
<a href="http://www.boots-dentalcare.co.uk">www.boots-dentalcare.co.uk</a>	
<a href="http://www.bootsinsurance.com">www.bootsinsurance.com</a>	

During the year Boots introduced a growing range of new treatments and services in BTC stores. Two of these – dentistry and chiropody – had already been trialled and enthusiastically received by customers. The latest innovation – Health & Beauty Experience stores – is currently being piloted. Early indications are that this, too, is proving a success with customers. Two other new developments – LASIK eyesight correction and Hearingcare – are described under Boots Opticians.



11/Review of operations

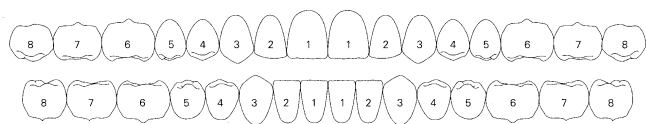
**Outer-tooth surface**



Your left-side teeth

Your right-side teeth

**Inner-tooth surface**



Your left-side teeth

Your right-side teeth

**Strategy**

We see a major opportunity to extend the Boots brand into a variety of health and beauty related treatments and services, which can broadly be categorised as ‘wellbeing services’. Research tells us there is strong demand for these services – some of which is currently frustrated because customers have not found a supplier with whom they feel comfortable.

We can bring accessibility to relatively new or specialised treatments such as laser hair removal, tooth whitening and cosmetic dentistry. Our brand lends authority to services that have traditionally operated on a fragmented level – such as osteopathy, homeopathy and herbalism. And Boots provides a natural setting for a wide range of beauty treatments such as facials, manicures and massage.

These activities are attractive to us because they build on our existing relationships with customers, leverage their trust in the Boots brand, take us into areas where our retail competitors will find it hard to follow, and have the potential to add substantial value to space in Boots stores. We are confident about the contribution these services will make to overall profitability.

**Boots Dentalcare**

Progress in our dentistry business has been strong enough for us to take it nationwide. By the financial year end we had opened 30 practices, mainly in the south of England, and by June 2001 we expect to have 48. The total investment will be £22m.

The first 30 practices have registered more than 30,000 patients and the original six now average 4,500 patients each. Occupancy rates average 70%. Direct mail advertising using Advantage Card data has proved very effective – for example to offer implants to customers who buy denture fixative. Financial performance is in line with expectations.

To extend the business beyond general dentistry we are establishing specialist centres that provide advanced services such as implantology, specialist prosthodontics, endodontics, periodontics and oral surgery. In March

we enhanced our in-house capabilities by acquiring the UK’s leading dental laboratory, Portland Ceramics.

**Boots Footcare**

Following six successful pilots in 1999, we opened 19 practices during the year and will add 16 more by June 2001 to make a total of 41. Typically, practices are co-located with Dentalcare practices and share reception areas.

So far we have registered more than 25,000 patients and are averaging 70% occupancy. We have broadened our offer to include minor surgery and biomechanics. Financial performance is meeting expectations, and we are also seeing an uplift in sales of footcare products in stores with chiropody practices.

**Health & Beauty Experience**

In September we opened two Health & Beauty Experience stores in the existing BTC stores at Kensington and Milton Keynes. These combine sales of health and beauty products with a wide range of treatments including facials, hair removal, nailcare, hydrotherapy, physiotherapy, osteopathy, stress management and homeopathy. We have now opened Health & Beauty Experience stores in Leeds, Manchester and Reading and intend to open up to seven more this year. By the financial year end we will have conducted a full review of the business to determine the way forward.

Research shows strong unsatisfied demand for services of this kind, and the overall market is growing at about 10% a year. Our initial experience indicates immediate strong demand for beauty services and treatments such as physiotherapy, with growing interest in complementary health services such as homeopathy. Customers see wellbeing services as a natural and welcome extension of the Boots offer – and early Advantage Card data suggests that they visit Boots more frequently and increase their spending after experiencing one of the services.

**Boots Wellbeing Centre**

In the summer we will open our first Boots Wellbeing Centre in Greenford,

west London. This trial marks our entry into the fitness/activity market in a location that contains a swimming pool and gym as well as a BTC store and the full range of health and beauty services.

**Boots Insurance Services**

Policy numbers grew strongly over the year – particularly in health insurance, led by substantial increases in our dental insurance sales. Travel cover continues to expand and we are now the largest direct travel insurer in the UK with more than 160,000 policies sold this year.

**Boots Internet Ventures**

Total sales £m	1.9
Operating loss £m	(22.1)
<a href="http://www.wellbeing.com">www.wellbeing.com</a>	
<a href="http://www.handbag.com">www.handbag.com</a>	
<a href="http://www.bootsphoto.com">www.bootsphoto.com</a>	

**The internet and digital TV are opening up new channels of communication with consumers. In the quest for more dynamic relationships with customers, we are creating new media platforms that have the potential to become profitable businesses while enhancing Boots reputation for innovation and accessibility.**

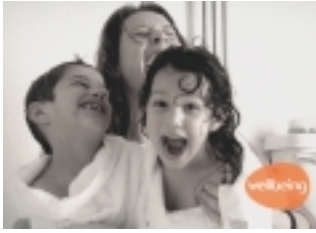
**Digital Wellbeing**

Joint managing directors	Richard Holmes Paula Carter
--------------------------	--------------------------------

In March 2001 we launched The Wellbeing Network, an integrated digital TV channel and website devoted to health and broader wellbeing issues such as beauty, fitness and nutrition. It is a joint venture between Boots and Granada, in which we have a 60% stake.

Revenue will come from advertising, sponsorship and e-commerce. The approach to e-commerce on the web and TV draws on many lessons learned from Boots own e-tailing experience; a popular feature is that points are automatically credited to customers’ Advantage Cards. Most of the 10,000 products on offer are sourced cost-effectively through the Boots supply chain.

12/Review of operations



The network brings together the country's leading provider of wellbeing products and services with the company that made eight of the ten most watched programmes on ITV in 2000. Its combination of 'bricks and clicks' retailing with interactive TV is virtually unique in the UK.

**bootsphoto.com**

Last summer we launched a revolutionary e-photo service, bootsphoto.com. Customers who have their films processed at Boots can now also have their pictures uploaded to their own secure webspace. Within this space they can organise their pictures and share them with friends and family. Prints ordered online are printed in the store selected by the customer and collected in the normal way or can be mail ordered. This has given us first mover advantage in e-photo, an emerging sector of the market which has already grown to an estimated \$1bn a year in the US. We believe it will also help us maintain our pre-eminence in the overall photographic market.

**handbag.com**

Managing director Dominic Riley

handbag.com is now firmly established as the UK's leading website for women, growing its monthly audited user base by 31% to 367,000 during the year.

Sales increased by 124% on a like for like basis, with 60% of revenues coming from advertising and sponsorship. The remainder represents e-commerce revenues: the site now provides access to 100 selected online retailers.

We have continued to enhance the site, adding new interactive content and involving more celebrity contributors. In summer 2000 we organised a worldwide online charity auction, and sold former Prime Minister

Thatcher's trademark handbag for more than £100,000.

Financial losses in the second half were 34% below the same period in the previous year, new users continue to be recruited cost effectively and overall financial performance continues in line with plan.

**Halfords**

Managing director	Rod Scribbins
Sales £m	508.5
Increase %	3.2
Profit £m	37.0
Decrease %	(18.1)
<b>Sales split</b>	<b>%</b>
Auto accessories, tools and audio	41.6
Cycles and accessories	23.2
Car parts	30.7
Garage servicing	4.5
www.halfords.com	

**Sales again grew strongly, despite a rather disappointing Christmas. The increase was 3.2% overall, with superstore sales rising by 6.6%. Our new Arcade trading format is dramatically increasing sales wherever it is introduced, but the investment cost of rolling it out has hit profits in the short term: operating profit fell 18.1% to £37.0m. Margins rose slightly – there were improvements in most categories offset by changes in the sales mix and currency effects.**

**Strategy**

Our strategy is to maximise Halfords unique advantages: greater scale than competitors and a trusted brand standing for good range and value. After extensive research and trials we are introducing a new 'Arcade' store format, which creates a store-within-a-store feel for individual departments. This is designed to increase our appeal to higher-spending car, cycle and audio enthusiasts while providing inspiration to mainstream consumers. We continue to relocate from high streets to superstores, which now account for the great majority of sales.

**Sales**

Excluding the impact of the 53rd trading week in the previous financial year, sales growth was 5.0%. The

**31%** growth in audited user base for handbag.com by the end of the year.

**4.6%** growth in cycle sales as a result of our broader offer in premium cycles.

**22%** sales growth in Halfords Arcade format stores.



13/Review of operations



**Left** The new Arcade trading format was a huge success. The initial Midlands sites have seen sales growth averaging over 22%.

strong superstore sales performance was particularly encouraging given the lacklustre market conditions. Cycle sales were up 4.6% against market growth of 2.9%, benefiting from our broader offer in premium cycles. Cycle sales were also stimulated by growth in our insurance replacement business.

Audio rose 23%. Market share rose from 11.4% to 15.1% overall, reaching almost 25% in CD systems and speakers.

Sales of performance and styling products doubled and we believe we are expanding the market by making these products more accessible.

As expected, the percentage of sales generated by own brands fell slightly to 46.6%. It is likely to reduce a little further because the new format is led by proprietary brands. However, we achieved good growth in our own free-standing brands, Carrera and Apollo cycles, and auto accessories under the Ripspeed brand.

The good overall sales performance was less evident at Christmas, when sales of cycles as gifts for 8 to 15 year-olds were hit by particularly strong competition from scooters, PlayStation 2 and mobile phones.

Garage servicing suffered a setback as the market weakened in mid-year. Sales fell 6.2% and the business slipped back into loss. Our mini-stores in motorway service areas also performed disappointingly, although tight cost control ensured that they are now breaking even.

During the year we launched an e-commerce site, which now offers some 400 products.

**Stores**

We opened 15 new superstores and closed 14 high street units. Of our 407 stores, only 66 are now on high streets; the transition will be virtually complete by 2005, after which we will retain high street sites only where there is



no suitable alternative.

The Arcade trading format was trialled at three sites in 1999 and extended to a further 33 in the Midlands in summer 2000. The Midlands sites have seen sales growth averaging over 22%, and the original three stores are still growing sales 4% faster than existing superstores. In March we announced plans to invest more than £19m to extend the rollout of the format to a further 34 stores in London and the south east by June 2001.

**Outlook**

The Arcade concept is proving an immediate success. The emphasis on the latest in-car technology, performance and styling products, and growing segments of the cycle market will ensure continuing sales and margin growth, and the implementation costs are falling as the rollout progresses.

Unless there is a major economic downturn, we expect sales growth to continue in all retail formats. Profits will reflect the continuing investment cost of store conversions, but we will be managing costs tightly as we review our systems and supply chain to support continued sales growth.

	<b>Bikes &amp; Accessories</b>
	<b>Car Care</b>
	<b>Parts &amp; Tools</b>
	<b>In Car Entertainment</b>
	<b>Performance Styling</b>
	<b>Touring &amp; Travel</b>
	<b>Garage &amp; Servicing</b>
	<b>Halfords Guarantees</b>



14/Review of operations



**Boots Healthcare International (BHI)**

Managing director	Barry Clare	
Sales £m	362.0	
Increase %*	13.0	
Profit £m (before exceptionals)	49.2	
Increase %*	112.1	
<b>Core brand sales</b>	<b>£m</b>	<b>Increase %*</b>
Analgesics	88.6	17.4
Cough & cold	70.8	8.1
Skincare	106.4	42.2
www.nurofen.com		
www.strepsils.com		
www.skinexpert.net		
www.clearasil.com		

\* comparable exchange rates

**With profits up 112.1% at comparable exchange rates to £49.2m, BHI is amply justifying our investment in developing a portfolio of leading consumer healthcare brands through product development and acquisition. It clearly demonstrates Boots ability to create a profitable, world-class business. Sales grew by 5.7% overall and 12.4% in the core categories. These sales growth figures exclude the impact of the acquisition of Clearasil in December by Boots Healthcare USA Inc. and Hermal, which immediately added 20% to BHI's sales going forward. We continued our gradual exit from non-core category products, where sales reduced by 9.4%.**

**Strategy**

BHI aims to benefit from the growing consumer interest in self-medication by leading in the development and marketing of innovative products and differentiated consumer healthcare brands. BHI products are sold in over 130 countries, concentrating on three categories: analgesics, cough & cold and skincare. These make up about half the over the counter (OTC) medicines market and account for more than 85% of our sales. Product innovation is the primary driver of growth, supported by further geographic expansion and strategic acquisitions.

**Acquisitions, disposals and alliances**

The £237m acquisition of Clearasil, the world's leading brand in acne

prevention and treatment, was BHI's largest acquisition to date. There is great scope for extending its distribution and applying our own skincare expertise to extend the product range. Most importantly, it extends BHI's presence into the world's two largest OTC markets: the US and Japan.

Following the acquisition, Boots Healthcare USA reached a US distribution agreement with Novartis in May 2001. As one of the world's top five pharmaceutical companies, Novartis will put considerable weight behind BHI's drive to build a substantial presence in the US. Negotiations with a Japanese distribution partner are well advanced.

In recent years we have made a series of smaller-scale acquisitions in Europe to gain a sales and distribution infrastructure rapidly, reselling those manufacturing facilities and products that do not fit in our core categories. During the year we sold our Italian factory and non-core brands and announced negotiations to sell several non-core French skincare brands and the factory that makes them.

**Brand investment**

Brand investment, excluding Clearasil, was slightly lower at £90.3m due to improved efficiency and the awareness levels we have achieved in some of our markets, allowing us to spend more effectively. In addition, we reduced investment on non-core products by 6.7% (£0.5m).

The most interesting new product development during the year was Nurofen Meltlets, the world's first 'melt-in-the-mouth' ibuprofen technology, which makes Nurofen easy to take without water.

**Analgesics**

The year's 17.4% increase in sales represented solid organic growth in existing markets, despite the relatively low incidence of flu in northern Europe. Launches of new presentations included Nurofen Gel in Spain and Nurofen Caplets in the Netherlands. Nurofen has strengthened its market leadership in the UK and has achieved record market share in 12 countries.

**£237m** acquisition of Clearasil, the world's leading brand in acne prevention and treatment.

**8.1%** growth achieved by Strepsils despite low incidence of cold and flu.

**13** different and specific variations make up the Nurofen range.

**11.1%** growth in skincare sales excluding Clearasil.



15/Review of operations

**Right** BCM manufactures innovative products for Boots businesses that help to differentiate them from competitors.



**Cough & cold**

Strepsils sales, also affected by the low incidence of colds and flu, still achieved 8.1% growth. Strepsils is now the market-leading sore throat brand in 21 countries.

Product launches included Strepsils Cough in the Philippines, Strepsils with anaesthetic in France, Zinc Defence in Belgium and Strepsils in Argentina. Strepfen, our innovative non-antibiotic therapy for severe sore throats, gained approvals for OTC sale in five more countries including Australia, bringing the total to seven.

**Skincare**

Our skincare business now has sufficient scale to allow us to focus on dermatitis and acne. It is now gathering impetus – excluding Clearasil, sales grew 11.1% last year.

Product launches included the Balneum range in Thailand, Aknemycin Plus in the UK, Balneum Intensiv in Portugal and the Aqeo range of consumer friendly products for psoriasis sufferers.

**Restructuring**

We have continued to reshape the business to increase productivity, with a number of specific initiatives implemented during the year.

Increasingly, our European order processing is being managed through a single UK-based system which is scalable to handle future growth.

As part of wider group restructuring, in April 2001 we transferred BHI's factories in Thailand and Germany to Boots Contract Manufacturing. This will complete BHI's outsourcing of manufacturing.

**Outlook**

BHI is fully justifying the confidence we expressed during the investment phase. It now has the momentum to deliver sustained organic growth in sales and profits, augmented by further acquisitions.

**Boots Contract Manufacturing (BCM)**

Managing director	John Watson
Sales £m	326.9
Increase %	1.8
Profit £m (before exceptionals)	35.2
Increase %	39.7
<b>Sales split</b>	<b>%</b>
Boots The Chemists	40.7
Boots Healthcare International	17.8
Boots Retail International	1.3
Third party	40.2
<a href="http://www.bcmhealthcare.co.uk">www.bcmhealthcare.co.uk</a>	
<a href="http://www.bcm-specials.co.uk">www.bcm-specials.co.uk</a>	

**At BCM we are now reaping the benefits of substantial investment in recent years. Profit before tax and exceptional items rose almost 40% to a record £35.2m. This was an outstanding performance – particularly since sales grew only 1.8%, or 2.5% allowing for currency impacts. Strong margin growth came from tight cost control, increased supply chain effectiveness, improved asset utilisation, the exit from lower-margin retail business and a further 5% productivity improvement from the continued drive for efficiency. These initiatives resulted in £13.0m of exceptional charges for the year, but have achieved a substantially lower cost base.**

**Strategy**

BCM has two customer groups: internal businesses (BTC, BHI and BRI), and third-party customers in the UK and Continental Europe. For the Boots businesses it manufactures innovative products that differentiate them from competitors; its widely respected product development team was transferred to a new Strategic Marketing Unit during the year. In BCM's third party business, accounting for about 24% of UK sales, it has been switching away from production for retailers' own brands to concentrate on products for leading multinational brand owners who require the highest standards of quality and service. This transition was completed during the year.

**UK business**

UK sales fell slightly to £264.2m. Strong growth in sales to brand owners was offset by the exit from third party retailer business and a fall in sales to BTC, down 3.8% to £132.9m due to further reductions in stock levels.

Growth areas in BTC sales included cosmetics – boosted by N°7, 17, and the successful new Liz Collinge cosmetics and Patrick Cox fragrance ranges. Healthcare sales suffered from the low incidence of winter flu. Sales to BHI were up 5.4% to £58.1m, led by continuing strong performances from Nurofen and Strepsils. Sales to BRI grew to £4.1m, and the start of the retail deal with Etos in the Netherlands generated sales of £2.5m.

Sales to brand owners grew by more than a third to £39.2m. However, sales to retail customers reduced by around £12m over the year as we exited from this business. As a result, overall sales to third party customers fell 7.4% to £63.7m.

Our small but fast-growing Specials business, offering a wide range of bespoke medicines to community pharmacies and hospitals, has doubled in size in the past four years. Last year sales rose 17.4% to £5.4m.

**International companies**

Our international companies delivered a substantially improved performance – increasing sales by 11.3% to £71.2m and operating profit by 18.2% to £2.6m. In Germany, BCM Kosmetik increased sales by almost half and moved into profit. In France, BCM Cosmétique grew sales by 15.4% and profit by 33.3% to £0.8m.

Royal, which supplies European retailers, saw profits fall 18.8% to £1.3m in an aggressively price-led market. As part of our exit strategy from retailers' own brands we sold Royal in April 2001.

**Cost management**

A cost management programme, which began in September 2000, achieved savings of some £4.7m in the second half and should deliver annual savings of about £9.5m. Around 400 people

16/Review of operations

left the UK business during the year, a reduction of almost 12%, and a further 30 will leave this year.

Capital expenditure, at £12.4m, was again substantially lower after the heavy investment of recent years.

**Outlook**

As part of a wider restructuring of the group, in April 2001 BCM took over BHI's factories in Germany and Thailand. Instead of being a free-standing profit centre, BCM will become a service unit to the other group businesses, which will then benefit directly from the substantial investment that has been made over recent years in reducing costs and improving service.

**Boots Properties**

Managing director	Ian Webster
Sales £m	89.7
Decrease %	(35.7)
Profit £m (before exceptionals)	56.0
Decrease %	(10.1)
<b>Store portfolio</b>	
Single units	565
Multi-tenanted properties	33
www.bootsprop.com	

**As expected, turnover fell 35.7% to £89.7m – the previous year's figure was boosted by the £45.1m sale of a major shopping centre development in Durham. This was also the reason for the 36.7% fall in free cash flow to £63.4m. In line with our strategic disposal programme, rental income fell 5.0% to £89.7m and operating profit before exceptionals was down 10.1% at £56.0m.**

**Strategy**

Boots Properties owns and manages freeholds and leaseholds on around 650 of the group's units. Our principal role is to provide property solutions for group retail businesses – continually reviewing the portfolio to ensure optimum flexibility, acquiring new sites and disposing of unwanted ones. Following reorganisation we will also provide a broad property management service across all sites and manage all

the group's building, construction and fit-out works. To focus on this work, we are in the process of selling our remaining development and investment portfolios.

**Portfolio management**

During the year we acquired 19 edge of town superstores and 11 high street units for BTC. We also continued the 'rightsizing' programme for Halfords – acquiring existing Halfords premises from their landlords, reconfiguring them to suit Halfords current needs and restructuring the lease commitments. To support the expansion of Boots Dentalcare and Footcare practices we obtained planning permission and landlords' consent for change of use at 40 retail sites, and managed cost-effective refits.

**Development**

Speculative development is no longer part of our strategy in current market conditions. We are therefore disposing of any remaining developments, together with our investment portfolio, whenever suitable opportunities arise.

**Reorganisation**

During the year Boots Properties amalgamated with the Property and Planning department of BTC and parts of the group Engineering and Facilities Management department. This has enabled Boots Properties to take on a wider role which includes fit-outs and refits for BTC, project management, and estate management activities on the group's 1,700 non-owned properties. Centralisation of resources has enabled us to halve the number of staff involved and reduced costs by some £6m a year. We are also planning to develop our partnership approach with contractors and intend to rationalise our procurement into fewer, larger contracts – which we expect to yield very substantial savings.

**Outlook**

Our focus this year will continue to be on providing property solutions and efficient fit-outs for group companies.

**People, community and environment**

**Independent research frequently tells us that Boots is one of the most trusted brands in the UK. We are determined to retain that trust – not only in our dealings with customers and suppliers but also in the way we behave towards our people, the communities we serve and the wider environment. We see a concern for social and environmental wellbeing, within a broader 'sustainability' agenda, as an integral part of the way we do business.**

**People**

Our success depends fundamentally on our ability to attract, retain and develop outstanding people – and to create the conditions in which they can excel. This applies at all levels. In the past year we have been thoroughly reviewing our top 50 managers' leadership competence and development needs against the demands of our new strategic vision. New programmes have also been introduced which involve store staff more closely in decision-making. All this is enhanced and underpinned by a newly developed set of group values.

During the year we introduced a cost-effective new pension scheme, designed to enhance our attractiveness to new joiners. This year saw the introduction of a new employee share scheme, which will give employees a tangible interest in the increasing value of the business. Some 66,000 UK staff have received an allocation of free shares, and a share tracking scheme has been introduced for overseas staff. Further shares will be allocated annually on a performance related basis.

**Community**

Boots has been active in contributing to a healthy and vibrant society for more than 120 years. Our stores play an essential role in developing strong links with local communities and we will build on these strengths as we begin to align community investment activity with key drivers within the business.



**Left** All the group's manufacturing facilities have now been brought together into a single service unit.

17/Review of operations

Many of our people make a valuable contribution to their communities by giving their time and skills and we will continue to develop initiatives to support and recognise their efforts.

Many of our innovative community investment initiatives have been developed in Nottinghamshire: we know the community well and have established many powerful partnerships. In March 2001 we opened a Community Investment Centre on our main Nottingham site, which adds a new dimension to our work, supports work-related learning and develops employee skills.

We take seriously the growing interest in the broader sustainability agenda. We are reviewing Boots position and developing a transparent and robust framework in which to report all our activities in the future.

For up-to-date information on our community programme, please visit our website at [www.boots-plc.com/communityinvestment](http://www.boots-plc.com/communityinvestment)

**Environment**

We have made further good progress with initiatives to cut waste and reduce energy and water consumption. These efforts clearly benefit the business and society as a whole. Among the highlights was a 108% increase in using return journeys from Boots store deliveries to bring suppliers' goods to the warehouse. This was equivalent to reducing road journeys by more than 860,000 km overall. We reduced water consumption per unit produced at Airdrie and Nottingham by 3.9%. And the Department of Environment Transport and the Regions formally recognised our Nottingham combined heat and power station as an example of energy efficiency best practice.

We extended our involvement in the Government's Making a Corporate Commitment initiative, by agreeing to target a 10% like for like reduction in carbon dioxide emissions over five years.

Information on our environmental performance is available on our website at [www.boots-plc.com/environment](http://www.boots-plc.com/environment).

You can view our annual environmental report and download an eight-page summary from the site; if you would prefer a copy by post, please call free on 0800 028 0367.

---

**66,000** UK staff given shares under our employee share ownership scheme.

---

**860,000km** of road journeys saved by more efficient use of delivery fleet.

---

**120** years of Boots activity in contributing to a healthy and vibrant society.

---



**Left** We actively support and encourage staff who give their time and skills to community and educational projects.