

Directors' report

The directors of Boots Group PLC present their annual report to shareholders, together with the audited financial statements for the year ended 31st March 2006.

Principal activities

The group's principal activities during the year were:

- > retailing of chemists merchandise;
- > the provision of opticians and other healthcare services;
- > the development, manufacture and marketing of healthcare and consumer products.

Further information on the group's continuing activities is provided in the OFR on pages 7 to 38.

Business review and future developments

A review of group activities during the year, research and development, and likely future developments are dealt with in the Chairman's statement, the chief executive's review and OFR on pages 2 to 38.

The OFR also contains a description of the key risks and uncertainties that face the business. In addition it contains details of the financial risk management objectives and policies of the group and details of the exposure of the group to financial risks.

Group results

The group income statement for 2006 shown on page 61 includes the following details:

From continuing operations	2006 £m	2005 £m
Revenue	5,027.4	4,935.5
Operating profit before finance costs	369.2	400.9
Profit before taxation	348.9	360.0

Appropriations

The directors recommend the payment of a final dividend of 21p per share (2005, 21p per share) which, if approved by shareholders, will be paid on 4th August 2006 to shareholders registered on 2nd June 2006. On 24th February 2006 a special dividend of 200p per share was paid. An interim dividend of 9.1p per share was paid on 20th January 2006 (2005, 9.1p).

Group structure and operations

On 7th April 2005, Boots announced its intention to sell Boots Healthcare International and return a significant proportion of the proceeds to shareholders. The sale was completed on 31st January 2006 and a special dividend of 200p per share was paid on 24th February 2006.

On 7th April 2005, Boots also announced the proposed sale and leaseback of 312 of its small stores which was completed on 29th July 2005. Proceeds from the transaction were used to pay down short term borrowings.

On 3rd October 2005, Boots announced its intention to merge with Alliance UniChem plc. The merger, if approved, is currently expected to become effective at the end of July 2006.

Share capital

Details of changes in the share capital are shown in note 27 to the financial statements.

On 13th February 2006 the authorised share capital of the company was decreased from £300,000,000 divided into 1,200,000,000 ordinary shares of 25p each by way of a subdivision and consolidation of shares, in the ratio of 39 for 58, to £299,999,983 divided into 806,896,506 ordinary shares of 37 $\frac{1}{2}$ p each. As part of the consolidation, 40 shares of 37 $\frac{1}{2}$ p each and the fraction of a share of 37 $\frac{1}{2}$ p each arising from the consolidation were cancelled. The 722,348,704 issued ordinary shares of 25p each were thus consolidated into 485,717,232 shares of 37 $\frac{1}{2}$ p each.

At the annual general meeting on 21st July 2005, shareholders authorised the company to make market purchases of its own ordinary shares of 25p each.

During the year the company entered the market and purchased 8.1 million (2005, 45.4 million) shares which have been cancelled. This represented 1.1% (2005, 6.2%) of the shares in issue immediately prior to the consolidation (2005, at the end of the period) and the total cost was £50m (2005, £300m). No shares were repurchased after the consolidation. At the forthcoming AGM on 20th July 2006, shareholders will be invited to renew the company's authority to make market purchases. The authority will be limited to the purchase of not more than 48,581,000 ordinary shares, being approximately 10% of the ordinary shares in issue at the date of this report, or, subject to the merger with Alliance UniChem becoming effective, not more than 96,756,000 ordinary shares being approximately 10% of the estimated issued share capital of the company following completion of the merger. The maximum price payable is not more than the higher of 5% above the average of the closing mid market quotations for the five business days before the purchase and that stipulated by Article 5 (1) of the Buyback and Stabilisation Regulation, with the minimum price being the nominal value, exclusive of any expenses payable by the company.

The aggregate number of shares held by Boots Qualifying Employee Share Trust, Boots All Employee Share Ownership Plan and Boots ESOP Trust are shown in note 27 to the financial statements.

Shareholders

As at 17th May 2006, the register maintained by the company under Section 211 of the Companies Act 1985 contains the following notifications to the company:

Name of shareholder	% of issued ordinary share capital held
Franklin Resources Inc	7.13%
Legal & General Investment Management	3.76%
Lazard Freres & Co	3.00%
Deutsche Bank AG	4.09%

Asset values

The directors are of the opinion that the market value of the group's properties at 31st March 2006 is 63% higher than that stated in the financial statements. It is not anticipated that any significant taxation will become payable on the revaluation surplus, as taxation gains on properties used for the purpose of the group's trade are expected to be deferred indefinitely or eliminated by capital losses.

Payment of suppliers

The group is a signatory of the Better Payment Practice Code (a copy of the code is available from www.payontime.co.uk). It is the policy of the group to agree appropriate terms and conditions for its transactions with suppliers (by means ranging from standard written terms to individually negotiated contracts) and that payment should be made in accordance with those terms and conditions, provided that the supplier has also complied with them.

The number of days' purchases outstanding for the group's UK operations at 31st March 2006 was 19 (2005, 20 days). The company has no trade creditors.

People

The group communicates with its people through a wide variety of channels including: Boots news, published quarterly, and available to all employees; regular briefings, held in head office and other locations; information cascades through line managers; store conference calls, held weekly; and the company's intranet, updated daily with news and information of concern to employees.

Works councils are established and operate in our French and German factories. Otherwise, each part of the business is represented on the Forum. The Forum meets four times a year, over 2 days. Prior to the meeting the 18 elected representatives gather opinions from the area they represent, and during the meeting receive presentations, review feedback from their areas, and discuss issues with the group executive. After the meeting the representatives agree follow up action, the feedback to their constituents, and the agenda for the following meeting. During the year constituencies for elected representatives were reviewed, and elections held to ensure compliance with the Information and Consultation of Employees Regulations 2004.

Our people's involvement in the company's performance is encouraged through performance-related bonuses and the annual allocation to all participating employees of free shares under the All Employee Share Ownership Plan. The award is subject to the group attaining business targets and employee eligibility is subject to completion of a qualifying period of employment. In the year under review all participating full time employees received free shares having a market value of £250 and part time employees received a pro rata entitlement.

The involvement extends to the board of Boots Pensions Ltd, the trustee of the Boots Pension Scheme, on which there are three employee representatives as well as a retired employee.

The group's aim for all its people and applicants for employment is to fit the qualifications, aptitude and ability of each individual to the appropriate job, and to provide equal opportunity, regardless of sex, race, religion or belief, sexual orientation, disability or ethnic origin. The group does all that is practicable to meet its responsibility towards the employment and training of disabled people. Where an employee becomes disabled, every effort is made to provide continuity of employment in the same job or a suitable alternative.

Charitable and political donations

The group made cash donations for charitable purposes in the UK for the year of £1.419m (2005, £1.65m) being £0.118m for education, £0.051m for relief of financial hardship, and £1.25m for other charitable purposes (including health and economic development). The company made no political payments (2005, £nil).

Directors

Mr H Dodd resigned from the board on 18th May 2005, Mr J Bennink retired from the board at the AGM on 21st July 2005 and Mr J R Smart was appointed to the board on 3rd October 2005.

Sir Nigel Rudd retires by rotation at the AGM in accordance with article 87 of the company's articles of association and offers himself for reappointment. Dr Martin Read also retires under article 87 but is not offering himself for reappointment.

Mr J R Smart, who was appointed as a director on 3rd October 2005, retires at the AGM in accordance with article 86 and offers himself for reappointment.

The performance of each director standing for reappointment has been formally evaluated; regard being had to length of service on the board of each such director and whether they be executive or non-executive.

› Directors' report

The board believes that each director standing for reappointment continues to demonstrate commitment, to be an effective member of the board, and to contribute to the balance of skills and knowledge and experience identified by the board in the course of its review. The board is satisfied that the Chairman is not precluded from devoting sufficient time to his duties to the company by reason of his other commitments. The board recommends reappointment of the directors standing for reappointment.

Details of directors, their roles, responsibilities, achievements and significant external commitments are set out on page 30 and, for those seeking reappointment, in the AGM notice, which is sent to shareholders with this report.

Information on service contracts and details of the interests of the directors and their families in the share capital of the company at 31st March 2006 are shown in the directors' remuneration report on pages 46 to 55. Copies of the service contracts of executive directors and of the appointment letters of the Chairman and non-executive directors are available for inspection at the company's registered office during normal business hours and at the AGM.

No director has a directorship in common or other significant links with any other director (except in the case of executive directors holding directorships of subsidiary companies of the company).

Auditors

Resolutions to reappoint KPMG Audit Plc as auditors and to authorise the directors to determine their remuneration will be proposed at the AGM.

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditors are unaware, and each director has taken all the steps that he or she ought to have taken as a director to make him or herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

By order of the board
Michael Oliver
Secretary

17th May 2006