

# How our business has performed

In the previous part of this review, we reported on our progress in relation to the five key pillars of our strategy during 2005/06. Here, we look more closely at how the individual parts of our business performed over the last 12 months, and explain a little of the context in which that performance was achieved...

## Boots The Chemists

**Market background:** As you've read, 2005/06 was a very challenging year for UK retailers. Retail sales rose by only 0.5% (like-for-like falling by 0.7%), as people went shopping less frequently, which meant retailers had to compete harder for their custom. At the same time, running costs rose with the result that many major retailers posted reduced profits for the year.

Value, of course, remained a major priority for shoppers, as did convenience, with customer-friendly EoT centres continuing to take a larger share of the market. And Sunday trading, only legalised in 1994, further established itself as an indispensable feature of the UK retailing landscape.

**Performance overview:** In view of the market conditions described above, Boots The Chemists performed well, with like-for-like sales and margins both holding firm. We also managed to keep running costs at last year's level, despite 3% inflationary pressure – thanks largely to better buying, and increased efficiency throughout our operation. And we turned in our fourth successive record Christmas, while many of our competitors struggled.

Our strong sales performance can be attributed to a number of factors including more competitive pricing; improvements in the layout of stores and product availability; and our increasing presence in EoT shopping centres. The Advantage Card, one of the UK's most rewarding loyalty schemes, continued to make a very important contribution and to grow in popularity.

## BTC in 2005/06 at a glance

**up 1.7%**

**Total sales** were up by 1.7%, down 0.1% like-for-like on 2004/05

Taking into account regulatory price changes, underlying like-for-like sales were slightly up in relation to last year

**Gross margin percentage** was broadly flat year-on-year

**up 6%**

**Trading costs** were 6% higher than last year, but our increased efficiency contributed savings sufficient to offset underlying inflation

**1.8%**

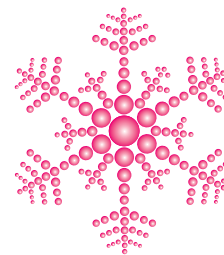
**New space** contributed 1.8% of sales growth

### Customer transactions

The average value of each customer transaction increased by 2.4% during the year, especially in the case of customers using the Advantage Card, which accounted for 70% of all BTC sales

**15 million**

We issued 2m new **Advantage Cards** to take the number of active users to nearly 15m



**up 1.0%**

**BTC Christmas sales** up by 1.0% on 2004/05, with a particularly strong contribution from beauty gifts

**down 7.7%**

**Average stock levels** were down by 7.7% thanks to greatly improved supply chain performance

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**BTC Health**

**Market background:** Despite the consumer spending downturn in 2005/06, the healthcare market remained strong and continued to grow. In January, the Community Health White Paper was published, an important step in the government’s continued policy of expanding locally based community healthcare services. In conjunction with the Community Pharmacy Contractual Framework introduced in 2005, this opens the door for much greater involvement in the public health agenda on the part of retailers.

In contrast, the value of the health market was adversely affected by price deflation during the year, with the Pharmaceutical Price Regulation Scheme reducing the price of prescription branded medicines by 7%.

**Performance overview:** The performance of our Health business was strong, with an increase in sales of 2.7% and a significant growth in our dispensing business of 2.8%. This reflected our emphasis on ‘putting the chemist back into Boots’ and, in particular, our success in developing the role of our pharmacists, as trusted healthcare advisers.

**BTC Health in 2005/06 at a glance**

**up 2.7%**

Sales up by 2.7%

**100m**

Dispensing prescriptions

Strong volume growth in our dispensing business with 100m prescription items dispensed for the first time

**down 7.0%**

Price deflation caused by Pharmaceutical Price Regulation Scheme (PPRS) reducing the price of branded prescription medicines by 7.0%

**up 2.8%**

Dispensing sales growth after the impact of price deflation from both PPRS and from price reductions to generic medicines which anniversaried in September

Good performance in the OTC market, particularly in vitamins and complementary health

**over 14,500**

Free Chlamydia testing service

Successful free Chlamydia testing service in London stores, with over 14,500 tests requested in the first few months, well above expectations



**up 23.0%**

Change One Thing campaign

Highly successful Change One Thing campaign, aimed at helping customers keep their New Year’s resolutions, resulting in a 23.0% increase in smoking cessation products

## BTC Beauty and Toiletries

**Market background:** We believe two key factors continue to drive growth in the Beauty and Toiletries market. The first is innovation, with advances in technology resulting in continuous improvement in product performance, in areas such as skincare. At the same time, attitudes among an ageing population are shifting; put simply, people want to go on looking good for longer – and, with higher average disposable incomes, customers of more mature years are more important to this market than ever before.

**Performance overview:** We continued to strengthen our position in the UK Beauty and Toiletries market. Our comprehensive range of both cosmetics and fragrances, is supported by our specially trained beauty consultants. The key factors in our strong performance during 2005/06 were our investment in new beauty halls and improved displays, the very successful relaunch of our N°7 and 17 ranges, and the performance of our sun care and skincare ranges.

### BTC Beauty and Toiletries in 2005/06 at a glance



**up 2.4%**

**Sales up** by 2.4%

Major investment in new beauty halls and new displays, improving sales generally and particularly premium cosmetics

**up 13.0%**

**N°7** Successful relaunch of N°7, resulting in 13.0% growth in its first year since relaunch

**up 2.2%**

**Toiletries** 2.2% growth in Toiletries, with skincare and dental performing very well

**Soltan** now established as the biggest brand in the sun care market in the UK

Overall performance was affected by slow sales of beauty-related electrical products, due to consumer spending slowdown

## BTC Lifestyle

**Market background:** For Boots, the product areas that come under this heading are most important as a means of giving customers more reasons to visit our stores, and make Health and Beauty purchases. But Lifestyle also makes a significant contribution in its own right; and over the last year, there were a number of largely foreseeable changes in the market which affected our business – notably the continued rapid growth of digital photography, and a sharp decline in sales of higher priced electrical goods caused by an overall downturn in consumer spending.

**Performance overview:** A difficult year for Boots, with sales down 2.5% on last year. Our Nutrition business, in particular, was disappointing and two reasons for this were the slowdown in sales of Atkins diet products and the terrorist disruption to our key London market in the second quarter. In contrast, Baby performed well, thanks to additional space and improved ranges; and we continued to increase our share of the digital photo market.

### BTC Lifestyle in 2005/06 at a glance

**down 2.5%**

**Sales down** 2.5% on last year

**up 3.7%**

**Baby sales** continued to grow strongly, with sales up by 3.7%

**Nutrition sales** down by 2.6%, partly due to slowdown in sales of Atkins diet products, although revenue in the core lunchtime business is marginally up

**up 26.8%**

**Digital processing growth** up 26.8%, despite decline in overall market

Decision taken to discontinue TVs and other large electrical items, leading to lower sales in the pre-Christmas period

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**Boots Opticians**

**Market background:** The market remains competitive with lower consumer expenditure on fashion eyewear and the deregulation of contact lenses in 2005 creating significant price deflation. Market conditions seem unlikely to improve in the foreseeable future.

**Performance overview:** Boots Opticians experienced another difficult year, with sales down by 3.3%. Integration with Boots The Chemists, changes to store and field management and changes to the supply chain all created disruption and impacted performance in the first half of the year. In the second half, improvements in the range, customer recall process and marketing began to have a positive effect on sales and profit and will enable us to reduce costs and drive efficiency next year.

**Boots Opticians in 2005/06 at a glance**

**down 3.3%**

**Sales** down by 3.3% – affected by downturn in consumer spending, and disruption caused by integration of Boots Opticians into Boots The Chemists



**0.8 million**

pairs of spectacles sold – with increased emphasis on value and range

Stronger performance in second half, as management and marketing improvements took effect

**Boots Healthcare International**

Our sale of BHI to Reckitt Benckiser for £1.9bn was successfully completed on 31st January 2006, and resulted in a profit of £1.4bn.

In February, over £1.4bn was returned to shareholders in the form of a special dividend of 200p per share.

This was accompanied by a share consolidation in the ratio of 39:58, intended to allow the comparability of share price and earnings per share.

The price achieved for BHI and the size of the cash return will enhance earnings per share, since the percentage of shares consolidated is greater than the proportion of group earnings being lost.

Around £400m has been retained to strengthen the balance sheet, for future investment in the business and the enlarged group post the proposed merger, and to further strengthen our pension fund.

**The BHI sale**

**£1.9bn**

BHI sold to Reckitt Benckiser for £1.9bn

**£1.4bn**

Over £1.4bn returned to shareholders

Shares consolidated in the ratio of 39:58

**EPS**

Earnings per share will be enhanced by the price achieved for BHI and the size of the cash return

**£400m**

Around £400m from sale retained for investment in the pension fund, in Boots and in the enlarged group

## Boots Retail International

Boots Retail International (BRI) has been one of our lower profile success stories in recent times, and continued to perform well in 2005/06.

BRI losses have reduced significantly over the last five years and we have now made real progress in bringing the business to profitability. Our aim has been to offer consumers all over the world the chance to buy and enjoy Boots brand products by working closely with other major retailers in their local markets, to open Boots branded 'implants' within their stores.

During the last year, we opened over 300 more implants, bringing the total number to 758 in 13 countries. We also continue to operate 96 stand-alone stores in Thailand.

### The future for BRI

We are gaining confidence in the consumer demand for Boots brand products around the world and are making good progress towards meeting that demand profitably.

The proposed merger with Alliance UniChem should enable us to accelerate our plans in a number of markets.

### BRI in 2005/06 at a glance

**up 20.1%**

Sales up by 20.1% (16.5% at comparative exchange rates)

**339**

Net new implants opened in 13 countries

Successful trials with US retailers Target and CVS, now extended to 167 stores

**71**

Stores Successful launch of Boots brand in Russia, with implants in 71 stores belonging to retailer '36.6'

Successful launch of Boots brand in Romania, with implants in 90 stores belonging to retailer Sensiblu

Deal concluded to open Boots franchised stores in the Middle East in 2006 with partner M.H. Alshaya

## boots.com

As on-line shopping continued its rapid growth, our internet business boots.com performed well, with sales benefiting from an improved on-line customer experience and order fulfilment. Sales are now bigger than the largest Boots store. Boots.com's new search functionality helped our on-line shoppers to find products more easily and drove improved visitor conversion. The strongest areas of on-line sales growth were in Healthcare, Fragrance, Skincare and Toys.

### boots.com in 2005/06 at a glance



**38.6% increase**

Sales up by 38.6%

**8%**

of customers had been on the website before coming into our stores

**43.6% increase**

Christmas sales up by 43.6%