



Financial Review



Performance measurement The company's governing objective is to maximise the value of the company for the benefit of its shareholders. In line with this we believe that the best overall measure of group performance is total return to shareholders calculated from the movement in the share price and the value of dividends as if reinvested when paid. We monitor our performance on a rolling five year basis against ten peer companies, the results of which are shown in the adjoining table.

During the year our share price rose from 675p at the end of last year to 957p on 31st March 1998, giving a market capitalisation of £8.7 billion. The share price ranged from a high of 963p to a low of 676p.

Sales and operating profits from continuing operations before exceptional items increased in the year by 11.7 per cent and 7.7 per cent respectively.

Basic earnings per share (EPS) decreased from 42.9p to 29.0p. After adjusting for exceptional items EPS rose from 39.5p to 42.6p. The board has proposed a final dividend of 15.6p. This brings the total dividend for the year to 22.3p, an increase of 8.8 per cent over the equivalent amount last year excluding the special dividend.

Cash flow Cash management is one of the key performance measures used by the company to monitor its businesses. The maximisation of cash flow is the key factor in value creation. The summary of cash flows shown below demonstrates the company's ability consistently to generate a healthy free cash flow which is defined as cash flow available to all the providers of capital.

Shareholder returns of The Boots Company compared with peer companies

Returns are calculated using average share prices over the three months to 31st March.

Five years to 31st March 98		%
1	SmithKline Beecham	282.4
2	Tesco	151.9
3	GUS	129.5
4	Boots	128.2
5	Kingfisher	117.6
6	Marks & Spencer	100.4
7	Reckitt and Colman	96.1
8	Smith & Nephew	37.3
9	W H Smith	31.7
10	J Sainsbury	6.8
11	Sears	(35.6)

Summary of cash flows	1998 £m	1997 £m
Operating cash flow before exceptional items	634	540
Exceptional operating cash flows	(28)	(25)
Acquisition of businesses	(181)	(170)
Disposal of businesses	(9)	130
Purchase of fixed assets	(249)	(223)
Disposal of fixed assets	262	54
Taxation paid	(233)	(174)
Other items	7	7
Free cash flow	203	139
Share repurchase	–	(300)
Dividends paid	(563)	(170)
Net interest	(11)	39
Net cash flow (page 53)	(371)	(292)

The group generated cash from operating activities of £634 million, an increase of £94 million on last year.

The exceptional cash flows are analysed in note 22 to the financial statements and include expenditure on terminating onerous contracts at Do It All of £36 million. These relate mainly to property lease commitments.



Investment in fixed assets was at a similar level to last year. The fixed asset disposal proceeds relate mainly to the sale of investment properties.

The adjoining graph shows the amounts generated by the group for each of the last five years.

Acquisitions and disposals of businesses Boots Healthcare International established a presence in Germany with the acquisition of a leading German medical skincare company Hermal Kurt Herrman oHG for £176 million.

Boots The Chemists extended its presence in The Republic of Ireland with the acquisition of the Hayes Conyngham & Robinson chemists chain for £11 million.

The group disposed of A G Stanley for £1.

Interest Net interest receivable for 1997/98 was £15 million compared with £44 million last year. The main reasons for this decrease are the effects of the special dividend in June 1997 and the acquisition of businesses offset by the proceeds on disposal of properties.

Given the overall cash, borrowing, interest rate swap and cap position of the group, each 1 per cent increase or decrease in short term interest rates, up to a level of 9 per cent, increases or decreases net interest payable by about £9 million. Beyond 9 per cent, for each 1 per cent, the impact is reduced to about £2 million.

Liquidity and funding At 31st March 1998 net debt was £149 million compared with net funds of £229 million at the start of the year.

During the year the group put in place committed credit lines totalling £210 million, with seven relationship banks. These committed lines, which have been substantially unused during the year, mature in August 2000.

Short term financing needs continue to be met from uncommitted bank borrowings.

The profile of the group's borrowings gives maturities of two to five years for 25 per cent of the borrowings and more than five years for 18 per cent.

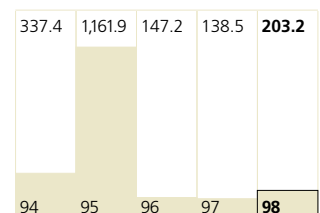
Capital structure Since 1994 the group has undertaken a series of transactions to help achieve a more efficient capital structure, in line with the policy of delivering shareholder value. It is sensible to finance a proportion of capital requirements with borrowings, especially when the business consistently produces strong cash flows.

The latest such transaction was a £400 million special dividend, paid in June 1997. Payments to shareholders in the form of dividends and share repurchases over the last five years are shown in the adjoining table.

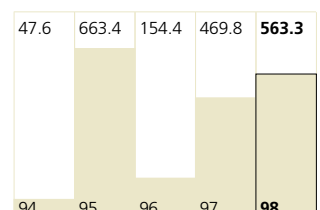
Treasury control policy We have clear strategies for all major aspects of treasury policy. Strict guidelines for cash investments apply worldwide with cash held only in bank deposits and commercial paper of high quality.

Controls seek to prevent fraud and other unauthorised transactions as well as counterparty risk. There are regular reviews by the group's internal audit staff.

Free cash flow £m
Includes the sale of Boots
Pharmaceuticals in 1995



Payment to shareholders £m
1995 and 1997 include share repurchases
of £511.3 million and £300 million
respectively. 1998 includes the special
dividend of £400.5 million.





Financial Review continued

Interest rate policy Since hedging against the impact of short term interest rate movements merely reduces earnings volatility, rather than increasing the value of the company, we do not enter into such hedging.

In common with other UK retailers, the group has significant liabilities through its unconditional obligations to pay rent under property leases. The implicit interest rate on these liabilities is fixed.

Some years ago the board adopted a strategy of regular long term interest rate swaps to change the balance between fixed and floating rate debt. This is strictly controlled and monitored and each swap is individually authorised by the group finance director.

The net present value of the lease liabilities has increased during the year, as a result of falling long term interest rates. This increase in liabilities has been offset, to some extent, by the corresponding increase in the value of the related interest rate swaps.

The total volume of lease related interest swaps in respect of this year end was £775 million, with four swaps, totalling £100 million, undertaken for the year. All of these swaps had an initial maturity of ten years to match the long term nature of the underlying property leases. The average maturity of these swaps is now eight years.

During the year the group entered into a series of arrangements which cap the floating rate payable under £700 million of these swaps. The average cap is just over 9 per cent and they all expire in September 2000.

Currency exposure policy Modest sales and purchases are made in a range of currencies but it is not considered that hedging them into sterling adds value.

Taxation The effective tax rate for the group was 30.3 per cent. The main reason for the reduction from the UK standard rate of 31 per cent is the release of corporate tax relating to prior years.

Pensions The next actuarial valuation of the principal UK pension scheme will be completed as at 1st April 1998. Following the previous valuation there is no requirement for the company to contribute to the scheme although a charge of £5 million has been taken in the year.

Year 2000 Assuring the ongoing operation of business systems and processes into the next millennium is a key focus of management. We recognise three elements in our Year 2000 compliance activity:

- assurance that all business systems will correctly process future dates
- verification that embedded logic units within our manufacturing, testing and environmental control systems operate correctly over the millennium change
- liaison with our trading partners, suppliers and customers, to ensure that the supply chains we depend on and are involved in continue to operate without disruption.

Across all our business units we have undertaken a comprehensive assessment programme to identify the issues to be addressed and a series of action plans are in the process of being implemented.

In addition we have formed working groups charged with co-ordinating compliance activity and communicating experience and best practice across the company. Regular progress reports are provided to the executive directors.



The approach we have adopted for business systems compliance involves a combination of modifying existing systems where they continue to meet our functional requirements and replacing others where there is opportunity to refine business processes. Work commenced in 1996 and we expect to have completed the majority of the compliance work on the existing business systems base by the end of 1998. Some work on new systems, which we view as part of implementing our IT investment strategy, will extend into 1999.

We have communicated to our supplier base and are now involved in follow-up work to assess their progress towards compliance. We continue to work closely with our suppliers of plant and equipment containing embedded logic units to verify effective operation.

Our costs involved in achieving systems compliance have been considerably offset by our active programme of systems replacement and renewal as part of our ongoing drive for business improvement. Many older systems that would have required rectification work were scheduled for replacement. The direct cost therefore of modifying our existing system base is comparatively modest, amounting to £3 million in 1997/98. We expect the incremental cost attributable to Year 2000 systems compliance to be in the region of £14 million throughout the length of the full programme.

Economic and Monetary Union (EMU) During the year we have appointed a full time project manager and undertaken a high level analysis of the impact of the introduction of the euro. We have retail businesses in The Republic of Ireland and The Netherlands and manufacturing and marketing companies in seven of the first wave countries. We anticipate total costs of approximately £5 million will be incurred between 1998 and 2002 to support the introduction of the euro in these countries.

The costs of the UK joining EMU are certainly greater than our costs in first wave countries but are more difficult to predict. This difficulty arises because of the uncertainty over whether and when the UK will join and what the UK transition plan would be. Early estimates are that our total costs will be in line with published surveys of other retailers at around 1 per cent of turnover, approximately £40 million.

Retailers will be in the front line in managing the transition for consumers. A particular issue for Boots is the need for extensive staff training prior to the introduction of euros in the UK. We are keen that the government leads a co-ordinated information campaign and starts outline planning of the practical issues surrounding the potential introduction of the euro as soon as possible.

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. Over the past 12 months we have continued to comment on ASB pronouncements relevant to our business and we will continue to do so.

David Thompson
Joint Group Managing Director and Finance Director