

Chief executive's review

# What we said

We said we should set our sights higher

We said the world is moving our way

We said we'd extend into wellbeing-related services as well as products

We said that, to succeed, Boots needed to be more exciting and energetic



Why did we decide to change Boots? Here's what we said a year ago.

**We said we should set our sights higher.** Boots had built a lot of strong brands and could build still more. We'd simplify the business to focus on what we're best at – health and beauty.

**We said the world is moving our way.** Healthcare, beauty and general fitness are converging into a popular pursuit of 'wellbeing'. This is our natural territory, where we should be market leader – first at home, and ultimately internationally.

**We said we'd extend into wellbeing-related services as well as products.** We'd create more wellbeing-related brands and keep building our international healthcare and retail businesses.

**We said that, to succeed, Boots needed to be more exciting and energetic.** We wouldn't be afraid to experiment. We'd try out new ideas, refine them, invest in the ones that worked. And we'd accept that some would fall by the wayside. All this wouldn't be cheap, but we'd protect profits by relentlessly cutting costs.

**Bold talk.** And there's more to do, but in the past year we've made good progress...

Steve Russell  
Chief Executive



# What we did

Creating value through a more enterprising innovative culture means being open to new ideas – backing those that show most promise, but also culling rigorously.

We simplified the business and organisational structure

We accelerated the transformation of our UK retail presence

We stepped-up the pace at Boots Healthcare International

We established a viable model for Boots Retail International



**We simplified the business and organisational structure** During the year we integrated our UK business as Boots Retail, with Boots Retail International (BRI) as its overseas extension. This is saving costs and making us a more agile organisation. For example, we moved from three separate property departments to one; from 100 construction suppliers to seven; and from 14 internal IT groups to one.

Integration is creating a single culture and sense of purpose behind one Boots brand.

Although these changes are far-reaching, we've taken care to minimise disruption to normal business operations.

**We accelerated the transformation of our UK retail presence** We're positioning Boots as the leader in wellbeing services, as well as products. By the year-end we had 297 Boots Opticians stores, 54 Dentalcare

practices, 44 Footcare practices, 47 Hearingcare centres, 22 laser hair removal clinics, five LASIK eyesight correction clinics, ten Health & Beauty Services centres offering a wide range of therapies and treatments.

We trialled new store formats designed to enhance our customer offer while reducing supply chain costs.

We addressed supermarket and department store competition with more imagination, focusing on opportunities as well as challenges.

One initiative was to take our beauty offer deeper into department store territory by trialling six Pure Beauty premium cosmetics stores.

Another was to work with Sainsbury's to build our edge of town representation faster: six trial implants gave Boots a presence in high-footfall Sainsbury's superstores, enabling them to give customers an enhanced health and beauty offer.



**We stepped-up the pace at Boots Healthcare International (BHI)**

Clearasil, acquired in December 2000, was the driving force behind BHI's 12.5% sales growth last year. We integrated the brand smoothly, turned its sales from decline to growth, and used it to open the door for our local businesses to the huge US and Japanese over-the-counter markets.

As BHI's profits grow, it's increasingly evident that this business has enormous potential. Within a few years it could be contributing very significantly to group profits.

To realise this potential, we announced in February this year that we will substantially increase our investment in the business.

**We established a viable model for BRI**

We're turning BRI round. We cut losses by 44.5%, closed our joint venture in Japan, tested and successfully trialled a new business model, and began a closure programme for underperforming old-model stores in Thailand and Taiwan.

The new model, based on relatively small implants in larger host stores, carries much lower capital risk. After successful trials we announced substantial rollouts with partners in Thailand and Taiwan.

**We made Halfords an even better business**

The new Arcade format already looked promising: the first store conversions achieved immediate sales growth of around 20%. Last year further conversions confirmed that this level of uplift was achievable, and that growth would continue. We stepped-up the Arcade rollout, found ways to do it more economically, and sharply increased both sales and profits.

Garage servicing had limited synergy with the new format, so we sold it.

**We kept taking out costs** We earn the freedom to innovate by cutting out needless expense. Creating value through a more enterprising, innovative culture means being open to new ideas, backing those that show most promise – but also culling rigorously. During the year we closed our bootsphoto.com online photo service and the Wellbeing TV joint venture with Granada when they proved unlikely to deliver acceptable returns.

We continued to make good progress with cost control and reached our £250m annualised savings target a year early, in March 2002.

# Where we're heading

Wellbeing is an exciting growth market, and one we intend to lead. Our aim – not just to take a bigger share but to grow the whole wellbeing market through more confident and ambitious investment.

Focused on wellbeing

Focused on growth

Focused on Managing For Value



**Focused on wellbeing** Boots is now all about products, advice and services that enhance personal wellbeing. That's allowed us to take complexity out of the business – simplifying management structures, types of store and types of offer. It's differentiated us from competitors. And it's helped us to develop relevant new products and services.

It's enabled us to identify the key customers that we need to target and satisfy – aided by Advantage Card data. The world's largest smartcard loyalty scheme, now with almost 14 million members, gives us unique insights.

'Wellbeing enthusiasts' account for 60% of our sales. Eager for new products and services, they see Boots as an appropriate and trustworthy source.

While focusing on these customers, we're approaching wellbeing on a broad front. We won't abandon our role as 'the nation's chemist'. On the contrary: as leaders in wellbeing we intend to reinforce our key role

in the UK's primary healthcare. Our pharmacists have a vital role to play here – not only by offering advice and guidance, but also through initiatives such as our Pro-Change smoking cessation programmes.

With our strong healthcare credentials the government's ambitions for the National Health Service could create many other new opportunities for us.

**Focused on growth** From concentration on margins we're renewing our focus on growth. Not just to take a bigger share, but to grow the whole wellbeing market through more confident and ambitious investment.

We're spending £17.4m this year on product innovation, to lift the proportion of own brand health and beauty sales.

Having trialled and refined new store formats, we plan to refurbish our



stores on a four-year cycle. This year 300 stores will be refurbished, giving priority to London. This is expected to involve £130m capital expenditure, £40m revenue expenditure and write-offs of about £70m.

Recognising the importance of pharmacy, we'll be investing this year to upgrade systems and ensure the highest levels of customer service.

We'll continue to develop our Wellbeing Services – but investment will be modest until the autumn, when we've established which services and operating models deliver the best returns.

We've set demanding growth targets for BHI. Organic growth will be spurred by investing 20% more in marketing and 30% more in new product development. On top of that, we're looking for major acquisitions to help us hit our targets faster.

BRI's capital-light new model enables us to move forward with our international retailing rollout.

Our growth will depend on generating a stream of improvements to our stores, products and services. We have a strong record in innovation, and the changes we're making to the culture and organisation will shift us into a higher gear.

**Focused on Managing For Value (MFV)** As we invest more ambitiously, commitment to MFV disciplines becomes even more crucial. Now we've set out our growth strategy, managers can apply MFV principles more stringently to weigh the long term costs and benefits of new ideas.

MFV works best when you can ensure a good flow of promising new ideas. We've got new structures that help good ideas to come through. We've brought in fresh thinking from outside – 25% of today's senior management team have joined in the past two years. And we're fostering a more creative and energetic culture.

Sharper focus on growth will involve reinvesting some profit in the short term. But demographic, political and economic trends are converging to make wellbeing an exciting growth market. We cannot ignore them. We've staked our claim on leadership in this territory – and we're investing now to take a sustainable lead in innovation, sales growth and value creation.

Steve Russell  
Chief Executive