Review of operations

Where we've got so far

Strong performances from premium cosmetics (+24.8%), skincare (+10.5%) and electrical beauty (+11.0%)

We are successfully positioning Boots as a provider of health and beauty services, as well as products

The intergration of Clearasil was completed on schedule and we quickly restored the brand from decline to 3% growth

Only from Boots Our strong own brand ranges strengthen our differentiation from other health and beauty retailers, and their growing share of our sales is helping to raise overall margins.

Boots Retail

Boots The Chemists

Boots The Chemists	
Sales £m	4,070.6
Increase %	2.0
Profit £m (before exceptionals)	629.0
Increase %	5.0
Sales split	**%**
Health and beauty	83.6
Photo, food and baby	14.1
Non-core categories	2.3
www.wellbeing.com	

Boots The Chemists (BTC) continued to increase sales and profits, with sales growth strengthening in the second half. Costs are well controlled and we continued to increase our margins. Our plans are designed to accelerate topline growth further and continue improving operational efficiency.

Strategy BTC's customer appeal is founded on the trust and heritage of the Boots brand, broad customer choice, 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, we are increasingly focused on achieving leadership in wellbeing. Our authoritative brand and product offer are complemented by a growing range of related wellbeing services including Boots Opticians, Hearingcare, Dentalcare and Footcare.

Sales and margin For the year as a whole, sales were up 2.0%, or 1.3% like for like. In the second half, growth accelerated to 2.9%. Growth in health and beauty was particularly strong – up by 4.8% overall and 3.3% like for like driven by the premium product areas – and we continue to gain market share.

There were also strong performances from premium cosmetics (+24.8%), skincare (+10.5%) and electrical beauty (+11.0%).

Key Boots brands such as Nº7 and Botanics – and the exclusive product ranges we develop with brand owners such as TONI&GUY, Liz Collinge and fcuk® – improve the sales mix and strengthen our differentiation from other health and beauty retailers. Encouragingly, their contribution to counter sales rose from 7.2% to 7.9% over the year.

Meanwhile, our withdrawal from non-core leisure merchandise is progressing as planned: sales in this category fell by 36.7% over the year and now account for only a minimal 2.1% of total BTC turnover.

Resale Price Maintenance (RPM) on over-the-counter (OTC) medicines was abolished in May 2001. This was expected to reduce group profits by the full-year equivalent of £15 -20m through the combined effects of keener pricing and sales lost to discounters. In the event, the impact was considerably smaller. This reflected the resilience of BTC's overall offer in the face of supermarket price competition: as we predicted, the impact of RPM abolition appears to have fallen mainly on independent chemists.

Our gross margin continued to grow, rising 0.4 percentage points overall. Importantly, this was not the result of price inflation – it was entirely due to cost control, the exit from leisure and the growing contribution of higher margin brands.

Advantage Card The Advantage Card scheme continues to give us a crucial edge in understanding our customers, helping us to recognise and reward the most important ones. With nearly 14 million members, it is linked with 50% of BTC sales. Both membership and usage received a further boost from the relaunch of the card in April 2002, when we introduced new member benefits. We also began awarding points for healthcare products, to broaden our understanding of customers in this area.

Strategic Marketing Unit New product development and management of our beauty brands is now the responsibility of the strategic marketing unit. This group has a global remit – seeking out new ideas worldwide and also supporting the international development of Boots brands through Boots Retail International (BRI).

Major brand launches during the year included Botanics Cosmetics, detox and time delay. We also relaunched Natural Collection with great success. Our ability to refresh and revitalise established ranges is a key factor in our track record of creating and building long term brands.

This year we are increasing the pace of new brand launches. In the first half these will include Ted Baker bodycare products, the Mediterranean range of natural face, body and hair products, and the Starlet range of fun and glamorous toiletries. New healthcare products will include dietary supplements and a range of Nº7 – branded Skincare Vitamins. We have also relaunched many of our basic toiletry products to create an attractive and accessible essentials range in co-ordinated packaging.

Newer, faster To step-up the pace of product launches we've given responsibility for new product development to the strategic marketing unit, which seeks out fresh beauty ideas worldwide.

Store development As we work to reinforce Boots' standing as the leading brand in health and beauty, we are aware that rather more of our stores than we would wish are in need of refurbishment. Work on improvements has already begun, including the introduction of new beauty halls. Over the next four years we plan to bring all of our stores into step with our latest customer offer.

In 23 stores we are testing a number of retail initiatives designed to enhance our customer offer while enabling us to cut costs by simplifying merchandising and supply chain operations. We are using the lessons learnt from these initiatives to guide our store investment programme.

We continue to open new stores in edge of town locations where we can find suitable sites: during the year we opened seven more, bringing the total to 77. Good sites are increasingly hard to obtain, and we have been looking for ways to broaden our edge of town representation more rapidly. During the year we opened trial Boots implants in six Sainsbury's superstores, offering pharmacy and a wide range of health and beauty products. These trials are continuing, and we are opening a further three stores this summer.

Pure Beauty During the year we opened six Pure Beauty stores, which offer premium skincare and cosmetics ranges in a stylish and exciting environment. Customers and suppliers have been very positive, and we are pleased with footfall and transaction values so far. The trials are continuing and before opening another standalone store we will explore the option of a unit inside a BTC store.

bootsphoto.com After 12 months of operation we decided to discontinue our online photo storage and services business. Demand had proved substantially lower than forecast and we closed the website in October, incurring exceptional costs of £10.4m. We will relaunch the site, offering a more limited range of services, later this year.

Business efficiency For the past three years BTC has maintained a highly effective cost reduction programme, as part of the wider group aim of cutting annualised costs by £250m. By the end of the year BTC had met its own target. We have been determined to achieve these efficiencies without adverse impacts on customer service or on-shelf availability.

Short term supply chain difficulties caused some problems with availability in late autumn. These were resolved in time for Christmas and we are confident of continuing improvement this year.

Outlook This year sales will benefit from an outstanding programme of new product launches, building momentum in the run-up to Christmas, as well as the cumulative impact of the store investment programme. To support these developments we will be focusing attention on lifting on-shelf availability and improving customer service standards. We are confident that 2002 will further enhance BTC's standing as the UK's leading health and beauty retailer.

Wellbeing Services

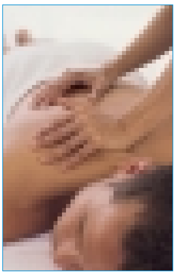
Sales £m	231.0
Increase %	12.9
Operating loss £m	(33.1)
Decrease %	(128.3)
www.bootsopticians.co.uk	
www.bootsopticianslasik.co.uk	
www.bootshearingcare.co.uk	
www.wellbeing.com/dental	
www.bootsinsurance.com	

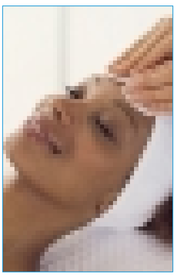
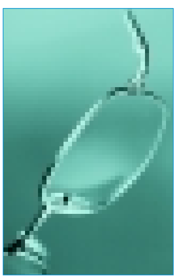
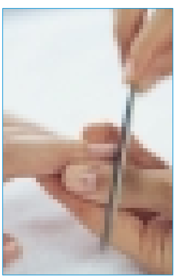
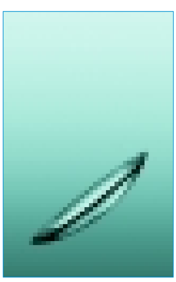
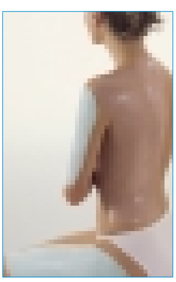
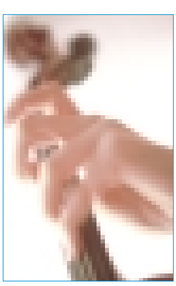
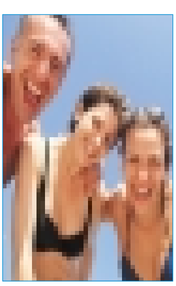
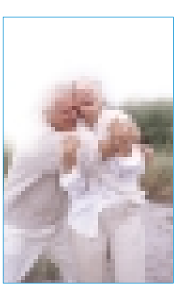
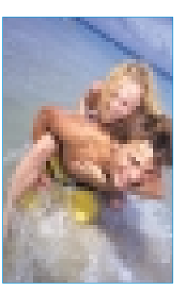
We are successfully positioning Boots as a provider of health and beauty services, as well as products. While expanding Boots Dentalcare and Footcare, we have invested substantially in in-store units offering a broad range of health and beauty services. The lessons we learn are helping us to integrate our services into a cohesive offering that makes best use of the Boots brand and more completely meets the wellbeing needs of our customers.

Strategy There is now strong demand for a range of wellbeing-related services – some of which is frustrated because potential customers have not found a supplier with whom they feel comfortable. Our existing customer relationships and the strength of the trusted Boots brand should enable us not only to build market share but also to grow the overall market – adding substantial value to the space in Boots stores vacated by leisure goods, and taking us into areas where we believe retail competitors will find it hard to follow.

Customer response Customers have strongly endorsed our services and the way we deliver them. They see Boots as a trustworthy and appropriate provider of these services, which enhance our

Wellbeing Services
In the space freed by our exit from leisure goods, we're developing a broad range of services from massage to eye care. Customers see these as fitting well with the Boots brand.



relevance to their lives. As we expected, there is a significant effect on product sales where service users become both more frequent visitors and heavier purchasers of products in our stores. There is also evidence that we are expanding the markets we have entered.

Boots Opticians Profits grew 113.6% overall, rising by 73% in the core optics business. Although turnover for this area of the business remained flat for the year as a whole, the second half brought an encouraging turnaround under a new management team. We kept costs under firm control and reduced stock losses.

After a disappointing first half, sales rose sharply in the fourth quarter as we broadened our offer to cater for a much wider range of customers. Contact lenses continued to be a strength, with sales up 11%. We substantially increased our investment in advertising and introduced two new services: LASIK laser eye correction clinics and Boots Hearingcare centres.

We opened our first LASIK clinic in London's Regent Street in December 2000 and had five by the end of 2001/02. We plan to open more this year. Customer demand has been extremely high, enabling the business to break-even in its first full year of trading. By the year-end our market share was running at 15%.

This year we expect the core optics business to maintain sales and profit growth while the LASIK business – supplemented by new clinics in London, Glasgow, Nottingham and Bristol – begins to add significant profit and cash flows.

Boots Dentalcare We opened a further 24 Dentalcare practices in Boots stores during the year, bringing the total to 54 nationwide. Another three are planned this year. We now have over 100,000 registered patients, and sales during the year exceeded £13m. Performance is meeting expectations and sales growth is gathering momentum. Direct mail to Advantage Card holders has proved a successful way to attract patients and drive sales of cosmetic dentistry. There were early concerns that our growth might be constrained by difficulty in recruiting enough dentists and specialists; these concerns have abated as the profession recognises our commitment to this market.

Boots Footcare A further 19 Footcare practices brought the total to 44 during the year. All but the first three units are co-located with Dentalcare practices, with which they share reception facilities. Consumer demand continues to be strong – we have registered over 80,000 patients and performance is meeting expectations as we develop more advanced treatments that command higher prices, such as bio-mechanics and cryosurgery.

Health & Beauty Services We opened a further eight in-store centres, bringing the total to ten. These offer a wide range of beauty treatments from manicures to massage, and health services from osteopathy to homeopathy. Research shows high levels of customer satisfaction and strong endorsement of Boots' participation in these markets. We are still experimenting with configurations but expect the centres to reach breakeven in two to three years and maturity within four.

We now have 22 laser hair removal clinics alongside Dentalcare practices and within Health & Beauty Services centres. Performance is exceeding expectations and we are adding further 'nurse-delivered' services into the portfolio, including travel clinics and health screening.

Boots Hearingcare We opened 47 Hearingcare centres in branches of Boots Opticians during the year. These supply the revolutionary Songbird disposable hearing aid, to which we have exclusive rights in the UK. This unique concept has proved as attractive as we expected, and the business is performing to plan: first-year losses totalled £3.8m on sales of £2.2m. We plan to open a further 39 centres this year and have established our own training programme to ensure an adequate supply of qualified hearing aid audiologists.

Insurance Services Health and travel cover is a small but profitable business that continues to grow. We are one of the UK's largest direct sellers of travel insurance. Following the success of our dental plans, we are developing a range of health insurance products related to our Wellbeing Services.

Outlook Our expectations of a year ago have been substantiated, and we are confident that Wellbeing Services can make a material contribution to sales and profits as well as positively influencing both brand perceptions and product sales in our stores.

Digital Wellbeing

(60% share of joint venture)

Sales £m	1.4
Operating loss £m	(16.9)
www.wellbeing.com	

Our e-commerce site, wellbeing.com, delivered a solid first year's trading, with total sales of £4.3m (60% share of incremental sales, £1.4m). Customer satisfaction ratings are very high: 95% say they will use the service again and 85% rate the fulfilment process as above-average. We expect average order values to rise as we introduce a growing number of premium fragrance and cosmetics brands. Already, we are the only UK website authorised to sell Chanel products, and one of only two approved to sell Estée Lauder and Clinique.

The related TV channel proved less successful. In view of the depressed advertising and sponsorship market, together with the delayed rollout of broadband infrastructure, we decided to close the operation in December. Our share of the net loss was £4.2m.

Supply and Support Services

In the new organisation, our supply and support services division brings together some 9,000 people and £1.7bn of annual spending. It includes our supply chain, logistics, procurement, manufacturing, properties, engineering and facilities management activities, and our retail buying operation in Hong Kong. By integrating these support activities into a single organisation serving all our retail activities and Boots Healthcare International (BHI), we aim to achieve major cost savings and focus greater attention on value creation in our 'backstage' activities. As part of this process we will look closely at the scope for outsourcing – not only to save costs but also so that we can focus our leadership resources on the activities that matter most to us.

Supply chain The accelerating pace of product innovation has made it increasingly challenging to maintain high levels of on-shelf availability. The group now handles some 70,000 different stock keeping units, of which about 40,000 will change in the course of the year. Our increasingly aggressive promotions programme adds further complexity and makes demand more volatile.

Progress towards integration of the supply chain has been underway for the past three years, improving availability and reducing costs.

By developing a fully integrated supply chain for our retail operations we can further improve availability while achieving large cost reductions over the next three years.

The new organisation enables us to view the supply chain more holistically – for example, by gearing manufacturing more closely to demand from the stores we can reduce the need to hold stocks as a buffer. We will also ensure that new product development is more closely meshed with the supply chain. Availability problems at many BTC stores last autumn were partly due to difficulties in handling a flow of around 1,500 new products in just two months.

Information Technology During the year we fundamentally reorganised our IT – bringing together some 650 staff from 14 independent IT groups across the business. The cost of integrating the IT organisation has been more than offset by first-year cost savings. This year we expect to accelerate cost reduction through further integration and rationalisation. In addition, we are currently developing proposals to outsource the development, delivery and support of IT across the business to improve our change capability and reduce operating and development costs.

This year has seen not only important IT initatives such as the intergration of Boots and Sainsbury's systems, but also the development of a systems blueprint for the new intergrated Boots Retail business. Systems investments over the next three to four years will be driven from this blueprint. The investments will include the replacement of our in-store EPoS, kiosk and pharmacy management systems as part of the store refurbishment programme. The new touch-screen tills and kiosks will enable us to give customers more personalised offers on products and services, based on Advantage Card data.

Manufacturing Integration of manufacturing has involved bringing together two factories from BHI – in Germany and Thailand – with the operations of Boots Contract Manufacturing under a single management structure. This will help us to maintain continued improvements in performance while bringing further opportunities for cost reduction.

Over the year our overhead cost reduction and lean process excellence programmes achieved total savings of £6m. This was a good achievement in a very busy year – we introduced on average four or five new products each working day through our factories, including the transfer of Clearasil from Procter & Gamble, and delivered almost ten million gift sets in over 200 variants for Christmas. We also supported significant growth in product innovation for our 'exclusives' brands such as fcuk® and TONI&GUY.

Sales to UK third parties fell by 35.9%, due largely to our decision to withdraw from supplying own brand products to UK supermarkets and other retailers. Over time we intend to offset this reduction either with additional work for third-party proprietary brand owners or reduction in installed capacity. We have won orders for significant toiletry and healthcare volumes, which will return the proprietary brands business to growth this year.

The overseas operations made good progress, increasing sales both to group businesses and third parties: our French and German factories together increased sales by 13.8% and profits by 53.8%.

We are working closely with BRI to support its new business model by developing cost-effective sources of supply worldwide, and have identified local sources in Asia for a growing number of products. This work will also lead to lower-cost Asian production for some of our UK products, and countries such as Thailand and China will become increasingly valuable sources of new product ideas.

Property We have integrated Boots Properties with the BTC property department, forging a single team that creates value by managing the group's property portfolio and store refit programme efficiently.

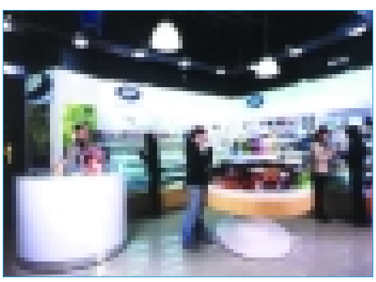
In the 1990s we earned a valuable income stream from property development and investment, when market conditions were favourable. More recently we have been withdrawing from these areas to concentrate on providing property solutions for our own retail operations. During the year we sold three of our four remaining development properties in a phased deal: the final value will depend on eventual lettings, but is expected to be around £32m. We expect to sell the remaining development property – land at Fareham in Hampshire – this year.

We also disposed of nearly £80m of properties, including investment properties, 26 high street properties and three multi-let retail warehouses. In addition, since the year-end we have sold a shopping centre in Bolton. The remaining investment portfolio consists of two shopping centres and two retail warehouses, which we expect to sell over the next 18 months.

Boots Retail International

Sales £m	40.3
Decrease %	(4.3)
Loss £m (before exceptionals)	(24.1)
Increase %	44.5
www.bootsretail.com.tw	

Last year BRI faced two urgent challenges: to stem its growing losses, which had reached unacceptable levels, and to develop a viable new business model. We made good progress towards both objectives – cutting the operating loss by 44.5% and successfully trialling a new model that will enable us to grow internationally at a faster pace with much lower risk.



Implanted In Taiwan we're opening implant units in Watsons stores.

Strategy Our original model – fully owned units with a full drugstore offering – proved too cumbersome and capital-intensive. To find a new way forward we set up a number of trials where we opened low-cost implants, focused on Boots brands, inside existing stores that already attract the kind of consumers we are targeting.

The performance of this formula in trials in Thailand and Taiwan has given us confidence to make it our model for the business going forward. We have closed old-model stores where we see little chance of achieving profitability – incurring relatively modest costs of £8m in Japan and £3.2m in Thailand and Taiwan. The new model is a much simpler business to operate, allowing central support costs to be reduced by some 35%.

Sales Sales fell 4.3% overall, as growth from new-model implants was offset by the closure of old-model stores. Importantly, the infusion of new-model units significantly changed the sales mix: sales of proprietary brands, on which we make relatively low margins, were down, while higher-margin Boots brands grew by 31%. We continue to improve the performance of the remaining old-model stores in Thailand, where like for like sales grew 2.2%.

South East Asia In Taiwan, trials of Boots brand implants in three Watsons drugstores proved successful and we announced national rollout plans for completion by March 2003. Watsons is the leading drugstore chain in South East Asia, with some 550 stores in six countries and a particularly strong presence in Taiwan and Hong Kong. We expect to close about four of our existing Taiwan stores to avoid overlaps with Watsons.

In Thailand, like for like sales grew by 2.2%. Focusing the offer much more on Boots brands, and hence driving up margin, generated an even stronger like for like gross profit growth. In July we began trials of Boots brand implants in TOPS supermarkets: as a result of their performance we have agreed with TOPS to rollout to a total of around 20. Meanwhile, we will close some 15 of our existing stores.

Europe In the Netherlands, sales of Nº7, 17 and Tricologie through the Etos chain grew in line with expectations as we gained national distribution. The number of participating stores grew from 74 to around 300 during the year.

In Italy, trials of Boots brand implants in four Esselunga supermarkets began in July 2001. We will be reviewing progress in Italy later this year.

Japan We announced the closure of our joint venture with Mitsubishi in July 2001. Our four stores stopped trading in August, incurring exceptional costs of £8m.

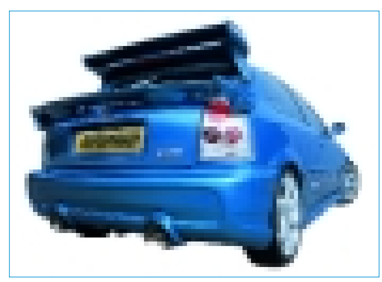
Outlook The reduction in losses will continue throughout this year.

The new retail model is a hybrid of retailing and brand management that is flexible and capital-light. It plays to Boots' strengths, taking full advantage of our brand management skills and vertical integration. As the group develops new products with global formulations and packaging, BRI's expanding markets will generate incremental sales volumes – lowering the cost of sales, improving margins and generating additional funds for the group to reinvest in further product development.

Halfords

Sales £m	528.7
Increase %	4.0
Profit £m (before exceptionals)	54.3
Increase %	29.6
Sales split	**%**
Car enhancement	30.5
Car maintenance	31.8
Cycling	21.8
Touring	12.7
Garage	3.2
www.halfords.com	

Profits rose sharply, driven by continued strong sales growth, despite £7.6m of investment in the new Arcade format. The sale of the loss-making garage servicing business in August involved a £2.3m write-off against profits but removed a long-standing distraction from the core business. Arcade is proving a major success, stimulating mainstream consumers and greatly enhancing Halfords' credibility with higher-spending enthusiasts.



Accessorised The success of our Ripspeed brand boosted performance styling sales by over 50%.

Strategy Our strategy is to maximise Halfords' unique advantages: greater scale and accessibility than competitors and a trusted brand standing for choice, reliability and value. Our Arcade format, which creates stores-within-a-store for individual departments, is successfully increasing 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 94.6% of sales.

Sales and margins Car maintenance, our largest category, grew 10% as we continued to gain market share, within this parts and consumables grew by 10%. Car enhancement had an excellent year, with sales up 21% overall. Performance styling rose 53.9%, boosted by the success of our Ripspeed brand, as we succeeded in making it more accessible to mainstream customers. Audio maintained its strong growth at 24.5%.

Sales of cycles and accessories declined by 2.3%, although we increased our share in a market depressed by the foot and mouth outbreak. Arcade stores held up better than the others, reflecting their strong attraction for enthusiasts.

Increasingly effective buying and promotion raised overall retail margins. This was despite price deflation on entry-level cycles, caused by broadening competition from supermarkets and sports stores: we were able to compete on price while offering superior choice and service.

Stores During the year we refitted a further 41 stores to the Arcade format and opened ten new ones. By the end of August 2002 we will have a total of 152 Arcade stores, generating over 60% of sales. We now know that the significant sales uplifts generated by conversion are sustainable and that growth will continue. The first Arcade stores in the Midlands grew sales 6% faster than comparable unconverted stores in the period from January 2002 onwards, well after the impact of first year launch activity.

The sales growth driven by Arcade is putting an increasing strain on our distribution infrastructure. We are currently strengthening it to handle larger volumes – improving availability while reducing stockholding, working capital and operating costs.

The transition from high streets to superstores is nearing completion. During the year we opened seven superstores and closed eight high street stores. We also closed five superstores where we had excessive space or could withdraw at a premium. At the year-end we had 330 superstores, 58 high street stores and 12 motorway units. The motorway units are now trading at breakeven.

Services Our garage business had slipped back into loss and we were pleased to sell it to the AA, with whom it has greater synergy. We will continue to supply parts to the business, rebranded as AA Service Centres, at least until August 2002.

Many customers value a fitting service, and in June we launched a 'We'll fit it' offer on many of the products we sell. In trials this has proved very popular – especially with women, who now constitute 47% of UK car drivers.

We are also stepping-up promotion of our build and repair service on cycles, to enhance our differentiation – particularly as we increase sales of highly-personalised enthusiast brands such as Airborne.

Outlook Arcade is galvanising Halfords' sales and profits. We are accelerating the rollout and developing a cost-effective version for smaller stores. We will continue to enhance the format, adding theatre and excitement and trialling extensions into additional outdoor leisure categories. We will also be investing some £8.2m in the supply chain enhancement project, but expect to fund all investment within Halfords' cash flow.

Halfords is now well placed to continue its development as an independent company, and in April we announced our intention to demerge or sell it. We are exploring both sale and demerger options to establish which will realise greater value for shareholders.

Boots Healthcare International

Sales £m		407.3
Increase %*		12.9
Profit £m (before exceptionals)		66.7
Increase %*		13.2
Core brand sales	£m	Increase %*
Analgesics	95.2	7.5
Cough & cold	72.0	2.0
Skincare	129.8	62.3
www.nurofen.com		
www.strepsils.co.uk		
www.skinexpert.net		
www.clearasil.com		

*comparable exchange rates

Sales grew 12.9% at comparable exchange rates, boosted by a full-year contribution from Clearasil, and comparable profits before exceptionals rose 13.2%. Like for like sales, excluding Clearasil, were flat, due largely to the abolition of RPM in the UK, which still accounts for about 30% of our business. Retailers anticipated a discounting-driven surge in demand following abolition of RPM, and built substantial stocks at the end of the previous financial year. This reduced sales in the first half and skewed year-on-year comparisons. Nevertheless, we successfully resisted pressure from retailers to reduce our margins.

Strategy BHI aims to benefit from the growing international trend towards self-medication. We are increasingly focused on three core therapy categories – analgesics, cough & cold and skincare – which make up about a third of the global OTC market. After four years in which we have reaped steeply-rising returns from past investment, we have begun a new cycle of investment designed to achieve a step-change in the company's growth rate.

The first step was the acquisition of Clearasil,which has extended our US and Japanese businesses' presence in the world's two largest OTC markets.

Over the next four years we plan to increase investment by £120m, raising brand investment to a range of 28-30% of sales and significantly increasing new product development to stretch our core brands and build a significant position in a fourth core category. Brand investment including Clearasil was 28% of sales compared with 26% in 2000/01.

This year we plan a 20% increase in marketing investment and a 30% increase in spending on new product development. We are also actively seeking opportunities to acquire more products and brands with potential to be global category leaders. Ultimately, we want to build six to eight 'must have' brands in four or five core categories. We will continue to sell our products in over 130 countries; but to maximise the impact of our marketing investment we will focus resources on the ten largest markets.

This strategy should enable us to accelerate organic top-line growth. Over the short term, profit growth will be constrained by the cost of investment. But we then expect to resume the virtuous circle in which sales growth delivers increasing returns.

Analgesics Sales of Nurofen grew 7.5% and we increased our share in all major markets. This was a good performance, given the low incidence of colds and flu in the UK and our key markets in Europe. New products included pain relief gels in the UK, Holland, Australia and New Zealand. We had particular success with the launch of Nurofen Plus in Australia.

Cough & cold Strepsils suffered from a second successive year in which the incidence of colds and flu was low. Despite this, we grew sales by 2% and increased market shares in most of our major markets. New products included Streppies sugar-free pastilles for children, which we launched in the UK, and Streps soothing herbal lozenges, launched in the UK, the Netherlands,

Brand stretch One key to BHI's success is our ability to increase sales by developing innovative brand extensions. The repackaged and extended Clearasil range reflects our experience in growing Nurofen and Strepsils worldwide.

Thailand, Malaysia and Singapore. We also rolled-out existing products into Bulgaria, Canada, New Zealand, Norway, Poland, Russia, Spain, Thailand and Ukraine.

Skincare Clearasil sales accounted for £78.5m of core skincare sales. Our core skincare brands excluding Clearasil declined by 9.9%.

We are currently reviewing our strategy for our dry-skin products, to develop the current diversity of brands and products into a more coherent offer. Launches during the year included E45 itch relief cream, E45 350g and E45 500g pump in the UK, a new Aqeo shampoo and cream bath formulation for psoriasis in Germany, and the rollout of Xeramance Plus and Fluid into Italy.

The integration of Clearasil was completed on schedule and we quickly restored the brand from decline to 3% growth before our first wave of product launches. The business in the US, the biggest market for Clearasil, (47% of total sales) has already grown market share. In addition excellent distributors were appointed in the two most critical markets: Novartis in the US and Chuo Bussan in Japan. Novartis has already helped to re-establish Clearasil's relationship with Wal-Mart, the number one account, where sales into the company jumped 11% in the second half. Chuo Bussan specialises in marketing personal care brands, including Dr Scholl's and Coppertone.

We completed the transfer of European manufacturing from Procter & Gamble's facilities to our own production operation, and we have been able to improve our cost base and margins significantly. The revitalisation of the brand is now well underway. We have modernised the packaging and are developing new products to broaden Clearasil's positioning as a problem-skin brand. In March 2002 we launched Clearasil Instant Effects, Deep Cleansing Body Wash, Wipes and Overnight Protection Gel in the UK. We also launched Clearasil Face and Body Wash in Germany.

Disposals We continue to sharpen our focus on core categories and brands. Including Clearasil, core brands now account for 73% of total sales. In July we sold two non-core skincare brands, Onagrine and Nobacter, to Beiersdorf. As part of our drive for operating efficiencies we also sold our French factory to a local manufacturer in August. The exceptional loss on these disposals, resulting primarily from the write-back of goodwill, totalled £10.2m.

Outlook After a year of transition BHI has begun a new phase in its development. While our increased investment is likely to preclude significant profit growth this year, it will bring a substantial and sustained increase in organic sales growth. This could be augmented by one or more acquisitions if we can find appropriate targets at a price that enables us to add significant value. Our aggressive growth strategy gives BHI the potential to make a material contribution to group profits within the next four years.

handbag.com

(50% of joint venture)

Sales £m	0.6
Operating loss £m	(2.1)
www.handbag.com	

Revenues grew by 20% in a difficult year for online advertising sales.

Losses continue to reduce – our share was £2.1m, down 43% from £3.7m – and the business is still expected to reach breakeven in 2003/04.

Encouragingly, many mainstream brands are finding handbag.com an effective medium for trialling marketing campaigns. It has been used successfully to launch new products, build brand awareness, provide cost-effective market research, and drive sales and awareness both in-store and online.

With its monthly user base of half a million users, handbag.com is the UK's leading lifestyle website for women and one of the country's strongest consumer brands on the internet.

handbag.com gives us a valuable way of communicating with higher spending consumers: there is a strong fit between its users and a key segment of our most valuable customers.