

Chairman's statement

772 bottles of nail varnish were sold in our stores every hour over the past year

772



This is my third and last annual report to you. As already announced, I am retiring on 15th September and handing over to Sir Nigel Rudd, who has been our deputy chairman since December 2001.

He takes the reins at an exciting time. The past three years have seen Boots transforming itself. It is now a much simpler and more focused business, and we are continuing to increase the pace and improve the effectiveness of change.

Results Our growth strategy is delivering the results we expected. Sales responded quickly to our renewed investment in the business, with underlying growth of 6.0%. As a result group sales for the year, at £5,327.3m, were almost unchanged on the previous year despite a sharply reduced contribution from Halfords, which we sold in August 2002. After a difficult first quarter, sales have grown strongly for three consecutive quarters. Boots The Chemists (BTC) had its best Christmas for a decade and we have

held or grown market share in all counter health and beauty categories.

As we predicted last year, profits have been impacted in the short term by three factors

- a major programme of investment in BTC, Boots Healthcare International (BHI), and reducing costs for the future
- the sale of Halfords which resulted in an exceptional loss of £123.2m, and
- increased pension costs.

Shareholder returns The proposed final dividend of 20.2p per share makes a total for the year of 28.6p – up 4.4% on last year.

Boots is a strongly cash generative business and the Halfords sale brought us an additional £396.0m. As promised, we have been returning this extra cash to investors through share buy backs, in addition to the earlier buy back programme completed in September 2002. During the financial year we bought and cancelled 78.8m shares at a total cost of £462.8m.

The progress we are making with the business is being recognised in the share price. Over the past two years Boots shares have outperformed the FTSE100 by 31.9% and the retail sector by 6.0%.

Strategy Boots is now more focused than it has been for over a decade – and a great deal leaner. We are now able to concentrate attention and investment

on a single company with two core businesses: BTC and BHI.

That focus has already resulted in several strategically important breakthroughs. We're investing to get all our stores up to the standards our customers expect, we've got on-shelf availability up to where it should be, and we've returned to strong, profitable sales growth.

In BHI our strategy of increased investment in brand and product development has restored strong organic growth and profits grew ahead of last year.

Our core operations are performing very well and our international retail operation is moving towards profitability with its new low risk, capital light business model.

This year we will continue to invest to improve product, price and service competitiveness, and to grow the business. To do this while stabilising margins at about their present level, we will keep improving productivity and cutting costs through our 'Getting in Shape' programme.

We have already acted to stem the losses from activities that look unlikely to deliver satisfactory returns in the foreseeable future. We are closing our 12 Wellbeing Services Centres and the six Pure Beauty stores – while continuing with Boots Opticians, LASIK, Dentalcare and Footcare. We are slimming down our international retail operations in

Europe and simplifying them in South East Asia.

Our passion for innovation in products and brands remains as strong as ever. Our ability to develop powerful own brand and exclusive ranges sets us apart from competitors and gives customers compelling reasons to see Boots as *the* place for health and beauty.

Pharmacy In January the Office of Fair Trading recommended proposals for full deregulation of NHS pharmacy licensing. The Government's intentions are not yet clear, but we expect to see at least partial deregulation. This would give us a welcome opportunity to build market share – similar to that presented by the abolition of Resale Price Maintenance on over the counter medicines in 2001, which has enabled us to increase profits by some £6m a year. Pharmacy is an important growth area in which we are market leader. We are investing substantially in systems and in-store pharmacy to maintain our pre-eminence and confidently expect our pharmacists to play a growing role in primary healthcare over the coming years, helping to relieve the pressure on overworked doctors.

People Change is always challenging and rapid change can be very uncomfortable. The past few years have been tough for our people and I am grateful to them for their support, flexibility and hard work. All levels of the organisation have been affected, and there has been more change at the top than almost anywhere else.

In the past three years we have reduced our senior management team from 233 to 167 – over half the old team has gone and 66 new members have joined by promotion or from outside. Virtually all today's board and executive committee members have been appointed since I became chairman. We now have a strong, energetic and experienced executive team with an average age of 44.

After reviewing our succession plans we announced in December that we were looking for a new chief executive to drive the pace of change faster. In May we announced that Richard Baker would be joining us as chief executive from 15th September; Steve Russell stepped down at the end of May and I have taken on the role of chief executive until Richard arrives.

We are enormously grateful to Steve for all he has done for the company in a distinguished 36-year career. In particular, we thank him for his work over the past three years in simplifying the business he inherited, which had

become too complex, refocusing it on its core strengths and restoring the momentum of sales growth.

Richard has an outstanding track record in both retail and marketing, and we are very pleased to welcome him to Boots. He joins us from Asda, where he has held a number of senior appointments including group marketing director and, latterly, chief operating officer. Previously to this he worked at Mars. I believe that with Sir Nigel as chairman and Richard as chief executive we have an excellent combination of skills to lead our strong new executive team.

Fiona Harrison resigned from the board in November due to ill health. During her time on the Boots board she made a distinctive and valuable contribution, most recently as chairman of our Social Responsibilities Committee. We will all miss her deep interest in, and knowledge of, our customers and employees, and her understanding of the business climate in which we operate.

Ken Piggott retired from the board at the end of December, taking a new part-time role as corporate responsibility director, and Barry Clare left the company at the end of January. We are grateful to both of them for their contribution to the transformation of the business over the past few years.

We took the opportunity to strengthen the executive committee by adding Paul Stoneham, managing director of BHI, and David Kneale, who took on the new role of chief operating officer, Boots Retail. Paul had previously been president of Alberto Culver International and held a variety of senior marketing positions at Procter & Gamble. David rejoins the Company after being managing director at Waterstones. He brings back to the business exceptional trading skills and customs focus. Ann Francke joined the executive committee as director of strategic marketing. She had previously been a vice president at Mars, and general manager for skincare and cosmetics at Procter & Gamble.

Corporate social responsibility (CSR) Boots is one of Britain's most trusted brands. The foundation for this is the company's long established community investment programme and desire for continuous improvement in its environmental performance.

We regularly participate in a variety of benchmarking surveys and welcome the opportunity to share best practice and experience with others. The feedback we receive is extremely valuable and helps us to shape our future plans to ensure they

are consistent with the expectations of modern society.

Many reviews, such as the FTSE4Good and Dow Jones Sustainability Indices, highlight the positive contribution we are making; while others, like the Business in the Community Corporate Responsibility Index, have helped us to develop new CSR processes and thinking.

Further details of our achievements and plans are set out in our dedicated CSR Review. This demonstrates that Boots is determined to live up to its proud social heritage and the trust customers place in the Boots name.

Outlook Boots has got back to its retailing roots. We're recognising the importance of our store managers and staff, and engaging them in the drive to create an outstanding retail offering. We have begun a review to simplify and further improve our still over-complex supply chain. We've consolidated our position as the place for health and beauty.

And internationally, BHI is making its presence felt increasingly in the consumer healthcare market. We have a robust business model, a strong balance sheet and cash flow, good growth prospects – and plenty more to play for.

Our new chairman and chief executive still have important issues to resolve. The store portfolio needs to be rebalanced with a stronger edge of town presence. We have to continue flexing our pricing and promotions to match customers' expectations of value for money. The challenge for our new marketing director is to make all our stores even more distinctive. But we are in no doubt that vigorous growth in the health and beauty markets will give us ample opportunity to grow the core business. Our ambition is to strengthen our market leadership – and we are investing in the right things to achieve this.

This year we will feel the benefit of the past year's cost reductions and closures. We intend to keep sales rising strongly while holding our margins steady, making last year's profit dip merely a pause in a continuing story of long term growth.

John McGrath
Chairman



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