

Financial review



Group performance

During the year our aim has been to refocus on the two core businesses: Boots The Chemists and Boots Healthcare International. Our priorities have been to drive profitable top line growth while increasing investment in the future. Following the sale of Halfords we have made a significant return of £462.8m to shareholders through our share buy back programme.

This has been a year of substantial change and the financial results reflect this.

Turnover from continuing operations increased by 6.0% to £5,092.4m. This reflects the progress made in Boots The Chemists where sales increased by 5.2% and in Boots Healthcare International where sales increased by 13.0%.

Operating profit fell by 10.7% to £544.1m. This masks underlying progress in both Boots The Chemists and Boots Healthcare International but shows the effect of the investments we are making to renew our core businesses and the costs associated with exiting activities. The major elements due to their nature and material impact on profitability are: i) removing Halfords' operating profits of £22.5m in 2003 and £54.3m in 2002, following the sale of this business during the year; ii) an increase in company pension costs of £25.2m to £33.5m due to the effect of a reduction in the amortisation of the fund surplus on the SSAP24 calculation; iii) rationalisation costs of £40.2m (2002 £16.4m) in relation to the rationalisation of Boots Retail International and the closure of the Pure Beauty stores, our J Sainsbury implants and the Airdrie factory the latter reflecting the early progress of the "Getting in Shape" £100m cost programme; and iv) new investment in stores and pharmacies of £22.0m (2002 £0.8m).

Profit before tax fell 16.9% to £494.9m due to the above items and £123.2m loss on the sale of Halfords and £34.5m costs on the closure of certain of the wellbeing services offering. These are both shown as exceptional items and are partially offset by an exceptional interest credit of £92.1m arising from the closure of interest rate swaps.

Taxation Excluding non-operating exceptional items before interest, the effective tax rate for the group was 31.5%, slightly higher than last year's rate of 31.1% due to increased profits overseas which were taxed at a higher rate.

Basic earnings per share before exceptional items decreased by 9.4% to 45.2p (basic earnings per share decreased by 21.6% to 36.0p). The weighted average number of shares in issue decreased in the year from 881.6m to 838.1m as a result of the share buy back programmes.

Dividend The board has proposed a final dividend of 20.2p. This brings the total dividend for the year to 28.6p, an increase of 4.4% over last year.

Cash flow The following summary of cash flow demonstrates the company's ability consistently to generate free cash flow.

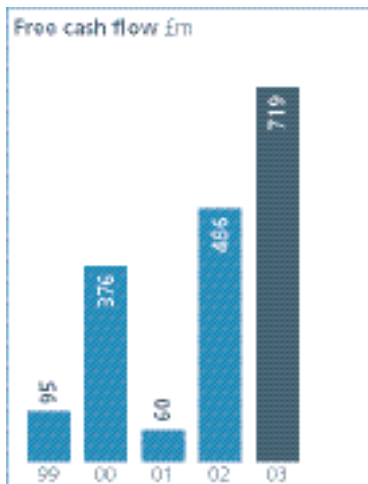
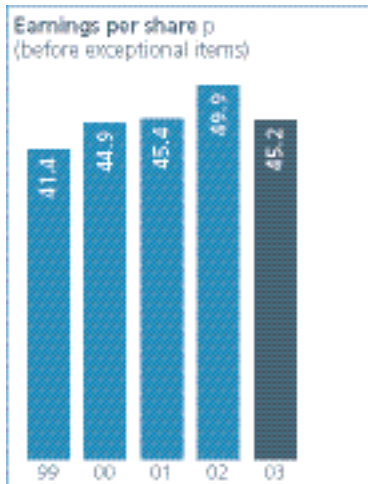
Summary of cash flows	2003 £m	2002 £m
Operating cash flows before exceptionals	590	752
Exceptional operating cash flows	(8)	(29)
Acquisition/disposal of businesses	358	4
Purchase of fixed assets	(146)	(172)
Disposal of fixed assets	119	62
Disposal of own shares	3	8
Taxation paid	(197)	(139)
Free cash flow	719	486
Repurchase of shares	(465)	(36)
Dividends paid	(238)	(235)
Net interest	75	41
Net cash flow	91	256

Free cash flow is defined as the cash flow available to all providers of capital.

Cash flow from operating activities before exceptionals was £590.4m, a decrease of £161.3m on last year mainly arising from lower operating profit and higher stock levels.

£358.1m realised from disposals and acquisitions of businesses includes £367.6m in respect of the sale of Halfords in August 2002. The proceeds from this sale are being used to fund the current £400m share repurchase programme.

78.8m shares at a cost of £462.8m were repurchased during the year. 41.4m shares at a cost of £253.9m were



purchased to complete the £300m buy back programme announced in March 2002 and 37.4m shares at a cost of £208.9m were purchased as part of the current programme.

Share price Our share price fell 21.1% from 672.5p at the end of last year to 530.5p on 31st March 2003. The price ranged from a high of 725p to a low of 492p.

Whilst this fall reflects a general decline in stock market values it represents a better performance than the FTSE100 which fell by 31.5% in the same period.

Total shareholder return (TSR) of the company over the last five years compared with those of our peer companies were as follows:

Five years to 31st March 2003		%
1	Smith and Nephew	123.9
2	Alliance UniChem	24.0
3	Reckitt Benckiser	21.4
4	Tesco	13.1
5	GUS	(17.1)
6	Debenhams	(17.4)
7	Boots	(24.0)
8	WHSmith	(24.2)
9	Kingfisher	(35.6)
10	Marks & Spencer	(37.8)
11	J Sainsbury	(39.3)

Debenhams replaced SmithKline Beecham last year but appears as a peer company for the first time as it has completed five years as a listed company. Position seven this year is an improvement of two places compared with last year. Our five-year TSR of (24.0)% represents (5.3)% on an annualised basis. Over a ten-year period our equivalent annualised return was 5.7%.

Pensions

Following the Accounting Standards Board proposal in July 2002 to extend the transitional regime of FRS17 'Retirement Benefits', the company decided not to adopt FRS17 in the financial statements for the current year and to continue to account for pensions under SSAP24. The Boots Pension Scheme cost for the year under SSAP24 is £31m (2002 £5m).

Disclosures under FRS17 are included in note 26 to the accounts. In contrast to a number of other UK companies, this shows that the scheme has a surplus of £0.2bn on the FRS17 basis.

Treasury policy and controls

Treasury manages financial risk and ensures that enough liquidity is available to meet likely needs.

Note 19 shows further details under the disclosure requirements of FRS13 'Derivatives and Other Financial Instruments Disclosures'.

Controls seek to prevent fraud and other unauthorised transactions as well as counterparty risk. The group's risk assurance and audit staff reviews annually the effective operation of key controls. Strict guidelines for cash investment apply worldwide, with cash held only in high quality bank deposits and commercial paper. Interest rate swaps, which the company uses to manage interest rate exposure, are strictly controlled and monitored, with each transaction authorised by the chief financial officer.

Liquidity and funding The company has good access to the capital markets due to its strong credit ratings from Moody's and Standard and Poor's (A1/P1 and A+/A1). The group has credit facilities with 7 banks which mature in 2004, £462m of which remain undrawn. Short term needs are met from uncommitted bank lines.

Lease liabilities In common with other UK retailers, the group has liabilities through its obligations to pay rents under property leases. The following table shows the capitalised value of the committed after tax rents payable at 31st March 2003, excluding any likely increase in rents at rent reviews, discounted at the group's after tax long term cost of borrowing of 3.99%.

Maturity of commitment	Annual rent commitment at 31st March 2003 £m	Capitalised value £m
1 to 10 years	69.1	235.0
10 to 20 years	79.4	584.2
20 to 30 years	10.1	102.3
Over 30 years	5.6	81.5
Total	164.2	1,003.0

Interest policy is to maintain a balance between debt at fixed and floating rates, but we do not hedge against the impact of short term interest rate movements.

During the year the group reviewed its interest rate management policy and concluded that certain interest rate swaps were no longer an effective hedge to the group's liabilities. This resulted in the closure of £1,315m of interest rate swaps. The closure generated a surplus of £100.6m.

A further £200m of index linked swaps were closed out following the year end at a value marginally lower than that provided for in the balance sheet as at 31st March 2003. This along with the surplus noted above and other related items gave rise to a net credit of £92.1m for the closure of interest related swaps in the year and this is highlighted in the interest note as exceptional (note 5). 50% of the company's other fixed rate borrowings have been swapped into floating rate.

Currency exposure Modest sales and purchases are made from the UK in a range of currencies, but we do not hedge them into sterling. We have partially hedged further cash flows of the Boots Healthcare International business using US dollar (\$93m) and Euro (€118m) foreign exchange swaps.

Capital structure The company has continued its policy of returning surplus capital to shareholders by repurchasing shares in the market. This amounted to £462.8m in the year to 31st March 2003.



Howard Dodd
Chief Financial Officer