

044 537

Alliance Boots plc Annual Report 2007

FRIDAY



L07N9T5M

LD3 21/09/2007 187
COMPANIES HOUSE



Contents

| | | | |
|---|-----------|---|-----|
| Highlights | 1 | Governance | |
| | | Board of Directors | 38 |
| Chairman's statement | 2 | Directors' report | 40 |
| | | Board report on corporate governance | 42 |
| Chief Executive's review | 4 | Board report on remuneration | 48 |
| | | Audit committee report | 64 |
| Market and business environment | 6 | Directors' responsibilities statement | 67 |
| | | Independent auditors' report | 68 |
| Group objectives and strategies | 8 | | |
| | | Financial statements | |
| Risk management | 10 | Group Income statement | 69 |
| | | Statements of recognised income and expense | 69 |
| Pro forma financial results and performance review | 13 | Balance sheets | 70 |
| | | Cash flow statements | 71 |
| Additional pro forma financial information for continuing operations | 25 | Notes to the financial statements | 72 |
| | | Group financial record – IFRS | 114 |
| | | Group financial record – UK GAAP | 116 |
| Financial review – statutory basis | 30 | | |
| | | Additional information | |
| Corporate responsibility | 35 | Glossary of key terms | 117 |

Glossary of key terms

Adjusted earnings per share

Adjusted earnings divided by the weighted average number of shares in issue during the year

Adjusted earnings

Profit for the year attributable to equity shareholders before exceptional items amortisation of customer related intangible assets and IAS 39 timing differences, all net of tax and deferred tax restatements for customer related intangible assets

Exceptional items

Items classified by Alliance Boots as exceptional in nature. These are not regarded as forming part of the trading activities of the Group, and so merit separate presentation to allow shareholders to understand the elements of financial performance and to assess the trends in financial performance. In 2006/07 these mainly comprised costs in relation to merger synergies, systems rationalisation and supply chain reconfiguration projects, and restructuring activities. In the previous year these mainly comprised the supply chain reconfiguration project, store refurbishment costs and profit on sale and leaseback

IAS 39 timing differences

Derivative financial instruments are used to hedge interest rate and currency exposures. IAS 39 dictates whether changes in the fair value of these instruments can be matched in the income statement by changes in the fair value of the item being hedged. Where they cannot be matched, or do not fully match, the unmatched amount represents a timing difference that will reverse over the life of the financial instruments

Interest cover

Trading profit divided by underlying net finance costs

Like for like revenue

Like for like revenue on a constant currency basis compared to the comparable period in the previous year

Net (borrowings)/cash

Borrowings net of cash and cash equivalents and derivative financial instruments

Net finance costs

Finance costs net of finance income

Trading margin

Trading profit expressed as a percentage of revenue

Trading profit

Profit from operations before exceptional items, amortisation of customer related intangible assets and share of associates' post tax earnings

Underlying net finance costs

Net finance costs adjusted to exclude IAS 39 timing differences

Underlying tax charge

The underlying tax charge excluding tax on exceptional items, amortisation of customer related intangible assets, IAS 39 timing differences, deferred tax restatements for customer related intangible assets and other exceptional tax credits

Underlying tax rate

The underlying tax charge expressed as a percentage of trading profit net of underlying net finance costs

Highlights

Group highlights – pro forma

To assist investors in understanding the performance of the Group, pro forma financial information has been prepared to show the results from continuing operations of the Group as if the two former groups had always been combined as was provided at the announcement of the Group's interim results on 14 November 2006. The pro forma revenue and profit statement for continuing operations has been prepared on an adjusted basis, which means before exceptional items, amortisation of customer related intangible assets and IAS 39 timing differences, all net of tax and deferred tax restatements for customer related intangible assets.

Detailed pro forma financial information, including the basis of preparation, is set out in the "Additional pro forma financial information for continuing operations" section of this Annual Report.

| | | |
|--|----------------------------|--------------------------------------|
| Revenue | up 3.6% to £14,608 million | (2005/06 £14,096 million) |
| Trading profit ¹ | up 6.3% to £641 million | (2005/06 £603 million) |
| Underlying trading profit ² | up 7.4% to £641 million | (2005/06 £597 million ²) |
| Adjusted earnings ³ | up 11.5% to £467 million | (2005/06 £419 million) |
| Adjusted earnings per share ⁴ | up 11.4% to 48.7 pence | (2005/06 43.7 pence) |

- Trading profit comprises profit from operations before exceptional items and amortisation of customer related intangible assets and share of associates post tax earnings.
- Underlying trading profit is after adjusting the previous year's trading profit to include a full year's rental charge on the 312 retail outlets which were sold and leased back in July 2005 so that the trading profits for both years are on a comparable basis.
- Adjusted earnings comprises profit for the year attributable to equity shareholders before exceptional items, amortisation of customer related intangible assets and IAS 39 timing differences, all net of tax and deferred tax restatements for customer related intangible assets.
- Adjusted earnings per share comprise adjusted earnings divided by the pro forma weighted average number of shares in issue during the year of 959 million (2005/06 958 million).

Group highlights – statutory

The statutory financial results for the year ended 31 March 2007 contain a full year of results for the former Boots Group PLC businesses and eight months results for the former Alliance UniChem PLC businesses on an acquisition accounting basis. The comparative figures contain only the results of the former Boots Group PLC businesses and include within "Profit for the year attributable to equity shareholders" a £1,470 million profit after tax from discontinued operations.

| | | |
|---|-----------------|--------------------------|
| Revenue – continuing operations | £11,502 million | (2005/06 £5,027 million) |
| Profit from operations – continuing | £480 million | (2005/06 £369 million) |
| Profit for the year attributable to equity shareholders | £387 million | (2005/06 £1,774 million) |
| Basic earnings per share – total | 48.4 pence | (2005/06 259.4 pence) |
| – continuing | 45.8 pence | (2005/06 44.4 pence) |

Key reconciliations between pro forma and statutory financial results are provided after the "Additional pro forma financial information for continuing operations" section of this annual report.

Details of exceptional items are shown after the "Key reconciliations between pro forma and statutory financial results" section of this annual report.

A glossary of key terms and principal businesses and associates by segment is provided at the end of this annual report.

Group highlights

On track to deliver promised merger cost synergies

Retail Division

- good revenue growth
- UK trading margin ahead of management's previous expectations
- Boots branded Health & Beauty business increased profits for first time in five years
- biggest expansion of Boots pharmacy brand to commence shortly

Wholesale Division

- performed well – reflecting strength of geographically diverse portfolio
- successfully implemented Pfizer sole logistics service contract in UK
- Chinese market entry agreed, subject to regulatory approval for the joint venture

FRIDAY



L07NAT5N

LD3

21/09/2007

186

COMPANIES HOUSE

Chairman's statement

Welcome to the first annual report of Alliance Boots. When as two separate boards we first talked of the merger between Alliance UniChem and Boots Group in the summer of 2005 it did not take us long to see the potential in what a combined company might look like.

Reporting to you now as the Chairman of Alliance Boots, I am pleased to be able to say that eight months into the life of the newly merged Group I remain confident of the potential that exists within our businesses and excited by the opportunity that our expertise in being a pharmacy-led health and beauty group offers.

This opportunity is also what lies at the heart of the recent interest shown in us by potential bidders for the Group. As a Board we have evaluated every approach to ensure that they best represent shareholders' interests. We did not take the decision lightly to open our books for due diligence. In recommending the Kohlberg Kravis & Roberts offer of £11.39 per share you are receiving we are confident that we are acting in your best interests as a shareholder.

Business as usual

The merger completed on 31 July 2006 and from that time, the Board has focused on ensuring that completing the merger was not seen as the end in itself. We have been determined that the merger should not allow our businesses to take their eyes off the ball of delivering day in, day out, great service to our customers which results in good performance for our shareholders. I am pleased to be able to report a set of results that shows Alliance Boots has had a successful start to its life.

Across our businesses we have seen good performance. Our Retail Division has operated well in all its markets with good performance in our key areas of expertise: health and beauty

Wholesale has also delivered a good set of results with once again the value of our wide geographical spread allowing us to mitigate the competitive pressures felt in some of our markets.

A common feature of the year has been the continued intervention of regulators into many of our market places to try and keep costs down for the tax payer. This is not unusual and it is a testament to the skills of our people and the strength of our business model that we have been able to cope with these and still deliver in line with our expectations.

A new Board

As part of the merger we had to constitute a new Board and adapt many of our working practices to take in the demands of being a company twice the size. Your new Board reflects the strengths of both companies when they merged and it has been impressive the way in which it has got on with the job so quickly and effectively.

We are clear that the role of the Board is to help set the strategy and then hold the executive accountable for delivery. We firmly believe that the executive have risen to the challenge set by your Board.

Clear objectives

As a Board we have set out the clear objectives we want the company executive to go and deliver. They are outlined on pages 8 and 9 but to us they are very simple. We operate in the attractive markets of healthcare and beauty

and we have strong positions in these through our core divisions of wholesale and retail. We want to grow these divisions both in existing and new locations by using our financial strength, our brand capabilities and the expertise of our people. This mix of good positions in attractive markets and opportunities to move into new geographical regions underpins our aim to deliver sustained profit growth for our shareholders.

One of the common features of the former Alliance UniChem and Boots Group companies when we talked about the merger was the fundamental belief and commitment to pharmacy. This is true to the heritage of both companies and something which runs right through Alliance Boots. Healthcare is a growing market and today we see people not only live longer but also have a real desire to stay active and look and feel good for as long as they can. This means that healthcare has to cope with not only a higher demand for drugs but also a desire for faster treatment, better drugs, additional services and more information than ever before.

These are trends that are set to continue and for a company like Alliance Boots this offers a real opportunity. However, we will face competition to be the healthcare provider of choice and we will also face continuing demands from regulators and Governments to help them control the costs of healthcare. We should not be afraid of this, they are what we have had to cope with for many years. The strength of the combined Group will mean we are even better placed to deliver against these challenges.

Responsible and sustainable

In reading the report you will of course notice many differences in our reporting and content than you were used to. The report we present to you takes into account the latest recommendations on best corporate practice and also the best of what we both used to do as individual companies. Because of the relative short time we have been merged and our focus

on business as usual there are one or two sections where we might not have as much detail and in particular targets as you and we as a Board would like. This is because we are keen not to rush to put things in place for the purpose of this report which will only necessitate change and adjustment during the forthcoming year. We will of course keep you well informed in these areas as we progress as a Company.

Where you may feel you see the biggest difference is in our corporate responsibility section on pages 35 to 37. As a newly formed Group we are at an early stage of rolling out a Group approach to corporate responsibility and key performance indicators have yet to be finalised. Please do not think that this means there is any less of a commitment by the Board to this very important topic. While we have been setting the future path for the Group's corporate social responsibility it is pleasing to report that our operating divisions remain highly committed to the agenda and activities they have been pursuing in the run up to the merger.

Foundation for future success

Alliance Boots has taken two great companies and made them into one even stronger company. The last year and our insistence on continuing to deliver against our business objectives while planning and then implementing a sensible operation of the merger has created a strong foundation for future success.

As a business, we are clear of the many challenges that lie ahead. Yet we know we have the people and the skills in the organisation to meet these challenges. All our people have worked hard this year and delivered more than many commentators and observers ever believed was possible. On your behalf and on behalf of the Board I would like to take this opportunity to thank them for their hard work and commitment.

Looking ahead the pressures on Alliance Boots will not change. We must continue to be totally focused on meeting our customers rising expectations and be highly efficient.

Regardless of who owns the business there are real opportunities for this business to grow and be recognised as the world's best pharmacy-led health and beauty group. It is a realistic ambition and there is great excitement at the challenge.

Chief Executive's review

For all of us at Alliance Boots, it's been an extraordinary year. As you'll see below, there have been real successes across the Group. But by far the biggest success story of 2006/07 has been the way that two very large groups have come together to form a new company with real international potential. Not only have we achieved this without significant disruption to any aspect of our operation; we've actually delivered a set of results that would do great credit to any long established business.

Traditionally, chief executives reserve their thanks for their closing paragraphs. But, on this occasion, I'm very happy to break with tradition. Our excellent performance since the merger on 31 July last year directly reflects the hard work, ability and determination of our 100 000 plus people, and every single one of us should be proud of what we've achieved together in our first year as Alliance Boots.

Making our merger work

Inevitably, the announcement of our merger met with scepticism in some quarters. So for me, one of the most satisfying moments of the past year came when we put it to the vote. Despite having been exposed to a lot of negative media coverage, 99% of shareholders in Alliance UniChem and Boots Group gave their support to our vision of building a new global power in healthcare.

And perhaps this is an even more remarkable feat, since the day of the merger we have kept our management team together, and they remain together as a team today.

In both cases, what I think these stories demonstrate is that, from the outset, we've been entirely clear about our vision for the new Company and what we stand for. We've known precisely where Alliance Boots is heading, and we've worked extremely hard to communicate how we believe we're going to get there.

It's this unanimity of purpose and ambition that's ensured the success of the merger. Put very simply, we've stuck together. And from day one, with that strong leadership backbone in place, our key people have known exactly what

is expected of them, which has enabled us to meet the targets we set for the new merged Company.

In short, we've delivered on our promises. And for a business whose most important brand value is trust, nothing matters more than that.

Great people, outstanding execution

We have performed to plan since the merger, and while our clearly defined strategy can take some of the credit for that, our greatest strength in 2006/07 has undoubtedly been in quality of execution. As I started by saying, our people have done their jobs outstandingly well.

At the time of the merger, we coined the phrase "Stronger together" as the theme for our integration programme, and, despite the massive challenges involved in blending and harmonising two very different large groups, we've achieved that aspiration. Across every business function – from HR to purchasing, IT to legal, marketing to finance – we haven't just been able to maintain "business as usual" in the early months of Alliance Boots existence; we've actually raised our game.

Wholesale highlights

Turning to a few of the year's key achievements across our businesses, it's a pleasure to start with our Wholesale Division's continued double digit profit growth. In what is supposedly a tough, low margin business, this is a really impressive performance, reflecting both the strength of our geographically spread portfolio of businesses and the merger synergies which we are starting to achieve in the UK.

A particular highlight came in March 2007 when our UK wholesale business successfully began its new sole logistics contract with pharmaceutical manufacturer Pfizer. Over the course of a single weekend, we geared up to increase our daily deliveries to pharmacists from nearly 8 000 to around 25 000, trebling the scale of our operation almost overnight, while maintaining extremely high service levels. Great execution.

Retail highlights

Meanwhile, within our Retail Division, performance was equally encouraging, with our Health & Beauty business, Boots The Chemists, achieving good profit growth for the first time in five years, as the large investment we've made over that period began to pay off.

Our positioning as trusted experts in healthcare continued to give us a crucial competitive advantage. There was no better example of this in 2006/07 than the success of the Boots Health Club, which we launched at the beginning of the year. Entitling members to receive regular information on healthcare issues, as well as discounts on our own brand products, this innovative scheme has proved incredibly popular, particularly with our more mature customers. Of 1.5 million Health Club members, around 40% are aged 60 or over.

It's equally clear that the trusted expertise our customers expect from Boots is vital to the success of our beauty offering, where results were also excellent. And a very good year was memorably rounded off in March, when the BBC's Horizon programme concluded – after rigorous scientific analysis – that no other anti-ageing product could match the effectiveness of Boots No7 Protect & Perfect Serum. Sales rocketed by nearly 2 000% after the day of the broadcast, as our customers were reminded once more that what we promise, our products deliver.

More accessible, more affordable

As the leading operator of retail pharmacies in the UK, we believe we have a key role to play in making healthcare services easily accessible and widely available. That's why this year we now have pharmacy services offered until midnight in more than 50 outlets.

We also continued to ensure that our prices are competitive while delivering the kind of keen competitive performance our shareholders expect

Extending the Boots brand

In our Community Pharmacy business the most exciting development came towards the end of the year when we successfully piloted a "best of both" approach in a number of pharmacies. The idea was to give our people from Alliance Pharmacy and Boots a chance to learn from each other and share ideas, which could then be incorporated into a new improved community pharmacy offering

In the pilot pharmacies both retail sales and dispensing volumes increased significantly, and, as a result, we'll be rolling out this new format, under the banner "your local Boots pharmacy" nationally over the next two years at a cost of around £65 million. It's the biggest extension of the Boots retail brand in the history of Boots

I can't end this brief gallop through the past year's achievements without making a very honourable mention of Boots manufacturing. They are the engine pumping away relentlessly putting the products our customers want into our businesses. We never for a single moment under-estimate the value of their contribution

Britain's most responsible retailer

Over the last year there has been more talk than ever in the media about the need for businesses to act responsibly particularly in relation to the environment. And a number of major retailers have made themselves very prominent in this respect, putting forward impressive claims for their green credentials and aspirations

So we're very pleased to say that in the Business in the Community Big Tick awards – the UK's leading awards for responsible practice – we retained our position as the country's number one retailer. Wherever you look in Alliance Boots you'll find great people doing the right things in the right way

A future of real potential

All in all then it's been a memorable year for everyone at Alliance Boots. As individuals, we've worked harder than ever before. Within our specific areas of the business, we've scored many notable successes (more of which you'll read about in the following pages). But by far our proudest achievement is a collective one to which over 100,000 people have all contributed the creation of an entirely new group with a clear vision to become the world's leading pharmacy-led health and beauty group

It hasn't always been easy, mergers never are. But we've stuck at it, and met every challenge. And I – and the rest of the executive team – couldn't believe more strongly that, over the last year, we've laid the foundations for a fantastic future for Alliance Boots for our people and for our customers

Market and business environment

Alliance Boots operates in highly attractive markets, with potential for significant long term growth. Major demographic and social trends are driving a rapid increase in demand for pharmaceuticals and healthcare services; and the necessity for governments to control health expenditure presents both challenges and opportunities. Meanwhile the growing focus on personal wellbeing coupled with increased personal wealth fuels an increase in awareness of personal care and is driving growth in the health beauty areas.

An ageing population a prescription for growth

The most important factor affecting our market is increasing life expectancy. As populations age, demand for healthcare services rapidly increases (on average, around 75% of all the pharmaceuticals used in an individual's lifetime are required after the age of 65).

Changing attitudes are also playing a significant role. As well as living longer, people have higher expectations in terms of quality of life. Across Europe, and beyond, consumers want products and services that will help them to feel and look good to be readily available.

Another important trend, partly driven by medical advances, is for individuals to take greater responsibility for managing their own health and wellbeing. We expect these demographic and social trends to fuel growth in the healthcare market for at least the next 20 years.

Governments' need to control costs

As demand for medicines and healthcare services increases, governments are recognising an urgent need to control costs, to remain within budgets and limit the burden on taxpayers. (In the UK, for example, only 30% of the population currently makes any contributions towards the cost of prescriptions.)

As a result, every part of the supply chain – from manufacturers to wholesalers, from doctors to pharmacists – is coming under increasing pressure to be more efficient.

We see this as little short of a healthcare revolution, beginning to take place throughout Europe, and with important implications for both the retail and wholesale markets we operate in.

Retail: a new focal point for healthcare provision

The role of the pharmacist is changing in a way that presents exciting growth opportunities. In continental Europe, pharmacists have traditionally been regarded as trusted healthcare advisers, but in the UK these highly qualified professionals have been an undervalued resource.

Now, in order to mitigate primary healthcare costs, the UK government is increasingly directing patients to their local community pharmacies, not just for medicines and health-related products but for a widening range of healthcare services.

We believe that, if pharmacists seize the opportunity, the value of their role as providers of personal healthcare advice will continue to increase rapidly.

The power of the supermarkets – and the web

As expenditure on healthcare soars, the major supermarkets are naturally keen to increase their share of this valuable market. Their strategy is to commoditise products and cut prices. Online sales of health and beauty products are also growing rapidly.

In both cases, this creates a need for pharmacy-led retailers to differentiate themselves through quality of advice and expertise, and also an opportunity for the development of specialist premium product ranges, capitalising on a relationship of trust with customers.

The rise of generics and over the counter medicines

As demand for pharmaceuticals grows, governments are exerting increasing pressure on doctors to prescribe cheaper generic medicines. Throughout the supply chain, the effect is to reduce revenues. But for large scale operators, efficient buying can secure excellent prices on generics, which may actually result in increased margins.

Similarly, the rapidly increasing number of medicines available over the counter – such as treatments for hay-fever and high cholesterol – has important implications for our market. As own brands are developed, prices fall. But our healthcare expertise means that we are strongly placed to secure a larger share of sales.

A market driven by innovation

In a market like health and beauty where customer expectations are getting higher all the time, innovation has a key role to play in driving growth. Technological advances can deliver products which offer significant benefits over their competitors in fields such as anti-ageing formulations and non-surgical "face-lift" preparations.

Wholesale opportunity in consolidation

In our core European pharmaceutical wholesale markets, consolidation is the key trend. A small number of very large wholesalers are achieving an increasingly dominant position. And similarly, major pharmaceutical manufacturers are joining forces in response to the rapidly increasing costs involved in developing new medicines.

As a result, the entire business model in these markets is changing. Consolidation leads to price control which, in turn, results in the continued rise of generics. In the short term, smaller local wholesalers will attempt to compete on price in order to survive. But, in the longer terms, scale will prove crucially important to ensure operating efficiency and negotiating power. A small number of very large manufacturers will increasingly want to do business with a small number of very large wholesalers, capable of providing them outstanding efficiency and a highly flexible tailored service.

Rapidly increasing volume, slower growth in value

In this environment, opportunities clearly exist. Volume will continue to grow across Europe, though value will increase less rapidly as cost control continues to tighten. But while governments can negotiate price with manufacturers, healthcare provision will always be dependent on an efficient distribution system.

In particular, one apparent threat in this market is that manufacturers will increasingly choose to cut out the middle man and distribute direct to pharmacies. But by securing agency contract delivery deals, this can be turned to valuable advantage.

Overall, though, we recognise that long term growth potential is limited in our competitive and highly consolidated core markets, and that major operators will therefore increasingly look to expand into new geographical markets.

Group objectives and strategies

As you have read, the purpose of our merger last July was to create a company capable of becoming the world's leading pharmacy-led health and beauty group. Below, we set out the key objectives that we set for the merger. And opposite, we outline the strategy that we believe will enable us to achieve sustained growth, and turn our vision for Alliance Boots into reality.

Capitalise on growth in demand for healthcare and beauty products

We do business in large and very attractive markets where there's strong potential for long term growth. As people live longer and have higher expectations in terms quality of life, Alliance Boots is strongly placed to meet increasing demand for medicines and health and beauty products.

Create Europe's leading retail pharmacy business

Scale and financial strength are increasingly important in all our markets. With a total of around 2,900 retail outlets, of which around 2,600 are in the UK alone, Alliance Boots holds a strong and profitable position in the geographical markets where we operate.

Pursue international growth opportunities in new markets

As a result of the merger, Alliance Boots has the skills, resources and financial strength to move profitably into new international markets. We plan to capitalise further on the strength and international appeal of Boots branded products, and to make use of our well developed acquisition skills in new markets where we see potential for significant growth.

Deliver cost savings of at least £100m

We've promised to deliver cost savings of at least £100million per annum by the fourth full year following our merger. Initial steps in our cost synergy plan include harmonising buying prices and reducing corporate costs, and we are on track with a longer term project to streamline our combined distribution network.

Our Wholesale strategy

Our Wholesale Division aims to provide customers throughout Europe with high service levels at the lowest possible cost to us.

The wholesale business marries high customer service levels with volume led efficiencies. Scale delivers crucial benefits in terms of minimising costs and maximising effectiveness. Currently, Alliance Boots is number one or two in almost all the European markets in which it operates and are also Europe's largest purchaser of generics.

Continued expansion is a priority and we recognise that, as our established markets mature, we must invest to establish Alliance Boots in new geographical markets with major growth potential. Organic growth through continued improvements in service levels will be supported by growth through corporate development.

Achieving organic growth

To increase our competitiveness and achieve profitable growth in our established European markets, we are continually seeking to add value to our offering to all parts of our customer base: pharmacists, dispensaries and manufacturers.

In particular, we are responding innovatively to a changing business environment in which some major pharmaceutical manufacturers are looking to bypass wholesalers, and do business directly with pharmacists. By adjusting our business model, we have turned this apparent threat into an opportunity, developing a new contract delivery service tailored to

manufacturers' needs. For Alliance Boots, an added benefit of this new service offering is that manufacturers retain ownership of the product, which frees up working capital that we can reinvest in other areas of the business.

We will continue to respond promptly and positively to emerging market trends, in order to differentiate our wholesale businesses and to maintain organic growth.

Increasing efficiency, driving down costs

Since our merger, interaction between our Wholesale and Retail Divisions has delivered significant business benefits. Our position as a major retailer enables us to increase the efficiency of our wholesale operation through combined buying, the potential for predictive ordering, and the implementation of joint development in ordering and sourcing.

In addition, our expertise in margin management and the scale of our operation will continue to enable Alliance Boots to obtain productivity savings and remain price competitive.

Moving into new markets

In assessing the attractiveness of new markets, we take into account three main factors:

- 1 **Regulatory environment** Is the healthcare framework in place to ensure stability and reimbursement?
- 2 **Population size** Is it big enough to fuel significant growth and justify the cost of market entry?
- 3 **Opportunity** Can we see a way achieving profile and scale within the market relatively quickly?

In most cases, we would want to make our move into a new market when it is at an early stage of consolidation, with national wholesalers beginning to emerge, so that we can see which management teams have the strength and skills to drive the consolidation, and which are likely to be left behind in that process.

Our Retail strategy

Our core strategy for our retail business is to capitalise on the largest pharmacy chain in Europe and to maximise the value of the Boots brand in established and new markets

Rolling out the Boots brand

Since our merger, we have focused on developing a new dual format retail strategy in the UK, in order to provide a higher level of service to different sections of the market

Our community pharmacies will be rebranded as "your local Boots pharmacy" and will focus on healthcare and dispensing. Our much larger health and beauty stores will offer "destination shopping" with a far wider range of products including all Boots leading brands such as No 7 and Soltan.

This major expansion of the Boots brand, with its strong association of expertise and trust, will further strengthen our position in the market. In addition, we expect to achieve significant cost and revenue synergies. Our wholesale network will supply medicines while the Boots distribution system will supply front of shop products – enabling us to optimise product availability while reducing stock levels.

Developing the role of our pharmacists

Our outstanding pharmacists are the embodiment of the trusted expertise in healthcare that is at the heart of the Boots brand.

The continued recognition of the pharmacists' expertise and training has formed a significant element of the evolution of the trend towards self-medication, preventative healthcare and advances in personal wellbeing, both in the UK and elsewhere.

Our brand and positioning is intrinsically linked to this and the relationship that our pharmacists have with their patients is both at the heart of and embodiment of, the public's trust in Boots, its products and its services.

The range of advice-driven wellbeing and preventative programmes that we operate

across all our pharmacies, from general medication reviews to specific programmes to screen for specific ailments or assist with such areas as weight loss or smoking cessation, are carefully designed to help our pharmacists reach their full potential as a healthcare professional while providing our customers a genuinely valuable and high quality service offering.

The implicit value of this service offering is clear. As well as improved patient loyalty and the premium such trust places on our brand, the nature of this patient interaction gives it a significant and very real value to not only our business but also to the pharmaceutical companies and, of course, the national health service. The realisation of this value means that these initiatives not only address genuine customer needs but significantly strengthen our commercial position, and enhance our financial performance.

Continued UK growth

Despite the size of our UK retail network, there is still considerable potential for growth in this market.

We can further increase customer footfall by optimising the use of our property portfolio. Since our merger, we've conducted a review which has enabled us to identify many local geographic areas in which we could better serve the needs of our retail and prescription customers through relocation or rationalisation.

In addition, it is of great interest to note that around 40% of the UK population still does not have easy access to one of our pharmacies. To address this need, we plan to continue to acquire pharmacies and open new stores.

Potential for exciting European growth

In continental Europe, where we currently operate around 400 healthcare outlets, we see enormous potential for medium to long term growth. Constraints on pharmacy ownership in countries such as France and Germany mean that we will have to wait for deregulation to occur before we are able to capitalise on this opportunity. Meanwhile, we see considerable scope for continued growth within our existing footprint.

Overall, we believe that the benefits resulting from our merger – greater financial strength, bigger talent pool, wider skills base – put Alliance Boots in a very strong position for sustained and profitable international growth.

Building on our brand expertise

Our brand expertise, coupled with strong product development and sourcing capabilities, is an asset we will continue to build on. Boots brand products such as No 7 and Soltan hold market leading positions in the UK and provide a springboard for further profitable brand development.

In addition, we see proven demand for a new suite of pharmacy-only front of shop brands offering high quality at medium cost. Drawing upon our product formulation skills, we intend to develop such an offering and, through our wholesale network, we will make this new product range available to our independent pharmacist customers, enabling them to maximise the value of their front of store operation. Yet another example of how our retail and wholesale businesses can increasingly be a source of competitive advantage to each other.

Risk management

Like all businesses, Alliance Boots faces a variety of risks, such as the possibility of changing trends in consumer spending and increasing competitive pressures. There are also potential risks specific to the healthcare market, notably those relating to complex regulations and changes in legislation. And, finally, there may be risks associated with the ongoing process of integrating the two very large companies that have come together in Alliance Boots.

Here we report on our approach to identifying, monitoring and assessing risks that may affect our business, and the steps we are taking, where necessary, to mitigate them.

Our risk management process

Our executive team plays the leading role, monitoring the overall risk profile and regularly reporting to the Board through the Audit Committee. In addition, the executive team is responsible for providing clear guidelines on what Alliance Boots considers to be acceptable levels of risk.

These guidelines seek to enable people throughout our Group to use their expertise both to identify risks that could undermine our performance and to devise ways of bringing them within acceptable levels.

Where we identify risks that are not acceptable, we develop and agree action plans with clear allocation of responsibilities and timescales for completion and we ensure that the progress of our action plans is monitored and reported upon.

The risks we face

Impact of regulation

Risk

Alliance Boots could be adversely affected by changes to existing regulation, the introduction of new regulation and/or failure to comply with

new regulation leading to significant reduction in market volumes or prices or increased cost burden, resulting in substantial loss of profit.

We operate in regulated markets and changes to existing regulations could have a negative impact on our businesses. In our Retail Division our revenues could be adversely affected by any change to the licensing regime for pharmacies, prescription processing regimes or reimbursement arrangements for state-funded pharmacies.

Businesses in our Wholesale Division are subject to a range of regulations relating to such things as the conditions under which products must be stored and dispensed and the integrity of the supply chain. Changes to these regulations could affect our Wholesale Division's operations and profitability.

Mitigating the impact of regulation

Most importantly, we seek to control this type of risk through active involvement in policy-making processes, understanding and contributing to government thinking on regulatory matters, and building relationships with national regulatory bodies. In order to further increase our ability to influence decisions in this area we are represented in relevant professional, trade and industry associations.

Changes and trends in consumer behaviour

Alliance Boots could be adversely affected by changes in trends of consumer spending and preferences or detrimental effect on brand names, leading to adjusted consumer actions resulting in reduction of sales and/or profit.

In our Retail Division the success of our Health & Beauty business depends very largely on the continued strength of the Boots brand. If this were to be impaired for any reason – for example by any failure to keep pace with changing consumer preferences or any decline in product quality – our business would inevitably suffer.

Other wider trends could have a negative effect on our Group, for example the increasing use of the Internet for the purchase of health and beauty products or a recessionary period, resulting in low consumer confidence.

Mitigating the changes and trends in consumer behaviour

Our long retailing experience means that our commercial skills and ability to respond flexibly to changing consumer demand are highly developed. More specifically our strategy for growth is based on further strengthening our market position, with demand for health and beauty products, backed by expert service, expected to continue to increase. Targeted marketing programmes continue both to generate short term sales and build the Boots brand.

Competition

Risk

Change in market dynamics or actions of manufacturers or competitors could detrimentally impact Alliance Boots current or planned market share/profits.

Although regulated in parts, the markets we operate in are highly competitive. Our Retail Division has a wide variety of competitors including national, regional and local pharmacies,

supermarkets, convenience stores and department stores. In particular, supermarkets have, in recent years, used their greater financial resources to increase their market share.

Our Wholesale Division faces competition from direct competitors and alternative supply sources, including importers, domestic opportunistic traders and manufacturers who supply direct to pharmacies or patients.

Mitigating the risk of competition

In our Retail Division, we actively manage our brands and our relationships with both customers and suppliers. Our strategy for continued growth is to capitalise on the potential and strength of our Boots brand and the trust in which it's held to continue to strengthen our position in the health and beauty market. Through our Community Pharmacy business, we will play an increased role in the delivery of local healthcare services while our Health & Beauty stores will enable us to compete more effectively in the wider health and beauty market.

In our Wholesale Division, we are continuing to expand the scope of our operation in response to a changing marketplace. Our strategy is to be a leader in all aspects of the supply chain, and to this end, we have moved into pre-wholesaling as well as distribution agreements with major manufacturers. Our successful development of innovative own brand generic medicines will also continue to improve our offering to pharmacists, and strengthen our competitive position.

Health, safety and environmental risks

Risk

Alliance Boots faces the risk of a health and safety or environmental incident leading to serious injury, loss of life, loss of strategic asset or impairment of operations, resulting in financial cost, loss of reputation, prosecution, fines and adverse share price impact.

For a company like Alliance Boots, dedicated to promoting good health and serving local communities, any kind of major health, safety or environmental incident could be especially damaging. And increasingly stringent regulatory requirements in these areas increase the risk of contravention, with serious consequences either financially or in terms of reputation and trust in our brand.

Mitigating health, safety and environmental risks

We set high health, safety and environmental standards throughout our Group, and these are monitored and maintained by local health, safety and environmental committees, as well as by regular audits. We carry out environmental surveys to assess the impact of our businesses and we take a thorough and systematic approach to maintaining plant and property in good condition. We have a system in place for logging and analysing incidents in order to learn the necessary lessons if mistakes are made.

Product/services

Risk

For Alliance Boots, there is a risk of control failures resulting in supply of defective products or provision of services, relating to current or discontinued business activities, leading to harm, liability claims or other action, resulting in material financial and other damage (health and safety, reputation and legal).

As manufacturers, retailers and wholesalers, Alliance Boots has potential exposure to claims arising from the manufacture or supply of defective products. In particular, we could suffer damage to our reputation and suffer financial penalties arising from infiltration of counterfeit products into the supply chain, re-labelling of products and contamination or mishandling issues. Through our pharmacies, we are also exposed to risks relating to the professional services we provide.

Mitigating the product/services risk

Throughout our Group, we have robust purchasing and manufacturing processes, well developed contractual controls in relation to suppliers and a cohesive product control framework. We have specific controls for the identification of counterfeit product.

In our pharmacies, we have rigorous governance frameworks in place, and we conduct regular dispensing compliance reviews to ensure that individual pharmacies follow approved processes.

Major operational business failures

Risk

Absence or breakdown of key controls for operational, IT, financial or other core processes, and internal or external created threats to business continuity, could lead to failure to control assets, liabilities or resources, resulting in loss, disruption or business failure.

Alliance Boots sales are dependent on the efficient operation of our warehousing and logistics infrastructure, IT systems and the operational systems of third parties who supply them. A major failure in any of these areas could adversely affect our businesses. Such a failure could result from many possible causes, including faulty equipment or IT systems, disruption to supply of raw materials, labour force shortages or events impeding transport of products.

Mitigating the risk of Major operational business failures

We maintain and adhere to rigorously audited control frameworks, and regularly updated and tested business continuity plans are in place. We continually seek to improve control of core business processes, both through self-assessment and through specific programmes relating to the delivery of key strategic projects.

Risk management (continued)

Merger execution risk

Risk

Following the merger of Alliance UniChem and Boots, there is a risk of delayed or impaired delivery of synergy benefits or cost savings due to failure of integration strategy, leading to reduction of profit/sub-optimal operation of key business processes

At the time of our merger, we projected pre-tax cost savings of at least £100 million per annum by the fourth full year following completion. There is a risk that these synergy benefits will not materialise or will be lower than we estimated, which could have a significant impact on our profitability.

Mitigating the merger execution risk

We have a dedicated project team for delivering synergy benefits and clear and committed leadership from our merged executive committee, which met weekly during the first six months following the merger. A 100 day merger plan was adopted, providing clear guidance on objectives for successfully integrating the two groups. We have embedded our new synergy targets into core budgets and plans, as well as adopting pro forma prior year comparative reporting to give ourselves an effective means of measuring the performance of our merged Group.

Acquisitions

Risk

Merger/acquisition activity exposes Alliance Boots to unforeseen or unmanageable risks in new markets, resulting in reputational damage or excessive costs or losses which could materially impact Group performance through impairment of competitive position and growth prospects.

Our strategy for continued growth includes acquiring businesses and associate interests to complement our existing business portfolio.

Failure to select suitable acquisitions, conduct appropriate due diligence and manage new acquisitions, particularly in new geographic

markets, could have a negative impact on our competitive position and growth prospects.

Mitigating the risk inherent in acquisition

As Alliance UniChem, we acquired extensive experience in completing successful acquisitions and developed well established processes which are now in place within Alliance Boots. We closely monitor market intelligence, continuously assessing market trends and business performance, and we conduct rigorous post-acquisition reviews, to ensure the successful integration of business units and processes.

Increased costs

Risk

Fixed and variable operating costs and interest rates may be subject to increases outside the control of our businesses, resulting in adverse effect on our financial performance and profitability.

Increases in oil, gas, electricity, labour and rent costs – among others, – could all have a negative impact on our businesses. Most of these possible increases in operating costs are beyond the control of Alliance Boots, and there is no guarantee that we would be able to pass them on to customers.

Mitigating the risk of increases in costs

We take all reasonable measures to control costs, including wage negotiation and controls, negotiation of lease renewal terms and procurement and competitive tendering strategies. To protect against increasing energy costs, we are carrying out wide-ranging energy efficiency programmes throughout our Group. And we guard against interest rate escalation through proactive treasury management and forecasting.

Pension contributions

Risk

Alliance Boots may be forced to increase funding of future pension benefits or cover shortfall in current pension schemes, leading to increased costs and cash outflows, resulting in adverse impact on operational results and financial condition.

The costs of providing adequate pension provision for our people may continue to rise for a number of reasons, including the increased life expectancy of pension scheme members. The possibility of pension fund asset under-performance also represents a risk, in terms of the increased costs involved in making good any resulting shortfall.

Mitigating the risk of increased pension contributions

To ensure an objective view of pension performance, Alliance Boots retains independent actuaries to conduct regular reviews. Investment performance is also reviewed quarterly by the Finance Committee. Defined benefit ("final salary") schemes have been closed for new entrants in the UK.

Currency exchange

Risk

Currency exposures relating to dealings in currencies other than sterling could result in an adverse effect on our performance.

Like other international businesses, we face the risk of currency exchange exposure when income or expense arise in currencies other than the business's functional currency, and the risk arising from the need to translate profits denominated in currencies other than sterling.

Mitigating the currency exchange risk

We have rigorous policies and procedures in place to help us manage currency exposures effectively. In addition, reporting from in-country enables us to understand exposures market by market.

Pro forma financial results and performance review

Pro forma

To assist investors in understanding the performance of the Group, pro forma financial information has been prepared to show the results from continuing operations of the Group as if the two former groups had always been combined as was provided at the announcement of the Group's interim results on 14 November 2006. The pro forma revenue and profit statement for continuing operations has been prepared on an adjusted basis, which means before exceptional items, amortisation of customer related intangible assets and IAS 39 timing differences, all net of tax, and deferred tax restatements for customer related intangible assets.

The results for the year are in line with management's targets at the time of the merger. The Retail Division delivered good revenue growth with trading margin in the UK ahead of management's previous expectations. The Wholesale Division performed well, reflecting the strength of our geographically diverse portfolio.

Revenue increased year on year by 3.6% to £14,608 million. Trading profit (which comprises profit from operations before exceptional items, amortisation of customer related intangible assets and share of associates' post tax earnings) increased by 6.3% to £641 million. This reflects an underlying increase in trading profit of 7.4% after adjusting the previous year's trading profit to include a full year's rental charge on the 312 retail outlets which were sold and leased back in July 2005, so that the trading profits for both years are on a comparable basis. Our share of associates' post tax earnings increased by 4.3% to £49 million. Underlying net finance costs (which exclude IAS 39 timing differences from hedging interest rate and currency exposures) reduced year on year by £19 million. Adjusted earnings (which comprises profit for the year attributable to equity shareholders before exceptional items, amortisation of customer related intangible

assets and IAS 39 timing differences, all net of tax, and deferred tax restatements for customer related intangible assets) increased by 11.5% to £467 million. Adjusted earnings per share increased by 11.4% to 48.7 pence based on a pro forma weighted average number of shares in issue of 959 million compared to 958 million in the previous year.

Dividends

The Board did not declare an interim dividend as dividends for the periods up until the merger on 31 July 2006 were paid to the respective shareholders of both former companies on 3 October 2006.

The Board would ordinarily be recommending in the normal course of business, a final dividend covering the period from 31 July 2006 until 31 March 2007. However, the terms of the recommended offer for the Company by AB Acquisitions Limited, announced on 20 April 2007, are such that the offer price is inclusive of any final dividend. Accordingly, no such final dividend will be paid. However, if the Company is not acquired by AB Acquisitions Limited (or any alternative offeror), the Board intends that the Company pay in due course an interim dividend in respect of the year ended 31 March 2007 of an amount equal to the final dividend that would have been paid.

Merger update

Phase one – cost synergies

Following completion of the merger on 31 July 2006, the key initial focus was on implementing our new organisational structure, establishing a new corporate office in London utilising existing office space, and on delivery of our cost synergy plan.

Good progress has been made during the year in delivering over £20 million of merger cost savings, primarily from harmonising buying prices and reducing corporate costs, and we are on track with the longer term project to streamline our combined distribution network.

We remain confident of delivering annual pre-tax cost savings of at least £100 million per annum as a result of the merger by the fourth full year following completion of the merger (being the 12 month period ending on the fourth anniversary of completion, completion having taken place on 31 July 2006). We still expect that over 60% of the run-rate savings will accrue by the second year following completion and 100% by the fourth year. As indicated in March 2007 in our pre year end close period announcement, the one-off costs related to achieving these synergies are not expected to exceed the £53 million estimate provided at the time of the merger, of which £23 million was taken as an exceptional charge before tax in 2006/07.

Phase two – UK retail

The development of our UK retail offer commenced shortly after the merger was completed. Following detailed work and various pilots, at the end of March 2007 we announced a major programme to capitalise on the pharmacy-led opportunities that we have in the UK market.

"your local Boots pharmacy"

During the last four months of our financial year we successfully trialled a new 'your local Boots pharmacy' branded format for our community pharmacies. This combines a strong Boots branded retail offer, including own label products and the Boots Advantage Card loyalty scheme, with a tailored community focused prescription and service proposition. Following the success of this trial, in which we are seeing substantial increases in both retail sales and dispensing volumes, in late March 2007 we announced that we were to roll out this new format, investing around £65 million of capital to re-brand and refit the majority of the Community Pharmacy network over two years, starting in the summer.

Pro forma financial results and performance review (continued)

Property optimisation

Following the merger we reviewed our combined UK retail property portfolio to identify opportunities to optimise our position in local markets to best serve the needs of our retail and prescription customers. This review, the conclusions of which we announced in late March 2007, identified around 100 localities where we are seeking to relocate or, in a limited number of cases, rationalise our portfolio over the next three years at a capital cost of around £35 million.

Systems harmonisation

In March 2007 we also announced our decision to harmonise our UK pharmacy management systems over the next three years utilising "Nexphase", a system originally co-developed by our UK wholesale business for its customers and used in our Community Pharmacy business.

As previously announced, the phase two projects will result in approximately £75 million of exceptional costs before tax, of which around £30 million will be in respect of non-current asset write-offs. In 2006/07 these exceptionals totalled £2 million.

Phase three – international product offer

The third phase of our merger-related plans is focused on opportunities to internationalise the Boots brand and access new markets and territories utilising the skills and resources of the combined Group. While these plans are at an early stage of development we remain confident about the potential available to shareholders over the longer term.

Corporate developments

In April 2006 Hedef Alliance, our Turkish-based associate, exercised its option to acquire control and majority ownership of its associate, UCP, a leading pharmaceutical wholesaler in Egypt. In June 2006 ANZAG, our German-based associate, acquired 60% of Farmexpert, the third largest pharmaceutical wholesaler in

Romania. Today we have wholesaling interests in 14 countries, either through direct ownership or via our associates.

In September 2006 we completed the acquisition of Cardinal Health's UK short-line pharmaceutical wholesale business for £38 million in cash, the business being subsequently re-branded "Cordia Healthcare". This has further developed our wholesale offering to independent pharmacy customers in the UK.

In January 2007 we announced that we were to enter the rapidly growing Chinese pharmaceutical market, currently the ninth largest in the world, through an agreement, which is subject to regulatory approval, to form a 50/50 joint venture in Guangzhou Pharmaceuticals Corporation, the third largest pharmaceutical wholesaler in China. The move into China follows our entry into Russia last year with the purchase of Apteka Holding.

The programme to comply with the undertakings given to the Office of Fair Trading at the time they approved our merger is now nearly complete. Of the 96 pharmacies in the UK originally identified for disposal, the Office of Fair Trading has subsequently agreed to withdraw two pharmacies from the agreed divestment list. To date 89 pharmacies have been sold, of which 68 were completed before the end of our financial year, with the remainder completed in April 2007. Negotiations for the sale of the remaining five pharmacies are progressing. The exceptional profit before tax on those Health & Beauty pharmacies sold during the year was £7 million. There was no recorded gain on those community pharmacies sold, as they were subject to fair value accounting on merger.

While fulfilling the Office of Fair Trading requirement to dispose of these pharmacies, our Community Pharmacy business has not acquired pharmacies at its historical rate. This

will reduce the contribution from pharmacy acquisitions in the new financial year. Since the beginning of 2007 we have stepped up the rate of acquisitions in the UK, acquiring 16 pharmacies in the fourth quarter, bringing the total acquired in the UK during our financial year to 29 pharmacies.

Outlook

The Board expects the good trading performance it has seen in 2006/07 to continue in the current financial year.

Segmentation

New segmental reporting was introduced in our interim results to reflect the composition of the merged Group the two principal segments being the Retail and Wholesale Divisions

In the pro forma operating and financial review the Retail Division results are further split between the UK and International businesses given the relative size of our UK retail businesses, and the Wholesale Division results are further split between Northern and Southern Europe to reflect the different regulatory and market dynamics typically encountered in these regions. Comparatives for the year have been prepared on the same basis

A glossary of terms and a list of principal businesses by segment are included in the information at the end of this announcement

Pro forma performance review

To assist Investors in understanding the performance of the Group pro forma financial information has been prepared to show the results from continuing operations of the Group as if the two former groups had always been combined as was provided at the announcement of the Group's interim results on 14 November 2006. The pro forma revenue and profit statement for continuing operations has been prepared on an adjusted basis which means before exceptional items, amortisation of customer related intangible assets and IAS 39 timing differences, all net of tax and deferred tax restatements of customer intangible assets

Detailed pro forma financial information, including the basis of preparation is set out in the "additional pro forma financial information for continuing operations" section of this announcement

Divisional highlights

for the year ended 31 March 2007

| | Revenue £million | Trading profit £million | Year on year growth | |
|---|---------------------|-------------------------------|---------------------|-------------------|
| | | | Revenue | Trading profit |
| Retail | 6,579 | 502 | +4.2% | +6.4% |
| Wholesale | 9,009 | 186 | +3.4% | +10.1% |
| Other Commercial Activities & Corporate Costs | 114 | (47) | +29.5% | |
| Intra-group | (1,094) | — | | |
| Group* | 14,608 | 641 | +3.6% | +6.3% |
| Share of associates revenue & trading profit | 2,118 | 70 | +4.5% | -1.4% |
| | 16,726 | 711 | +3.7% | +5.5% |

* Group trading profit comprises profit from operations before exceptional items, amortisation of customer related intangible assets and share of associates post tax earnings

Pro forma financial results and performance review (continued)

Retail Division

Performance overview

The Retail Division delivered good revenue growth with trading margin in the UK ahead of management's previous expectations. Revenue increased year on year by 4.2% to £6,579 million, trading profit increasing by 6.4% to £502 million. This reflects an underlying increase in trading profit of 7.7% after adjusting the previous year's trading profit to include a full year's rental charge on the 312 retail outlets which were sold and leased back in July 2005 so that the trading profits for both years are on a comparable basis. Trading margin increased by 0.1 percentage point to 7.6%, an underlying increase of 0.2 percentage points after adjusting for the sale and leaseback transaction. On a constant currency basis, revenue increased by 4.3% up 2.9% on a like for like basis and trading profit increased by 6.2%, an increase of 7.6% after adjusting for the sale and leaseback transaction.

Trading profit in the Retail Division in the second half of the year was £294 million, an increase of 8.1% on the second half of the previous year on revenue up 2.9% to £3,454 million, reflecting a particularly strong trading margin in the UK.

Retail Division highlights

for the year ended 31 March 2007

| | Total £million | Year on year growth | |
|-----------------------|-------------------|---------------------|---------------|
| | | Total | Like for like |
| Revenue | | | |
| UK | | | |
| Health & Beauty | 4,945 | +3.8% | +3.0% |
| Community Pharmacy | 1,011 | +4.6% | +2.1% |
| | 5,956 | +3.9% | +2.9% |
| International | | | |
| Republic of Ireland | 155 | +9.2% | +7.5% |
| Norway | 267 | +3.1% | +0.8% |
| The Netherlands | 138 | +12.2% | +2.7% |
| Russia | 1 | n/a | n/a |
| Italy | 25 | +4.2% | +6.4% |
| Thailand | 37 | +12.1% | -4.9% |
| | 623 | +7.2% | +2.8% |
| | 6,579 | +4.2% | +2.9% |
| Trading profit | | | |
| UK | 469 | +7.3% | |
| International | 33 | -5.7% | |
| | 502 | +6.4% | |
| Trading margin | | | |
| UK | 7.9% | +0.3pp | |
| International | 5.3% | -0.7pp | |
| | 7.6% | +0.1pp | |

Retail outlets¹

at 31 March 2007

| | With a pharmacy | Without a pharmacy | Total |
|---------------------|--------------------|-----------------------|-------|
| UK | | | |
| Health & Beauty | 1 313 | 230 ² | 1,543 |
| Community Pharmacy | 939 | 55 | 994 |
| | 2 252 | 285 | 2 537 |
| International | | | |
| Republic of Ireland | 36 | 5 | 41 |
| Norway | 129 | 9 | 138 |
| The Netherlands | 75 | — | 75 |
| Russia | 6 | — | 6 |
| Italy | 20 | 1 | 21 |
| Thailand | 117 | — | 117 |
| | 383 | 15 | 398 |
| | 2,635 | 300 | 2 935 |

¹ Excludes franchised outlets

² Includes 124 standalone optical practices

Retail – UK

In the UK total retail revenue increased year on year by 3.9% to £5,956 million, like for like revenue increasing by 2.9%. Trading profit increased by 7.3% to £469 million and trading margin by 0.3 percentage points. Adjusting for the sale and leaseback transaction underlying trading profit increased by 8.8% and underlying trading margin increased by 0.4 percentage points. Trading profit in the second half of the year was £277 million, an increase of 9.9% on the second half of the previous year on revenue up 2.5% to £3 133 million reflecting a particularly strong trading margin in what continues to be a highly competitive market.

UK revenue by product category

for the year ended 31 March 2007

| | £million | Mix | Year on year growth |
|----------------------------------|----------|--------|---------------------|
| Health ¹ | 3,089 | 51.9% | +5.0% |
| Beauty & Toiletries ² | 1,729 | 29.0% | +5.4% |
| Lifestyle ³ | 1,138 | 19.1% | -1.0% |
| | 5,956 | 100.0% | +3.9% |

¹ The Health category comprises the dispensing & related income and retail healthcare sub-categories the latter including sales of non-prescription medicines and optical sales

² The Beauty & Toiletries category comprises the cosmetics & fragrances and toiletries sub-categories

³ The Lifestyle category comprises the baby nutrition photography electrical seasonal and other lifestyle sub-categories

Pro forma financial results and performance review (continued)

Revenue in the Health category increased by 5.0% to £3,089 million with strong performances in both our dispensing & related income and healthcare sub-categories. Total dispensing volumes increased year on year by 5.5% to 182 million items, growth being particularly strong in the care homes sector and from our prescription collection services.

In England and Wales the adjustments to the reimbursement rate in relation to generic prescription medicines, which came into effect from the beginning of October, slowed market growth in value terms in the second half of the year as anticipated. This regulatory action was expected and we have taken steps to mitigate the impact of these changes.

We continue to develop the role of retail pharmacists in the provision of healthcare services. Total service income, which came primarily from Medicine Use Reviews and other locally commissioned services, while still relatively modest, increased year on year by more than 60%.

Over three quarters of our pharmacies now incorporate private consultation facilities. This, together with our pharmacist accreditation programmes, has enabled us to increase the number of Medicine Use Reviews carried out by our pharmacists by over six times compared to the previous year. Over 184,000 reviews were carried out during the year, which we believe is well above our overall healthcare market share. At the beginning of October 2006 the Department of Health raised the fee rate for Medicine Use Reviews from £23 to £25 per review, and for pharmacies that were already carrying out such reviews, further increased the upper limit from 250 to 400 reviews per annum. The new pharmacy contract was introduced in Scotland in April 2006 and since the Minor Ailment Service became fully operational in July 2006 we have signed up over 205,000 patients.

Further development of our service offering is ongoing with nearly 12,000 private or publicly funded chlamydia tests carried out during the year from around 500 pharmacies.

In Scotland the smoking ban in public indoor spaces was introduced at the end of March 2006. Since then we have seen significant increases in the provision of smoking cessation services and sales of related products in our Scottish pharmacies. Similar bans in Wales and Northern Ireland have just been implemented, with the ban in England to take effect from the beginning of July. By the year end, around 850 of our pharmacies were providing state funded stop smoking services in support of the public health agenda.

The National Health Service continues to plan for electronic prescriptions to be fully operational across all pharmacies in England by the end of 2007, the introduction being planned in phases. The initial service, which has now been fully deployed into all our pharmacies in England, enables pharmacies to scan barcodes on paper subscriptions printed by doctors. This service, coupled with smart cards issued by Primary Care Trusts to individual pharmacists who are registered users of the new system, enables pharmacies to claim an allowance of £200 per month for running the system. Once the vast majority of doctors and pharmacies have the new system operational, printed bar coded prescriptions will be superseded by electronically transferred prescriptions from the doctor to the patient's nominated pharmacy. A similar electronic prescription service is scheduled to begin roll out in Scotland in September 2007.

During the year three central dispensaries were opened which dispense high volumes of acute and repeat prescriptions in a highly efficient way to local pharmacies. This brought the total number of central dispensaries to 13 at the year end. The changes being introduced by the Department of

Health, including the introduction of electronic prescriptions, mean that we see an increasing role for such central dispensaries over the coming years, thereby freeing up community-based pharmacists to spend an increasing proportion of their time providing services and advice to their patients, in addition to dispensing acute prescriptions.

As the leading operator of retail pharmacies in the UK with significantly more outlets than any other operator, we remain committed to making high quality healthcare more available and accessible and now provide pharmacy services up until midnight in more than 50 pharmacies.

Retail healthcare revenue in the UK benefited from the programme to address historic under-investment in Boots branded smaller Health & Beauty stores and the good summer weather in 2006. A strong "Change One Thing" campaign was run for the second consecutive New Year and the Boots Health Club was launched in April 2006, which enables customers to receive targeted healthcare information and offers on specific health issues on a periodic basis. The Boots Health Club now has 1.5 million members and particularly appeals to our older customers with around 40% of its members now aged 60 or over who, as members, are entitled to a 10% discount on our own brand products. This is an age group which was not previously highly represented in the Boots Advantage Card loyalty scheme. The most popular topics for Health Club members, of which almost 90% are women, are women's health, vitamins and supplements, and weight loss.

Revenue in the Beauty & Toiletries category in the UK, where we have leading market positions and brands, increased by 5.4% to £1,729 million. Revenue growth was strong in fragrances and in both self selection and premium cosmetics, these being key contributors to our biggest ever trading week in the run-up to Christmas.

supported by the "Gorgeous" advertising campaign and our successful post-Christmas sale. Fragrances growth mainly came from new product launches and the introduction of fragrance cabinets into more Health & Beauty stores. In August 2006 we successfully re-launched our Natural Collection range with its cosmetics products all priced below £2, resulting in very strong sales growth for this brand.

No 7, our leading cosmetics brand, has continued its growth, assisted by a successful promotional programme and continuing new product development with a strong pharmaceutical focus. Recently we have experienced unprecedented demand from customers for No 7 Protect and Perfect Beauty Serum. This follows extensive media coverage highlighting independent research at Manchester University that concluded that our patented anti-oxidant complex repairs photo-aged skin and improves fine wrinkles associated with photo-ageing. We are currently stepping up production in our manufacturing facility in Nottingham to meet demand.

We continued to grow revenue in Toiletries helped by good growth in skincare due to improved layout and merchandising and higher sales of gradual tanning and premium skincare products. Men's toiletries performed particularly well, partly as a result of a new branded razor launch in the first half of the year. Sun care revenues also grew, boosted by the warm summer with Soltan retaining its market leading position assisted by new product launches.

Revenue in the Lifestyle category in the UK decreased by 1.0% to £1.138 million. This reflected a continued decline in photographic revenue, despite market share gains in traditional photo products and growing digital photo sales from the kiosks we now have in 350 stores, together with flat sales of electrical beauty products. In contrast, our seasonal baby and nutrition sub-categories all performed well throughout the year. Good seasonal gift sales combined with more selective

buying, tight stock control and an excellent post-Christmas sale resulted in good sales and margin growth in our seasonal sub-category. Nutrition, which is a strong driver of footfall, benefited from an extension in our "Meal Deal" lunchtime offer to include more products. Baby sub-category growth reflected a particularly strong performance in nursery products assisted by a successful re-launch of our Boots own brand nappies. We continue to provide value to our customers via the Boots Parenting Club which we believe to be the largest membership baby club in the UK.

Our own brands and exclusive ranges enable us to differentiate our retail offer from that of our competitors and remain very important drivers of revenue and margin. No 7 and Soltan continue to be leaders in their respective markets. New product developments include the launch in August 2006 of the niche "Soap & Glory" indulgent bathing range, which is exclusive to Boots, and in January 2007 we launched the "Expert" range of products which sold over a million units in our fourth quarter and is now being backed by a new marketing campaign in our new financial year. Limited ranges of Boots branded products have been sold through over 800 of our Community Pharmacy business outlets since the merger was completed and are proving a popular addition to the range, particularly consumer healthcare medicines and our "Basics" range of low priced toiletries.

The Boots Advantage Card loyalty scheme, where customers earn points on purchases for redemption at a later date, remains a key element of our customer offer in our Boots branded stores. At the year end the number of active Boots Advantage Card holders (i.e. members who have used their card at least once in the last 12 months) was 15.1 million. Boots.com sales, which are allocated to the relevant product category, increased by 19.0% year on year to £29 million.

Pro forma financial results and performance review (continued)

Looking at the individual performances of our two retail businesses in the UK

The Boots branded Health & Beauty business increased both its trading margin and trading profit year on year for the first time in five years. Revenue increased by 3.8% to £4,945 million, like for like revenue increasing by 3.0% of which we attribute about half a percentage point to the warm weather during the summer. Trading margin increased particularly in the latter part of the year, mainly as a result of improved stock management following recent infrastructure investments, better buying (partially as a result of merger synergies) and better targeted marketing programmes. Boots Opticians made a trading profit during the year, a further 15 practices being switched to the franchise model bringing the total franchised to 23.

The number of retail outlets the Health & Beauty business operates with a pharmacy increased by a net 23 during the year. 39 new NHS pharmacy contracts were opened, 26 of which were in existing destination. Health & Beauty stores previously without a pharmacy and one pharmacy was acquired. 242 retail outlets underwent major refits, many of which were part of our programme designed to address historic under-investment in smaller stores, and we carried out 11 relocations. At 31 March 2007 the Health & Beauty business operated 1,543 retail outlets of which 1,313 had a pharmacy and 264 had an optical practice, 124 of which were standalone optical practices.

Our Health & Beauty business is on track with its systems rationalisation and supply chain reconfiguration programme announced in March 2006. Of the £40 million exceptional costs before tax identified when this programme was announced, £20 million was incurred in 2006/07 and in addition, the business exited certain third party logistics activities in Nottingham which resulted in incremental exceptional costs before tax of £5 million.

During the year our Health & Beauty business implemented a new training and development programme designed to raise the motivation, knowledge and enthusiasm of our people in store. Following the success of the initial programme in 80 stores we plan to roll out the programme to all Health & Beauty stores over the next two years.

Our Community Pharmacy business increased revenue by 4.6% to £1,011 million. Like for like sales increased by 2.1%, this being lower than in our Health & Beauty business due to Community Pharmacy's greater weighting towards the dispensing market where adjustments to the reimbursement rate in relation to generic prescription medicines came into effect from the beginning of October 2006, which slowed market growth. In value terms, trading profit increased year on year due to the like for like revenue growth, trading margin being lower due to the generics reimbursement rate adjustments.

Following the successful trial of our new "your local Boots pharmacy" branded format for community pharmacies in which we are seeing substantial increases in both retail sales and dispensing volumes, we announced in late March 2007 that we were to roll out this new format, investing around £65 million of capital to re-brand and refit the majority of the Community Pharmacy network over the next two years, starting in the summer. This is expected to further increase sales of products exclusive to Boots.

The number of pharmacies in the Community Pharmacy business reduced by a net 23 in the year as a result of the divestment programme to comply with the undertakings given to the Office of Fair Trading at the time they approved our merger. While fulfilling these undertakings our Community Pharmacy business has not acquired pharmacies at its historical rate. Since the beginning of 2007 we have stepped up the rate of acquisitions, acquiring 16 pharmacies in the fourth quarter bringing the total acquired

during the financial year to 29 pharmacies. At 31 March 2007 the Community Pharmacy business operated 994 retail outlets, of which 939 were pharmacies.

Retail – International

Total retail revenue in countries outside the UK increased year on year by 7.2% to £623 million, like for like revenue increasing by 2.8%. Trading profit reduced by 5.7% to £33 million, trading margins reducing by 0.7 percentage points. On a constant currency basis, revenue increased by 8.3%. Trading profit in the second half of the year was £17 million, a decrease of 15.0% on the second half of last year, the reduction being mainly as a result of higher costs in Norway, total second half revenue increasing by 7.4% on the second half of last year to £321 million.

43 retail outlets were added during the year, the number of outlets with pharmacies increasing by 38. The major areas of expansion were a net 21 Boots openings in Thailand, six of which are airport concessions, and 12 additions in Norway, eight of which sell specialist surgical products into which we plan to incorporate new pharmacies. At 31 March 2007 we operated 398 retail outlets outside the UK, of which 383 had a pharmacy.

In the Republic of Ireland revenue increased by 9.2% to £155 million, an increase of 7.5% on a like for like basis, growth being very strong in the second half of the year due to a particularly good performance in the cosmetics & fragrances and retail healthcare sub-categories assisted by a well executed seasonal marketing campaign. Trading profit and trading margin both increased year on year as a result.

In Norway revenue increased by 3.1% to £267 million, an increase of 0.8% on a like for like basis, like for like growth being higher in the second half of the year. The total number of pharmacies has continued to increase in the Norwegian market, newer openings taking share from existing outlets. Trading margin and

profit was lower than in the previous year due to higher operating costs, mainly as a result of increased employment costs particularly in the latter part of the year and the addition of new outlets which take time to reach maturity

In The Netherlands revenue increased by 12.2% to £138 million, an increase of 2.7% on a like for like basis. As in Norway, the total number of pharmacies continued to increase. Despite strong competition, trading margin increased year on year, mainly due to a more favourable product mix. Trading profit was higher as a result.

In Italy revenue increased by 4.2% to £25 million, an increase of 6.4% on a like for like basis. This increase, together with an increase in trading margin due to reduced operating expenses, resulted in a higher trading profit.

In Thailand revenue increased by 12.1% to £37 million, a decrease of 4.9% on a like for like basis due to the difficult economic and political climate and increased competition from new openings and on pricing which resulted in a lower trading margin and trading profit. Despite this, like for like transaction volumes increased and No 7 was successfully re-launched in October 2006.

Wholesale Division

Performance overview

The Wholesale Division performed well reflecting the strength of our geographically diverse portfolio of businesses. Revenue totalled £9,009 million, an increase of 3.4%, trading profits increasing by 10.1% to £186 million. Overall trading margins increased by 0.2 percentage points. Adjusting for acquisitions and disposals, on a constant currency basis, like for like revenue increased by 1.0%, like for like trading profit increasing by 9.7% and like for like trading margins increasing by 0.2 percentage points.

Trading profit in the second half of the year in the Wholesale Division was £101 million, an increase of 13.5% on the second half of the previous year, merger synergies being

increasingly realised in the UK, on revenue up 5.8% to £4,621 million.

In January 2007 we announced plans to re-brand the Wholesale Division's principal businesses in each country under a common brand name, "Alliance Healthcare". By the year end we had completed the re-branding in four of the eight countries in which we operate plus our associate in Portugal, with the programme scheduled for completion in early 2008.

Markets

We estimate that our wholesale markets grew year on year by around 2.5% in value on a constant currency basis, this growth being weighted on the basis of our wholesale revenue. This is lower than in the previous year, mainly as a result of negative volume growth in France as its government attempts to bring consumption down towards levels typically seen in other European countries. We expect that the overall market growth in 2007/08 will be higher at around 3.5%, largely because we believe that the rate of decline in consumption in France will start to slow down.

The growth in the market from the introduction of higher priced new pharmaceuticals has continued to be partially offset by growth in market penetration of lower priced generic drugs. This percentage is typically significantly higher in our markets in Northern Europe than in Southern Europe. Compared to the previous year, penetration of generics grew in all markets in which we operate.

We estimate that the overall level of parallel trade in Europe was broadly in line with the level in the previous year, with manufacturers continuing to seek ways to curtail these activities.

The continued growth of Almus, our exclusive range of generic drugs, is providing marketing and sourcing benefits aimed at offsetting the impact of patent expiries. The phased launch of Almus outside the UK commenced with France and Italy in April and May 2006 respectively, with additional products subsequently having been launched in these countries. The roll-out of Almus into other European countries is set

to continue on a phased basis. Almus has been introduced into all Boots pharmacies in the UK, which is increasing the brand's sales and market presence.

Pro forma financial results and performance review (continued)

Wholesale Division highlights for the year ended 31 March 2007

| | Total £million | Year on year growth | |
|-----------------------|-------------------|---------------------|---------------|
| | | Total | Like for like |
| Revenue | | | |
| Northern Europe | | | |
| UK | 1 978 | +7.4% | +3.2% |
| Norway | 222 | -0.4% | +1.7% |
| The Netherlands | 702 | +3.1% | +3.7% |
| Russia | 195 | n/a | n/a |
| Czech Republic | 247 | +12.3% | +7.6% |
| | 3,344 | +12.8% | +3.5% |
| Southern Europe | | | |
| France | 3 746 | -1.4% | -0.8% |
| Italy | 931 | +0.4% | +0.3% |
| Spain | 1 053 | +7.7% | +2.2% |
| Portugal | 3 | n/a | +3.0% |
| | 5,733 | -1.1% | -0.1% |
| Intra-segment | (68) | | |
| | 9,009 | +3.4% | +1.0% |
| Trading profit | | | |
| Northern Europe | 108 | +14.9% | +12.9% |
| Southern Europe | 78 | +4.0% | +5.6% |
| | 186 | +10.1% | +9.7% |
| Trading margin | | | |
| Northern Europe | 3.2% | – | +0.3pp |
| Southern Europe | 1.4% | +0.1pp | +0.1pp |
| | 2.1% | +0.2pp | +0.2pp |

Wholesale – Northern Europe

Trading profit in the Northern Europe geographical area of our wholesale division totalled £108 million, a year on year increase of 14.9% on revenue up 12.8% to £3,344 million. Trading margin was in line with the previous year at 3.2% like for like improvements being offset by the lower margin business in Russia which was acquired in March 2006. Adjusting for acquisitions and disposals on a constant currency basis like for like revenue increased by 3.5%, like for like trading profits increased by 12.9% and like for like trading margins increased by 0.3 percentage points. Trading profit in the second half of the year was £59 million, an increase of 20.4% on the second half of the previous year on revenue up 16.8% to £1,741 million.

In the UK revenue increased by 7.4% to £1,978 million, like for like revenue increasing by 3.2% mainly as a result of higher intra-group sales to our Health & Beauty business. Trading margin

and trading profit both increased year on year merger synergies being increasingly realised as the year progressed.

In September 2006 we completed the acquisition of Cardinal Health's UK short-line pharmaceutical wholesale business for £38 million in cash, the business being subsequently re-branded as "Cordia Healthcare". This has further developed our wholesale offering to independent pharmacy customers.

In March UniChem, our UK full-line wholesale business, successfully commenced its previously announced sole logistics services contract with Pfizer under which it provides delivery and related services to all pharmacies in the UK. Implementation of the contract was well planned and executed, resulting in high service levels since its launch. We are aware that other manufacturers are also contemplating whether to change their existing arrangements. In April

2007 the Office of Fair Trading announced that it had launched a market study into the distribution of medicines in the UK, which it has indicated will be concluded by the end of 2007. Since our year end, we have also entered into an agency agreement with AstraZeneca to provide delivery and related services on a non-exclusive basis.

In Norway revenue decreased by 0.4% to £222 million, an increase of 1.7% on a like for like basis, which was ahead of our estimate of market growth. Increased benefits from running our Norwegian retail and wholesale businesses more closely together resulted in increased trading margin and profit.

In The Netherlands revenue increased by 3.1% to £702 million, an increase of 3.7% on a like for like basis. Trading profit increased as a result of the revenue growth, trading margin being lower due to increased customer discounts. The development of Kring, our virtual chain of

pharmacies continued during the year with over 300 pharmacies now participating in the Kring programme including the 75 pharmacies operated by our retail business in The Netherlands

In Russia revenue was £195 million an increase of around 16% in local currency on the comparable period in the previous year when the business was under prior ownership. The business traded profitably during the year, its integration into the Wholesale Division proceeding according to plan

In the Czech Republic revenue increased by 12.3% to £247 million an increase of 76% on a like for like basis, which was well ahead of our estimate of market growth, the business performing particularly well in the independent retail pharmacy sector throughout the year. Trading profit increased due to the revenue growth trading margin being lower as a result of higher costs

Wholesale – Southern Europe

Trading profit in the Southern Europe geographical area of our Wholesale Division totalled £78 million a year on year increase of 4.0% on revenue down 1.1% to £5,733 million. In what remain competitive markets trading margin increased by 0.1 percentage points to 1.4%. Adjusting for acquisitions and disposals, on a constant currency basis like for like revenue was down 0.1 percentage points year on year like for like trading profit increased by 5.6% and like for like trading margin increased by 0.1 percentage points. Trading profit in the second half of the year was £42 million, an increase of 5.0% on the second half of the previous year on revenue up 0.1% to £2,910 million

In France, revenue decreased by 1.4% to £3,746 million, a decrease of 0.8% on a like for like basis the proportion of product which manufacturers sell and distribute direct to pharmacies continuing to increase. In the second half of our financial year the French government announced an additional healthcare tax for 2006 allocated between all pharmaceutical wholesalers and distributors. Our share of this tax was £4 million which resulted in a reduction in trading margin in the second half of the year our full year trading margin and trading profit increasing year on year due to the replacement of the debtor securitisation programme during the year which resulted in a corresponding increase in net finance costs

We continue to counter the trend in direct sales within the French market through actions such as the roll out of a more competitive generics

offer and the launch of Almus in France in April 2006. As a result of these initiatives our generics revenue increased year on year by over 20%

Following the completion of our service offering review in the first half of the year the previously announced restructuring of the warehouse network is well underway, which will improve operational efficiency and better position our business to adapt as the market continues to evolve. £10 million of exceptional restructuring costs before tax were charged during the year one depot being closed

In Italy revenue increased by 0.4% to £931 million an increase of 0.3% on a like for like basis, the market continuing to be impacted by government price cuts. Trading margin and profit were both higher than the previous year, mainly as a result of a beneficial mix of business in the second half of the year. Good progress has continued to be made in establishing our virtual chain of pharmacies in Italy. In May 2006 Almus was launched in the Italian market followed by Alivita, our own label range of healthcare commodity products. In July 2006

In Spain total revenue increased by 7.7% to £1,053 million, an increase of 2.2% on a like for like basis revenue growth from existing customers being particularly strong in the fourth quarter. Trading margin and profit increased year on year due to increased trading activities. During the year the integration into our Spanish operations of the Farmacen and CERFC businesses acquired in 2005 was completed, with the closure of two depots common IT systems being introduced and administration centralised

Revenue in Portugal of £3 million was from our wholly owned pre-wholesale and contract logistics business

Other Commercial Activities & Corporate Costs

Revenue from Other Commercial Activities totalled £114 million a year on year increase of 29.5%

Within this, revenue from contract manufacturing for third party health and beauty brands, which utilises capacity in our three Health & Beauty manufacturing facilities increased by 36.5% to £86 million as a result of contract manufacturing for Reckitt Benckiser. Volumes manufactured for internal use increased by

nearly 30%. The profit contribution from contract manufacturing has been allocated to our Health & Beauty business in the UK, as in prior years

At the time of the £1.9 billion disposal of Boots Healthcare International in February 2006 Reckitt Benckiser entered into certain contract manufacturing arrangements with us. They have served notice of their intent to exit these arrangements at the beginning of 2008. To mitigate the impact of this decision on the efficiency of our manufacturing operations, we announced in March 2007 the need for around 300 redundancies in our Nottingham facility when the contract ends

Revenue from our own brand export business increased by 12.0% to £28 million, higher sales in North America from the opening of over 1,500 new "implants" (i.e. dedicated merchandising display units). In third party retailers being partially offset by lower sales in Asia. At 31 March 2007 we had 2,413 "implants", of which 1,689 were in North America. Trading losses from our own brand export business increased by £5 million to £8 million, as a result of losses in Asia and adverse US Dollar currency movements. In the second half of the year the business broke even at the trading profit level compared to a loss of £1 million in the second half of the previous year

A review of our own brand export business completed in the fourth quarter of our financial year concluded that its activities should be focused on our own international businesses and selected large export markets. Accordingly, we are in the process of withdrawing from a number of smaller export markets in Asia and Europe, which will result in a reduction of around 380 "implants"

Together the actions in respect of our manufacturing operations and own brand export business have resulted in exceptional charges before tax of £23 million

Corporate Costs which include unrealised profit in stock adjustments, increased year on year by £4 million to £39 million, due to higher unrealised profit in stock adjustments as our Health & Beauty business increased the amount of prescription medicines it buys from our UK wholesale business. Fixed corporate costs reduced as a result of merger synergies, these being largely offset by higher incentive payments. Fixed corporate costs are expected to reduce further as more synergies are realised

Pro forma financial results and performance review (continued)

Intra-group

Intra-group revenue totalled £1 094 million a year on year increase of £79 million of which £45 million resulted from higher sales from our UK wholesale business to our UK Health & Beauty retail business

Associates

Our share of associates' revenue increased year on year by 4.5% to £2 118 million. Our share of trading profit at £70 million reduced year on year by 1.4%, our share of adjusted earnings increasing by 4.5% to £49 million. Our results were adversely impacted by a 19% adverse change in the exchange rate used to translate Hedef Alliance's results from Turkish Lira into Sterling compared to the previous year. Hedef Alliance contributing over half our associate earnings.

On a constant currency basis, adjusting for changes in associate interests including Alliance Healthcare Portugal as an associate from the end of June 2005 like for like revenue increased by 6.6%, like for like trading profit by 6.9% and like for like earnings before exceptional items by 11.9%. Earnings benefited from an underlying tax rate on associates' earnings of 20.2% a year on year decrease of 7.7 percentage points which was mainly due to a reduction in the Turkish tax rate.

Hedef Alliance increased its trading profit year on year in local currency despite the more difficult economic climate in Turkey, its net finance costs increasing as a result of higher interest rates. Alliance Healthcare Portugal performed particularly strongly reflecting the benefits of the strategic partnership we entered into with the Portuguese national association of pharmacies in June 2005. We do not comment on the performance of Galenica in Switzerland and ANZAG in Germany as both associates are quoted companies which report their own results separately.

Underlying net finance costs

Underlying net finance costs (which exclude IAS 39 timing differences from hedging interest rate and currency exposures) were £42 million. This was £19 million lower than the comparable figure for the previous year, of which £9 million was due to higher net returns on our defined benefit pension schemes, partially as a result of additional contributions into the Boots Pension Scheme. The balance of the reduction was mainly

due to lower net borrowings following the disposal of Boots Healthcare International and related special dividend and the sale and leaseback of 312 retail outlets in July 2005, partially offset by higher Euro interest rates acquisition expenditure and interest costs which replace the fixed element of securitisation charged against trading profit up until the programmes were replaced by standard borrowings. Interest cover (which we define as trading profit divided by underlying net finance costs) was 15.3 times compared to 9.9 times in the previous year.

Net finance costs are expected to increase in the new financial year, partially due to higher interest rates and the full year impact of replacing the securitisation programmes.

Underlying tax

The underlying tax rate (which we define as the underlying tax charge (i.e. excluding tax on exceptional items, IAS 39 timing differences and exceptional tax credits), expressed as a percentage of trading profit net of underlying net finance costs), was 30.2%. This was 1.0 percentage points lower than in the previous year, mainly due to the impact of a reduction in the capital gains tax rate in France and the resolution of prior year issues.

Cash flow

Net cash generated by operations totalled £887 million. This included a net working capital inflow of £114 million of which around half was due to the factoring of receivables on a non recourse basis primarily in Italy, a £67 million decrease in provisions mainly comprising store refurbishment and system rationalisation in Boots, and a one-off Boots pension outflow of £43 million. The one-off pension outflow, which was in the first half of the year, was the second and final instalment of the £85 million additional contributions which Boots agreed to pay into the Boots Pension Scheme from the Boots Healthcare International disposal proceeds.

The net cash outflow on acquisitions and disposals of businesses and associates was £19 million. The principal cash expenditure was £38 million on the Cordia Healthcare wholesale acquisition in the UK and the acquisition of 41 retail outlets, 30 of which were pharmacies in the UK. This was partially offset by £58 million of cash proceeds from the 68 pharmacies sold before the year end under

the divestment programme agreed with the Office of Fair Trading.

Net cash capital expenditure was £236 million, of which £110 million was for growth and efficiency projects. Around 75% of the net expenditure was incurred in the UK in the Retail Division, the major area being our store investment programme.

Overall total cash inflow in the year was £297 million. This compared to an outflow of £1 232 million in the previous year, which included a special dividend of £1 426 million.

Financial position

At the year end net borrowings (defined as borrowings, net of cash and cash equivalents and derivative financial instruments) were £1,048 million and shareholders' equity was £5,760 million.

Retirement benefit obligations

The total charge before tax for retirement benefit obligations was £76 million which was in line with the previous year. This comprised £81 million of costs within trading profit, a year on year increase of £9 million, and net finance income of £5 million compared to a net finance expense in the previous year of £4 million.

The Group's total net retirement benefit obligations at 31 March 2007 on an accounting basis were £26 million before deferred tax. This comprised a net surplus of £20 million for the former Boots schemes and £46 million of net obligations for the former Alliance UniChem schemes.

The net surplus in the former Boots schemes arose due to the £43 million additional contribution payment made in the first half of the year and a 0.5 percentage point increase in the long-term bond yield used to discount estimates of future pension obligations, partially offset by an allowance for future improvements to longevity.

At the date of the merger, the net retirement benefit obligations for the former Alliance UniChem schemes were £78 million. The decrease in the net obligations since then arose due to additional contributions and a 0.3 percentage point increase in the long-term bond yield used to discount estimates of future retirement benefit obligations.

Additional pro forma financial information for continuing operations

Basis of preparation

The Group completed the acquisition of Alliance UniChem Plc on 31 July 2006. The statutory results for the Group for the year ended 31 March 2007 therefore include trading of the former Alliance UniChem Plc businesses for the period from 31 July 2006 to 31 March 2007.

To assist investors in understanding the performance of the Group, pro forma financial information has been prepared to show the results from continuing operations of the Group as if the two former groups had always been combined. This information has been prepared for the year ended 31 March 2007, with comparatives on the same basis for the year ended 31 March 2006. The pro forma revenue and profit statement for continuing operations has been prepared on an adjusted basis which means before exceptional items, amortisation of customer related intangible assets and IAS 39 timing differences all net of tax and deferred tax restatements for customer related intangible assets.

Pro forma combined Group revenue and adjusted profit statement for continuing operations for the year ended 31 March 2007

| | 2007 £million | 2006 £million |
|---|------------------|------------------|
| Revenue including share of associates' revenue | 16,726 | 16,123 |
| Less: share of associates' revenue | (2,118) | (2,027) |
| Revenue | 14,608 | 14,096 |
| Trading profit including share of associates' trading profit | 711 | 674 |
| Less: share of associates' trading profit | (70) | (71) |
| Trading profit | 641 | 603 |
| Share of associates' post tax earnings before exceptional items | 49 | 47 |
| | 690 | 650 |
| Underlying net finance costs | (42) | (61) |
| | 648 | 589 |
| Underlying tax | (181) | (169) |
| Adjusted profit for the year | 467 | 420 |
| Attributable to | | |
| Equity shareholders (adjusted earnings) | 467 | 419 |
| Minority interests | - | 1 |
| | 467 | 420 |
| Adjusted earnings per share | 48.7p | 43.7p |

Additional pro forma financial information for continuing operations (continued)

Pro forma combined Group adjusted segmental analysis for continuing operations – primary segments
for the year ended 31 March 2007

Group revenue and trading profit

| | 2007 £million | 2006 £million |
|---|------------------|------------------|
| Revenue | | |
| Retail | 6,579 | 6,312 |
| Wholesale | 9,009 | 8,711 |
| Other Commercial Activities | 114 | 88 |
| Intra-group | (1,094) | (1,015) |
| | 14,608 | 14,096 |
| Trading profit | | |
| Retail | 502 | 472 |
| Wholesale | 186 | 169 |
| Other Commercial Activities & Corporate Costs | (47) | (38) |
| | 641 | 603 |

Retail revenue and trading profit

| | 2007 £million | 2006 £million |
|-----------------------|------------------|------------------|
| Revenue | | |
| UK | | |
| Health & Beauty | 4,945 | 4,764 |
| Community Pharmacy | 1,011 | 967 |
| | 5,956 | 5,731 |
| International | | |
| Republic of Ireland | 155 | 142 |
| Norway | 267 | 259 |
| The Netherlands | 138 | 123 |
| Russia | 1 | – |
| Italy | 25 | 24 |
| Thailand | 37 | 33 |
| | 623 | 581 |
| | 6,579 | 6,312 |
| Trading profit | | |
| UK | 469 | 437 |
| International | 33 | 35 |
| | 502 | 472 |

Additional UK retail revenue analysis

| | 2007 £million | 2006 £million |
|---------------------|------------------|------------------|
| UK | | |
| Health | 3,089 | 2,941 |
| Beauty & Toiletries | 1,729 | 1,640 |
| Lifestyle | 1,138 | 1,150 |
| | 5,956 | 5,731 |

Pro forma combined Group adjusted segmental analysis for continuing operations – primary segments (continued)
for the year ended 31 March 2007

Wholesale revenue and trading profit

| | 2007 £million | 2006 £million |
|-----------------------|------------------|------------------|
| Revenue | | |
| Northern Europe | | |
| UK | 1,978 | 1 841 |
| Norway | 222 | 223 |
| The Netherlands | 702 | 681 |
| Russia | 195 | – |
| Czech Republic | 247 | 220 |
| | 3,344 | 2,965 |
| Southern Europe | | |
| France | 3,746 | 3 799 |
| Italy | 931 | 927 |
| Spain | 1,053 | 978 |
| Portugal | 3 | 94 |
| | 5,733 | 5 798 |
| Intra-segment | (68) | (52) |
| | 9,009 | 8 711 |
| Trading profit | | |
| Northern Europe | 108 | 94 |
| Southern Europe | 78 | 75 |
| | 186 | 169 |

Other Commercial Activities & Corporate Costs

| | 2007 £million | 2006 £million |
|-----------------------------|------------------|------------------|
| Revenue | | |
| Contract manufacturing | 86 | 63 |
| Own brand exports | 28 | 25 |
| | 114 | 88 |
| Trading loss | | |
| Other Commercial Activities | (8) | (3) |
| Corporate Costs | (39) | (35) |
| | (47) | (38) |

Additional pro forma financial information for continuing operations (continued)

Pro forma combined Group adjusted cash flow for continuing operations for the year ended 31 March 2007

| | 2007 £million | 2006 £million |
|------------------------------------|------------------|------------------|
| Cash generated by operations | 887 | 770 |
| Tax and interest | (131) | (183) |
| Dividends (net) | (225) | (1,671) |
| Acquisitions and disposals | (19) | (90) |
| Capital expenditure | (236) | (266) |
| Fixed asset disposal proceeds | 20 | 317 |
| Other investments (net) | 9 | (40) |
| Other | (8) | (69) |
| Total cash inflow/(outflow) | 297 | (1,232) |

The pro forma combined cash flow excludes cash outflows related to the merger which comprise capitalised transaction costs and costs in relation to merger synergies

Key reconciliations between pro forma and statutory financial results
for the year ended 31 March 2007

| | 2007 £million | 2006 £million |
|---|------------------|------------------|
| Revenue – continuing operations | | |
| Pro forma revenue | 14,608 | 14,096 |
| Relating to pre acquisition | (3,106) | (9,069) |
| Statutory revenue | 11,502 | 5,027 |
| | | |
| | 2007 £million | 2006 £million |
| Trading profit/profit from operations – continuing operations | | |
| Pro forma trading profit | 641 | 603 |
| Relating to pre acquisition | (92) | (267) |
| | 549 | 336 |
| Exceptional items | (77) | 33 |
| Amortisation of customer related intangible assets | (31) | – |
| | 441 | 369 |
| Share of associates' post tax earnings | 39 | – |
| Statutory profit from operations | 480 | 369 |
| | | |
| | 2007 £million | 2006 £million |
| Earnings/profit attributable to equity shareholders | | |
| Pro forma adjusted earnings – continuing operations | 467 | 419 |
| Relating to pre acquisition | (69) | (199) |
| | 398 | 220 |
| Exceptional items | (77) | 33 |
| Amortisation of customer related intangible assets | (31) | – |
| Share of associates' exceptional post tax earnings | 6 | – |
| IAS 39 timing differences | 1 | – |
| Tax credit on restatement of deferred tax for customer related intangible assets | 6 | – |
| Tax on exceptional items amortisation of customer related intangible assets and IAS 39 timing differences | 35 | 39 |
| Other exceptional tax credits | 28 | 12 |
| | 366 | 304 |
| Discontinued operations | 21 | 1,470 |
| Statutory profit for the year attributable to equity shareholders | 387 | 1,774 |

Financial review – statutory basis

Alliance Boots was created on 31 July 2006 through the merger of Alliance UniChem Plc and Boots Group PLC. The merger took place by way of a scheme of arrangement, Alliance UniChem Plc shares being cancelled, its shareholders receiving 1 332 shares in Boots Group PLC for each Alliance UniChem Plc share held. For statutory accounting purposes the merger has been accounted for as an acquisition of Alliance UniChem Plc by Boots Group PLC. On completion of the transaction Boots Group PLC was renamed Alliance Boots plc.

Accounting policies

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU as they apply to the financial statements of the Group for the year ended 31 March 2007. The principal accounting policies applied in the preparation of these consolidated financial statements are set in note 2 of the notes to the financial statements.

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts in the financial statements. The areas involving a higher degree of judgment or complexity or where assumptions or estimates are significant to the financial statements are disclosed in note 40 to the financial statements.

Financial results

The statutory financial results for the year ended 31 March 2007 contain a full year of results for the former Boots Group PLC businesses and

eight months of results for the former Alliance UniChem Plc businesses on an acquisition accounting basis.

Profit from continuing operations was £480 million, compared to £369 million in the previous year. Within profit from continuing operations was a net £77 million of exceptional costs before tax and a £31 million charge for the amortisation of customer related intangible assets following the 31 July 2006 fair valuation of the consolidated assets of Alliance UniChem Plc. This compares with £33 million of net exceptional income before tax in the previous year. Net finance costs were £25 million compared to £20 million in the previous year. Total profit for the year attributable to equity shareholders including profit after tax from discontinued operations was £387 million compared to £1 774 million in the prior year which included profit after tax from discontinued operations of £1 470 million. Total basic earnings per share were 48.4 pence compared to 259.4 pence. Basic earnings per share from continuing operations were 45.8 pence compared to 44.4 pence.

Dividends

The Board did not declare a normal interim dividend, instead paying a merger dividend of 10.0 pence per share on 3 October 2006 covering the period from the beginning of the financial year up until the merger on 31 July 2006.

The Board would ordinarily be recommending in the normal course of business a final dividend covering the period from 31 July 2006 until 31 March 2007. However, the terms of the recommended offer for the Company by AB Acquisitions Limited announced on 20 April 2007, are such that the offer price is inclusive of any final dividend. Accordingly, no such final dividend will be paid. However, if the Company is not acquired by AB Acquisitions Limited (or any alternative offeror) the Board intends that the Company pay in due course an interim dividend, in respect of the year ended 31 March 2007, of an amount equal to the final dividend that would have been paid.

Exceptional items

Exceptional items in the year were as follows

| | Retail £million | Wholesale £million | Other Commercial Activities & Corporate Costs £million | Total £million |
|---|--------------------|-----------------------|---|-------------------|
| Costs in relation to merger synergies | (17) | (1) | (5) | (23) |
| Pharmacy systems harmonisation | (2) | – | – | (2) |
| Systems rationalisation and supply chain reconfiguration | (25) | – | – | (25) |
| French wholesale network restructuring | – | (10) | – | (10) |
| Restructuring of Other Commercial Activities | – | – | (23) | (23) |
| Health & Beauty pharmacy disposals | 7 | – | – | 7 |
| Other | – | (1) | – | (1) |
| Net exceptional costs within profit from operations before share of associates' post tax earnings | (37) | (12) | (28) | (77) |
| Net exceptional income within share of associates' post tax earnings | | | | 6 |
| Net exceptional costs within profit from operations | | | | (71) |
| Related tax credits | | | | 26 |
| Other exceptional tax credits ¹ | | | | 28 |
| | | | | (17) |

¹ Other exceptional tax credits comprised a deferred tax release of £14 million in respect of pharmacy disposals where the taxable gains arising are covered by previously unrecognised losses and a release of £14 million of tax provisions in respect of exceptional items recognised in prior years

Net finance costs

Net finance costs were £25 million which was £5 million higher than the figure for the previous year. The increase was due to higher average indebtedness reflecting the cost of servicing net borrowings arising from the acquisition of Alliance UniChem and additional contributions to the Boots Pension Scheme, partially offset by the retained proceeds from the disposal of Boots Healthcare International, the sale and leaseback of 312 retail outlets in July 2005 and the benefit from £9 million of higher net returns on our defined benefit pension schemes, part of which was as a result of additional contributions into the Boots Pension Scheme.

Net finance costs are expected to increase in the new financial year, partially due to higher interest rates and the full year impact of the absorbed merger debt and replacement of the securitisation programmes.

Tax

The tax rate, which we define as the tax charge expressed as a percentage of profit from operations before share of associates' post tax earnings, net of net finance costs, was 21.4%. This compares to a rate of 12.9% in the previous year. The increase in the rate was mainly due to the utilisation in the previous year of previously unrecognised losses to shelter the profit on a sale and leaseback transaction, and also a release of a deferred tax liability no longer required following this transaction.

In the current year the effective tax rate is lower than the expected rate of 29.8% mainly as a result of the recognition of previously unrecognised tax losses, the utilisation of previously unrecognised capital losses and the release of provisions no longer required.

Financial review – statutory basis (continued)

Cash flow

| | 2007 £million | 2006 £million |
|--|------------------|------------------|
| Cash generated from operations – continuing operations | 682 | 501 |
| Tax and interest | (90) | (89) |
| Dividends (net) | (182) | (1,640) |
| Acquisitions and disposals | (1,354) | – |
| Purchase of property, plant and equipment and intangible assets | (213) | (181) |
| Disposal of property, plant and equipment | 18 | 308 |
| Other | (12) | (74) |
| Net cash outflow from continuing operations | (1,151) | (1,175) |
| Net cash inflow from discontinued operations | – | 59 |
| Cash flows arising from disposal of discontinued operations | (13) | 1,854 |
| Total cash (outflow)/inflow | (1,164) | 738 |
| Currency translation differences and fair value adjustments on financial instruments | 16 | 3 |
| (Increase)/decrease in net (borrowings)/cash in the year | (1,148) | 741 |
| Net cash/(borrowings) at 1 April | 100 | (641) |
| Net (borrowings)/cash at 31 March | (1,048) | 100 |

Net cash generated from continuing operations totalled £682 million. This included a net working capital inflow including provisions of £25 million and a one-off Boots pensions outflow of £43 million. The one-off pension outflow, which was in the first half of the year, was the second and final instalment of the £85 million additional contributions which Boots agreed to pay into the Boots Pension Scheme from the Boots Healthcare International disposal proceeds.

The net cash outflow on dividends was £182 million which included the dividends for the periods up until the merger on 31 July 2006 paid to the respective shareholders of both former groups and was net of the dividends received from associates. The previous year outflow was £1,640 million, which included a special dividend of £1,426 million from the proceeds of the Boots Healthcare International disposal.

The net cash outflow on acquisitions and disposals was £1,354 million. The principal cash outflows were on the acquisition of Alliance UniChem where net borrowings at acquisition were £1,312 million, expenditure of £38 million on the Cordia Healthcare wholesale acquisition in the UK and the acquisition of retail outlets. This was partially offset by £58 million of cash proceeds from the 68 pharmacies sold before the year end under the divestment programme agreed with the Office of Fair Trading.

The cash outflow on the purchase of property, plant and equipment was £213 million compared to £181 million in the previous year. Proceeds from the disposal of property, plant and equipment were £18 million compared to £308 million in the previous year which included the sale and leaseback of 312 stores.

Overall, total cash outflow from continuing operations in the year was £1,151 million.

Shareholders' equity

Shareholders' equity at 31 March 2007 totalled £5,760 million, a year on year increase of £4,108 million. £3,820 million of the increase arose on the acquisition of Alliance UniChem Plc as the net shares issued and to be issued were recorded at fair value. Profits for the year increased equity by £387 million, which was partially offset by dividends declared to equity shareholders of £149 million.

Financial position

At the year end net borrowings (defined as borrowings, net of cash and cash equivalents and derivative financial instruments) were £1,048 million which compared to net cash (defined in the same way as net borrowings) at the beginning of the year of £100 million.

Borrowings were raised under privately placed notes, a medium term note programme, finance leases and under bank facilities. Of gross borrowings, £565 million matures within 12 months, £94 million in the year ended 31 March

2009 and £670 million thereafter. The Group does not have a prescribed maturity profile for its longer term borrowings but manages its refinancing risk by limiting the level of maturities within a 12 month period.

Capital structure

Our policy as a publicly listed Company is to have a strong balance sheet and maintain an investment grade credit rating, providing a robust financial framework from which to grow our business. As at 31 March 2007, the Group had long term investment grade ratings from Standard and Poor's of BBB and from Moody's of Baa2, these being determined after the resolution of the credit watches imposed by the agencies on announcement of the merger with Alliance UniChem. Following the approach made by Kohlberg Kravis Roberts & Co. L.P. and Stefano Pessina in March 2007 to make an offer for the Company, Standard and Poor's placed its rating on CreditWatch Negative and Moody's under review for possible downgrade.

We finance our operations through mixture of retained profits, capital markets funding, bank borrowings and leases. The objective is to ensure that the Group has access to liquidity at all times and can fund in a cost-effective manner.

When considering appropriate debt levels for the Group, we take into account both the level of unfunded pension liabilities and ongoing operating lease commitments.

Operating lease commitments

In common with UK retailers the Group has long term obligations to pay rents under property leases. This means that the period over which operating lease commitments extend falls beyond 30 years in some cases. Minimum operating lease commitments over this timeframe as at 31 March 2007 were

| £million | 0-1 years | 1-5 years | 5-10 years | 10-20 years | 20-30 years | 30+ years |
|----------|-----------|-----------|------------|-------------|-------------|-----------|
| Property | 240 | 849 | 698 | 420 | 68 | 94 |
| Other | 6 | 9 | — | — | — | — |

The capitalised value of these liabilities is approximately £1.4 billion based upon discounting the rentals, after taking into account assumed property rental growth of 2.5% per annum at the Group's estimated long term cost of borrowing. The Group, in common with the credit rating agencies, treats its lease liabilities as borrowings when evaluating financial risk and investment returns.

Treasury policies

The Group's treasury policies were approved by the Board on 26 April 2007. Prior to that date the policies previously approved by the Boards of Boots Group and Alliance UniChem, which were broadly consistent, were applied.

Treasury has responsibility for the Group's funding and cash management and manages the Group's financial counterparty credit, interest rate and currency risks. It enters into financial instruments solely for the purpose of managing these risks. It does not act as a profit centre and the undertaking of speculative transactions is not permitted.

Treasury risk management activities (principally foreign exchange and interest rate risk) will be undertaken to protect the economic value of the Group. Where possible, the Group seeks to apply hedge accounting to financial instruments transacted for the purpose of hedging underlying exposures. However, the practical application of IAS 39 means that, in some circumstances, timing differences in the recognition of financial instruments are recorded in the Group Income statement. These unwind over the life of the instruments.

Liquidity and funding

Access to cost-effective funding is managed by maintaining a range of committed and uncommitted facilities sufficient to meet unanticipated needs, arranging funding ahead of requirements, developing diversified sources

of funding and maintaining good access to the capital markets through an investment grade credit rating.

Group liquidity is optimised through cash pooling and deposits with or loans from Group treasury companies. Surplus cash is invested for periods of three months or less.

During the year, the Group financed its borrowing needs from the bank market, existing issues under its Euro Medium Term Note programme and private placements of notes. In limited circumstances the Group has also used factoring to finance local activities.

The policy is to spread maturity of debt such that annual refinancing of term debt is limited to £300 million and to maintain a buffer of committed facilities in excess of the Group's projected peak net indebtedness. At 31 March 2007, the Group had undrawn committed facilities of £875 million under a syndicated committed facility which matures in August 2011.

During the year, a £1.1 billion revolving credit facility was arranged to replace Boots Group's £600 million syndicated facility agreement and two Alliance UniChem revolving credit facilities of €390 million and €435 million respectively which were cancelled on completion of the merger.

This merger facility was subsequently replaced in August 2006 with an £875 million five-year credit facility and a £225 million one-year facility. This latter facility was cancelled in December 2006 and as at 31 March 2007, only the £875 million facility maturing in August 2011, remained.

At 31 March 2007, the Group was in compliance with the financial covenants included in its borrowing agreements.

The Group's net borrowings vary throughout the year in a predictable seasonal pattern. In particular, net borrowings peak in the period September to December due to the working capital requirements of Christmas trading. The increase in borrowing at this time is met through drawing committed and uncommitted facilities or by reducing surplus cash.

Interest rate risk management

The Group's policy is to maintain levels of interest cover that are commensurate with a BBB/Baa2 investment grade debt rating.

The Board's policy is to limit the impact of interest rate volatility on profits. The policy fixes the interest cost (either directly through fixed coupons or synthetically through the use of interest rate swaps) on that proportion of the total of the Group's average projected net borrowings including any financing linked to securitisation that will give a minimum 95% statistically significant confidence level that the Group's key financial metrics (as defined in its borrowing agreements or as published by the rating agencies from time to time) will be met over a three year forward period. This is determined using Monte Carlo simulation techniques, taking into account the Group's three year business plans, forward interest rates and implicit volatility derived from options pricing. The simulation model determines the minimum amount of the total of net borrowings that is to be fixed, but this can be increased to protect profits.

At 31 March 2007, after taking account of cross-currency and interest rate swaps, 31% of the total of the Group's net borrowings was fixed.

Based on the net borrowing and hedging position of the Group at 31 March 2007, and assuming no changes, a 1% increase in interest rates would increase the annual interest charge by £7 million.

Financial review – statutory basis (continued)

Currency risk management

The Group owns significant businesses and investments in continental Europe which cause a translation exposure on consolidation of their earnings statements and balance sheets. The Group partially hedges these translation exposures with borrowings denominated in the same currency either directly or through the use of cross currency swaps.

At 31 March 2007 £1 183 million of the total of the Group's net borrowings and related currency swaps was in Euros. Since overall Group borrowings were below that level at that point in time, this resulted in a Sterling net investment position.

The Group has a policy of hedging material foreign currency denominated transaction exposures other than those offset by corresponding translation exposures, by entering into forward foreign exchange sale and purchase contracts where such exposures arise.

Based on the hedging position and currency mix of earnings of the Group at 31 March 2007, movements in exchange rates relative to Sterling would not have a significant impact on the Group's earnings.

Counterparty risk

The Group seeks to protect itself against financial loss arising from failure of financial counterparties to repay cash when due or honour settlements on derivative contracts by spreading financial transactions including bank deposits, across an approved list of high quality banks and AAA credit rated money market funds. Limits are established for each counterparty based on their credit rating and regularly monitored.

Retirement benefit obligations

The total charge before tax for continuing operations retirement benefit obligations was £72 million, which was a decrease of £1 million compared to the previous year. This comprised £77 million of costs within profit from operations, a year on year increase of £8 million, and net finance income of £5 million compared to a net finance cost in the previous year of £4 million.

The Group's total net retirement benefit obligations at 31 March 2007 on an accounting basis were £26 million before deferred tax. This comprised a net surplus of £20 million for the former Boots schemes and £46 million of net obligations for the former Alliance UniChem schemes.

The principal Boots scheme is the Boots Pension Scheme. This scheme, which is closed to new members, has continued with its investment strategy of planning to hold 15% of assets in equity and property to back long-term liabilities and 85% of assets in a diverse portfolio of high quality bonds to match liabilities up to 35 years. The overall asset allocation provides a relatively good hedge against liabilities on an actuarial basis and an accounting IAS 19 basis. In March 2006 and April 2006 respectively, the Group made contributions totalling £85 million to the scheme from the Boots Healthcare International disposal proceeds. These supplement the additional contributions (over and above the normal rate) of £12 million per year over 10 years agreed at the last full actuarial valuation in April 2004. The net surplus in the former Boots schemes arose due to the additional contribution payments made and a 0.5 percentage point increase in the long term bond yield used to discount estimates of future pension obligations, partially offset by an allowance for future improvements to longevity. During the new financial year the Boots Pension Scheme will undergo a full actuarial valuation as at April 2007.

The principal Alliance UniChem scheme is the Alliance UniChem UK Group Pension Scheme. This scheme, which is closed to new members, has an investment strategy of planning to hold 70% of assets in equities and 30% in high quality bonds and property. The Group has agreed to make additional annual contributions (over and above the normal rate) of £12 million for each of the years from 2007 to 2011 inclusive. At the date of the merger, the net retirement benefit obligations for all of the former Alliance UniChem schemes were £78 million. The decrease in the net obligations since then arose due to additional contributions and a 0.3 percentage point increase in the long term bond yield used to discount estimates of future retirement benefit obligations.

Share price

The mid-market price of the Company's shares ranged during the year from a low of 685.5 pence on 18 April 2006 to a high of 1036.5 pence on 23 March 2007. On 31 March 2007 the mid market price was 1026.5 pence, giving a market capitalisation of approximately £9.9 billion.

Financial reporting

The Directors have acknowledged their responsibilities in relation to the financial statements in the Directors' responsibilities statement. The Directors are also responsible for the publication of unaudited interim reports of the Group that provide balanced and understandable assessments of the Group's financial position for the first six months of each accounting period.

Corporate responsibility

A shared sense of responsibility

Merging two very large groups presents major challenges and opportunities. In terms of corporate social responsibility (CSR), the biggest of these has been to support the integration of the Group by developing a new framework and practical policies that can be applied consistently across Alliance Boots, engaging all our people.

So we're delighted to report that in 2006/07 we've made excellent progress, having developed and agreed a new unified CSR strategy which will be implemented this year to come into full effect across the entire Group in April 2008.

But as you'll see overleaf, while much of our energy over the past year has been devoted to planning for the future, a shared sense of responsibility within Alliance Boots is already strongly in evidence. In fact, as far as CSR is concerned, it's been very much business as usual.

The challenge of sustainable business

These days, it's easier than ever before to justify the importance of CSR for modern businesses. Increasingly widespread concern about the impact of climate change and other major social trends, such as the rise of the "ethical consumer", have combined to bring the concept of sustainability into the mainstream.

As a result, the best managed companies have come to see CSR not just as a social duty, or legal obligation, but as an important means of gaining both competitive advantage and valuable operational benefits (Reducing energy consumption, for example, is as good for the bottom line as it is for the environment.)

For Alliance Boots, then, the need to be recognised as a leader in sustainable business is clear. And, following the merger, we set ourselves the challenge of achieving that in 2008.

Developing an adaptive approach

From our consultation with stakeholders, the nature of the challenge facing us became even clearer. Our new cross business CSR approach would need to be based upon a consistent framework, capable of accommodating the widely varying levels of achievement across our two divisions, and of taking account of different social, environmental and economic priorities in each country where Alliance Boots operates.

As our starting-point, we took the CSR structure successfully developed by Boots over the last three years. This defines four main areas in which we have responsibilities: Marketplace, Community, Environment and Workplace.

To make this applicable throughout Alliance Boots, we identified a key unifying theme – our highest priority – in each of the four main areas, as the diagram on page 37 shows. Crucially, these all support our broader aim of building a truly sustainable 21st century business. And, no less important, they reflect the reality of our business as it is today.

Delivering our unified strategy

We're delighted with the progress we've made during 2006/07 in laying the foundations for a new unified Alliance Boots CSR strategy that will play a key role in driving our business forward. And now comes the challenge of embedding it throughout the business, in time to go live in April 2008.

To this end, we've devised a new support structure, which will ensure that the very considerable expertise and understanding within the Group is shared freely throughout Alliance Boots.

In our Wholesale Division, for example, a senior director from each country, assisted by a fully trained CSR Champion, will lead a team responsible for developing a detailed action plan for implementation in 2008. This will then be presented to our central CSR Action Group for approval, following which each country will generate appropriate KPIs for independent validation early in 2008.

A consistent approach to measuring and reporting

Over the last three years, Boots has developed its own bespoke CSR database, working with credit360, which has been used with great success. Having reviewed our new, more extensive data capture requirements, we've concluded that this system is ideally suited for use throughout the Group, enabling a consistent company-wide framework for measuring and reporting on our performance. CSR Champions throughout the business will, therefore, be introduced to the CSR database, as an important part of their training.

Next steps to sustainable success

We're excited about what we've achieved over the last 12 months. We've reaffirmed our belief that CSR has a crucial part to play in helping Alliance Boots achieve its strategic objective of becoming the world's leading pharmacy-led health and beauty group. We've defined precisely what we want to achieve: recognition for Alliance Boots as a leader in CSR from 2008 onwards. And, while there's still a long journey ahead, we've mapped out the route which we're confident will take us forward successfully on that journey.

Corporate responsibility (continued)

Acting responsibly business as usual

During 2006/07, our main strategic focus has been on developing the role of Corporate Social Responsibility within Alliance Boots

But, of course that doesn't mean we've put CSR on hold over the past 12 months. Throughout the Group, we've continued to pursue with dedication and enthusiasm the many and varied activities which reflect our commitment to doing business responsibly, and help to build the trust upon which our continuing success depends.

Here are just a few of our proudest achievements in 2006/07 together with some of our revised targets for the current year.

Marketplace

In a highly competitive environment, we believe it's crucial to our success that Alliance Boots is trusted by customers – both the general shopping public and the pharmacists whose businesses our wholesale network supports. So **stewardship and integrity** must be evident in everything we do, from product safety, through supply chain management, to the relationships we build with partners and suppliers.

Packaging safer dispensing Helping thousands of independent pharmacists throughout Europe to serve their customers better is a very high priority. And one of our most successful recent advances is significantly improving the safe dispensing of prescriptions. The secret? Our Almus range of generic medicines features innovative colour-coded packaging, greatly reducing the chances of dispensing mishaps.

Breast Cancer Care Forming close relationships with leading charities has played a major part in establishing Boots' reputation as a trusted healthcare adviser, none more so than our partnership with the UK's leading breast cancer charity. In its 10th year, we raised over £800,000 for Breast Cancer Care, a new record figure. We also helped to promote greater awareness of breast care through our innovative "41 000 faces" campaign, which created a unique online showcase for photos of some of the 41,000 people diagnosed with the disease each year (www.41000faces.org.uk).

Targets for 2007/08

- Review shareholder communications to ensure they reflect our mission, purpose and values
- Work with leading charities to raise awareness of key health concerns among our customers
- Introduce a Code of Conduct to all our employees

Community

Wherever we do business, we believe Alliance Boots should be seen to make a significant contribution to community healthcare. Most obviously, we achieve that through our network of community pharmacies, but, more widely still, we want to encourage all our employees to share their expertise to help people lead healthier lifestyles and to build happier, more cohesive communities.

Change One Thing Repeating a major success for Boots in 2005/06, our New Year campaign to help customers achieve a single health-related goal made a welcome return. With our expert advice, a further 500,000 customers committed to stop smoking, and many thousands more set themselves targets for weight loss or improved fitness this year, a really valuable contribution to community health and wellbeing. Not all succeeded with their aims, but for those that did, it has made a huge difference to health and wellbeing.

In our Community Pharmacy business, we once again helped to take important health education out into the community by sponsoring the Macmillan Mobile Cancer Information Unit's 2006 countrywide tour.

Volunteering to make a difference We strongly encourage our people to get out into the community and get involved in something positive. In our Community Pharmacy business in the UK, for example, we introduced a new Volunteering Challenge for our pre-registration pharmacy graduates – asking them to work in regional teams, as part of their training. Meanwhile, in our Health and Beauty business in the UK, we've been developing our first ever national volunteering programme, Healthy Communities, which will offer the people who work in our stores a menu of volunteering opportunities.

Targets for 2007/08

- Increase community health activity that makes a positive contribution to the wider public health agenda and is aligned to our business priorities
- Increase customer and employee fund raising for our key charity partners
- Set up payroll giving schemes in our corporate office, UK retail and wholesale businesses

Environment

For Alliance Boots, continuously improving our carbon management is clearly our highest environmental priority. Because nowhere is the connection between what's good for the environment and what's good for our business more apparent. In virtually everything we do, from developing new products to heating and lighting our stores, reducing carbon emissions can potentially deliver significant cost savings – and, in many cases, is already doing so.

More energy-efficient stores Since 2002, our Health & Beauty business in the UK has been working with the Carbon Trust to improve the energy efficiency of all its stores, with resulting annual savings of around 10,000 tonnes of carbon dioxide and £1.35 million. Over the last year, our Community Pharmacy business in the UK has followed suit – and, at the time of writing, is awaiting a detailed report on how best to achieve energy efficiencies both through improved store design and educating branch teams.

Products for the 'low carbon consumer'

We've recently completed a flagship project to assess and minimise the carbon footprint of two shampoos in the Boots Botanics range. By analysing every aspect of the product life-cycle from raw material production through to customer use and ultimate disposal, we are now able to target specific opportunities to deliver the best reduction in the carbon footprint of both products. We have already implemented initiatives that have reduced their carbon footprint by 20%. We strongly believe low carbon products like this will enable us to achieve real cost savings while taking a valuable share of a potentially exciting new market segment.

On the road to lower emissions In recent years, we've significantly improved the efficiency of the Boots supply chain and updated our vehicle fleet, and we continued to make good progress in this important area in 2006/07.

By taking measures such as expanding our double deck trailer fleet from 16 to 41 vehicles and collecting goods ourselves from our suppliers, we've made additional annual savings of around 8.5 million road kilometers – further reducing carbon emissions by 5% and cutting fuel costs by £1.4 million.

Targets for 2007/08

- In line with national and international commitments on climate change, we will establish a long-term corporate strategy to reduce the carbon intensity of our businesses, including our products, services and buildings.
- We will continue to reduce waste at source and work towards zero waste to landfill, setting appropriate targets within each business and reporting annual progress.
- We will continue to reduce like for like own brand packaging by 2.5% each year until 2010, in line with our UK Government "Courtauld Commitment".

Workplace

For any well managed business, **employee wellbeing** must be a priority. But for Alliance Boots – a Group concerned with making the world a happier, healthier, more beautiful place – it would be hard to exaggerate the importance of looking after our people as well as we possibly can. And from helping with any problems to setting the highest health and safety standards, that's precisely what we do.

Someone to talk to In 2006/07, our Community Pharmacy business formed a partnership with Retail Trust, a charity providing help and support to people working in the retail industry and their families. It's a free and completely confidential service, with a helpline open seven days a week, providing independent advice and information on virtually any issue or problem – work-related or personal. Meanwhile within our Health & Beauty business, a similar service is provided by BootsHelp, which received around 7,164 calls in 2006/07 and carried out 1,882 counselling appointments.

A healthier place to work During 2006/07, the Boots Healthy Workplace team has been hard at work embedding health promotion activity into the way we do business. To give our healthy workplace initiative a major boost, we tied it into our customer-facing "Change One Thing" campaign. All our Health & Beauty employees received a free pack including a pedometer, a healthy snack and a chance to sign up to a programme to receive extra support to give up smoking, or get fitter. And over 1,000 employees signed up for a healthier future.

Targets for 2007/08

- Establish a long term, cross-group health and safety strategy to prevent accidents and report progress annually.
- Deliver a workplace health programme that is aligned to the business and makes a positive contribution to the health and wellbeing of our people.
- Introduce an induction day for new joiners across the Group.



Board of Directors

Sir Nigel Rudd

Non-executive Chairman, 60

Was appointed to the Board in December 1999 as a non-executive director, became Deputy Chairman in December 2001 and Chairman in September 2003. He is also Chairman of Pendragon, Deputy Chairman of Barclays, a non-executive director of BAE Systems and Chairman of the Boardroom Issues Group of the CBI. Sir Nigel was previously Executive Chairman of Williams for nearly 20 years and is a chartered accountant.

Stefano Pessina

Executive Deputy Chairman, 65

Was appointed to the Board on 31 July 2006 having been Executive Deputy Chairman of Alliance UniChem with responsibility for strategic development including acquisitions and previously Chief Executive for three years until December 2004. He was appointed to the Alliance UniChem board in 1997 when UniChem merged with Alliance Sante the Franco-Italian pharmaceutical wholesale group which he established in Italy in 1977. Stefano is an engineer by profession.

Richard Baker

Chief Executive, 44

Was appointed to the Board when he joined the Company as Chief Executive in September 2003. Before that he was Chief Operating Officer and Group Marketing Officer at ASDA. Prior to joining ASDA he worked for Mars where he held a number of senior management positions.

George Fairweather

Group Finance Director, 49

Was appointed to the Board on 31 July 2006 having been Group Finance Director of Alliance UniChem since 2002. Before that he held similar positions with Elementis and Dawson International and also worked for Dixons Group, Procter & Gamble and KPMG Thomson McLintock. George is non-executive director of Mitchells & Butlers. He is a member of the Institute of Chartered Accountants of Scotland.

Ornella Barra

Wholesale & Commercial Affairs Director, 53

Was appointed to the Board on 31 July 2006 having been an Executive Director of Alliance UniChem with wholesale and commercial affairs responsibilities since 1997 when Alliance Sante became part of Alliance UniChem. Before that, she was a Director of Alliance Sante and General Manager of Alleanza Salute Italia. She is a pharmacist by profession.

Steve Duncan

Community Pharmacy Director, 56

Was appointed to the Board on 31 July 2006 having been the Executive Director of Alliance UniChem responsible for its retail division since September 2001. Steve was previously Managing Director of Alliance Pharmacy having joined the business in 1974. He is a pharmacist and a member of the Royal Pharmaceutical Society of Great Britain.

Scott Wheway

Health & Beauty Retail Director, 40

Was appointed to the Board on 31 July 2006 having previously held the position of Retail Director at Boots The Chemists since joining Boots in January 2005. Before this he was CEO of Tesco Japan having previously held a number of senior management positions with Tesco in the UK originally starting as a management trainee in 1985.

Guy Dawson

Senior Independent non-executive Director, 54

Was appointed to the Board in September 2003. He is senior independent non-executive director chairman of the audit committee and a member of the nomination and social responsibilities committees. Guy is a founding partner of Tricorn Partners, an independent corporate finance advisory business and a non-executive director of The BOC Group. He has previously held senior investment banking positions at Merrill Lynch and Deutsche Bank.

Adrian Loader

Independent non-executive Director, 58

Was appointed to the Board on 31 July 2006 having been an independent non-executive director of Alliance UniChem since September 2003. He is a member of the audit and remuneration committees. Adrian is Director of Strategy and Business Development at Royal Dutch Shell. Chairman of the supervisory board of Deutsche Shell, having previously held a number of other senior management positions within Royal Dutch Shell. He is a Fellow of the Chartered Institute of Personnel and Development.

Tim Parker

Independent non-executive Director, 51

Was appointed to the Board in January 2004. He is chairman of the remuneration committee and a member of the nominations committee. Tim is chief executive of the Automobile Association and a non-executive Director of Compass Group. He was previously chief executive of Kwik-Fit and C & J Clark. Before that, he led the management buy-out and flotation of Kenwood Appliances.

Helene Ploix

Independent non-executive Director, 62

Was appointed to the Board in September 2000 and is chairman of the social responsibilities committee and a member of the audit and remuneration committees. Helene is Chairman of Pechel Industries Partenaires, a private equity investment management company. She is also a non-executive director of BNP Paribas, Ferring, Lafarge and Publicis Groupe.

Patrick Ponsolle

Independent non-executive Director, 62

Was appointed to the Board on 31 July 2006 having been an independent non-executive director of Alliance UniChem since December 1997. He is chairman of the nominations committee and a member of the audit committee. Patrick is Vice Chairman of Morgan Stanley International and chairman of Morgan Stanley (France). Before that, he was executive chairman of Eurotunnel.

Manfred Stach

Independent non-executive Director, 64

Was appointed to the Board on 31 July 2006 having been an independent non-executive director of Alliance UniChem since December 2003. He is a member of the remuneration, nominations and social responsibilities committees. Manfred is head of the supervisory board of Unilever Deutschland, chairman of the supervisory board of Unilever Austria and a member of the supervisory boards of British American Tobacco (BAT) Germany and Neumann Coffee Group. Manfred was president of Unilever Bestfoods Europe until June 2005, having previously held a number of other senior management positions within Unilever.

Directors' report

The Directors present their report and audited financial statements for the year ended 31 March 2007. For the purposes of this report, "Company" means Alliance Boots plc and "Group" means the Company, its subsidiaries and associates.

Principal activities, business review and development

The Company is the holding company for the Group. The principal activity of the Group is pharmacy-led health & beauty retailing, wholesaling, distribution and related services which it undertakes on an international basis.

A review of Group activities during the year and likely future developments and the principal risks and uncertainties facing the business are set out in the risk management, performance review and financial review on pages 10 to 34.

The Group carries out research and product development to support existing activities and to ensure the adoption of best practice in business processes used throughout the Group.

The Company acquired Alliance UniChem Plc ("Alliance UniChem") on 31 July 2006 and changed its name to Alliance Boots plc from Boots Group PLC on the same date. This process is, for the purposes of this report, defined as a "merger". The merger took place by way of a scheme of arrangement, whereby Alliance UniChem shares were cancelled and its shareholders received 1,332 shares in the Company for each Alliance UniChem share held. For the purposes of this report, "enlarged Group" means the combined businesses of the Company and Alliance UniChem Plc and its subsidiaries and associates.

The principal subsidiary undertakings and associates of the Group at 31 March 2007 are listed in note 39 to the financial statements.

Results and dividend

The Group profit for the year attributable to equity shareholders was £387 million (2006 £1,774 million).

The Board did not declare an interim dividend as dividends for the periods up until the merger on 31 July 2006 were paid to the respective shareholders of both former companies on 3 October 2006.

The Board would ordinarily be recommending in the normal course of business a final dividend

covering the period from 31 July 2006 until 31 March 2007. However, the terms of the recommended offer for the Company by AB Acquisitions Limited, announced on 20 April 2007, are such that the offer price is inclusive of any final dividend. Accordingly, no such final dividend will be paid. However, if the Company is not acquired by AB Acquisitions Limited (or any alternative offeror), the Board intends that the Company pay in due course an interim dividend. In respect of the year ended 31 March 2007, of an amount equal to the final dividend that would have been paid.

Directors

The Directors of the Company as at 31 March 2007 were Sir Nigel Rudd (Chairman), Stefano Pessina (Executive Deputy Chairman), Richard Baker (Chief Executive), George Fairweather (Group Finance Director), Ornella Barra (Wholesale & Commercial Affairs Director), Steve Duncan (Community Pharmacy Director), Scott Wheway (Health & Beauty Director), Guy Dawson (senior independent non-executive Director), Adrian Loader, Tim Parker, Helene Ploix, Patrick Ponsolle and Manfred Stach (independent non-executive Directors). Biographical details of the Directors are shown on page 38 and 39.

Stefano Pessina, George Fairweather, Ornella Barra, Steve Duncan, Adrian Loader, Patrick Ponsolle and Manfred Stach, who all served as Directors of Alliance UniChem before its acquisition, were appointed as Directors of the Company on 31 July 2006. Scott Wheway was also appointed as a Director on 31 July 2006. All these Directors were re-appointed to the Board in accordance with article 88 at an Extraordinary General Meeting held on 4 July 2006.

Richard Baker, Guy Dawson, Tim Parker and Helene Ploix retire by rotation at the AGM. In accordance with article 89 and will seek re-election at the meeting. In addition, Patrick Ponsolle, who has served for more than nine years combined service as a non-executive of the Company and Alliance UniChem, will seek re-election at the AGM in accordance with the Combined Code.

Dr Martin Read resigned as a Director on 20 July 2006 and Paul Bateman and Jim Smart resigned as Directors on 31 July 2006.

Details of Directors' service contracts and a statement of their interests in the share capital of the Company are set out in the Board report

on remuneration. Copies of the service contracts of executive Directors and of the appointment letters of the Chairman and non-executive Directors are available for inspection at the Company's registered office during normal business hours and at the AGM.

The performance of each Director standing for re-election has been formally evaluated, regard being had to length of service on the Board of each such Director and whether they be executive or non-executive.

The Board believes that each Director standing for re-election continues to demonstrate commitment, to be an effective member of the Board and to contribute to the balance of skills and knowledge and experience identified by the Board in the course of its review. The Board recommends re-election of the Directors standing for re-election.

Share capital

At 31 March 2007, there were 967,554,529 ordinary shares in issue held by 76,807 shareholders on the register. Details of changes in the share capital are shown in notes 32 and 35 to the financial statements.

At an EGM held on 4 July 2006 it was agreed, subject to the Scheme of Arrangement being sanctioned by the Court, that the authorised share capital of the Company would be increased from £299,999,983 to £479,148,237 by the creation of 481,847,028 new ordinary shares of 37 7/39 pence each. This increase became effective on 31 July 2006 following the Court approval of the Scheme of Arrangement. In addition, the Directors were authorised to allot relevant securities in connection with the merger up to an aggregate nominal amount of £179,148,254 for a five year period.

An additional 481,837,297 ordinary shares were issued to former shareholders of Alliance UniChem following the court sanction of the Scheme of Arrangement on 31 July 2006.

There were no shares purchased in the market during the year.

The aggregate number of shares held by Boots Qualifying Employee Share Trust, Boots All Employee Share Ownership Plan, Boots ESOP Trust and The Alliance UniChem 1992 Employee Share Trust are shown in note 35 to the financial statements.

As at 27 April 2007 the Company has been notified pursuant to the Companies Act 1985 of the following material or notifiable interests in the issued ordinary share capital

| Name of shareholder | Number of shares | % of present issued ordinary share capital |
|-------------------------|------------------|--|
| S Pessina | 146 158,129 | 15.11 |
| AB Acquisitions Limited | 131,444,856 | 13.59 |
| Barclays PLC | 45 499 822 | 4.70 |
| Legal & General plc | 40 484 901 | 4.18 |
| State Street Global | 31,004,612 | 3.20 |

AB Acquisitions Limited is deemed to be acting in concert with Stefano Pessina and Ornella Barra in connection with the recommended acquisition of the Company announced on 24 April 2007

145 300,000 shares of the interest of Stefano Pessina are held by Alliance Sante Participations S.A. Stefano Pessina indirectly wholly owns Alliance Sante Participations S.A., which is registered in Luxembourg and its Directors include Stefano Pessina and Ornella Barra. Stefano Pessina holds 299,108 shares in his own name and Ornella Barra holds 559 021 shares in her own name

Asset values

The Directors are of the opinion that the market value of the Group's land and buildings at 31 March 2007 are in excess of the net book value of £722 million stated in note 18 of the financial statements

Creditors and supplier payment policy

The Group applies a policy of abiding by the payment terms negotiated with each of its suppliers whenever it is satisfied that the invoiced goods or services have been ordered and have been supplied in accordance with agreed terms and conditions. The Company is a holding company and has no trade creditors

Financial instruments

The Group's treasury policies are described on page 33 in the Financial review. The exposure of the Group to price risk, credit risk, liquidity risk and cash flow risk in respect of financial instruments is set out in notes 27 and 28 to the financial statements

Post balance sheet event

On 24 April 2007 the Independent Directors of the Company and the board of AB Acquisitions Limited, a company controlled by certain funds advised by Kohlberg Kravis Roberts and by Stefano Pessina released an announcement that they had reached agreement on the terms of a recommended conditional offer for the acquisition of the Company at a price of 1.139 pence in cash for each share in the Company. A loan note alternative will be made available for the cash price

Going concern

Having considered Group cash flow forecasts and strategic plans the Directors are satisfied that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements

People

The Group communicates with its people through a wide variety of channels reflecting the diversity and geographical spread of the businesses

The aim is to ensure that all its people are informed and engaged about their part of the business locally augmented with deeper understanding about the Group overall and its future direction

The Group has a variety of approaches to fulfil these aims – regular face-to-face team briefings, conference calls, magazines and newsletters and a number of Intranet sites. Feedback is sought on the effectiveness of the communications and surveys have been instituted in the businesses to gauge the morale of its people and what is important to them. New communication channels and meeting forums have been set up since the merger last year to bring people together from across the businesses so that people can learn from each other and share ideas

It is critical to the success of the Group that it continues to nurture the different and diverse talents in the businesses – the employment policies are designed to achieve this. The Group aims to provide equal opportunities, regardless of sex, race, religion or belief, sexual orientation, disability or ethnic origin

The Group does all that is practicable to meet its responsibilities towards the employment and training of disabled people. Where one of its people becomes disabled every effort is made to provide continuity of employment in the same job or a suitable alternative

The Group communicates closely with works councils and other employee forums around Europe and has a European Works Council to brief and consult with representatives on pan-European issues

The Group encourages the further interest and involvement of its people in the Group's future through performance-related bonuses and share schemes. There are a number of recognition schemes within the businesses to highlight and reward particular achievements of the people in providing service to its customers

Charitable and political donations

The Group made charitable donations of £1.7 million for the year (2006 £1.4 million) of which £1.6 million were made in the UK. The Group has no affiliation to any political party or group in any country and makes no political donations (2006 £nil)

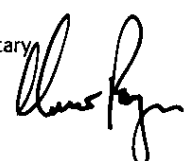
Auditors

The audit committee are to propose to the Board the appointment of a single auditor prior to the notice of meeting being sent to shareholders. A resolution to appoint an auditor selected by the Board and to authorise the Directors to determine their remuneration will be proposed at the AGM

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the auditors of the Company are unaware and each Director has taken all the steps that he or she ought to have taken as a Director to make him or herself aware of any relevant audit information and to establish that the auditors of the Company are aware of that information

Approved by and signed on behalf of the Board of Directors

Marco Pagni
Company Secretary
2 May 2007



Board report on corporate governance

The requirements of corporate governance are set out in the Financial Services Authority ("FSA") Listing Rules together with the related Principles of Good Governance and Code of Best Practice (the "Combined Code") adopted by the FSA

Directors are assisted in complying with the internal control requirements of the Combined Code by the Institute of Chartered Accountants in England and Wales publication Internal Control Guidance for Directors on the Combined Code (the Turnbull guidance)

The Board considers that good corporate governance is an essential element of achieving its overall objectives. It has reviewed the Group's corporate governance policies and practices and has determined that during the period 1 April 2006 to 31 March 2007 the Company complied with the provisions of the Combined Code. This report, together with the audit committee report on pages 64 to 66 and the Board report on remuneration on pages 48 to 63, describes how the Board applied the Combined Code during the year under review

The Board

On 31 March 2007, the Board comprised the Chairman, an Executive Deputy Chairman, five executive Directors and six non-executive Directors. There were a number of changes to the composition of the Board during the year mainly as a result of the merger with Alliance UniChem. Details of the changes are set out on page 40 of the Directors' report. The Board has reviewed the composition of the Board and the balance of skills, knowledge and experience its members brought and concluded that the Board was of the appropriate balance for the Company. The Nominations Committee have requested Spencer Stuart to assist in finding an additional non-executive Director.

The appointment of Guy Dawson as the senior independent non-executive Director was reconfirmed by the Board following the merger with Alliance UniChem. Biographies and other details of members of the Board of Directors are shown on pages 38 and 39 and, for those seeking re-election, in the AGM notice.

The Chairman meets with individual Directors privately at least once a year to review their contribution to the Board and personal development plans including training needs. Further, the Chairman meets with the non-executive Directors as a group in the absence of the executive Directors. As part of the Board evaluation programme, the non-executive Directors led by the senior independent non-executive Director review the performance of the Chairman, having considered the views of the executive Directors.

During the year, the Board formally evaluated its own performance and that of the Board committees. Because of the significant changes to the Board composition during the year, it was decided not to conduct a performance review involving consultants in 2006/07. The internal review process in the year took the form of a questionnaire, supplemented by one-to-one meetings between the Chairman and each of the Directors when they had an opportunity to express their views on their overall impression of the Board and its committees and their organisation, composition, involvement in the business and effectiveness, the roles and contributions of Board members, communications with shareholders, stakeholder issues and succession planning. The results were consolidated and reported to the Board and, in so far as they related to the Chairman, to the senior independent non-executive Director. The Board considers the outcome of the programme in its evaluation of the skills, knowledge and experience of the Board and the nominations committee applies the output in formulating its development plans for the Board. It is likely that consultants will be involved in reviews every other year.

Non-executive Directors are appointed for an initial term of three years from the AGM/EGM following their joining the Board, and subject to performance and re-appointment where appropriate, there is an expectation of renewal of that appointment for two further three-year periods. Patrick Ponsolle, who has served under a year as a non-executive Director of the Company, was initially appointed a non-executive Director of Alliance UniChem in December 1997. The Board have considered his combined length of service on the Board of the Company and on the Board of Alliance UniChem, which exceeds the nine years recommended by the Combined Code. The Board recognises that length of service can impact on the independence of a non-executive Director and has therefore considered his position carefully. The Board concluded that his significant corporate and financial experience together with his detailed understanding of the former Alliance UniChem business makes a significant contribution to the Company and provides necessary continuity. The Board undertook a rigorous review following a formal performance evaluation and concluded that Patrick Ponsolle remains as an independent non-executive Director and he is being proposed for re-election at the AGM. It is the intention of the Board to appoint an additional non-executive Director.

Details of executive Directors' service contracts are given on page 56. All executive Directors normally retire on reaching the age of 60; however, in the case of Stefano Pessina, the Executive Deputy Chairman, his service contract terminates when he reaches the age of 70. Copies of service contracts and letters of appointment are available for inspection at the company's registered office and at the AGM.

All Directors appointed by the Board must stand for re-appointment at the first AGM/EGM following their appointment and thereafter at least every three years. In addition, at least one third of the continuing members of the Board must retire, and if willing, stand for re-election at each AGM. Directors retiring and those standing for re-election at the 2007 AGM are identified on page 40.

The Chairman and the other non-executive Directors bring a variety of experience and expertise to the Board and they are all considered to be independent. Sir Nigel Rudd was considered by the Board to be independent at the date of his appointment as Chairman. The Board considers that an independent Director is one who is independent in character and judgment, and where there are no relationships or circumstances which could affect the Director's judgment. Relationships or circumstances which could affect judgment include having been previously an employee of the Company, having had close ties with any of the Company's advisors, Directors or senior managers, having had a material relationship with the Company, receiving additional remuneration from the Company apart from Director's fees, participating in the Company's performance related pay or pension schemes, holding cross directorships, having significant links with other Directors, representing a significant shareholder or having served on the Board of the Company for more than nine years. The Board undertook a rigorous review following a formal performance evaluation and concluded that Patrick Ponsolle remains as an independent non-executive Director and he is being proposed for re-election at the AGM.

The division of responsibilities between the Chairman and Chief Executive is in writing and has been agreed by the Board. The Chairman's responsibilities follow the guidance given in the Combined Code. Richard Baker, the Chief Executive, is responsible for leading the

executive Directors of the Company in the achievement of the Company's objectives. Stefano Pessina, the Executive Deputy Chairman, has responsibility for integration and strategic development, including acquisitions.

The Board has a programme to enable it to discharge its responsibility to provide leadership to the Company within a framework of prudent and effective controls, and to assess and manage risk. The Board has ten regular meetings in the year, including one strategy meeting, and other meetings are convened as required. In 2006/07, three additional meetings took place.

Board report on corporate governance (continued)

| | Board | | Audit committee | | Nominations committee | | Remuneration committee | | Social responsibilities committee | |
|------------------------|----------|-----------------------------|-----------------|-----------------------------|-----------------------|-----------------------------|------------------------|-----------------------------|-----------------------------------|-----------------------------|
| | Attended | Maximum possible attendance | Attended | Maximum possible attendance | Attended | Maximum possible attendance | Attended | Maximum possible attendance | Attended | Maximum possible attendance |
| Sir Nigel Rudd | 12 | 13 | – | – | 3 | 3 | – | – | – | – |
| S Pessina ¹ | 8 | 10 | – | – | 3 | 3 | – | – | – | – |
| R A Baker | 13 | 13 | – | – | – | – | – | – | 2 | 2 |
| G R Fairweather | 10 | 10 | – | – | – | – | – | – | – | – |
| O Barra ¹ | 8 | 10 | – | – | – | – | – | – | 2 | 2 |
| S W J Duncan | 10 | 10 | – | – | – | – | – | – | – | – |
| J S Wheway | 10 | 10 | – | – | – | – | – | – | – | – |
| G N Dawson | 13 | 13 | 5 | 5 | – | – | – | – | 1 | 2 |
| W A Loader | 9 | 10 | 3 | 3 | – | – | 6 | 6 | – | – |
| T C Parker | 12 | 13 | 2 | 2 | 3 | 3 | 8 | 8 | 1 | 2 |
| H Ploix | 12 | 13 | 5 | 5 | – | – | 8 | 8 | 4 | 4 |
| P Ponsolle | 10 | 10 | 3 | 3 | 3 | 3 | – | – | – | – |
| M Stach | 10 | 10 | – | – | 3 | 3 | 6 | 6 | 2 | 2 |
| P Bateman | 4 | 4 | – | – | – | – | – | – | 2 | 2 |
| J R Smart | 4 | 4 | – | – | – | – | – | – | – | – |
| Dr M P Read | 2 | 4 | – | – | – | – | 1 | 2 | – | – |

¹ Stefano Pessina and Ornella Barra did not receive papers or attend the last two Board meetings following the KKR and Stefano Pessina conditional approach for the Company announced on 9 March 2007

The table above shows the attendance of Directors at Board meetings and at meetings of the audit, nominations, remuneration and social responsibilities committees during the year. All Directors have attended meetings of the Board and of committees of the Board of which they are members unless prevented from doing so by prior commitments, particularly which may have occurred in the case of additional meetings called at short notice.

A revised schedule of matters reserved for decision by the Board and delegated authorities was agreed following the merger. These matters cover strategy and business plans, share capital and dividends, Board committees, remuneration and employment benefits, corporate reporting, capital and revenue commitments, corporate governance, internal control and risk management, corporate and social responsibilities and the appointment and removal of the Company Secretary. The Board delegates day to day management of the business to the executive Directors.

For all Board meetings an agenda is established. For regular meetings this generally comprises reports from the Chief Executive, the Group Finance Director, the Executive Deputy

Chairman and the business Directors' reports on the financial performance of the business, approval of major items of expenditure and other significant policy issues. The Board is also notified of any permission given to Directors and senior managers to deal in the securities of the Company under the Company's dealing code and receives reports from the committees of the Board, to enable it to be informed of and supervise the matters within their remit. Appropriate papers are provided to the Directors in advance of each Board meeting. In addition, the Board considers at least annually the strategic plans of the Group and of individual businesses, and from time to time Directors receive presentations from management concerning key areas of the Group's operations.

Full year and interim results are reviewed by the audit committee and approved by the Board prior to publication.

The composition and terms of reference of Board committees and a summary of the current terms of reference and details of membership of major Board committees during the year are set out on pages 45 and 46 and have been published on the Company's website.

In the furtherance of their duties, the Directors have full access to the services of the General Counsel & Company Secretary and may take independent professional advice at the cost of the Company. In addition, each of the committees of the Board is entitled to take independent professional advice as appropriate. The Company maintains appropriate directors and officers insurance in respect of legal action against its Directors and has granted deeds of indemnity to each of the Directors and to the Company Secretary.

The Company provides corporate governance training to those Directors for whom it is their first appointment to a listed company board and provides a tailored induction programme for all Directors on appointment. The induction programme includes details of Board and Company policies and procedures, information and briefings by members of management on the Company's business and operations, and on laws and regulations particularly applicable to them, which includes the "insider dealing" obligations, and visits to stores, factories, warehouses and other operations on a selective basis.

The Board is regularly updated on developments relating to the business of the Group, corporate governance and other matters of relevance, and non-executive Directors visit the Group's operations

The Board's policy concerning executive Directors seeking appointment as non-executive Directors of other companies is that the additional experience and knowledge such an appointment brings benefits the Company and accordingly, executive Directors are permitted subject to the approval of the Chairman to accept one such appointment where no conflict of interest arises, and to retain the fees received

All non-executive Directors disclosed to the Board prior to appointment their other significant commitments and they are required to notify and have notified any changes to or additional commitments from time to time to the Chairman. Sir Nigel Rudd is chairman of Pendragon, deputy chairman of Barclays, non-executive Director of BAE Systems and Chairman of the Boardroom Issues Group of the CBI. The Board is satisfied that Sir Nigel Rudd meets his obligations to the Company

The Senior Independent Director is available to shareholders if they have concerns which have failed to be resolved through the normal channels of Chairman, Chief Executive or Group Finance Director, or for which such channels are inappropriate

The General Counsel & Company Secretary acts as the secretary of all Board committees and fulfils the responsibilities required of him by the Combined Code

Board committees

There are four principal Board committees, all of which operate within written terms of reference. Summaries of the terms of reference and details of the membership of committees are set out below. Copies of the terms of reference are available from the Company Secretary and on the Company's website. Only members of each committee are entitled to attend the meetings of committees although each committee may invite other Directors, managers and advisors to attend and frequently do so. Membership of Board committees is regularly reviewed. The Chairman of the remuneration committee does not serve on the audit committee and vice versa and the Board

is satisfied that no one Director exercises a disproportionate influence or has a disproportionate burden of work which is likely adversely to affect his/her performance. No Director has served on any committee for six years or more other than the Chairman who has served on the nominations committee for seven years. The Board considers the Chairman's continual service on this committee to be appropriate as it ensures continuity following the merger. Attendance at meetings of committees is set out on page 44

Audit committee

The independent non-executive Directors who served on the committee during the year are as follows

| | |
|----------------------------|-------------------------------|
| Guy Dawson ¹ | Patrick Ponsolle ² |
| Adrian Loader ² | Tim Parker ³ |
| Helene Ploix | |

¹ Chairman appointed September 2003

² Appointed 31 July 2006

³ Resigned 31 July 2006

The Board approved revised terms of reference for the audit committee on 4 October 2006 and a copy is available on the Company's website

The role of the committee and details of how it carried out its duties are set out in the audit committee report on pages 64 to 66

The committee met five times during the year, the attendance record of members is reported in the table on page 44

Nominations committee

Directors who served on the committee during the year are as follows

| | |
|-------------------------------|-----------------------------|
| Patrick Ponsolle ¹ | Manfred Stach ³ |
| Sir Nigel Rudd ² | Guy Dawson ⁴ |
| Stefano Pessina ³ | Helene Ploix ⁴ |
| Tim Parker | Dr Martin Read ⁵ |

¹ Appointed to committee and as Chairman 31 July 2006

² Chairman until 31 July 2006

³ Appointed to committee 31 July 2006

⁴ Resigned from committee 31 July 2006

⁵ Resigned from committee 20 July 2006

The Board approved revised terms of reference for the nominations committee on 31 October 2006 and a copy is available on the Company's website

Following the merger Patrick Ponsolle replaced Sir Nigel Rudd as chairman of the committee. Sir Nigel Rudd remained a member of the committee. Stefano Pessina and Manfred Stach were appointed to the committee on 31 July 2006. Dr Martin Read retired from the Board and ceased to be a member of the committee on 20 July 2006 and Guy Dawson and Helene Ploix resigned from the committee on 31 July 2006. The nominations committee meets as required by its terms of reference and for any additional matters arising in the year. The committee met three times during the year.

The main responsibilities of the nominations committee are to

- Review regularly the structure, size and composition of the Board and make recommendations to the Board concerning that
- Give full consideration to succession planning for Directors,
- Evaluate the balance of skills, knowledge and experience of the Board,
- Prepare a description of the role and capabilities required for any particular Board appointment including that of the Chairman,
- Identify and nominate for the approval by the Board candidates to fill Board vacancies as and when they arise and
- Review annually the time required from a non-executive Director and assess whether each of the non-executive Directors contributes effectively and demonstrates commitment to the role

The committee also makes recommendations to the Board concerning the standing for reappointment of Directors

During the year the committee determined the desired capabilities, background and experience of a further non-executive Director given the current balance of skills, knowledge and experience on the Board and external consultants have been instructed to identify suitable candidates

Board report on corporate governance (continued)

Remuneration committee

Directors who served on the committee during the year are as follows

| | |
|----------------------------|-----------------------------|
| Tim Parker ¹ | Manfred Stach ² |
| Hélène Ploix | Dr Martin Read ³ |
| Adrian Loader ² | |

¹ Appointed as Chairman 21 July 2006

² Appointed 31 July 2006

³ Resigned as Chairman and from the committee 20 July 2006

The Board approved revised terms of reference for the remuneration committee on 4 October 2006 and a copy is available on the Company's website

The Executive Deputy Chairman and Chief Executive are invited to attend meetings as appropriate but are not present when their own remuneration is discussed

The role of the remuneration committee and details of how it applied the principles of the Combined Code and the Directors' Remuneration Report Regulations 2002 are set out in the Board report on remuneration on pages 48 to 63

The committee met eight times during the year the attendance record of members is reported in the table on page 44

Social responsibilities committee

Directors who served on the committee during the year are as follows

| | |
|----------------------------|----------------------------|
| Hélène Ploix ¹ | Manfred Stach ³ |
| Richard Baker ² | Paul Bateman ⁴ |
| Ornella Barra ³ | Tim Parker ⁴ |
| Guy Dawson ³ | |

¹ Chair

² Appointed 24 November 2006

³ Appointed 31 July 2006

⁴ Resigned 31 July 2006

The social responsibilities committee met four times during the year. The main responsibility of the committee is to keep under review and advise the Board on the company's policies and practices in the areas of social responsibility, including those relating to the environment, diversity and equal opportunities, race relations, employment of the disabled, charitable giving and ethical matters, and the company's values and standards.

During the year the terms of reference of the social responsibilities committee were revised and these were enlarged to include a broader stakeholders interest and a copy is available on the Company's website

The committee during the year reviewed

- a revised Code of Conduct and Business Ethics. This code was released, following Board approval in December 2006 and a copy is available on the Company's website. The code sets out the ethics principles and standards which must be consistently upheld by each business and corporate function,
- a revised Corporate Social Responsibility approach taking into account the best practice from the businesses of the merged Group involving a consistent approach for data capture and reporting;
- those matters and policies within its remit and reviewed and monitored performance against agreed targets in the area of social responsibility, and
- specific reports on business diversity and transport, waste and recycling

The committee met four times during the year the attendance record of members is reported in the table on page 44

Disclosure committee

The disclosure committee, which was established in 2005, did not meet during the year. The proposed work for this committee was dealt with by the other committees.

Investor relations

Communications with shareholders are given a high priority. In addition to the annual and interim results presentations and the AGM, a programme of meetings between institutional shareholders and analysts with the executive Directors or the Chairman is held throughout the year to discuss information made public by the Group and address any questions that may arise. The Company ensures that no price-sensitive information is disclosed in these meetings. This programme is led by the Chief Executive and Group Finance Director and involves the Director of Investor Relations.

A summary of the views expressed at these meetings is reported to the Board. Non-executive Directors are given an opportunity to attend meetings with shareholders, and each non-executive Director is prepared to do so. In addition to the programme described above the Company's website provides financial and other information about the Group. Published preliminary and interim results, as well as all announcements to the London Stock Exchange are on the Company's website.

All members of the Board attend the AGM. A business presentation is given at the meeting, followed by a question and answer session. In accordance with best practice the notice of the meeting, together with any related papers, is sent to shareholders at least 20 working days before the meeting, or for those who have elected for electronic communication, notice is given to such shareholders of the availability of documents on the Company's website. Shareholders are given the opportunity to vote on each separate issue. Postal proxy votes are counted and the proxy votes lodged for and against each resolution as well as abstentions are announced after the vote on show of hands on each item. Summary proxy figures are made available in writing at the end of the meeting and are also published on the Company's website.

Internal control

The Directors have overall responsibility for the group's system of risk management and internal control and for reviewing its effectiveness. The system of internal control is designed to manage, rather than eliminate the risk of failing to achieve business objectives and can provide only reasonable, and not absolute, assurances against material misstatement or loss.

The Board considers an efficient risk management and control framework to be fundamental to the Company achieving its corporate objectives with an actively managed balance of risk and reward. The effectiveness of the ongoing process to identify, evaluate and manage significant risks in the Group's system of risk management and internal controls is reviewed annually by the audit committee on behalf of the Board, the committee having responsibility for overseeing management action needed to remedy any shortcomings or weaknesses identified.

Throughout the year and up until the date of this report the risk management and internal controls systems comply with the revised Turnbull guidance for Directors as required by the Code

Members of the Board have responsibility for monitoring the conduct and operations of individual businesses within the Group. This includes the review and approval of business strategies and plans and the setting of key business performance targets. The executive management responsible for each business are accountable for the conduct and performance of their business within the agreed strategies

Key elements of the Group's system of internal controls are as follows

- regular Board meetings with a formal schedule of matters reserved by the Board for decision,
- Board approval of the Group's strategic plan and annual budget,
- an annual risk review by the audit committee and subsequently by the Board, based on business risk reviews and control self assessments,
- clearly defined organisational structures and appropriate delegated authorities for the Group's businesses with delegated authorities reviewed on an annual basis
- monthly reviews by the executive management of key performance indicators to assess progress towards objectives, with action being taken as required
- continuous monitoring of regulatory developments,
- procedures for planning, approving, executing and monitoring business acquisitions, divestments and capital expenditure projects, supplemented by post-investment performance reviews
- dispensing and professional pharmacy protocols which are reviewed and against which compliance is audited on a regular basis
- procedures for security and specialist handling of certain drug classes,
- a rolling programme of surveys by the Group's insurance brokers to advise on physical risks,
- centralised treasury operations operating within defined limits and subject to regular reporting requirements,
- a Group internal audit function providing independent scrutiny of internal control systems and risk management procedures,
- operational review teams within individual businesses providing management assurance on key controls primarily in wholesale depots and retail outlets,
- regular monitoring of risks and control systems throughout the year by operating businesses with periodic exception reporting;
- a self-certification process whereby operating businesses are required to confirm in writing that the system of internal control is operating effectively,
- the Director of Internal Audit & Risk Management has the right of direct access to the audit committee and the Chairman of the Company
- continuous monitoring by the Group legal function of claims and litigation throughout the Group, and
- a requirement for specialist legal, financial and other professional advice to be obtained as part of the Group's business activities

Social, environmental and ethical matters

The company has for many years recognised the benefits that accrue from responsible employment, environmental and community policies which are also described elsewhere in this report. Identifying and managing risks to the Company's reputation has been described above and has a high priority. The evaluation of the Company's performance in social, environmental, community and ethical matters is ongoing.

Compliance statement

The Company applied the provisions of the Combined Code throughout the year under review.

Board report on remuneration

Dear Shareholder

On behalf of the Board, I am pleased to present the Board report on remuneration for the year ending 31 March 2007

During the year the Remuneration Committee conducted a review of remuneration with particular focus on the impact of the merger to ensure continued alignment of remuneration arrangements with the interests of our shareholders, and with the executive Directors and senior management team of the combined entity focused on common objectives

As a result of this review, the Committee has

- introduced revised bonus arrangements to provide better alignment with, and focus on, achieving merger benefits,
- reviewed the performance conditions for the Bonus Co-Investment Plan and Performance Share Plan to take account of the increased growth potential of the Company, and
- proposed the introduction of a one-off long-term incentive plan ('Merger LTIP') which is subject to shareholder approval. These proposals are held in abeyance following the recommended offer for the Company by AB Acquisitions Limited, announced on 20 April 2007

We will continue to review our approach as policy and practice inevitably evolves over time

Tim Parker

Chairman of the Remuneration Committee
2 May 2007

Compliance

This report has been prepared in compliance with the Directors' Remuneration Report Regulations 2002 (the Regulations) and the Combined Code

Remuneration committee (the Committee)

The members of the Committee during the year were

Tim Parker¹
Helene Ploix
Adrian Loader²

Manfred Stach²
Dr Martin Read³

- 1 Appointed Chairman of the Committee 21 July 2006
- 2 Appointed 31 July 2006
- 3 Resigned as Chairman and from the Committee 20 July 2006

The Committee meets on at least four occasions each year. The Committee met eight times during the year as the result of the merger. The main responsibilities of the Committee are summarised in the Board report on corporate governance on page 46

The Board approved revised terms of reference for the Committee on 4 October 2006 and a copy is available on the Company's website

Following a formal review the Committee has re-appointed Kepler Associates as the primary adviser to the Committee with effect from February 2007

During the year, Kepler Associates and PricewaterhouseCoopers LLP, who previously advised Alliance UniChem's remuneration committee, provided the Committee with external advice in determining the appropriate remuneration, terms and conditions and bonus schemes for Directors, and to assist it in reviews of remuneration policies and practices. PricewaterhouseCoopers LLP provided additional services to the Group during the year in connection with the merger cost savings project. The following individuals also advised the Committee to enable it to make informed decisions.

- Sir Nigel Rudd, Chairman of the Board
- Stefano Pessina, Executive Deputy Chairman
- Richard Baker, Chief Executive
- Marco Pagni, General Counsel & Company Secretary
- Paul Bateman, in his former role as Human Resources & Operations Director of Boots Group
- Andrew Stemp, Director of Group Reward
- Mike Cutt, Boots The Chemists Human Resources Director
- Mike Higgins, Alliance UniChem Interim reward consultant

A summary of the terms under which Kepler Associates provide services to the Committee is available on the Company's website

Remuneration policies

Policy overview

In determining its remuneration policies, the Committee has followed the provisions of the Combined Code

The philosophy of the Committee is to

- provide a total reward package designed to retain employees of the highest calibre and provide genuine long-term wealth creation opportunities for senior management,
- set basic salaries at competitive levels in the relevant market to help ensure the Group is able to attract and retain people of the required standard and
- set total remuneration aimed at market median for sustained levels of good performance and upper quartile for superior financial and personal performance

It is the practice of the Board to maintain contact (where appropriate) with its major shareholders about remuneration issues

No Director is permitted to vote in respect of their own remuneration or to be present when his or her remuneration is being discussed

Remuneration policies 2006/07 – key elements of remuneration

Executive remuneration in the year comprised the following key elements

- Basic salary
- Short Term Executive Bonus Scheme
- Bonus Co-Investment Plan
- Performance Share Plan
- All Employee Share Arrangements
- Pension
- Other benefits

There are also outstanding awards in respect of previous Boots incentive arrangements. These awards were made under the Executive Share Option Plan and the Long-Term Bonus Scheme. These two schemes ceased to be operated for new awards after 31 March 2005.

Each of these elements is described below.

Basic salary

During the year, a review of executive Directors' salaries was undertaken. This review took into account the size and complexity of the combined Group. The basic salaries following this review became effective from 1 August 2006 and the salaries approved are as shown in the table below. These are unchanged as at 31 March 2007.

| | £ |
|-------------------|---------|
| S. Pessina | 593,000 |
| R. A. Baker | 810,000 |
| G. R. Fairweather | 470,000 |
| O. Barra | 400,000 |
| S. W. J. Duncan | 380,000 |
| J. S. Wheway | 420,000 |

Before the merger, the existing executive Directors' basic salaries had been reviewed by the Committee with effect from 1 June 2006 and the basic salary for Richard Baker had been increased to £696,000. The basic salaries for Paul Bateman and Jim Smart were increased to £378,000 and £385,000 respectively.

Short Term Executive Bonus Scheme

2006/07 arrangements

The former Boots and Alliance UniChem bonus arrangements for executive Directors provided a maximum bonus potential of 100% of annual basic salary in respect of a financial year. These arrangements were in force up to 31 July 2006. Any bonus payable from these arrangements was scaled back pro rata to allow for a performance period of less than one year since the start of each respective company's financial year. In the case of Boots, this period was four months. In the case of Alliance UniChem, this period was seven months.

In the case of the former Boots bonus arrangements, two-thirds of the available short term bonus depended upon business performance targets including operating profit sales and return on capital and earnings and one-third depended on individual performance against personal targets.

Under the former Alliance UniChem bonus arrangement, 80% of the short term bonus was based on adjusted earnings and 20% was based on personal performance. In the case of Ornella Barra and Steve Duncan, half of their financial performance target was based on the results of Alliance UniChem as a whole and half on the combined performance of the businesses for which they had responsibility.

Over the eight month period from 1 August 2006 to 31 March 2007, a harmonised bonus arrangement was put in place for all executive Directors. This was in two parts. The first part provided a maximum bonus potential of 100% of salary, pro-rated for the eight month period and consistent with arrangements already in place for each Company. Two-thirds of this bonus was dependent on adjusted earnings (including merger synergies) and the remaining one-third was dependent on individual performance against personal targets. The second part provided a maximum bonus potential of a further two thirds of annual basic salary based on the attainment of stretching earnings targets arising from the delivery of synergy benefits with no personal performance element. The addition of the second part effectively provided a doubling of the bonus opportunity for the eight month period.

The bonus amounts actually earned by each executive Director are detailed in the emoluments section on page 59.

For the 2007/08 financial year the short term bonus arrangement for executive Directors will provide a maximum bonus potential of 100% of annual basic salary. 75% of the bonus is dependent on adjusted earnings targets and the remaining 25% on personal targets.

Bonus Co-Investment Plan (BCIP)

The BCIP aligns executives' interests with those of shareholders as their initial investment in the Company's shares is exposed to share price movement over the performance period. Further matching shares are then provided only in return for the achievement of challenging adjusted earnings per share growth targets over a three-year period.

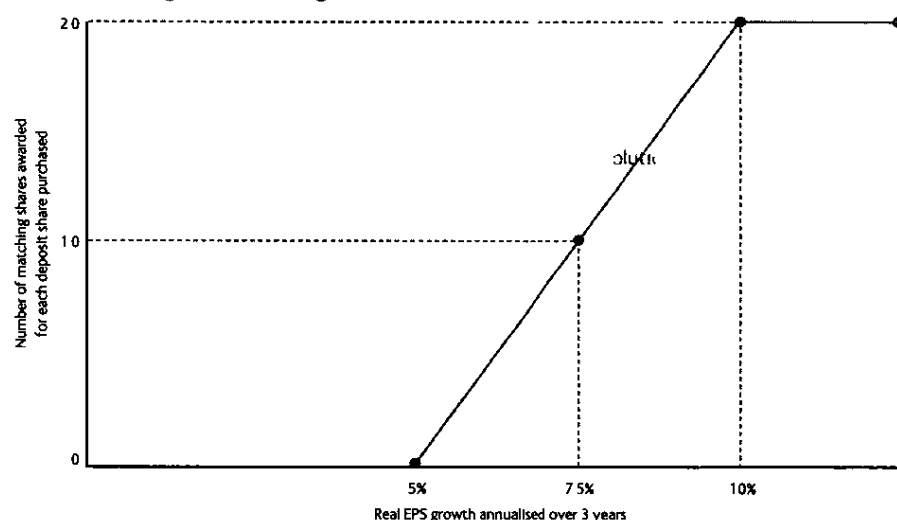
Adjusted earnings per share is defined as profit for the period attributable to equity shareholders before exceptional items, amortisation of customer related intangible assets and IAS 39 timing differences, all net of tax and deferred tax restatements for customer related intangible assets divided by the weighted average number of shares in issue during the period.

Under the BCIP executive Directors are entitled to invest up to 50% of their earned short term bonus for the previous year in shares of the Company in return for a matching opportunity of up to 2:1. The size of the match depends on real earnings per share growth and continued employment over a three-year performance cycle. Following the merger, the Committee increased the rate of growth required for threshold and maximum vesting to reflect the higher expected growth of the group.

In respect of the 2006/07 bonus year, a proportion of matching shares will be awarded provided growth in adjusted earnings per share exceeds growth in the RPI-X by 5% p.a. compound over the next three years. No matching shares are awarded if growth is less than this. A maximum match of two shares is earned if growth in EPS exceeds growth in the RPI-X by 10% p.a. compound with pro rata matching for performance in between these levels (previously 3% p.a. and 8% p.a. over the growth in RPI). The policy of the Committee is to review the targets at the beginning of each cycle to ensure they remain suitable.

Board report on remuneration (continued)

BCIP matching share vesting element



If real growth in adjusted earnings per share performance does not exceed 5% p a , the matching awards will lapse. There is no retest.

Matching shares are forfeited if an executive Director resigns or withdraws their investment within three years of the start of the performance period. The second part of the short term bonus applying over the last eight months of the financial year is not eligible for investment under the BCIP.

The table below sets out the bonus invested by the executive Directors during 2006/07 where they were required to co-invest at least 25% of their annual bonus for 2005/06. No short term bonus was earned by the executive Directors in 2004/05 and as a result, no co-investment opportunity arose in relation to that bonus cycle.

| Director | Bonus invested in year £ | Deposited shares | Matching opportunity £ | Conditional award in shares |
|-------------------------|--------------------------|------------------|------------------------|-----------------------------|
| R A Baker | 140,000 | 18,116 | 466,667 | 65,195 |
| J S Wheway ² | 35,300 | 4,567 | 117,667 | 16,438 |

1 Deposited shares were purchased on 12 July 2006 at a price of 767 pence per share these interests are included in the Directors' shareholdings shown later in this report.

2 Held at the date of appointment to the Board on 31 July 2006.

3 Performance period 1 April 2006 to 31 March 2009.

4 Release date of matching award 13 July 2009 subject to the satisfaction of the performance conditions.

5 The conditional award in shares is calculated by dividing the matching opportunity by 715.8 pence being the average of the middle market closing prices for the five days following the date of the preliminary announcement (18 May 2006).

6 The bonus invested is grossed up before the matching opportunity is calculated.

Performance Share Plan (PSP)

The Performance Share Plan, which replaced the Boots Long-Term Bonus Scheme for performance periods commencing on or after 1 April 2005 was designed to provide a direct link between the pay of executive Directors and the creation of value for shareholders

The Committee revised the PSP following the merger to provide a focus on earnings per share growth as well as relative total shareholder return

In 2006/07, an award of 165% of basic salary was granted to Richard Baker an award of 130% of basic salary was granted to Scott Wheway and awards of 163% of basic salary were granted to Stefano Pessina George Fairweather, Ornella Barra and Steve Duncan the former Alliance UniChem executives The grants of 163% of salary made to former Alliance UniChem executives reflected the delay in making share-based incentive grants as a result of the timing of the merger Executive Directors can be

granted awards worth up to 200% of basic salary (250% for the Chief Executive)

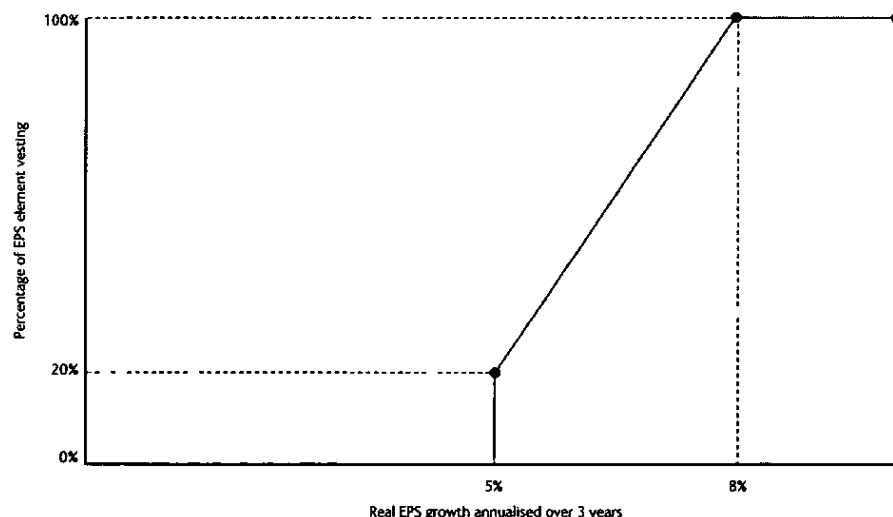
The general prohibition on the grant of awards more than four months after the start of the performance period was removed following the passing of a resolution at the 2006 AGM

67% of an award will be subject to real annual growth in earnings per share If growth in adjusted earnings per share exceeds the RPI-X by 5% p a compound, 20% of the earnings per share award will vest This rises to 100% if real growth in adjusted earnings per share exceeds the RPI-X by 8% p a compound with straight line vesting between these two levels Nothing vests for performance below this as illustrated below

The remaining 33% of an award will be subject to the Company's total shareholder return performance over the three-year period relative to the FTSE 100 as at the start of the performance period 20% of the total shareholder return award will vest if the total

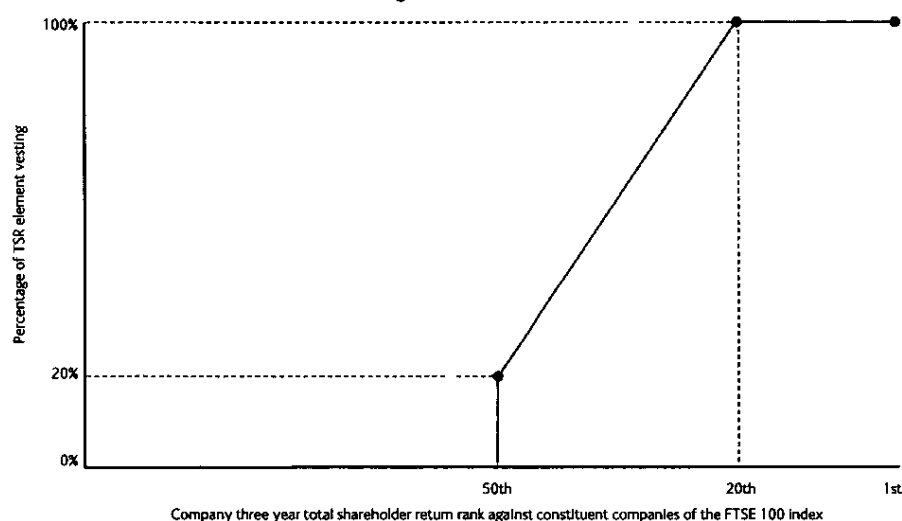
shareholder return performance equals or exceeds the median of the constituent companies rising to 100% if the total shareholder return performance reaches the upper quintile of the constituent companies with straight line vesting between these two levels None of the total shareholder return award will vest for performance below median

PSP earnings per share vesting element



Board report on remuneration (continued)

PSP total shareholder return vesting element



Dividends accrue over the performance period and are paid at vesting but only on shares that actually vest

For awards made under this plan in 2005/06, the performance conditions for the provisional award measured the Company's out-performance over a three-year performance period of total shareholder return performance relative to a UK retail Index comprising the FTSE 350 General Retailers Index and the FTSE 350 Food & Drug Retailers Index (weighted 50% each). At the end of the performance cycle none of the award will vest unless the annualised total shareholder return performance exceeds the index total shareholder return by at least 2% p.a. All the shares vest if the annualised total shareholder return performance exceeds the index total shareholder return by at least 10% p.a. (historically equivalent to almost top decile performance), with pro rata vesting in between.

Unvested awards under the PSP

The table below sets out the unvested conditional awards (in shares) for each financial year

| Conditional award of shares | 2005/06 | 2006/07 | Total |
|-----------------------------|---------|---------|---------|
| S Pessina | – | 115,779 | 115,779 |
| R A Baker | 273,605 | 160,435 | 434,040 |
| G R Fairweather | – | 88,537 | 88,537 |
| O Barra | – | 74,916 | 74,916 |
| S W J Duncan | – | 74,916 | 74,916 |
| J S Wheway | 53,648 | 61,976 | 115,624 |
| P Bateman | 118,851 | – | 118,851 |
| J R Smart | 28,103 | – | 28,103 |

The performance periods for the allocations are

| Allocation | 2005/06 | 2006/07 |
|--------------|---------------|---------------|
| Period start | 1 April 2005 | 1 April 2006 |
| Period end | 31 March 2008 | 31 March 2009 |

The share price used to calculate the 2006/07 conditional awards was 715.8 pence being the average share price for the five business days immediately following the preliminary announcement in May 2006. The outcome for this cycle and the related vested awards will not be determined until June 2009. The share price when the awards were first made was 719.5 pence on 1 April 2006.

All Employee Share Arrangements Boots All Employee Share Ownership Plan (AESOP)

Boots established an AESOP in 2000/01 to enable all employees to become shareholders in the Company. Under the free share part of the AESOP, the participating executive Directors were each given the opportunity to be awarded 34 shares (28 shares in 2005/06) the same number as any employee with average contracted hours of 35 or more per week. All the eligible executive Directors opted to receive this award. Shares in this part of the AESOP must normally be held in trust on behalf of the employees for at least three years.

The share investment plan element of the AESOP gives employees, including executive Directors, the opportunity to purchase shares from their pre-tax income, subject to a maximum of £125 per month. Shares purchased under the partnership plan are included in the total shareholdings shown in the table on page 62.

The Boots SAYE Share Option Plan 2002

This Scheme has been activated for the UK executive Directors, who have given up their rights to receive or purchase further shares under the AESOP and the UK employees of the former Alliance UniChem companies. Details of the Directors' outstanding options under this scheme are shown in the table on page 54.

Alliance UniChem Savings Related Share Option Scheme

Employees of former Alliance UniChem companies, including UK executive Directors, were entitled to participate in this scheme. Details of the executive Directors' outstanding options under this scheme are shown in the table on page 54.

Share Ownership Guidelines

During the year the Company has revised its share ownership guidelines which require that executive Directors retain a holding in the Company's shares having a value equivalent to one times (Chief Executive one and a half times) their basic salary. The executive Directors are required to retain 50% of shares (net of income tax and exercise costs) from any vested incentive share awards until the guideline is achieved. Unvested shares or options will be excluded from the required holding. Any shares previously held by an executive Director can be included as part of the required holding. Once the shareholding is met, the number of shares required to be held by the executive Director will be fixed, so that fluctuations in the share price will not require the executive Director to purchase more shares.

Legacy incentive awards

During the year there were awards outstanding over two Boots incentive schemes: the Executive Share Option Plan and the Long-Term Bonus Scheme. There were also awards vesting under the Alliance UniChem Long Term Incentive Plan for the former executive Directors.

Executive Share Option Plan (ESOP) – former Boots incentive arrangement

Under the Executive Share Option Plan, which operated for performance periods commencing before 1 April 2005, executive Directors could be granted options to subscribe for ordinary shares in the Company. The maximum face value of options that could be granted under the plan to any executive Director in any financial year of the Company was twice basic salary. Grants did not normally exceed one times annual salary. Options granted to executive Directors were granted subject to the satisfaction of a performance condition.

The ESOP aligns reward to executives with returns to shareholders if share price growth is achieved and the performance condition is met. Annual growth in earnings per share over the relevant period must be at least 3% p.a. plus RPI in order for an award to vest in full.

If the performance condition is not met, then performance is retested annually until the end of the sixth year, using the same methodology, for options granted prior to 2004. If the performance condition has still not been met at the end of the sixth year, the options lapse. For options granted in 2004, only one retest will be permitted. This retest will take place at the end of the fifth year where the performance condition is not met after the third year.

The exercise price of options granted under the scheme is the average market value of the shares in the three days preceding the grant of an option. The rules of the plan allow the exercise of vested options in the period between three and ten years from grant. Gains arising from the exercise of share options are set out below.

The performance tests for options granted in 2001, 2002 and 2003 were not met as at 31 March 2007.

Board report on remuneration (continued)

Options have been granted under these arrangements and in respect of all employee option plans as follows

| Director | Type | 1 April 2006 | Granted in year | Exercised/ lapsed in year March 2007 | 31 March 2007 | Exercise price pence | Normal exercise from |
|---------------------------|------|--------------|-----------------|--|---------------|----------------------|----------------------|
| R A Baker | a | 181,950 | – | – | 181,950 | 68700 | 18 09 06 to 17 09 13 |
| | b | 90,975 | – | – | 90,975 | 68700 | 18 09 06 to 17 09 13 |
| | a | 99,536 | – | – | 99,536 | 64700 | 14 06 07 to 13 06 14 |
| | c | – | 1,482 | – | 1,482 | 63734 | 01 02 10 to 01 08 10 |
| | | 372,461 | 1,482 | – | 373,943 | – | |
| G R Fairweather | c | | 1,482 | – | 1,482 | 63734 | 01 02 10 to 01 08 10 |
| S W J Duncan ¹ | d | 4,948 | – | – | 4,948 | 33033 | 01 07 09 to 31 12 09 |
| P Bateman ² | a | 26,428 | – | – | 26,428 | 63000 | 12 09 04 to 30 09 07 |
| | a | 40,944 | – | – | 40,944 | 63500 | 18 06 05 to 30 09 07 |
| | a | 49,504 | – | – | 49,504 | 60600 | 23 06 06 to 30 09 07 |
| | | 54,095 | – | – | 54,095 | 64700 | 31 03 07 to 30 09 07 |
| | | 170,971 | – | – | 170,971 | – | |
| J R Smart ² | a | 25,371 | – | – | 25,371 | 60600 | 23 06 06 to 30 09 07 |
| | a | 24,517 | – | – | 24,517 | 64700 | 31 03 07 to 30 09 07 |
| | | 49,888 | – | – | 49,888 | – | |

1 Held at date of appointment 31 July 2006

2 Following the termination of their employment Paul Bateman and Jim Smart have six months from 31 March 2007 to exercise unvested share options if these options were to vest at 31 March 2008 compensation would be paid to them

a = Executive Share Option Plan

b = Richard Baker's individual option plan (to accommodate a joining award of 3x his annual basic salary in share options consisting of 2x his annual basic salary under the ESOP and 1x annual basic salary under an individual option plan)

c = The Boots Group SAYE Share Option Plan 2002

d = Alliance UniChem Savings-Related Share Option Scheme 1990

All options granted under the Executive Share Option Plan and the Richard Baker individual option plan are subject to the performance conditions set out above

The market price of the Company's shares at 31 March 2007 was 1026.5 pence and the range of market prices during the year was 685.5 pence to 1036.5 pence

Directors' interests in share options on 2 May 2007 remain unchanged

Gains on share options represent the number of shares under options which have been exercised valued at the difference between the market price at the date of exercise and the exercise price paid

The total gains on share options exercised during the year was £nil (2006 £nil)

Long Term Bonus Scheme (LTBS) – former Boots incentive arrangement

The LTBS was operated for performance periods commencing before 1 April 2005 and provided executive Directors with a maximum potential bonus award (MPBA) worth up to 125% of basic salary. No awards were made under the LTBS after the 2004/07 cycle. The LTBS rewarded Directors for the Company's performance in terms of TSR over a three-year performance period relative to a peer group of ten other leading companies. There is no retest.

The peer group comprised those companies that the Committee considered at the beginning of the cycle to provide the best comparators for performance given the mix of businesses carried on by the Company. For the 2004/07 cycle, the relevant peer group was

| | |
|--------------------------------|---------------------------|
| DSG International | Reckitt Benckiser |
| Home Retail Group ² | Smith & Nephew |
| J Sainsbury | Tesco |
| Kingfisher | W H Smith |
| Marks & Spencer | W M Morrison ¹ |

1 Replaced Alliance UniChem

2 Replaced Great Universal Stores

For the 2004/07 cycle, the TSR was below median (and was below median for the 2003/06 cycle). Accordingly, no long-term bonus units were earned by executive Directors and no payment will be made in June 2007 (2006 nil).

No share awards in respect of prior periods have vested and been exercised in the year, and none were outstanding at 31 March 2007 (2006 nil).

Alliance UniChem Long-Term Incentive Plan – former Alliance UniChem incentive arrangement

The former executive Directors of Alliance UniChem participated in the Alliance UniChem

Long-Term Incentive Plan under which allocations were made with the aim of rewarding them for creating shareholder value. All outstanding awards under this plan vested on the date of the merger in accordance with the plan rules. The details of how these arrangements affected former executive Directors of Alliance UniChem, including the former Chief Executive Ian Meakins, are set out below in the pro forma emoluments table on page 60.

Pension

Richard Baker and Scott Wheway receive pension entitlements from the Company's principal UK defined benefit pension scheme referred to in note 38. They also receive supplementary pension arrangements which are aimed at providing a pension (when taken together with retained benefits from other employment) of two-thirds final basic salary at normal retirement age. There is no pension arrangement for Stefano Pessina. George Fairweather is a member of the defined benefit section of the Alliance UniChem Group UK Pension Scheme and is a deferred member of the Alliance UniChem 1993 Pension Scheme. Steve Duncan is a deferred member of the Alliance UniChem Group UK Pension Scheme and has ceased to accrue pension benefits in respect of future service. His accrued pension benefit is defined by reference to his final pensionable salary as defined in the Alliance UniChem Group UK Pension Scheme. From 6 April 2006, Steve Duncan has received a supplementary payment set at 40% of his basic salary. Ornella Barra is a member of a tax approved pension scheme to which defined contributions are made by the Company. Subject to Ornella Barra only selecting investments offered by the scheme, a certain level of benefits are guaranteed to be payable at retirement; are guaranteed Pension entitlement is calculated only on the basic salary element of remuneration.

Richard Baker and Scott Wheway were subject to the former revenue caps and are subject to the new revenue limits, and accordingly have been and will, where appropriate, continue to be members of unfunded unapproved pension arrangements which provide similar benefits in excess of the relevant caps. George Fairweather was subject to former revenue caps, but since April 2006, the earnings cap has been removed in respect of his benefits under the Alliance UniChem Group UK Pension Scheme. As a result, he ceased membership of the Alliance UniChem 1993 Pension Scheme, and an annuity adjustment was made to his benefits under the Alliance UniChem Group UK Pension Scheme commensurate with the value of his entitlement. With effect from 1 June 2006, the Company closed its UK defined benefit pension schemes to new employees.

Other benefits

Executive Directors are entitled to a company car or car allowance, security costs and other benefits comparable to those provided by other major UK companies. During the year, Richard Baker, George Fairweather, Scott Wheway, Paul Bateman and Jim Smart participated in funded unapproved death benefit schemes which provided benefits on death comparable to those contained in the Company's approved pension schemes. In respect of income above the revenue income cap, Stefano Pessina and Ornella Barra are reimbursed the cost of travel to and from work, accommodation and subsistence while working for the Company in the UK. The provision of these benefits reflects market practice and does not relate to performance. The value of these benefits for each Director serving during the year, including expenses chargeable to UK income tax, are detailed in the emoluments section of this report. Where a Director is entitled to a benefit but chooses not to take that benefit, a cash supplement is paid in lieu of that benefit.

Board report on remuneration (continued)

Service contracts

Each of the executive Directors has a service contract which terminates when the Director in question reaches the age of 60 with the exception of Stefano Pessina whose service contract terminates when he reaches the age of 70. All executive Directors' service contracts are terminable by the Company on one year's notice and the Committee has determined that one year's notice is the appropriate period of notice to be given to an executive Director. Stefano Pessina, Richard Baker and Ornella Barra have service contracts that can be terminated by each of them with notice of six months.

Details of the contracts of executive Directors who served during the year are as follows:

| | Date of contract | Unexpired term | Notice period |
|------------------------------|------------------|----------------------------|---------------|
| Stefano Pessina ¹ | 31 July 2006 | 1 year rolling | 1 year |
| Richard Baker ¹ | 8 August 2003 | 1 year rolling | 1 year |
| George Fairweather | 31 July 2006 | 1 year rolling | 1 year |
| Ornella Barra ¹ | 31 July 2006 | 1 year rolling | 1 year |
| Steve Duncan | 31 July 2006 | 1 year rolling | 1 year |
| Scott Wheway | 1 August 2006 | 1 year rolling | 1 year |
| Paul Bateman | 25 July 2002 | Terminated on 31 July 2006 | 1 year |
| Jim Smart | 17 May 2006 | Terminated on 31 July 2006 | 1 year |

1 The service contracts for Stefano Pessina, Richard Baker and Ornella Barra can be terminated by each of them with six months' notice.

There are provisions in the service contracts for payment of current basic salary in lieu of the required notice period to terminate a service contract. The Committee's policy on termination of executive Directors' service contracts is that in the event of any service contract being terminated by the Company giving less than the contractual period of notice the requirement for the Director to mitigate their loss where appropriate is taken into account in determining any resulting compensation. In the case of Richard Baker, however, the Company at the date of his appointment agreed provisions relating to pay in lieu of notice under which if Richard Baker's contract is terminated with less notice than his contract provides, then he will receive 85% of the salary, pension and short term bonus and other benefits he would have received had he been given the notice to which he was entitled under his contract, but without receiving any compensation for loss of long-term incentives or share options.

Paul Bateman and Jim Smart resigned as executive Directors of the Company on 31 July 2006. Their emoluments for the year as Directors and their payment for loss of office

are set out in the emoluments section of this report. Before the merger, the Company agreed with Jim Smart that if his appointment as Chief Financial Officer was terminated without notice as a consequence of the merger he would receive a redundancy payment calculated in accordance with the Company's redundancy policy. His termination package, which was effective from 30 September 2006, included ten months' basic pay, a sum equal to the value he might reasonably have expected to receive under the bonus schemes and share option plans in which he participated, car allowance and other benefits had he been given and accepted 10 months' notice. In addition, his pension was enhanced for that period. Paul Bateman received the same terms for his termination which was effective from 28 February 2007.

It is recognised that executive Directors may be invited to become non-executive Directors of other companies and that the additional experience and knowledge that this brings will benefit the company. Accordingly, the policy is to allow executive Directors to accept up to one such appointment where no conflict of interest arises, and to retain the fees received.

Stefano Pessina is a non-executive Director of Galenica, an associate company. He waived his entitlement to fees as part of the agreement with Galenica. George Fairweather is a non-executive Director of Mitchells & Butlers and retained fees of £36,616 paid for the period 31 July 2006 to 31 March 2007 for that appointment.

Each Director is required to stand for re-election every three years and may be required to stand for re-election at an earlier date in order to satisfy the provisions in the Company's Articles of Association that not less than one-third of the Board seek re-election at each AGM. The Articles of Association of the Company contain provisions relating to earlier vacation of office without notice.

Non-executive Directors

The Chairman and each of the other non-executive Directors has a written letter of appointment with the Company, terminable by either party without notice or compensation with the exception of the former Alliance UniChem non-executive Directors whose appointments are terminable by either party on one month's notice. The letters of appointment set out the expected time commitment.

During the year the Board reviewed the fees payable to the Chairman and each of the other non-executive Directors following a benchmarking review undertaken by Kepler Associates. The Chairman's fee was increased to £500,000 per annum with effect from 1 November 2006. These fees are paid in the form of shares in the Company which the Company purchases on his behalf. The fee was fixed for a three year period. Before the merger the Chairman's fee had been increased to £360,000 per annum with effect from 1 June 2006.

The fees for the other non-executive Directors were also reviewed during the year. The basic fee for other non-executive Directors was increased to £55,000 per annum with effect from 1 August 2006. Guy Dawson the senior

independent non-executive Director receives a fee of £70,000 per annum which includes an additional fee of £15,000 per annum for chairing the audit committee. Tim Parker receives a fee of £70,000 per annum which includes an additional fee of £15,000 per annum for chairing the remuneration committee. Patrick Ponsolle receives a fee of £65,000 per annum which includes an additional fee of £10,000 per annum for chairing the nominations committee. Hélène Ploix receives a fee of £65,000 per annum which includes an additional fee of £10,000 per annum for chairing the social responsibilities committee. Before the merger the basic fees for the existing Boots non-executive Directors had been increased to £45,000 per annum with effect from 1 June 2006 with an additional fee for chairing the audit committee of £15,000 per

annum and an additional fee for chairing the remuneration committee and social responsibilities committee of £9,000 and £7,000 per annum respectively.

Non-executive Directors do not participate in any pension scheme, bonus or share option scheme arrangements. Sir Nigel Rudd is reimbursed the expenses that the committee considers reasonable for providing his own car and driver whilst travelling on the Company's business. Non-executive Directors are reimbursed travel, subsistence and accommodation costs, security costs (in some cases) and where applicable, the related tax benefit in kind.

The initial appointment date and the year of last appointment at an AGM/EGM for the non-executive Directors are as follows:

| Director | Initial appointment date | Year of last appointment at an AGM/EGM |
|---------------------------|--------------------------|--|
| Sir Nigel Rudd | 14 December 1999 | 2006 |
| G. N. Dawson | 15 September 2003 | 2004 |
| W. A. Loader ¹ | 31 July 2006 | 2006 |
| T. C. Parker | 28 January 2004 | 2004 |
| H. Ploix | 7 September 2000 | 2004 |
| P. Ponsolle ² | 31 July 2006 | 2006 |
| M. Stach ³ | 31 July 2006 | 2006 |

¹ Appointed at the EGM held on 4 July 2006. Initially appointed to Alliance UniChem Board on 24 September 2003.

² Appointed at the EGM held on 4 July 2006. Initially appointed to Alliance UniChem Board on 30 December 1997.

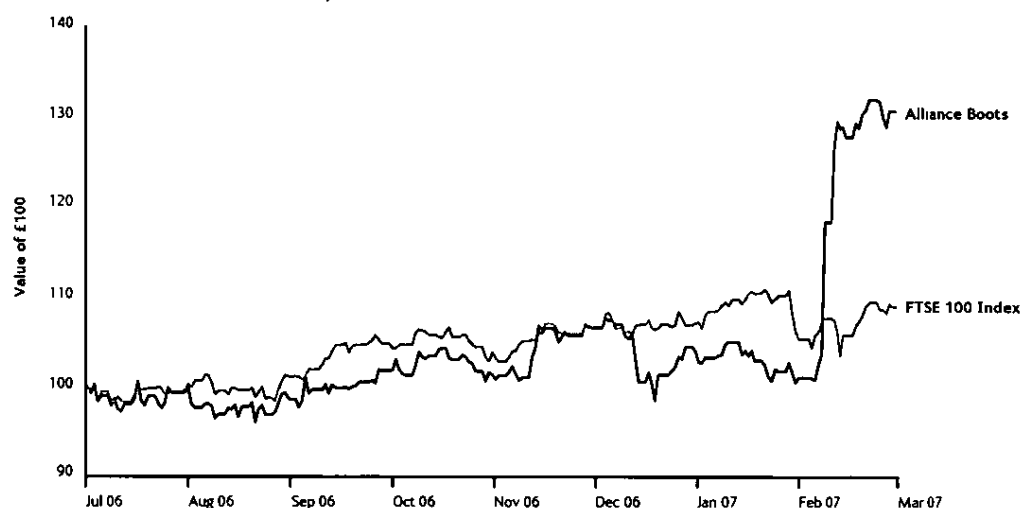
³ Appointed at the EGM held on 4 July 2006. Initially appointed to Alliance UniChem Board on 8 December 2003.

Board report on remuneration (continued)

Performance graph

The following graph shows the total shareholder return over the period since the merger to 31 March 2007 for the Company's shares relative to the FTSE 100 Index. The FTSE 100 is considered to be an appropriate index for comparison as it is well recognised the Company forms part of that index and investors in the Company are likely to regard other FTSE 100 companies as alternative investments.

Value of £100 invested in July 2006



Dilution information

The Company share plans have always complied with recommended guidelines on dilution limits. Assuming none of the outstanding Executive Share Option Plan or SAYE options lapse and will be exercised and having included all exercised options under these plans since April 1997 the Company has utilised under 1% of the 10% in 10 years and under 1% of the 5% in 10 years in accordance with the NAPF corporate governance policy.

Audit

The following sections of the above report form part of the financial statements on which the auditors have expressed their opinion on page 68: the statutory emoluments table, the Directors' share interest tables on pages 58 to 62 and the pension entitlement table on page 63.

Directors' remuneration 2006/07

Analysis of emoluments and short term bonuses are shown on pages 59 and 60. Details of outstanding share options and gains on share options are shown on page 54, shareholdings are shown on page 62, and pension entitlements on page 63.

Emoluments

An analysis of Directors' emoluments relating to salary and fees, short term bonuses, pension supplement, other benefits (other than share options, LTBS and pensions) and termination payments for the year ended 31 March 2007 are shown in the tables on pages 59 and 60.

The first table is prepared on a statutory basis and shows the emoluments for the Directors of the Company that served during the reporting

periods. The emoluments relating to the former Directors of Alliance UniChem are therefore included for the period from 31 July 2006 to 31 March 2007.

The second table is prepared on a pro forma basis to assist investors and includes the information from the first table with the addition of the emoluments of the former Alliance UniChem Directors who were appointed to the Board on 31 July 2006 for the period from 1 April 2005 to 31 July 2006 and is based on their emoluments received from Alliance UniChem. It excludes the emoluments of the Directors of the Company who resigned on or before 31 July 2006.

Statutory information

| £000 | Salaries and fees | Short term bonuses | Pension supplement | Other benefits | Termination payment | Total 2007 | Total 2006 |
|--------------------------------|-------------------|--------------------|--------------------|----------------|---------------------|------------|------------|
| Executive directors | | | | | | | |
| S Pessina ² | 395 | 680 | – | 49 | – | 1,124 | – |
| R A Baker ¹ | 767 | 1,167 | – | 53 | – | 1,987 | 1,181 |
| G R Fairweather ² | 313 | 531 | – | 15 | – | 859 | – |
| O Barra ² | 267 | 463 | – | 17 | – | 747 | – |
| S W J Duncan ² | 253 | 436 | 101 | 14 | – | 804 | – |
| J S Wheway ² | 281 | 482 | – | 24 | – | 787 | – |
| | 2,276 | 3,759 | 101 | 172 | – | 6,308 | 1,181 |
| Former directors | | | | | | | |
| P Bateman ³ | 122 | 103 | – | 9 | 1,017 | 1,251 | 641 |
| J R Smart ⁴ | 121 | 129 | – | 5 | 788 | 1,043 | 304 |
| Dr M P Read ⁵ | 15 | – | – | 1 | – | 16 | 45 |
| H Dodd ⁶ | – | – | – | – | – | – | 552 |
| J Bennink ⁷ | – | – | – | – | – | – | 14 |
| | 258 | 232 | – | 15 | 1,805 | 2,310 | 1,556 |
| Non-executive directors | | | | | | | |
| Sir Nigel Rudd ⁸ | 419 | – | – | 31 | – | 450 | 312 |
| G N Dawson | 65 | – | – | 1 | – | 66 | 54 |
| W A Loader ² | 37 | – | – | – | – | 37 | – |
| T C Parker | 61 | – | – | 3 | – | 64 | 39 |
| H Ploix | 59 | – | – | 20 | – | 79 | 54 |
| P Ponsolle ² | 43 | – | – | – | – | 43 | – |
| M Stach ² | 37 | – | – | – | – | 37 | – |
| | 721 | – | – | 55 | – | 776 | 459 |
| | 3,255 | 3,991 | 101 | 242 | 1,805 | 9,394 | 3,196 |

¹ Highest paid director

² Appointed to the Board on 31 July 2006

³ Resigned from the Board on 31 July 2006. Remained as an employee until 28 February 2007 and received emoluments of £232,570 covering basic salary and car allowance. Received payment on termination of his employment. This payment covered basic salary for an agreed ten months notice period, a severance payment, car allowance, performance share plan, bonus co-investment AESOP and a bonus payment for the period to 31 December 2007 based on target performance.

⁴ Appointed to the Board on 3 October 2005, resigned 31 July 2006 and remained as an employee until 30 September 2006 and received emoluments of £68,679 covering basic salary and car allowance. Received a payment on termination of his employment. This payment covered basic salary for an agreed ten months notice period, a severance payment, car allowance, performance share plan, bonus co-investment, life insurance and a bonus payment for the period to 31 July 2007 based on target performance.

⁵ Resigned from the Board on 20 July 2006

⁶ Resigned from the Board on 18 May 2005

⁷ Resigned from the Board on 21 July 2005

⁸ The 2006 comparative has been adjusted by £15,000

⁹ Other benefits for non-executive Directors comprise travel, subsistence and accommodation costs and the related tax benefit in kind

The aggregate of directors' emoluments before termination payments was £7,589,000 (2006 £2,705,000)

Board report on remuneration (continued)

Pro-forma information

| £000 | Salaries and fees | Short term bonuses | Pension supplement | Other benefits | Total 2007 | Total 2006 |
|--------------------------------|-------------------|--------------------|--------------------|----------------|--------------|--------------|
| Executive directors | | | | | | |
| S Pessina | 565 | 794 | – | 69 | 1,428 | 872 |
| R A Baker | 767 | 1,167 | – | 53 | 1,987 | 1 181 |
| G R Fairweather | 443 | 618 | – | 23 | 1,084 | 681 |
| O Barra | 377 | 537 | – | 24 | 938 | 580 |
| S W J Duncan | 363 | 510 | 145 | 21 | 1,039 | 589 |
| J S Wheway ¹ | 391 | 546 | – | 29 | 966 | 617 |
| | 2,906 | 4,172 | 145 | 219 | 7,442 | 4,520 |
| Non-executive directors | | | | | | |
| Sir Nigel Rudd ² | 419 | – | – | 31 | 450 | 312 |
| G N Dawson | 65 | – | – | 1 | 66 | 54 |
| W A Loader | 53 | – | – | – | 53 | 50 |
| T C Parker | 61 | – | – | 3 | 64 | 39 |
| H Ploix | 59 | – | – | 20 | 79 | 54 |
| P Ponsolle | 60 | – | – | – | 60 | 50 |
| M Stach | 53 | – | – | – | 53 | 50 |
| | 770 | – | – | 55 | 825 | 609 |
| | 3,676 | 4,172 | 145 | 274 | 8,267 | 5 129 |

1 The pre 31 July 2006 data covers disclosure of emoluments received as an employee

2 The 2006 comparative has been adjusted by £15 000

3 Other benefits for non executive Directors comprise travel subsistence and accommodation costs and the related tax benefit in kind

Ian Meakins the former Chief Executive of Alliance UniChem, received total emoluments of £1 155 000 for the period 1 January 2006 to 31 March 2007. He resigned from the Alliance UniChem Board on 31 July 2006.

These emoluments were made up as follows

| | £000 |
|---------------------------------|--------------|
| Salary | 390 |
| Bonus | 201 |
| Salary supplement | 169 |
| Compensation for loss of office | 61 |
| Payment in lieu of notice | 297 |
| Benefits | 37 |
| | 1 155 |

Payment in lieu of notice will cover a twelve month period from 31 July 2006 and has been subjected to mitigation for the period from 1 January 2007 to 31 March 2007.

Jeff Harris resigned as Chairman from the Board of Alliance UniChem on 22 April 2005. He received fees of £40 000 for the period from 1 January 2006 to 31 March 2007 for acting as a member of the supervisory board of Andrae-Noris Zahn (ANZAG) an associate company. In addition he received an unfunded pension of £21,734 in the period and executive share option gains of £80 179.

No termination payments were made to the former non-executive Directors of Alliance UniChem who were not appointed as non-executive Directors of the Company. The former non-executive Directors of Alliance UniChem received no increase in the rate of their fees between 1 January 2006 and 31 July 2006.

In respect of the former executive Directors of Alliance UniChem the following awards were made on previous allocations between 1 January 2006 and the date of the merger

| | Performance period | Allocation £ | Award nominal value £ | Option price pence | Award Alliance UniChem shares number | Boots shares |
|-----------------|--------------------|-----------------|--------------------------|-----------------------|--------------------------------------|--------------|
| S Pessina | 01/01/03-31/12/05 | 233 333 | 210 233 | 914 0 | 23,001 | Exercised |
| | 01/01/04-31/12/06 | 300 000 | 300 000 | 1018 0 | 29,469 | 39 252 |
| | 01/01/05-31/12/07 | 485,000 | 485,000 | 1018 0 | 47,642 | 63,459 |
| G R Fairweather | 01/01/03-31/12/05 | 220,000 | 198 220 | 914 0 | 21 687 | 28,887 |
| | 01/01/04-31/12/06 | 233 333 | 233 333 | 1018 0 | 22,920 | 30 529 |
| | 01/01/05-31/12/07 | 375 000 | 375 000 | 1018 0 | 36,836 | 49 065 |
| O Barra | 01/01/03-31/12/05 | 180,000 | 162,180 | 914 0 | 17 743 | Exercised |
| | 01/01/04-31/12/06 | 193,333 | 193 333 | 1018 0 | 18 991 | 25,296 |
| | 01/01/05-31/12/07 | 310 000 | 310 000 | 1018 0 | 30,451 | 40 560 |
| S W J Duncan | 01/01/03-31/12/05 | 156,667 | 141,156 | 914 0 | 15 443 | Exercised |
| | 01/01/04-31/12/06 | 186 666 | 186 666 | 1018 0 | 18,336 | 24,423 |
| | 01/01/05-31/12/07 | 315 000 | 315 000 | 1018 0 | 30,943 | 41 216 |

During the performance period from 1 January 2003 to 31 December 2005 Alliance UniChem was in the 68 4th percentile of the comparator group on total shareholder return, which was the FTSE 100 for the 2003 allocation and the increase in diluted earnings per share was in excess of RPI-x +6%. On this basis awards equivalent to 90 1% of the allocations were made and converted into Alliance UniChem share options at 914 pence per Alliance UniChem share at the time of the merger

The Alliance UniChem remuneration committee determined that all the applicable performance targets were met at the time of the merger for the 2004 and 2005 allocations. Consequently awards equivalent to 100% of the allocations vested and converted into Alliance UniChem shares options at 1018 pence per Alliance UniChem share following the sanction of the merger by the Court

Each of these directors has voluntarily agreed to continue to hold the shares awarded from the 2004 and 2005 allocations until the earlier of

the date they would have been able to realise the value of the allocations under the rules of the scheme if the merger had not occurred or the date of ceasing to be employed by the Company. In the case of George Fairweather and Steve Duncan sufficient shares were sold to settle the income tax and National Insurance liability arising on the vesting of the awards

Stefano Pessina and Ornella Barra exercised their awards arising from the 2003 allocations for £1 respectively on 16 March 2006. The market price of an Alliance UniChem share on the date of exercise was 933 5 pence. Steve Duncan exercised his award arising from the 2003 allocation for £1 on 14 March 2006. The market price of an Alliance UniChem share on the date of exercise was 918 pence

George Fairweather exercised 2,804 shares at 337 pence which had matured under the Alliance UniChem Savings Related Share Option Scheme on 28 July 2006. The market price of an Alliance UniChem share on the date of exercise was 1 068 0 pence

Ian Meakins the former Chief Executive of Alliance UniChem received an award equivalent to 100% of his 2004 and 2005 allocations and these provided an award of £1,025,000 in cash

Alliance UniChem Ian Meakins – share incentive plan

Ian Meakins was granted an option to acquire 119 946 Alliance UniChem shares on 17 December 2004. In accordance with his service agreement with Alliance UniChem he was also granted a further option to acquire 153 571 Alliance UniChem shares matching the initial award. These awards vested as a consequence of the merger and the initial award and matching award realised a total of £1,977,430

Board report on remuneration (continued)

Directors' shareholdings

The beneficial interests of the Directors in office at 31 March 2007 and their families in the share capital of the Company at 31 March 2007 are shown below. The Company's register of Directors' interests, which is open to inspection, contains full details of Directors' interests in the Company's shares.

| Shareholdings | Ordinary shares 2007 | Ordinary shares 2006 |
|--------------------------------|----------------------|----------------------|
| Sir Nigel Rudd | 49,028 | 31,600 |
| S. Pessina ¹ | 145,599,108 | 145,048,918 |
| R. A. Baker | 24,514 | 6,226 |
| G. R. Fairweather ¹ | 83,171 | 83,171 |
| O. Barra ¹ | 559,021 | 559,021 |
| S. W. J. Duncan ¹ | 44,419 | 64,419 |
| J. S. Wheway ¹ | 4,567 | 4,567 |
| G. N. Dawson | 2,689 | 2,689 |
| W. A. Loader ¹ | 8,159 | 8,159 |
| T. C. Parker | 4,263 | 4,263 |
| H. Ploix | 2,740 | 2,740 |
| P. Ponsolle ¹ | 693 | 666 |
| M. Stach ¹ | 1,500 | — |

¹ The holdings disclosed in 2006 are at the date of appointment on 31 July 2006.

As at 31 March 2007, 145,300,000 shares of the interest of Stefano Pessina are held by Alliance Santé Participations S.A. Stefano Pessina indirectly wholly owns Alliance Santé Participations S.A., which is registered in Luxembourg and its Directors include Stefano Pessina and Ornella Barra. The other interests of Ornella Barra in the Company's shares are as detailed in this report.

Each executive Director is deemed, as potential beneficiaries, to have an interest in 4,321,954 (2006: 5,374,119) ordinary shares of the Company held by Boots (QUEST) Trustee Ltd, on behalf of Boots Qualifying Employee Share Trust, established in connection with the Company's UK All Employee SAYE Share Option Scheme. In 3,749,682 (2006: 2,039,980) ordinary shares of the Company held by Boots Share Plan Trustees Ltd, on behalf of The Boots Company PLC AESOP Trust and The Boots Group PLC AESOP Trust, established to hold shares for employees in connection with the Company's AESOP and in 589,619 (2006: 589,619) ordinary shares of the Company held by Boots ESOP Trust Ltd, on behalf of Boots Employee Trust, established to facilitate the operation of the Company's executive bonus schemes.

Stefano Pessina, George Fairweather, Ornella Barra and Steve Duncan are deemed, as potential beneficiaries, to have an interest in 3,333,029 ordinary shares of the Company held by The Alliance UniChem 1992 Employee Share Trust. The trust exists in connection with the discretionary Alliance UniChem 1997 Share Option Scheme. The Trust has not acquired any shares in the Company since the merger. Under the terms of the Trust, the dividend receivable on shares held is 0.001 pence per share. This waiver was lifted for the merger dividend. No Director holds any loan capital. The personal shareholdings of Directors in office at 31 March 2007 remain unchanged on 2 May 2007, other than Richard Baker who now holds a further 11 shares purchased under the share investment plan element of the AESOP and the number of shares held by Boots Share Plan Trustees Ltd has reduced, thereby reducing each Director's deemed interest.

Other interests

Save for the Interests mentioned in this report no Director was materially interested in any contract during the financial year that is or was significant to the business of the Company or any subsidiary undertaking

No Director has common or other significant links with any other Director (except in the case of executive Directors holding directorships of subsidiary companies of the Company)

Pension entitlement

Details of pensions earned by the executive Directors in office at 31 March 2007 or at date of retirement are shown below

Directors' Pension Entitlements 31 March 2007

| £000 | Age | Accrued pension at 31 March 2007 or date of resignation from Board if earlier | Increase in accrued pension during the year to 31 March 2007 gross of inflation per annum | Increase in accrued pension during the year to 31 March 2007 net of inflation per annum | Money purchase contributions during the year | Transfer value of accrued benefits as at 31 March 2006 or date joined Board if later | Transfer value of accrued benefits as at 31 March 2007 or date of resignation from Board if earlier | Increase in transfer value of benefits less directors contributions | Transfer value of net of inflation in accrued benefits less Directors contributions |
|------------------------------|-----|---|---|---|--|--|---|---|---|
| R A Baker | 44 | 71 | 22 | 20 | – | 724 | 1 124 | 347 | 271 |
| G R Fairweather ³ | 49 | 78 | 22 | 20 | – | 592 ⁴ | 883 | 277 | 212 |
| O Barra ¹ | 53 | – | – | – | 139 ² | – | – | – | – |
| S W J Duncan ⁹ | 56 | 115 | – | – | – | 1 688 ⁴ | 1,855 | 167 | – |
| J S Wheway ³ | 40 | 16 | 8 | 8 | – | 123 ⁴ | 229 | 86 | 87 |
| P Bateman ⁵ | 53 | 88 ⁶ | 7 | 4 | – | 1 462 | 1 719 ⁶ | 249 | 72 |
| J R Smart ⁵ | 47 | 35 ⁶ | 6 | 4 | – | 484 | 62 ⁶ | 130 | 71 |

The information above has been based on data supplied by the advisers of the respective schemes

1 Omella Barra appointed on 31 July 2006 is a member of the International Pension Scheme (money purchase scheme)

2 Contributions paid since 31 July 2006

3 George Fairweather and Scott Wheway appointed on 31st July 2006

4 Figures shown as at 31 July 2006

5 Jim Smart and Paul Bateman resigned on 31 July 2006

6 Figures shown as at 31 July 2006

7 The increase in accrued pension during the year is after deducting the increase due to inflation at the rate of 3.6% on the previous year's accrued pension

8 AVC contribution and benefits are excluded from the table

9 Steve Duncan was appointed on 31 July 2006 and he holds a deferred pension with the Alliance UniChem Group UK Pension Scheme. His accrued pension has not increased between his date of appointment as director and 31 March 2007

The pension entitlement shown is that which would be paid annually on retirement based on service to the end of the year. Retained benefits from previous employments are taken into account. The increase in accrued pension during the year is after deducting the increase due to inflation at the rate of 3.6%, on the previous year's accrued pension. Members of the schemes have the option to pay additional voluntary contributions.

By order of the Board

Tim Parker

Chairman of the remuneration committee

2 May 2007



Audit committee report

The audit committee consists of four independent non-executive Directors: Guy Dawson (committee Chairman), Adrian Loader, Hélène Ploix and Patrick Ponsolle. The Group Finance Director, the Group Financial Controller, the Director of Internal Audit & Risk Management and representatives from the external auditors are normally invited to attend meetings as appropriate. The committee met five times during the year, the attendance record of members being shown in the table on page 44 in the Board report on corporate governance.

The Director of Internal Audit & Risk Management has the right of direct access to the committee and the Chairman of the Company. The committee has the right to seek and receive any information it requires to fulfil its duties and all Directors and employees are directed to co-operate with any request made by the committee and to attend on demand any meeting of the committee to answer questions.

At each meeting the committee met the Director of Internal Audit & Risk Management and representatives from the external auditors without executive management present. The Chairman of the committee attends the AGM to respond to any shareholder questions that might be raised on the committee's activities. Following each committee meeting, the Chairman of the committee reports material matters to the Board at the next available opportunity.

Guy Dawson, the Chairman of the committee, was, until 2002, Chairman of European Investment Banking at Merrill Lynch and is currently a partner in Tricorn Partners, an independent corporate advisory business, and accordingly has recent relevant financial experience.

The committee agreed that for the period following the merger KPMG Audit Plc would continue to act as auditors for the former Boots Group companies including acting as auditors of the Group and Company. They have had responsibility for issuing public opinions to the members of the Group and Company for the interim and full year consolidated financial

statements. Deloitte & Touche LLP have undertaken audit work to an agreed scope for the former Alliance UniChem businesses reporting to KPMG Audit Plc. Prior to the merger Deloitte & Touche LLP were retained to deliver internal audit services to the former Boots Group companies. Under transitional arrangements Deloitte & Touche LLP continue to provide these services to companies within the Group which are not subject to external audit by them, to provide continuity for internal control purposes. No Deloitte & Touche LLP staff undertaking internal audit services were allowed to be involved in any external audit work and no staff working on the external audit were allowed to undertake any internal audit services. Following the recent appointment of the Director of Internal Audit & Risk it is intended that Deloitte & Touche LLP will phase out their internal audit services by June 2007 by which time internal resources will be established capable of delivering against a full audit and risk management agenda.

As disclosed in the Directors' report the audit committee will undertake a selection process for the selection of a single external auditor for the Group for 2007/08 and make recommendations to the Board as appropriate. Details of the Board recommendations will be set out in the notice of meeting of the AGM to be sent out to shareholders.

Terms of reference

The terms of reference for the committee, which are available on the Company's website, were reviewed and updated in October 2006.

The main responsibilities of the committee, which are set out in the terms of reference, are to:

- review the effectiveness of systems for internal financial control, financial reporting and risk management;
- monitor, review and challenge where necessary the integrity of financial statements and formal announcements relating to the financial performance of the Group;

- consider the appointment, re-appointment and/or removal of the external auditors;
- consider any change to the independence of objectivity of and fees to the external auditors;
- consider the effectiveness of the external audit process taking into consideration relevant UK professional and regulatory requirements;
- maintain and monitor a policy on the engagement of the external auditors to supply non-audit services;
- agree with the external auditors the scope and nature of their audit, review their quality control procedures, ensure co-ordination of audits, review their management letter and management's response and discuss any issues arising from their audit;
- review the programme, resourcing, effectiveness and results of the internal audit function and approve any change to the Director of Internal Audit & Risk Management;
- oversee the process for dealing with complaints received by the Group regarding accounting, internal accounting controls or auditing matters and the confidential anonymous submission by employees of concerns regarding questionable accounting or auditing matters;
- review the consistency of accounting policies;
- monitor compliance with the Group's borrowing limits;
- review the status of any material litigation and contingent liabilities involving the Group and;
- monitor compliance with the principles of good boardroom practice.

Operation of the audit committee

During the year the business considered and discussed by the committee included

- a review of the financial disclosures contained in the Interim and Annual Reports to shareholders together with the associated interim and preliminary announcements
- a review of the Company's compliance with the Code, including disclosures required to be included in the Annual Report,
- a review of accounting policies
- a review of fair value adjustments under IFRS 3 in respect of intangible assets acquired during the year,
- a review of International Accounting Standard 34 ("IAS 34") which established that the standard would be followed for the 2007/08 interim results when it became mandatory
- proposals from the external auditors KPMG Audit Plc and Deloitte & Touche LLP about their independent review of the financial information contained within the 2006/07 Interim Report and their audit programme for the 2006/07 financial statements,
- the amounts of audit and non-audit fees paid to the external auditors (The amounts for the year are set out in note 8 to the financial statements) The Company's policy on non-audit services provided by the external auditors is set out on this page and page 66,
- a review of the objectivity, independence and effectiveness of the external auditors,
- a review of internal controls and practices and risk management procedures including an annual risk review. A unified approach is being adopted covering policies and procedures for risk management commencing with a full business risk review embedded as part of the annual strategic planning process. The committee monitored and reviewed the effectiveness of the Group's internal control systems accounting

policies and practices and risk management procedures, as well as the Company's statement on internal controls. The Board retains overall responsibility for internal control and the identification and management of risks

- proposals from the internal audit function setting out the internal audit plan for the first quarter of 2007/08. This involved using the audit planning processes used by each of the former Boots and the Alliance UniChem businesses by establishing business priorities and common areas of focus for the two merged businesses,
- the results of audits conducted by the internal audit function and management's response to issues raised,
- an annual review of the effectiveness of the internal audit function. The committee considered that the function had been effective throughout the year
- a review of the arrangements for employees to raise concerns, in confidence about possible wrongdoing in financial reporting or other matters further details of which are set out below,
- a review of the principal performance measurement metrics for the enlarged Group,
- a fair value review of the assets and liabilities of the two businesses at the time of the merger in accordance with IFRS 3,
- a review of the accounting assumptions used for the pension schemes of the two businesses at the time of the merger
- a control self assessment process involving letters of representation from each of the business units which are presented to the Committee at half year and full year reporting periods to provide a formal process for confirmation of compliance with internal controls, and
- a review of the committee's effectiveness which concluded that it had discharged its responsibilities as set out in its terms of reference

Policy on non-audit services

As part of its remit the committee keeps under review the nature and extent of audit and non-audit services provided to the Group by the external auditors. The committee has approved a policy for the approval of non-audit services provided by the external auditors. Under this policy the external auditors cannot be engaged to perform any of the following services

- bookkeeping for underlying accounting records or preparation of financial statements to be audited and used outside the Group
- appraisals or other valuation services where the results may be incorporated in audited financial statements,
- actuarial or pension advisory services,
- management functions including human resources,
- investment advisory services including broking or investment banking,
- legal services
- internal audit (on an outsourced basis),
- design and/or implementation of financial information systems and
- any other services that a listed company's external auditors are prohibited from providing under UK or US regulations

Audit committee report (continued)

This list of prohibited non-audit services may only be varied by the audit committee

Under this policy it has been agreed that due to their significant understanding of the Group's business and therefore ensuring cost efficiency, the external auditors may be engaged for the following non-audit services

- assistance in tax compliance activities including tax advisory services,
- due diligence activities associated with potential acquisitions or disposals of businesses,
- accountants reports for any Stock Exchange purposes and ad hoc reporting on historical financial information, and
- any other services which are not prohibited and are authorised by the audit committee

The policy requires the fees for these permitted non-audit services to be approved in advance by the committee. Where such services are considered to be recurring in nature such as for tax and due diligence approval may be sought for the full financial year at the beginning of that year. Approval for other permitted non-audit services has to be sought on a case by case basis. Where no committee meeting is scheduled within an appropriate time frame, the approval is to be sought from the Chairman of the committee. The fee threshold for pre-approved services was set at £0.7 million for each of the auditors KPMG Audit Plc and Deloitte & Touche LLP after the merger. The transitional fees paid to Deloitte & Touche LLP for internal audit services were in addition to any pre-paid fees paid to Deloitte & Touche LLP and were specifically excluded from this policy throughout the transitional period.

Policy on employment of former employees of the external auditor

As part of its remit the committee keeps under review the objectivity, independence and effectiveness of the external auditor. The committee approved a revised paper on the policy on employment of former employees of external auditors. Under this policy

- no member of the external audit team can be recruited into a Group role in the Company for a period of two years following their association with the audit and
- no current or former partner of the external auditor may be appointed as a Director of the Company for three years after the termination of their employment with the external auditor

Until such time as the Company moves to a single audit firm this policy shall apply to both KPMG Audit Plc and Deloitte & Touche LLP

Whistleblowing

24 hour helplines, managed by Expolink operated in the UK during the year. The helplines provide reports to designated officers of the Company including the Company Secretary who in turn report cases to the committee. The committee monitor these cases until resolution is completed. Following the merger a process to review the effectiveness and harmonise the reporting lines throughout the Group is being undertaken to take account of the best practice framework taken from the Public Concern at Work reference material. Throughout the rest of the Group the Company's whistleblowing policy sets out arrangements whereby employees can report to the Company Secretary any concerns or suspicions about possible wrongdoing in financial reporting or other matters which are reported to the committee.

Guy Dawson
Chairman of the audit committee
2 May 2007

Directors' responsibilities statement

The Directors are responsible for preparing the Annual Report and the Group and Company financial statements in accordance with applicable law and regulations

Company law requires the Directors to prepare Group and Company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and have elected to prepare the Company financial statements on the same basis

The Group and parent Company financial statements are required by law and IFRSs as adopted by the EU and applicable law to present fairly the financial position of the Group and the Company and the performance for that period, the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation

In preparing each of the Group and Company financial statements the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and estimates that are reasonable and prudent,
- state whether they have been prepared in accordance with IFRSs as adopted by the EU, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Company will continue in business

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent Company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities

Under applicable law and regulations the Directors are also responsible for preparing a Directors' report, Board report on corporate governance and Board report on remuneration that comply with that law and those regulations

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

Independent auditors report

to the members of Alliance Boots plc

We have audited the Group and Company financial statements (the “financial statements”) of Alliance Boots plc for the year ended 31 March 2007 which comprise the Group income statement, the Group and Company statements of recognised income and expense, the Group and Company balance sheets, the Group and Company cash flow statements, and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Board report on remuneration that is described as having been audited.

This report is made solely to the Company’s members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company’s members those matters we are required to state to them in an auditor’s report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company’s members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The Directors’ responsibilities for preparing the Annual Report, the Board report on remuneration and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Directors’ responsibilities statement.

Our responsibility is to audit the financial statements and the part of the Board report on remuneration to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Board report on remuneration to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether, in our opinion, the information given in the Directors’ report is consistent with the financial statements. The information given in the Directors’ report includes that specific information presented in the risk management, performance review and financial review that is cross referred from the principal activities, business review and development section of the Directors’ report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors’ remuneration and other transactions is not disclosed.

We review whether the Board report on corporate governance reflects the Company’s compliance with the nine provisions of the 2003 Combined Code specified for our review by the Listing Rules of the Financial Services Authority and we report if it does not. We are not required to consider whether the Board’s statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group’s corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

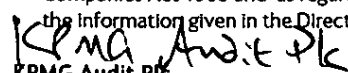
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Board report on remuneration to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group’s and Company’s circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Board report on remuneration to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Board report on remuneration to be audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Group’s affairs as at 31 March 2007 and of its profit for the year then ended,
- the Company financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU as applied in accordance with the provisions of the Companies Act 1985, of the state of the Company’s affairs as at 31 March 2007,
- the financial statements and the part of the Board report on remuneration to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation, and the information given in the Directors’ report is consistent with the financial statements.


 RPMG Audit Plc
 Chartered Accountants
 Registered Auditor
 London 2 May 2007

Group income statement

for the year ended 31 March 2007

| | Notes | 2007 £million | 2006 £million |
|---|-------|------------------|------------------|
| Continuing operations | | | |
| Revenue | 4 | 11,502 | 5 027 |
| Profit from operations before share of associates post tax earnings | 4 6 | 441 | 369 |
| Share of associates' post tax earnings | 19 | 39 | – |
| Profit from operations | 8 | 480 | 369 |
| Finance income | 11 | 251 | 187 |
| Finance costs | 12 | (276) | (207) |
| Profit before tax | | 455 | 349 |
| Tax | 13 | (89) | (45) |
| Profit after tax from continuing operations | | 366 | 304 |
| Discontinued operations | | | |
| Profit after tax from discontinued operations | 5 | 21 | 1,470 |
| Profit for the year | | 387 | 1,774 |
| Attributable to | | | |
| Equity shareholders of the Company | | 387 | 1 774 |
| Minority interests | | – | – |
| | | 387 | 1,774 |
| Earnings per share – total | | | |
| Basic | 14 | 48 4p | 259 4p |
| Diluted | 14 | 48 2p | 259 0p |
| Earnings per share – continuing | | | |
| Basic | 14 | 45 8p | 44 4p |
| Diluted | 14 | 45 6p | 44 4p |

Dividends paid to equity shareholders in the year and shown in the cash flow statement totalled £149 million (2006 £1,640 million)

The Board would ordinarily be recommending in the normal course of business a final dividend covering the period from 31 July 2006 until 31 March 2007. However, the terms of the recommended offer for the Company by AB Acquisitions Limited announced on 20 April 2007 are such that the offer price is inclusive of any final dividend. Accordingly, no such final dividend will be paid. However, if the Company is not acquired by AB Acquisitions Limited (or any alternative offeror), the Board intends that the Company pay in due course an interim dividend, in respect of the year ended 31 March 2007 of an amount equal to the final dividend that would have been paid.

Statements of recognised income and expense

for the year ended 31 March 2007

| Group | 2007 £million | 2006 £million |
|---|------------------|------------------|
| Exchange differences on overseas operations | | |
| – currency translation differences | (11) | 8 |
| – currency translation differences recycled on disposal of Boots Healthcare International | – | (12) |
| Defined benefit pension schemes | | |
| – actuarial gains and losses | 55 | (77) |
| Available-for-sale investments | | |
| – gains on revaluation deferred in equity | 6 | – |
| | 50 | (81) |
| Tax (charge)/credit on items taken directly to equity | (12) | 23 |
| Income and expense recognised directly in equity | 38 | (58) |
| Profit for the year | 387 | 1 774 |
| Total recognised income and expense for the year | 425 | 1 716 |
| Attributable to | | |
| Equity shareholders of the Company | 425 | 1,717 |
| Minority interests | – | (1) |
| | 425 | 1,716 |

Company

There is no recognised income or expense for the Company other than the profit for the year as stated in note 32

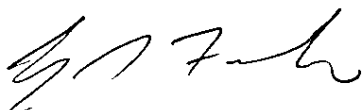
Balance sheets

as at 31 March 2007

| | Notes | Group 2007 £million | Group 2006 £million | Company 2007 £million | Company 2006 £million |
|--|--------|---------------------------|---------------------------|-----------------------------|-----------------------------|
| Assets | | | | | |
| Non-current assets | | | | | |
| Goodwill | 15 | 2,388 | – | – | – |
| Other Intangible assets | 16 | 1,508 | 147 | – | – |
| Property, plant and equipment | 18 | 1,671 | 1,268 | – | – |
| Investments in associates | 19 | 628 | – | – | – |
| Investments in subsidiary undertakings | 20 | – | – | 7,571 | 3,046 |
| Available-for-sale Investments | 21 | 55 | – | – | – |
| Other receivables | 23 | 58 | 32 | – | 1 |
| Derivative financial instruments | 27 | 3 | 2 | – | – |
| Deferred tax assets | 25 | 4 | 55 | 1 | 1 |
| | | 6,315 | 1,504 | 7,572 | 3,048 |
| Current assets | | | | | |
| Inventories | 22 | 1,360 | 594 | – | – |
| Trade and other receivables | 23 | 1,985 | 461 | 1,546 | 1,230 |
| Current tax assets | | 2 | 14 | – | 12 |
| Cash and cash equivalents | 24 | 404 | 856 | 290 | 774 |
| Derivative financial instruments | 27 | 2 | 1 | – | 1 |
| Assets held for sale | 5 | 29 | 1 | – | – |
| | | 3,782 | 1,927 | 1,836 | 2,017 |
| Total assets | | 10,097 | 3,431 | 9,408 | 5,065 |
| Liabilities | | | | | |
| Current liabilities | | | | | |
| Borrowings | 27 | (565) | (183) | (225) | (291) |
| Trade and other payables | 26 | (2,112) | (632) | (978) | (754) |
| Current tax liabilities | | (115) | (56) | (2) | – |
| Provisions | 31 | (75) | (62) | – | – |
| Derivative financial instruments | 27 | (7) | (1) | – | – |
| | | (2,874) | (934) | (1,205) | (1,045) |
| Net current assets | | 908 | 993 | 631 | 972 |
| Non-current liabilities | | | | | |
| Borrowings | 27 | (764) | (575) | (314) | (531) |
| Other payables | 26 | (30) | (30) | (7) | – |
| Deferred tax liabilities | 25 | (456) | (97) | – | – |
| Retirement benefit obligations | 38 | (26) | (56) | – | – |
| Provisions | 31 | (54) | (87) | – | – |
| Derivative financial instruments | 27 | (121) | – | (2) | – |
| | | (1,451) | (845) | (323) | (531) |
| Net assets | | 5,772 | 1,652 | 7,880 | 3,489 |
| Equity | | | | | |
| Share capital | 32, 35 | 360 | 181 | 360 | 181 |
| Share premium | 32 | 2 | 2 | 2 | 2 |
| Shares to be issued | 32 | 11 | – | 11 | – |
| Retained earnings | 32 | 1,393 | 1,131 | 1,052 | 1,154 |
| Merger reserve | 32 | 3,972 | 311 | 6,426 | 2,123 |
| Capital redemption reserve | 32 | 29 | 29 | 29 | 29 |
| Other reserves | 32 | (7) | (2) | – | – |
| Shareholders' equity | | 5,760 | 1,652 | 7,880 | 3,489 |
| Minority interests | 32 | 12 | – | – | – |
| Total equity | | 5,772 | 1,652 | 7,880 | 3,489 |

The financial statements were approved by the Board of Directors on 2 May 2007 and are signed on its behalf by

Richard Baker
George Fairweather
Directors



Cash flow statements

for the year ended 31 March 2007

| | Notes | Group 2007 £million | Group 2006 £million | Company 2007 £million | Company 2006 restated £million ² |
|--|-------|---------------------------|---------------------------|-----------------------------|--|
| Operating activities – continuing operations | | | | | |
| Profit/(loss) from operations | | 480 | 369 | 622 | (641) |
| Adjustments to reconcile profit/(loss) from operations to cash generated from operations | | | | | |
| Share of associates post tax earnings | | (39) | – | – | – |
| Depreciation amortisation and impairments | | 261 | 180 | – | – |
| Share-based compensation | | 9 | 5 | – | 5 |
| Profit on disposal of businesses | | (7) | – | – | – |
| Profit on disposal of property plant and equipment | | – | (171) | – | – |
| (Reversal of impairment)/impairment of investments in subsidiary undertakings | | – | – | (651) | 632 |
| Decrease in inventories | | 9 | 65 | – | – |
| Increase in receivables | | (10) | (27) | (315) | (510) |
| Increase/(decrease) in payables and provisions | | 26 | 127 | 222 | (41) |
| Decrease in retirement benefit obligations | | (47) | (47) | – | – |
| Cash generated from operations – continuing operations | | 682 | 501 | (122) | (555) |
| Tax (paid)/received | | (55) | (69) | 3 | (21) |
| Interest paid | | (92) | (37) | (88) | (220) |
| Net cash from/(used in) operating activities – continuing operations | | 535 | 395 | (207) | (796) |
| Investing activities – continuing operations | | | | | |
| Acquisition of businesses | | (96) | – | (30) | (55) |
| Net cash of businesses acquired | | 76 | – | – | – |
| Disposal of businesses | | 58 | – | – | – |
| Purchase of investments in associates | | (2) | – | – | – |
| Purchase of available-for-sale investments | | (7) | – | – | – |
| Dividends received from associates | | 14 | – | – | – |
| Purchase of property, plant and equipment and intangible assets | | (213) | (181) | – | – |
| Disposal of property, plant and equipment | | 18 | 308 | – | – |
| Interest received | | 64 | 21 | 156 | 289 |
| Dividends received from subsidiaries | | – | – | 10 | 1,000 |
| Net cash (used in)/from investing activities – continuing operations | | (88) | 148 | 136 | 1,234 |
| Financing activities – continuing operations | | | | | |
| Interest element of finance lease obligations | | (7) | (4) | – | – |
| Dividends paid to equity shareholders | | (149) | (1,640) | (149) | (1,640) |
| Payment of Alliance UniChem dividend declared prior to acquisition | | (47) | – | – | – |
| Net (repayment of)/proceeds from borrowings | | (786) | 1 | (104) | 20 |
| Repayment of capital element of finance lease obligations | | (26) | (12) | – | – |
| Purchase of own shares | | – | – | (5) | (6) |
| Repurchase of own shares | | – | (50) | – | (50) |
| Disposal of own shares | | 3 | – | – | – |
| Repayment of loans to subsidiaries | | – | – | 16 | 291 |
| Net cash used in financing activities – continuing operations | | (1,012) | (1,705) | (242) | (1,385) |
| Net cash outflow from continuing operations | | (565) | (1,162) | (313) | (947) |
| Net cash inflow from discontinued operations ¹ | | – | 39 | – | – |
| Cash flows arising from disposal of discontinued operations | | (13) | 1,854 | – | 1,539 |
| Net (decrease)/increase in cash and cash equivalents in the year | | (578) | 731 | (313) | 592 |
| Cash and cash equivalents at 1 April | | 813 | 80 | 589 | (3) |
| Currency translation differences | | – | 2 | – | – |
| Cash and cash equivalents at 31 March | 24 | 235 | 813 | 276 | 589 |

1 During the year ended 31 March 2006 discontinued operations had cash inflows from operating activities of £67 million cash outflows from investing activities of £7 million and cash outflows from financing activities of £21 million

2 As set out in note 20 the Directors have identified certain dividends received that should have been presented as reductions in cost of investment rather than income. The reclassification has a consequential effect on the reconciliation of profit from operations to cash generated from operations from continuing operations. There is no net impact on the cash flow statement.

Notes to the financial statements

for the year ended 31 March 2007

1 General information

Alliance Boots plc (formerly Boots Group PLC) is a public company incorporated in the United Kingdom. The address of its registered office is disclosed in the Information for shareholders section of the Annual Report. The principal activities of the Group are described in the Directors' report. The principal accounting policies applied in the preparation of the financial statements of the Group and the Company are set out below. These policies have been applied consistently to all the years presented unless otherwise stated.

2 Accounting policies

The principal accounting policies adopted in the preparation of the financial statements of the Group and the Company are set out below.

Basis of accounting

The financial statements, prepared in Sterling rounded to the nearest £1 million, have been prepared in accordance with International Financial Reporting Standards as adopted by the EU (adopted IFRSs) as they apply to the financial statements of the Group and of the Company for the year ended 31 March 2007.

The financial statements have been prepared on the historical cost basis, except for certain areas where fair value measurement required by a specific standard has been applied as identified in the accounting policies below.

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts in the financial statements. The areas involving a higher degree of judgement or complexity, or areas where assumptions or estimates are significant to the financial statements are disclosed in note 40.

A separate income statement for the Company has not been presented as permitted by section 230 (4) of the Companies Act 1985.

New accounting policies and future requirements

The accounting policies adopted are consistent with those of the previous financial year except for the following new and amended IFRSs and IFRIC interpretations during the year. Adoption of these revised standards and interpretations did not have any material effect on the financial statements of the Group and the Company.

- IAS 21 (Amendment) The Effects of Changes in Foreign Exchange Rates,
- IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions,
- IAS 39 (Amendment) The Fair Value Option,
- IAS 39 and IFRS 4 (Amendment) Financial Guarantee Contracts
- IFRS 6, Exploration for and Evaluation of Mineral Resources,
- IFRIC 4, Determining whether an Arrangement Contains a Lease,
- IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds,
- IFRIC 6 Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment
- IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies

Standards, amendments and interpretations that are not yet effective and have not been adopted early by the Group

The following standards, amendments and interpretations have been published and are available for early adoption but have not yet been applied by the Group or the Company in these financial statements.

- IAS 1 (Amendment), Capital Disclosures Effective for years commencing on or after 1 January 2007
- IFRS 7 Financial Instruments Effective for years commencing on or after 1 January 2007,
- IFRS 8 Operating Segments Effective for years commencing on or after 1 January 2009
- IFRIC 8 Scope of IFRS 2 Effective for years commencing on or after 1 May 2006,
- IFRIC 9, Reassessment of Embedded Derivatives Effective for years commencing on or after 1 June 2006
- IFRIC 10, Interim Financial Reporting and Impairment Effective for years commencing on or after 1 November 2006
- IFRIC 11 IFRS 2 – Group and Treasury Share Transactions Effective for years commencing on or after 1 March 2007,
- IFRIC 12 Service Concession Arrangements Effective for years commencing on or after 1 June 2008

The Directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements in the period of initial application.

Consolidation

The consolidated financial statements of the Company as at and for the year ended 31 March 2007 comprise the Company and its subsidiaries (together referred to as the "Group") and the Group's interest in associates.

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies so as to obtain benefits from their activities. The results of subsidiaries acquired or disposed of during the year are included in the Group income statement from and to the date that control commences or ceases as appropriate.

An associate is an entity over which the Group, either directly or indirectly, is in a position to exercise significant influence by participating in but without control, or joint control of the financial and operating policies of the entity. Associates are accounted for using the equity method. Unrealised profits and losses recognised by the Group on transactions with an associate are eliminated to the extent of the Group's interest in the associate concerned. Financial statements of some associates are prepared for different reporting periods from that of the Group. Adjustments are made for the effects of transactions and events that occur between the reporting date of an associate and reporting the consolidated financial statements of the Company.

2 Accounting policies (continued)

All intra-group transactions balances and unrealised gains on transactions between Group companies are eliminated on consolidation

In the Company balance sheet Investments in subsidiaries are stated at fair value at the date of acquisition less any dividends received out of the pre acquisition profits of a subsidiary and provisions for subsequent impairment. Where an impairment is charged in the income statement an equal amount is transferred from the merger reserve where available An impairment reversal results in an equal transfer back to the merger reserve

Currency

Foreign currency transactions

At entity level, transactions in currencies other than the entity's functional currency are translated into the entity's functional currency at the exchange rate ruling at the date of the transactions Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the exchange rate ruling at that date Non-monetary assets and liabilities that are measured in terms of historical cost in foreign currencies are translated using the exchange rates at the date of the transaction Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined Exchange gains and losses are recognised in the income statement

Overseas operations

The assets and liabilities of overseas operations including goodwill and fair value adjustments arising on consolidation are translated into Sterling at exchange rates ruling at the balance sheet date The results and cash flows of overseas subsidiaries are translated into Sterling at the average exchange rate for the period which approximates to the underlying actual rates

Exchange differences arising from the translation of the results and net assets of overseas subsidiaries are recognised in the translation reserve

When an overseas operation is sold, the related balance in the translation reserve is recognised in the income statement as part of the gain or loss on sale

The cost of the Company's investments in shares of overseas subsidiaries is stated at the rate of exchange in force at the date each investment was made

Revenue

Revenue shown on the face of the income statement is the amount derived from the sale of goods and services in the normal course of business outside of the Group net of trade discounts value added tax and other sales-related taxes Revenue from the sale of goods is recognised when the Group has transferred the significant risks and rewards of ownership and control of the goods sold and the amount of revenue can be measured reliably Revenue from services is recognised when it is probable that the economic benefits associated with the transaction will flow to the entity and the amount of revenue can be measured reliably

The accounting policies for the major revenue categories are as follows

Retail

Consideration received from customers is recorded as revenue when the Group has completed full performance in respect of that consideration, which is at the point of sale

In respect of the Boots loyalty scheme (the Advantage Card), as points are issued to customers, the retail value of those points expected to be redeemed is deferred When the points are used by customers they are recorded as revenue Sales of gift vouchers are only included in revenue when vouchers are redeemed

Wholesale

Revenue is recognised upon despatch

When the Group acts in the capacity of an agent rather than as the principal in a transaction revenue recognised is the net amount of commission earned by the Group

When the Group acts as a logistics service provider, the service fees are recognised upon performance of the services concerned

Contract manufacturing

Revenue is recognised upon despatch

Own brand export

Revenue is recognised upon despatch

Supplier rebates

Certain suppliers offer rebates when purchases made in a period meet or exceed a predetermined level Rebates are only recognised when there is clear evidence of this type of binding arrangement with the supplier and the rebate receipt is both probable and can be reasonably estimated The rebate is recognised as a reduction in the purchase price

Exceptional items

Exceptional items are items classified by Alliance Boots as exceptional in nature These are not regarded as forming part of the trading activities of the Group and so merit separate presentation to allow shareholders to understand the elements of financial performance and to assess the trends in financial performance

Notes to the financial statements (continued)

for the year ended 31 March 2007

2 Accounting policies (continued)

Finance income

Finance income comprises interest receivable on funds invested calculated using the effective interest rate method, exchange gains, expected returns on pension scheme assets, gains on hedging instruments that are recognised in the income statement and dividends received from investments.

Finance costs

Finance costs comprise interest payable on borrowings calculated using the effective interest rate method, exchange losses, interest on pension scheme liabilities, the interest expense component of finance lease payments and losses on hedging instruments that are recognised in the income statement.

Current/non-current classification

Current assets include assets held primarily for trading purposes, cash and cash equivalents and assets expected to be realised in, or intended for sale or consumption in, the course of the Group's operating cycle. All other assets are classified as non-current assets.

Current liabilities include liabilities held primarily for trading purposes, liabilities expected to be settled in the course of the Group's operating cycle and those liabilities due within one year from the reporting date. All other liabilities are classified as non-current liabilities.

Business combinations and goodwill

Business combinations are accounted for under IFRS 3 using the purchase method of accounting. The cost of acquisition is the consideration given in exchange for the identifiable net assets. This consideration includes any cash paid plus the fair value at the date of exchange of assets given, liabilities incurred or assumed and equity instruments issued by the Group. The cost of acquisition also includes directly attributable costs.

The acquired net assets are initially recognised at fair value. Where the Group does not acquire 100% ownership of the acquired company, a minority interest is recorded as the minority's proportion of the fair value of the acquired net assets. Any adjustment to the fair values is recognised within twelve months of the acquisition date.

Goodwill on acquisitions comprises the excess of the fair value of the consideration plus any associated costs for investments in subsidiary undertakings over the fair value of the identifiable net assets acquired. Any goodwill and fair value adjustments are recorded as assets and liabilities of the acquired company and are recorded in the local currency of that company. The costs of integrating and reorganising acquired businesses are charged to the post-acquisition income statement.

Goodwill is carried at cost less accumulated impairment losses. No amortisation is charged.

For acquisitions prior to 1 April 2004, goodwill is included on the basis of its deemed cost, which represents the amount recorded under UK GAAP. Goodwill arising on acquisitions prior to 1 April 1998 was offset against reserves.

Intangible assets

Retail pharmacy licences

Retail pharmacy licences, being the exclusive right to operate as a pharmacy, are capitalised where there is an asset that can be separated from other identifiable assets that together form a retail pharmacy business. The cost of retail pharmacy licences less any impairment and accumulated amortisation is included in intangible fixed assets.

Customer relationships and contracts

Customer relationships and contracts consist of established relationships with customers through contracts that have been acquired in a business combination or non-contractual customer relationships that meet the requirement for separate recognition. The fair value of customer relationships and contracts less any impairment and amortisation is included in intangible fixed assets.

Software

Software that is not integral to an item of property, plant and equipment is recognised separately as an intangible asset. Software is stated at cost less accumulated amortisation and impairment losses.

Certain direct and indirect development costs associated with internally developed software, including direct costs of materials and services, and payroll costs for employees devoting time to the software projects, are capitalised once the project has reached the application development stage. The costs are amortised from when the asset is ready for use. Costs incurred during the preliminary project stage, maintenance and training costs and research and development costs are expensed as incurred.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the useful lives of the intangible assets unless such lives are indefinite. Intangible assets with an indefinite life are tested for impairment at each balance sheet date. Other intangible assets are amortised from the date they are available for use. The useful lives are as follows:

- Retail pharmacy licences – indefinite
- Customer relationships – 7 to 13 years
- Customer contracts – life of contract
- Software costs – 3 to 8 years

Amortisation periods and methods are reviewed annually and adjusted if appropriate.

2 Accounting policies (continued)

Property, plant and equipment

All property plant and equipment is stated at cost or deemed cost less accumulated depreciation and impairment losses

Depreciation of property plant and equipment is provided to write off the cost, less residual value in equal instalments over their expected useful economic lives as follows

- Freehold land and assets in the course of construction – not depreciated
- Freehold and long leasehold buildings – depreciated to their estimated residual values over their useful economic lives of not more than 50 years,
- Short leasehold properties – remaining period of lease,
- Plant and machinery – 3 to 10 years,
- Fixtures fittings tools and equipment – 3 to 20 years

Residual values remaining useful economic lives and depreciation methods are reviewed annually and adjusted if appropriate

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement

Impairment of assets

The Group's assets are reviewed at each balance sheet date to determine whether events or changes in circumstances exist that indicate that their carrying amount may not be recoverable. If such an indication exists, the asset's recoverable amount is estimated. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. An impairment loss is recognised in the income statement for the amount by which the asset's carrying amount exceeds its recoverable amount. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (referred to as cash-generating units)

For goodwill, other intangible assets that have an indefinite life and assets not yet available for use, the recoverable amount is estimated annually or more frequently when there is an indication that the asset is impaired

Non-current assets held for sale and discontinued operations

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through sale rather than through continuing use. The asset or disposal group must be available for immediate sale and the sale must be highly probable and within one year of the balance sheet date

Non-current assets and disposal groups classified as held for sale are measured at the lower of fair value less costs to sell and carrying amount

Impairment losses on initial classification as held for sale are included in the income statement. Gains reversing previous impairment losses or losses on subsequent remeasurements are also included in the income statement

Assets classified as held for sale are disclosed separately on the face of the balance sheet and classified as current assets or liabilities with disposal groups being separated between assets held for sale and liabilities held for sale. No amortisation or depreciation is charged on non-current assets (including those in disposal groups) classified as held for sale

A discontinued operation is a component of the Group's business that represents a separate major line of business or geographical area of operations that has been disposed of, has been abandoned or meets the criteria for classification as held for sale

Discontinued operations are presented in the income statement as a separate line entitled 'Profit after tax from discontinued operations'

Available-for-sale investments

The Group classifies its listed and unlisted investments as available-for-sale financial assets and measures them at fair value. The fair values of quoted investments are based on current bid prices and for investments where there is no quoted market price, fair value is determined by using valuation techniques, such as estimated discounted cash flows or by reference to the current market value of similar investments. Gains and losses arising from changes in fair values and exchange translation are recognised in equity until the investment is either disposed or derecognised. When an investment is disposed, the related balance in the available-for-sale reserve is recognised in the income statement as part of the gain or loss on sale

Inventories

Inventories are valued at the lower of cost and net realisable value. With the exception of retail, cost is determined using the first in, first out (FIFO) method. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs necessary to make the sale

The cost of raw materials and packaging is their purchase price. The cost of work in progress and finished goods comprises the purchase cost of goods direct labour and those overheads related to manufacture and distribution based on normal activity levels. Retailing merchandise is valued at retail prices and reduced by appropriate margins to take into account factors such as average cost, obsolescence, seasonality and damage

Cash and cash equivalents

Cash and cash equivalents comprises cash in hand and short term deposits with maturities of three months or less from the date of acquisition and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet. Bank overdrafts are included as a component of cash and cash equivalents for the purpose of the cash flow statement

Notes to the financial statements (continued)

for the year ended 31 March 2007

2 Accounting policies (continued)

Financial instruments and derivative financial instruments

Financial assets and liabilities are recognised in the balance sheet at fair value when the Group becomes a party to the contractual provisions of the instrument. The Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operating, financing and investing activities.

In accordance with its treasury policy the Group does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for at fair value with movements taken to the income statement.

Derivative financial instruments are recognised initially at fair value, with movements on remeasurement recognised immediately in the income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged (see below).

The fair value of interest rate swaps is the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

The fair value of forward exchange contracts is their market price at the balance sheet date.

Hedges

Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability or a highly probable forecasted transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in the hedging reserve.

When the forecasted transaction subsequently results in the recognition of a non-financial asset or non-financial liability, the associated cumulative gain or loss is removed from equity and included in the initial cost or other carrying amount of the non-financial asset or liability.

If the hedged forecasted transaction subsequently results in the recognition of a financial asset or financial liability, the associated gains and losses that were recognised directly in equity are reclassified into profit or loss in the same period, or periods, during which the asset acquired or liability assumed affects profit or loss.

For cash flow hedges, other than those covered by the preceding two policy statements, the associated cumulative gain or loss is removed from equity and recognised in the income statement in the same period or periods during which the hedged forecast transaction affects profit or loss. The ineffective part of any gain or loss is recognised immediately in the income statement.

When a hedging instrument expires or is sold, terminated or exercised, or the entity revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised immediately in the income statement.

Fair value hedges

Where a derivative financial instrument hedges the changes in the fair value of a recognised asset or liability or an unrecognised firm commitment (or an identified portion of such an asset, liability or firm commitment), any gain or loss on the hedging instrument is recognised in the income statement. The hedged item is also stated at fair value in respect of the risk(s) being hedged, with any gain or loss recognised in the income statement.

Hedge of monetary assets and liabilities

Where a derivative financial instrument is used to hedge economically the foreign exchange exposure of a recognised monetary asset or liability, no hedge accounting is applied and any gain or loss on the hedging instrument is recognised in the income statement.

Hedge of net investment in foreign operations

On consolidation, the effective portion of the gain or loss on an instrument designated as a hedge of net investment in a foreign operation that is determined to be an effective hedge is recognised directly in the translation reserve. The ineffective portion is recognised immediately in the income statement.

Borrowings

Borrowings are recognised initially at fair value less attributable transaction costs.

Subsequent to initial recognition, borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

Employee benefits

Pensions

The Group operates a number of pension schemes under which contributions by employees and by the sponsoring companies are held in trust funds separated from the Group's finances. Where a pension arrangement is unfunded, provision is made in the balance sheet for the obligation.

2 Accounting policies (continued)

Defined benefit schemes

A defined benefit scheme is a pension scheme that defines an amount of pension benefit that an employee will receive on retirement usually dependent on one or more factors such as age, years of service and compensation. The Group's net obligation in respect of defined benefit pension schemes is calculated separately for each scheme by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods, that benefit is discounted to determine its present value and the fair value of any scheme assets is deducted.

The discount rate is the yield at the balance sheet date on AA rated bonds that have maturity dates approximating to the terms of the Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method. Scheme assets are valued at bid price.

Current and past service costs are recognised in operating profit. Finance costs include interest on pension scheme liabilities and the expected return on scheme assets is included in finance income. Past service costs are recognised immediately to the extent that the benefits are already vested; otherwise they are amortised on a straight-line basis over the average period until the benefits become vested. All actuarial gains and losses that arise in calculating the Group's obligation in respect of a scheme are recognised immediately in reserves and reported in the statement of recognised income and expense.

Defined contribution schemes

Obligations for contributions to defined contribution pension schemes are recognised as an expense in the income statement as they fall due.

Share-based compensation

The fair value of the employee services received in exchange for the grant of options is recognised as an expense. The total amount expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the Company revises estimates of the number of options that are expected to become exercisable, and the impact of the revision of original estimates is recognised in the income statement and a corresponding adjustment is made to equity.

Employee share trusts

Employee share trusts provide for the issue of shares to Group employees, including share issues under share options. Own shares held by the Group's employee share trusts are deducted at cost from equity.

Leases

Leases, for which the Group assumes substantially all the risks and rewards of ownership, are classified as finance leases, including outsourced assets held exclusively for the use of the Group. The cost of assets held under finance leases is included under property, plant and equipment and depreciation is provided in accordance with the policy for the class of asset concerned over the length of the lease. The corresponding obligations under these leases are shown as liabilities. The finance charge element of rentals is charged to the income statement through finance costs to produce, or approximate to, a constant periodic rate of charge on the remaining balance of the outstanding obligations. Lease premiums paid are treated as prepayments and are amortised over the period of the lease.

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Predetermined rental increases included in the lease are recognised on a straight-line basis. Benefits received as an incentive to sign a lease, whatever form they may take, are credited to the income statement on a straight-line basis over the lease term.

Taxation

Tax on the profit or loss for the year represents the sum of the tax currently payable and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current taxation

Current tax is the expected tax payable on the taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates enacted or substantively enacted at the balance sheet date, and any adjustments to tax payable in respect of previous years.

Deferred taxation

Deferred tax is provided in full using the balance sheet liability method. It is the tax expected to be payable or recoverable on the temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. The following temporary differences are not provided for: those arising from the initial recognition of goodwill, the initial recognition of assets and liabilities that affect neither accounting nor taxable profit and differences relating to investments in subsidiaries to the extent that it is not probable that they will reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. The carrying amounts of deferred tax assets are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

Additional income taxes that arise from receipt of dividends from the Group's subsidiary and associate interests are recognised at the same time as the payee recognises the liability to pay the related dividend except where the timing of the payment is not controlled by the Group, in which case a deferred tax liability is recognised in full against those distributable reserves.

Notes to the financial statements (continued)

for the year ended 31 March 2007

2 Accounting policies (continued)

Deferred tax assets and liabilities are offset in the balance sheet when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis

Provisions

Provisions are recognised in the balance sheet when there is a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and that obligation can be measured reliably. If the effect of time value of money is material, provisions are discounted using a current pre-tax rate that reflects the risks specific to the liability.

Dividends

Dividends are recognised through equity in the period in which they are declared.

3 Exchange rates

The significant exchange rates relative to Sterling used in the preparation of the financial statements were as follows:

| | Average | | | Year end | |
|--------------|--|--------------------------------|--------------------------------|----------|-------|
| | 2007 Eight months ended 31 March | 2007 Year ended 31 March | 2006 Year ended 31 March | 2007 | 2006 |
| Euro | 1 487 | 1 475 | 1 464 | 1 472 | 1 445 |
| Turkish Lira | 2 843 | | | 2 737 | |
| US Dollar | 1 936 | 1 893 | 1 778 | 1 963 | 1 734 |

4 Segmental information

Segmental information is presented in respect of the Group's business and geographical segments. The primary format (business segments) is based on the Group's management and internal reporting structure. Inter-segment pricing is determined on an arms length basis. Following the acquisition of Alliance UniChem the Group reassessed its segmental analysis in the light of the size of the Group and its structure. Comparative information has been restated to comply with this new segmental format.

The Group comprises the following continuing business segments:

Retail

Includes all the retail operations across the Group being principally Health & Beauty and Community Pharmacy in the UK along with retail businesses in the Republic of Ireland, Norway, The Netherlands, Italy and Thailand.

Wholesale

Includes all the wholesale operations across the Group. These include operations in the UK, Norway, The Netherlands, Russia, the Czech Republic, France, Italy and Spain.

4 Segmental information (continued)

Other Commercial Activities & Corporate Costs

Includes any activities which fall outside both the retail and wholesale segments being principally contract manufacturing own brand exports and corporate costs, including unrealised profit in stock adjustments

| | Retail £million | Wholesale £million | Other Commercial Activities & Corporate Costs £million | Eliminations £million | Total £million |
|--|--------------------|-----------------------|---|--------------------------|-------------------|
| Revenue and profit for the year ended 31 March 2007 | | | | | |
| Continuing operations | | | | | |
| External revenue | 6,085 | 5,303 | 114 | – | 11,502 |
| Inter-segment sales | 14 | 735 | – | (749) | – |
| Total revenue | 6,099 | 6,038 | 114 | (749) | 11,502 |
| Trading profit/(loss) | 462 | 128 | (41) | – | 549 |
| Exceptional items (note 7) | (37) | (12) | (28) | – | (77) |
| Amortisation of customer related intangible assets | – | (31) | – | – | (31) |
| Profit/(loss) from operations before share of associates post tax earnings | 425 | 85 | (69) | – | 441 |
| Share of associates post tax earnings ¹ | | | | | 39 |
| Profit from operations | | | | | 480 |
| Finance income | | | | | 251 |
| Finance costs | | | | | (276) |
| Profit before tax | | | | | 455 |
| Tax ² | | | | | (89) |
| Profit after tax from continuing operations | | | | | 366 |
| Discontinued operations | | | | | |
| Profit after tax from discontinued operations ³ | | | | | 21 |
| Profit for the year | | | | | 387 |

1 Share of associates post tax earnings included exceptional income of £6 million comprising a profit on disposal of businesses of £3 million and an exceptional tax credit of £3 million

2 Tax on exceptional items amortisation of customer related intangible assets and IAS 39 timing differences amounted to a £35 million credit. Tax also included a credit of £14 million in respect of pharmacy disposals where the taxable gains arising are covered by previously unrecognised losses a release of £14 million of tax provisions in respect of exceptional items recognised in prior years and £6 million of tax credits in respect of restating deferred tax for customer related intangible assets following tax rate reductions in certain continental European countries

3 Profit after tax from discontinued operations included a £17 million release of a prior year tax provision no longer required and £4 million of other items net of tax

| | Retail £million | Other Commercial Activities & Corporate Costs £million | Total £million |
|--|--------------------|---|-------------------|
| Revenue and profit for the year ended 31 March 2006 | | | |
| Continuing operations | | | |
| External revenue | 4,939 | 88 | 5,027 |
| Trading profit/(loss) | 352 | (16) | 336 |
| Exceptional items (note 7) | 65 | (32) | 33 |
| Profit/(loss) from operations | 417 | (48) | 369 |
| Finance income | | | 187 |
| Finance costs | | | (207) |
| Profit before tax | | | 349 |
| Tax ¹ | | | (45) |
| Profit after tax from continuing operations | | | 304 |
| Discontinued operations | | | |
| Profit after tax from discontinued operations ² | | | 1,470 |
| Profit for the year | | | 1,774 |

1 Tax on exceptional items amounted to a £39 million credit relating to continuing operations. The tax charge also included a £12 million credit for adjustments in respect of prior periods

2 Profit after tax from discontinued operations included an attributable tax credit of £31 million in respect of the disposal costs

Notes to the financial statements (continued)

for the year ended 31 March 2007

4 Segmental information (continued)

The primary segment assets and liabilities were as follows

| | Assets £million | Liabilities £million | 2007 Total £million | Assets £million | Liabilities £million | 2006 Total £million |
|---|--------------------|-------------------------|---------------------------|--------------------|-------------------------|---------------------------|
| Retail | 4,857 | (1,054) | 3,803 | 2,400 | (882) | 1,518 |
| Wholesale | 4,127 | (1,405) | 2,722 | – | – | – |
| Other Commercial Activities & Corporate Costs | 357 | (154) | 203 | 244 | (69) | 175 |
| Discontinued operations | – | – | – | 1 | (2) | (1) |
| Eliminations | (343) | 343 | – | (140) | 140 | – |
| Net operating assets | 8,998 | (2,270) | 6,728 | 2,505 | (813) | 1,692 |
| Investments in associates | | | 628 | | | – |
| Available-for-sale investments | | | 55 | | | – |
| Tax | | | (565) | | | (84) |
| Net (borrowings)/cash | | | (1,048) | | | 100 |
| Retirement benefit obligations | | | (26) | | | (56) |
| Total | | | 5,772 | | | 1,652 |

Eliminations include inter-segmental current accounts and interest bearing balances between subsidiary companies

Other segmental information in respect of the primary segments is as follows

| | Retail £million | Wholesale £million | Other Commercial Activities & Corporate Costs £million | Total £million |
|---|--------------------|-----------------------|---|-------------------|
| Year ended 31 March 2007 | | | | |
| Amortisation of other intangible assets | 31 | 32 | – | 63 |
| Capital expenditure | | | | |
| – property, plant and equipment | 181 | 22 | 1 | 204 |
| – intangible fixed assets | 28 | 13 | 5 | 46 |
| Depreciation | 159 | 18 | – | 177 |
| Significant other non-cash expenses | 15 | 1 | 1 | 17 |

| | Retail £million | Wholesale £million | Other Commercial Activities & Corporate Costs £million | Discontinued Operations £million | Total £million |
|---|--------------------|-----------------------|---|--|-------------------|
| Year ended 31 March 2006 | | | | | |
| Amortisation of other intangible assets | 25 | 2 | – | – | 27 |
| Capital expenditure | | | | | |
| – property, plant and equipment | 156 | 7 | 4 | 4 | 167 |
| – intangible fixed assets | 33 | 4 | 6 | – | 43 |
| Depreciation | 140 | 7 | – | – | 147 |
| Significant other non-cash expenses | 5 | 1 | – | – | 6 |

Geographical segments

Segment revenue is based on the geographical location of the customers. Segment assets are based on the geographical location of the assets.

The secondary segment financial information was as follows

| | 2007 £million | Revenue 2006 £million | 2007 Segment assets £million | 2006 Segment assets £million | 2007 Capital expenditure £million | 2006 Capital expenditure £million |
|-----------------|------------------|-----------------------------|------------------------------------|------------------------------------|---|---|
| UK | 6,530 | 4,895 | 6,443 | 3,275 | 220 | 197 |
| Norway | 195 | – | 297 | – | 5 | – |
| The Netherlands | 499 | – | 600 | 38 | 2 | – |
| France | 2,516 | – | 1,220 | 27 | 11 | 2 |
| Italy | 619 | – | 485 | – | 6 | – |
| Spain | 697 | – | 277 | – | 2 | – |
| Other | 573 | 245 | 1,118 | 231 | 4 | 11 |
| Intra-group | (127) | (113) | (343) | (140) | – | – |
| | 11,502 | 5,027 | 10,097 | 3,431 | 250 | 210 |

5 Assets held for sale and discontinued operations

Discontinued operations

In the year ended 31 March 2007 profit after tax from discontinued operations of £21 million related to a £17 million release of a prior year tax provision no longer required in respect of previously discontinued operations and £4 million of other items net of tax, relating to operations discontinued in previous years

The principal disposal in the year ended 31 March 2006 was the Boots Healthcare International business to Reckitt Benckiser (completed on 31 January 2006). The consideration was £1.9 billion. The Portland Ceramics business was also disposed of in the prior year. The disposal of Boots Healthcare International was largely tax free due to the substantial shareholding exemption rules and the utilisation of capital losses previously not recognised for deferred tax purposes. The tax credit of £31 million related to tax relief due on the costs associated with the disposal.

The results of the discontinued operations in the year ended 31 March 2006 were as follows:

| | 2006 £million |
|---|------------------|
| Revenue | 444 |
| Profit from operations | 90 |
| Finance income | 2 |
| Finance costs | (2) |
| Profit before tax | 90 |
| Attributable income tax expense | (22) |
| Profit on disposal of discontinued operations | 1,371 |
| Attributable tax credit | 31 |
| Profit for the year | 1,470 |

The effect of the disposal on individual assets and liabilities of the Group was as follows:

| | 2006 £million |
|---|------------------|
| Other intangible assets | (295) |
| Property, plant and equipment | (49) |
| Inventories | (56) |
| Trade receivables | (146) |
| Overdrafts (net of cash and cash equivalents) | 40 |
| Trade payables | 129 |
| Income and deferred tax | (17) |
| Net identifiable assets | (394) |
| Consideration received ¹ | 1,878 |
| Disposal and other termination costs | (125) |
| Exchange gains recycled | 12 |
| Profit on disposal of businesses | 1,371 |
| Attributable tax credit | 31 |
| Profit on disposal | 1,402 |
| Consideration received, satisfied in cash | 1,926 |
| Costs of disposal paid | (72) |
| Net cash inflow | 1,854 |

¹ Consideration received was cash consideration of £1,926 million less an adjustment for net borrowings items in the disposal balance sheet of £48 million.

For the Company, the cash inflow of £1,539 million was the net proceeds received from the sale of Boots Healthcare International companies owned directly by the Company.

Assets held for sale

The Group is in the process of selling a number of pharmacies as part of the undertaking to the Office of Fair Trading. As such these are classified as disposal groups held for sale. The majority of these were sold in April 2007. In the prior year two properties with a net book value of £1 million were classified as held for sale.

In summary the following are classified as held for sale in the balance sheet:

| | 2007 £million | 2006 £million |
|-------------------------------|------------------|------------------|
| Retail pharmacy licences | 24 | – |
| Property, plant and equipment | 3 | 1 |
| Inventories | 2 | – |
| | 29 | 1 |

Notes to the financial statements (continued)

for the year ended 31 March 2007

6 Profit from operations before share of associates' post tax earnings

| | Before exceptional items and amortisation of customer related intangible assets £million | Exceptional items £million | Amortisation of customer related intangible assets £million | 2007 £million | Before exceptional items £million | Exceptional items £million | 2006 £million |
|--|--|----------------------------------|--|------------------|--|----------------------------------|------------------|
| Revenue | 11,502 | – | – | 11,502 | 5,027 | – | 5,027 |
| Cost of sales | (8,390) | (1) | – | (8,391) | (2,782) | – | (2,782) |
| Gross profit | 3,112 | (1) | – | 3,111 | 2,245 | – | 2,245 |
| Selling distribution and store costs | (2,218) | (60) | (31) | (2,309) | (1,687) | (124) | (1,811) |
| Administrative costs | (345) | (16) | – | (361) | (222) | 157 | (65) |
| Profit from operations before share of associates post tax earnings | 549 | (77) | (31) | 441 | 336 | 33 | 369 |

7 Exceptional items

| | 2007 £million | 2006 £million |
|---|------------------|------------------|
| Costs in relation to merger synergies | (23) | – |
| Pharmacy systems harmonisation | (2) | – |
| Systems rationalisation and supply chain reconfiguration ¹ | (25) | (91) |
| French wholesale network restructuring ² | (10) | – |
| Restructuring of Other Commercial Activities ³ | (23) | – |
| Health & Beauty pharmacy disposals ⁴ | 7 | – |
| Store refurbishment costs | – | (33) |
| Profit on disposal of property, plant and equipment | – | 7 |
| Profit on sale and leaseback ⁵ | – | 150 |
| Other | (1) | – |
| | (77) | 33 |

1 Associated with the systems rationalisation and supply chain reconfiguration programme within the Health & Beauty business

2 Arising from the restructuring of the warehouse network in France

3 Arising on restructuring decisions in contract manufacturing and own brand export business

4 Profit on disposal of Health & Beauty pharmacies sold in accordance with the undertakings given to the Office of Fair Trading

5 Profit on sale and leaseback of 312 stores in July 2005

8 Profit from operations

The following items have been included in arriving at profit from operations

| | Notes | 2007 £million | 2006 £million |
|--|-------|------------------|------------------|
| Amortisation of other intangible assets | | 63 | 27 |
| Depreciation of property plant and equipment | | | |
| – owned assets | | 153 | 125 |
| – held under finance leases | | 24 | 22 |
| Research and development costs | | 5 | 16 |
| Staff costs | 10 | 1,393 | 1,004 |

An analysis of the total remuneration paid to the Group's principal auditor is provided below

| | 2007 £million | 2006 £million |
|---|------------------|------------------|
| Audit of the Group and Company financial statements | 0.8 | 0.2 |
| Audit of subsidiary financial statements | 0.6 | 0.5 |
| Other services supplied as required by legislation | 1.0 | 0.1 |
| Other services relating to taxation | 0.7 | 0.4 |
| Services relating to corporate finance transactions | 0.2 | 0.4 |
| All other services | – | 0.1 |

As detailed in the Audit committee report, following the merger, KPMG Audit plc has continued as the Company's auditors and auditors of the former Boots businesses and Deloitte & Touche LLP has continued as auditor to the former Alliance UniChem businesses. Audit fees paid to Deloitte & Touche LLP in respect of this audit work amounted to £1.5 million. Non audit fees paid to Deloitte & Touche LLP in the year amounted to £1.8 million including £1.4 million for the provision of internal audit services to former Boots businesses under transitional arrangements agreed prior to the merger.

9 Acquisitions and disposals of businesses

Acquisitions

Alliance UniChem

On 31 July 2006 the Company acquired 100% of the ordinary shares of Alliance UniChem Plc ("Alliance UniChem") by means of a scheme of arrangement between Alliance UniChem and its shareholders. The scheme of arrangement was achieved by cancelling Alliance UniChem shares and issuing new shares in Boots Group PLC to existing Alliance UniChem shareholders under a fixed share ratio of 1 332 Boots Group PLC shares for each Alliance UniChem share. On completion of the transaction Boots Group PLC was renamed Alliance Boots plc.

The total purchase consideration of £3,850 million included £3,840 million for the issue of 481.8 million ordinary shares at a fair value of £7.97 per share, £11 million for ordinary shares to be issued in respect of outstanding share options, less £31 million for ordinary shares held in employee share trusts. In addition, £30 million of costs were incurred on the acquisition.

Alliance UniChem is a pan European distributor of healthcare products and provider of healthcare related services. The investment in Alliance UniChem has been included in the Company's balance sheet at its fair value at the date of acquisition.

The book values of the identifiable assets and liabilities and their fair value to the Group at the date of acquisition were as follows:

| | Book value before acquisition £million | Fair value adjustments £million | Fair value £million |
|--|---|---------------------------------------|------------------------|
| Intangible assets | 790 | 572 | 1,362 |
| Property, plant and equipment | 348 | 64 | 412 |
| Investments in associates | 398 | 205 | 603 |
| Available-for-sale investments | 42 | – | 42 |
| Inventories | 749 | 1 | 750 |
| Assets held for sale | 52 | 33 | 85 |
| Trade and other receivables | 1,525 | – | 1,525 |
| Cash and cash equivalents | 191 | – | 191 |
| Borrowings | (1,483) | (20) | (1,503) |
| Trade and other payables | (1,411) | (58) | (1,469) |
| Current and deferred tax liabilities | (148) | (295) | (443) |
| Retirement benefit obligations | (78) | – | (78) |
| | 975 | 502 | 1,477 |
| Minority interests | | | (12) |
| Goodwill arising on acquisition | | | 2,385 |
| | | | 3,850 |
| Satisfied by: | | | |
| Fair value of shares issued/to be issued | | | 3,820 |
| Costs associated with the acquisition | | | 30 |
| | | | 3,850 |

From the date of acquisition, Alliance UniChem contributed £124 million to the profit of the Group. If the combination had taken place at the beginning of the year, the profit for the Group would have been £438 million and revenue from continuing operations would have been £14,608 million.

The goodwill of £2,385 million represents the intangible assets that could not be individually separated and reliably measured due to their nature. This included the increased ability to capitalise on the growth in demand for healthcare and beauty products, the enhanced international growth opportunities in new markets by utilising the complementary skills of the businesses, the cost synergies achievable through the integration, combined with revenue benefits from the application of retail pharmacy and wholesale skills across the enlarged Group.

9 Acquisitions and disposals of businesses (continued)

Other acquisitions

Other acquisitions during the year included the acquisition of the trade and assets of Cardinal Health, the business being subsequently renamed Cordia Healthcare, the acquisition of 33 pharmacies in the UK and The Netherlands, and eight retail outlets in Norway. Total consideration was £67 million, which, after net assets fair valued at £55 million, resulted in goodwill of £12 million arising on acquisition.

Disposals

During the year the Group disposed of 68 pharmacies in accordance with the undertakings given to the Office of Fair Trading. Proceeds were £58 million, which, on net assets of £51 million, led to a profit of £7 million recorded as exceptional items. Disposals in the prior year are disclosed in note 5.

Notes to the financial statements (continued)

for the year ended 31 March 2007

10 Staff costs

The average monthly number of persons employed by the Group including Directors and part-time staff, was

| | Number of heads | 2007 Full time equivalents | Number of heads | 2006 Full time equivalents |
|---|--------------------|----------------------------------|--------------------|----------------------------------|
| Continuing operations | | | | |
| Retail | 69,477 | 42,078 | 60,843 | 35,954 |
| Wholesale | 9,893 | 9,234 | – | – |
| Other Commercial Activities & Corporate Costs | 2,573 | 2,477 | 2,999 | 2,870 |
| | 81,943 | 53,789 | 63,842 | 38,824 |
| Discontinued operations | – | – | 1,999 | 1,907 |
| | 81,943 | 53,789 | 65,841 | 40,731 |

Costs incurred in respect of these employees were

| | 2007 £million | 2006 £million |
|--------------------------|------------------|------------------|
| Wages and salaries | 1,181 | 864 |
| Social security costs | 126 | 69 |
| Pension costs | 77 | 66 |
| Share-based compensation | 9 | 5 |
| | 1,393 | 1,004 |

There are no personnel expenses in the Company

11 Finance income

| | 2007 £million | 2006 £million |
|--|------------------|------------------|
| Interest income | | |
| Bank deposit interest income | 43 | 17 |
| Other finance income | 22 | 7 |
| | 65 | 24 |
| Expected return on pension scheme assets | 185 | 163 |
| Gains on derivative financial instruments | | |
| Ineffectiveness on fair value hedges | 1 | – |
| | 251 | 187 |

12 Finance costs

| | 2007 £million | 2006 £million |
|---|------------------|------------------|
| Interest expense | | |
| Bank loans and overdrafts | 34 | 7 |
| Other loans ¹ | 55 | 29 |
| Finance charges on finance leases | 7 | 4 |
| | 96 | 40 |
| Interest on pension scheme liabilities | 180 | 167 |
| | 276 | 207 |

¹ Included in other loans is interest payable on the £300 million Eurobond of £16 million (2006 £16 million) interest payable on the €300 million Eurobond of £7 million (2006 £5 million) and interest payable on senior notes of £15 million (2006 £nil)

13 Tax

An analysis of the tax charge/(credit) in the year was as follows

| | Continuing 2007 £million | Continuing 2006 £million | Discontinued 2007 £million | Discontinued 2006 £million |
|--|--------------------------------|--------------------------------|----------------------------------|----------------------------------|
| UK corporation tax | | | | |
| Current tax on income for the year at 30% (2006 30%) | 131 | 68 | (15) | (3) |
| Double tax relief | (8) | – | – | – |
| Adjustments in respect of prior years | (24) | (10) | – | 2 |
| Exceptional adjustments in respect of prior years | (14) | – | – | – |
| | 85 | 58 | (15) | (1) |
| Overseas tax | | | | |
| Current tax on income for the year | 25 | 6 | – | 1 |
| Adjustments in respect of prior years | 1 | – | – | – |
| | 26 | 6 | – | 1 |
| Current tax charge | 111 | 64 | (15) | – |
| Deferred tax | | | | |
| Deferred tax charge/(credit) relating to the origination and reversal of temporary differences | | | | |
| – UK | (47) | (29) | – | (5) |
| – overseas | (1) | – | – | (4) |
| Remittable associates' earnings | 3 | – | – | – |
| Adjustments in respect of prior years | 16 | (3) | – | – |
| Adjustments due to changes in tax rates | (8) | – | – | – |
| | (37) | (32) | – | (9) |
| Deferred tax charge on defined benefit pension schemes | 15 | 13 | – | – |
| Deferred tax credit | (22) | (19) | – | (9) |
| Tax charge/(credit) in the income statement | 89 | 45 | (15) | (9) |

The underlying tax charge, calculated before exceptional items, amortisation of customer related intangible assets, IAS 39 timing differences deferred tax restatements for customer related intangible assets and other exceptional tax credits, reconciles to the tax charge in the year as follows

| | Continuing 2007 £million | Continuing 2006 £million | Discontinued 2007 £million | Discontinued 2006 £million |
|--|--------------------------------|--------------------------------|----------------------------------|----------------------------------|
| Underlying tax charge | 158 | 96 | – | 23 |
| Tax on | | | | |
| – exceptional items | (26) | (39) | 2 | – |
| – amortisation of customer related intangible assets | (9) | – | – | – |
| – restating deferred tax on customer related intangible assets | (6) | – | – | – |
| Other exceptional credits | (28) | (12) | (17) | (32) |
| | 89 | 45 | (15) | (9) |

The Group's principal operations are in Europe and therefore the appropriate standard rate of tax is the average of the standard tax rates in the countries of operation, weighted by the amount of profit on ordinary activities before taxation. The reconciliation of expected total tax charge is based on this standard tax rate of 29.8%.

The tax rate, which we define as the tax charge expressed as a percentage of profit from operations before share of associates post tax earnings, net of net finance costs, was 21.4%. This compares to a rate of 12.9% in the previous year. The increase in the tax rate was mainly due to the utilisation in the previous year of previously unrecognised losses to shelter the profit on a sale and leaseback transaction, and also a release of a deferred tax liability no longer required following this transaction.

In the current period the effective tax rate is lower than the expected rate of 29.8% mainly as a result of the recognition of previously unrecognised tax losses, the utilisation of previously unrecognised capital losses and the release of provisions no longer required.

The reconciliation for the year ended 31 March 2006 has been restated to the same basis as for the current year using a standard tax rate of 29.2% for continuing operations and 29.9% for discontinued operations.

Notes to the financial statements (continued)

for the year ended 31 March 2007

13 Tax (continued)

The reconciliation of the expected total tax charge was as follows

| | Continuing 2007 £million | Continuing 2006 £million | Discontinued 2007 £million | Discontinued 2006 £million |
|---|--------------------------------|--------------------------------|----------------------------------|----------------------------------|
| Profit before tax | 455 | 349 | 6 | 1 461 |
| Less share of associates' post tax earnings | (39) | – | – | – |
| | 416 | 349 | 6 | 1 461 |
| Expected tax charge at standard tax rate | 124 | 102 | 2 | 437 |
| Factors affecting charge for the year | | | | |
| Non-taxable/non-deductible items | 5 | 2 | (17) | 2 |
| Depreciation on non-qualifying fixed assets | 6 | 8 | – | – |
| (Profit)/loss on disposal of non-qualifying assets | (1) | (45) | – | 1 |
| Other movements in deferred tax | (8) | (9) | – | (2) |
| Non-taxable disposal of discontinued operations | – | – | – | (445) |
| Movements on unprovided deferred tax in respect of losses | (18) | – | – | (1) |
| Deferred tax on unremitted associates' earnings | 3 | – | – | – |
| Tax losses brought forward and utilised in year | (2) | – | – | – |
| Unrelieved tax losses arising in year | 1 | – | – | – |
| Prior year deferred tax adjustment | 16 | (4) | – | (3) |
| Prior year corporation tax adjustment | (23) | (9) | – | 2 |
| Prior year exceptional corporation tax adjustments | (14) | – | – | – |
| Total tax charge/(credit) | 89 | 45 | (15) | (9) |

Tax on items charged/(credited) to equity comprised

| | 2007 £million | 2006 £million |
|---|------------------|------------------|
| Tax credit on share-based compensation | (3) | – |
| Tax charge/(credit) on retirement benefit obligations | 15 | (23) |
| | 12 | (23) |

14 Earnings per share

Earnings per share is calculated by dividing the profit for the year attributable to equity shareholders by the weighted average number of shares in issue during the year. Diluted earnings per share is calculated by dividing the profit for the year attributable to equity shareholders by the weighted average number of shares in issue added to the dilutive potential shares assuming they had all converted to issued shares at the beginning of the year.

| | 2007 | | | 2006 | | |
|------------------------------------|--------------------|---|--------------------------------|--------------------|---|--------------------------------|
| | Profit £million | Weighted average number of shares million | Earnings per share pence | Profit £million | Weighted average number of shares million | Earnings per share pence |
| Total | | | | | | |
| Basic | 387 | 800 | 48.4 | 1 774 | 684 | 259.4 |
| Potentially dilutive share options | – | 2 | | – | 1 | |
| Diluted | 387 | 802 | 48.2 | 1 774 | 685 | 259.0 |
| Continuing operations | | | | | | |
| Basic | 366 | 800 | 45.8 | 304 | 684 | 44.4 |
| Potentially dilutive share options | – | 2 | | – | 1 | |
| Diluted | 366 | 802 | 45.6 | 304 | 685 | 44.4 |
| Discontinued operations | | | | | | |
| Basic | 21 | 800 | 2.6 | 1 470 | 684 | 215.0 |
| Potentially dilutive share options | – | 2 | | – | 1 | |
| Diluted | 21 | 802 | 2.6 | 1 470 | 685 | 214.6 |

The weighted average number of shares used in the basic earnings per share calculation excludes shares held by various employee share ownership trusts. The dilutive effect relates to options under an employee savings related scheme and executive option schemes.

15 Goodwill

| Group | £million |
|--|--------------|
| Cost | |
| At 1 April 2005 and 1 April 2006 | 2 |
| Businesses acquired | 2,397 |
| Currency translation difference | (9) |
| At 31 March 2007 | 2,390 |
| Impairment losses | |
| At 1 April 2005 1 April 2006 and 31 March 2007 | 2 |
| Net book value | |
| At 31 March 2006 | – |
| At 31 March 2007 | 2,388 |

16 Other intangible assets

| Group | Product rights £million | Retail pharmacy licences £million | Customer relationships £million | Software £million | Total £million |
|---|----------------------------|--------------------------------------|------------------------------------|----------------------|-------------------|
| Cost | | | | | |
| At 1 April 2005 | 287 | 34 | – | 207 | 528 |
| Additions | – | – | – | 43 | 43 |
| Disposals | (290) | – | – | (56) | (346) |
| Currency translation differences | 3 | – | – | – | 3 |
| At 1 April 2006 | – | 34 | – | 194 | 228 |
| Additions | – | – | – | 46 | 46 |
| Businesses acquired | – | 829 | 515 | 46 | 1,390 |
| Disposals | – | – | – | (11) | (11) |
| Currency translation differences | – | – | (3) | – | (3) |
| At 31 March 2007 | – | 863 | 512 | 275 | 1,650 |
| Amortisation and impairment losses | | | | | |
| At 1 April 2005 | 29 | 9 | – | 48 | 86 |
| Charge for the year | – | 2 | – | 25 | 27 |
| Impairment charge | – | – | – | 1 | 1 |
| Disposals | (29) | – | – | (4) | (33) |
| At 1 April 2006 | – | 11 | – | 70 | 81 |
| Charge for the year | – | – | 31 | 32 | 63 |
| Impairment charge | – | – | – | 8 | 8 |
| Disposals | – | – | – | (10) | (10) |
| At 31 March 2007 | – | 11 | 31 | 100 | 142 |
| Net book value | | | | | |
| At 31 March 2006 | – | 23 | – | 124 | 147 |
| At 31 March 2007 | – | 852 | 481 | 175 | 1,508 |

17 Impairment testing of goodwill and other intangible fixed assets with indefinite lives

Goodwill acquired and retail pharmacy licences with indefinite useful lives are allocated to the appropriate cash generating units (CGUs) identified according to the country of operation and business. Those with significant amounts allocated at 31 March 2007 are given in the table below.

| | Goodwill £million | Retail pharmacy licences £million |
|-----------------------|----------------------|--------------------------------------|
| UK Health & Beauty | 278 | 24 |
| UK Community Pharmacy | 807 | 823 |
| Netherlands Retail | 107 | – |
| UK Wholesale | 588 | – |
| Norway Wholesale | 121 | – |
| Netherlands Wholesale | 205 | – |
| France Wholesale | 144 | – |
| Other | 138 | 5 |
| | 2,388 | 852 |

Notes to the financial statements (continued)

for the year ended 31 March 2007

17 Impairment testing of goodwill and other intangible fixed assets with indefinite lives (continued)

Goodwill and retail pharmacy licences are subject to annual impairment testing or more frequently if there are indications of impairment. The recoverable amounts of the CGUs are determined from value-in-use calculations which use discounted post tax cash flows from approved budgets and three year forecasts and extrapolated cash flows for the periods beyond these using estimated long term growth rates. The key assumptions are as follows:

- **Long term average growth rates** are used to extrapolate cash flows. These are determined with reference to both internal approved budgets and forecasts and available external long term growth data for both the country and business of each CGU's operation.
- **Discount rates** are calculated separately for each CGU and reflect the individual nature and specific risks relating to the business and the market in which it operates. These have been calculated using a weighted average cost of capital approach.
- **Gross margins** used are determined based on past performance and management's expectations of market development. No improvement to margin beyond periods covered by approved budgets and forecasts has been assumed.

The pre-tax discount rates used in the impairment tests at 31 March 2007 for each of the CGUs above were as follows:

| | Discount rate % |
|-----------------------|-----------------|
| UK Health & Beauty | 12.0 |
| UK Community Pharmacy | 12.0 |
| Netherlands Retail | 10.5 |
| UK Wholesale | 11.5 |
| Norway Wholesale | 11.0 |
| Netherlands Wholesale | 10.5 |
| France Wholesale | 11.5 |

Long term growth rates used in the impairment tests at 31 March 2007 were 2.5% to 4% for retail businesses and 3% to 5% for wholesale businesses.

18 Property, plant and equipment

| Group | Land and buildings £million | Plant and machinery £million | Fixtures, fittings, tools and equipment £million | Total £million |
|--|--------------------------------|---------------------------------|---|-------------------|
| Cost | | | | |
| At 1 April 2005 | 657 | 278 | 1,494 | 2,429 |
| Additions | 4 | 27 | 136 | 167 |
| Transfer to non-current assets held for sale | (1) | – | – | (1) |
| Disposals | (143) | (89) | (37) | (269) |
| Reclassifications | 1 | (1) | – | – |
| Currency translation differences | 1 | 1 | – | 2 |
| At 1 April 2006 | 519 | 216 | 1,593 | 2,328 |
| Additions | 11 | 32 | 161 | 204 |
| Businesses acquired | 266 | 26 | 120 | 412 |
| Transfer to non-current assets held for sale | – | – | (1) | (1) |
| Disposals | (12) | (30) | (39) | (81) |
| Currency translation differences | (1) | – | (2) | (3) |
| At 31 March 2007 | 783 | 244 | 1,832 | 2,859 |
| Depreciation and impairment losses | | | | |
| At 1 April 2005 | 55 | 167 | 754 | 976 |
| Charge for the year | 5 | 13 | 129 | 147 |
| Impairment losses | 2 | 14 | 1 | 17 |
| Disposals | (9) | (60) | (12) | (81) |
| Currency translation differences | – | – | 1 | 1 |
| At 1 April 2006 | 53 | 134 | 873 | 1,060 |
| Charge for the year | 10 | 18 | 149 | 177 |
| Impairment losses | – | 8 | 5 | 13 |
| Disposals | (2) | (26) | (33) | (61) |
| Currency translation differences | – | – | (1) | (1) |
| At 31 March 2007 | 61 | 134 | 993 | 1,188 |
| Net book value | | | | |
| At 31 March 2006 | 466 | 82 | 720 | 1,268 |
| At 31 March 2007 | 722 | 110 | 839 | 1,671 |

Included within the net book values above are amounts in respect of assets held under finance leases of £34 million in land and buildings (2006: £nil), £13 million in plant and machinery (2006: £15 million) and £43 million in fixtures, fittings, tools and equipment (2006: £56 million).

Property, plant and equipment includes payments on account and assets in the course of construction of £nil (2006: £4 million). Disposals include assets with a net book value of £5 million (2006: £49 million) associated with the disposal of businesses.

19 Investments in associates

| Group | £million |
|----------------------------------|------------|
| At 1 April 2005 and 1 April 2006 | – |
| Businesses acquired | 603 |
| Share of post tax earnings | 39 |
| Additions | 2 |
| Dividends | (14) |
| Currency translation differences | (2) |
| At 31 March 2007 | 628 |

Details of the Group's principal associates are provided in note 39

Included within the total carrying value of investments in associates was £267 million (2006 £nil) in respect of listed companies. Their market value, based on the closing share prices at 31 March 2007 was £353 million (2006 £nil)

The aggregated assets and liabilities reported by associates at 31 March 2007 were as follows

| | £million |
|-------------------|----------|
| Total assets | 2,599 |
| Total liabilities | (1,668) |
| Net assets | 931 |
| Group share | 330 |

The aggregated revenues reported by associates for the year ended 31 March 2007 were as follows

| | £million |
|---------------|----------|
| Total revenue | 4,157 |
| Group share | 1,514 |

The aggregated post tax earnings reported by associates for the year ended 31 March 2007 were as follows

| | £million |
|-------------------------|----------|
| Total post tax earnings | 104 |
| Group share | 39 |

There were no investments in associates in the year ended 31 March 2006

Notes to the financial statements (continued)

for the year ended 31 March 2007

20 Investments in subsidiary undertakings

| Company | Shares in subsidiary undertakings restated ¹ £million | Loans to subsidiary undertakings £million | Total restated ¹ £million |
|----------------------------------|--|---|--------------------------------------|
| Cost | | | |
| At 1 April 2005 | 3 835 | 1,109 | 4,944 |
| Additions | 65 | 45 | 110 |
| Disposals | (805) | (440) | (1 245) |
| Pre acquisition dividends | (115) | – | (115) |
| Currency translation differences | – | 3 | 3 |
| At 1 April 2006 | 2,980 | 717 | 3,697 |
| Additions | 3,890 | – | 3,890 |
| Disposals | – | (16) | (16) |
| At 31 March 2007 | 6,870 | 701 | 7,571 |
| Provision | | | |
| At 1 April 2005 | – | 19 | 19 |
| Movements | 642 | (10) | 632 |
| At 1 April 2006 | 642 | 9 | 651 |
| Movements | (642) | (9) | (651) |
| At 31 March 2007 | – | – | – |
| Carrying value | | | |
| At 31 March 2006 | 2,338 | 708 | 3 046 |
| At 31 March 2007 | 6,870 | 701 | 7,571 |

The principal subsidiary undertakings are listed in note 39

1 The Directors have identified that dividends received by the Company in the years ended 31 March 2005 (£200 million) and 31 March 2006 (£115 million) represented pre acquisition dividends and should have been presented as reductions in the cost of investment rather than income. Consequently an impairment of £957 million recognised in the year ending 31 March 2006 was overstated by £315 million and transfers between the merger reserve arising on acquisition of the relevant subsidiary and retained earnings have been revised accordingly (see note 32)

The impact of these restatements is to reduce the cost of investment in subsidiaries net assets and merger reserve at 1 April 2005 by £200 million (there was no impact on retained earnings) to increase profit for the year ended 31 March 2006 by £200 million and to revise the movements on cost of subsidiary and provisions thereon and transfers between the merger reserve and retained earnings accordingly. There is no impact on net assets or retained earnings at 31 March 2006

21 Available-for-sale investments

| Group | £million |
|----------------------------------|-----------|
| At 1 April 2005 and 1 April 2006 | – |
| Businesses acquired | 42 |
| Additions | 7 |
| Movement in fair value | 6 |
| At 31 March 2007 | 55 |

Available-for-sale investments at 31 March 2007 comprised the following

| Group | £million |
|------------------------------|----------|
| Listed securities | |
| – equity | 47 |
| – non-equity | 7 |
| Unlisted securities – equity | 1 |

The Group held no available-for-sale investments at 31 March 2006

22 Inventories

| Group | 2007 £million | 2006 £million |
|------------------|------------------|------------------|
| Raw materials | 22 | 17 |
| Work in progress | 7 | 11 |
| Finished goods | 1,331 | 566 |
| | 1,360 | 594 |

Included in the above are inventories held at net realisable value of £18 million (2006 £26 million)

During the year £28 million (2006 £26 million) of inventories were written down as an expense in the Income statement and £2 million (2006 £3 million) of inventory provisions made in previous years were reversed

23 Trade and other receivables

| | Group 2007 £million | Group 2006 £million | Company 2007 £million | Company 2006 £million |
|---------------------------------|---------------------------|---------------------------|-----------------------------|-----------------------------|
| Non-current | | | | |
| Loans to customers | 29 | – | – | – |
| Other receivables | 29 | 32 | – | 1 |
| | 58 | 32 | – | 1 |
| Current | | | | |
| Trade receivables | 1,659 | 346 | – | – |
| Owed by subsidiary undertakings | – | – | 1,540 | 1 215 |
| Loans to customers | 68 | – | – | – |
| Prepayments and accrued income | 124 | 100 | – | 11 |
| Other receivables | 134 | 15 | 6 | 4 |
| | 1,985 | 461 | 1,546 | 1 230 |

All amounts within current trade and other receivables are due within one year

24 Cash and cash equivalents

| | Group 2007 £million | Group 2006 £million | Company 2007 £million | Company 2006 £million |
|---|---------------------------|---------------------------|-----------------------------|-----------------------------|
| Bank balances | 115 | 82 | 2 | 1 |
| Short term deposits | 289 | 774 | 288 | 773 |
| Cash and cash equivalents | 404 | 856 | 290 | 774 |
| Bank overdrafts | (169) | (43) | (14) | (185) |
| Cash and cash equivalents in the cash flow statement | 235 | 813 | 276 | 589 |

25 Deferred tax assets and liabilities

Recognised deferred tax assets and liabilities

Deferred tax is calculated in full on temporary differences under the liability method using the appropriate country tax rate. Deferred tax assets and liabilities have been offset where they relate to the same fiscal jurisdiction and when there is also a legally enforceable right to offset the associated current tax assets and liabilities. Deferred tax assets and liabilities are attributable to the following after offset:

| Group | 2007 £million | Assets 2006 £million | 2007 £million | Liabilities 2006 £million | 2007 £million | Net 2006 £million |
|--|------------------|----------------------------|------------------|---------------------------------|------------------|-------------------------|
| Unrelieved tax losses | 4 | – | 9 | – | 13 | – |
| Accelerated capital allowances | – | – | (96) | (77) | (96) | (77) |
| Retirement benefit obligations | – | 17 | 10 | – | 10 | 17 |
| Assets previously revalued | – | – | (306) | (15) | (306) | (15) |
| Business combinations | – | – | (5) | (3) | (5) | (3) |
| Rolled over gains | – | – | (11) | – | (11) | – |
| Associate remittable earnings | – | – | (93) | – | (93) | – |
| Other temporary differences | – | 38 | 36 | (2) | 36 | 36 |
| Net deferred tax assets/(liabilities) | 4 | 55 | (456) | (97) | (452) | (42) |

Notes to the financial statements (continued)

for the year ended 31 March 2007

25 Deferred tax assets and liabilities (continued)

No deferred tax is provided on unremitted earnings of overseas subsidiaries except where the earnings are expected to be remitted in the foreseeable future, or where the Group does not control the timing of the remittance of such earnings

| Company | 2007 £million | Assets 2006 £million | 2007 £million | Liabilities 2006 £million | 2007 £million | Net 2006 £million |
|--------------------------------|------------------|----------------------------|------------------|---------------------------------|------------------|-------------------------|
| Financial Instruments | 1 | 1 | – | – | 1 | 1 |
| Net deferred tax assets | 1 | 1 | – | – | 1 | 1 |

The movement in the net deferred tax balance is as follows

| | Group 2007 £million | Group 2006 £million | Company 2007 £million | Company 2006 £million |
|--|---------------------------|---------------------------|-----------------------------|-----------------------------|
| At 1 April | (42) | (71) | – | – |
| Income statement credit – continuing | 22 | 19 | – | 1 |
| Income statement credit – discontinued | – | 9 | – | – |
| (Charged)/credited to equity | (12) | 23 | – | – |
| Businesses acquired | (420) | – | – | – |
| Businesses disposed | – | (22) | – | – |
| At 31 March | (452) | (42) | – | 1 |

The movement in deferred tax assets and liabilities during the year without taking into consideration the offsetting of balances in the same fiscal jurisdiction is as follows

| | Unrelieved tax losses £million | Accelerated capital allowances £million | Retirement benefit obligations £million | Assets previously revalued £million | Business combinations £million | Rolled over gains £million | Associate remittable earnings £million | Other temporary differences £million | Total £million |
|---|--------------------------------------|--|--|--|--------------------------------------|-------------------------------------|---|---|-------------------|
| Deferred tax assets | | | | | | | | | |
| At 1 April 2005 | – | – | 27 | 5 | – | 48 | – | 55 | 135 |
| Businesses disposed | – | – | (4) | – | – | – | – | (42) | (46) |
| Income statement (charge)/credit | – | – | (29) | (1) | – | (11) | – | 26 | (15) |
| Credited to equity | – | – | 23 | – | – | – | – | – | 23 |
| At 1 April 2006 | – | – | 17 | 4 | – | 37 | – | 39 | 97 |
| Businesses acquired | 15 | – | 23 | 2 | 14 | – | – | 10 | 64 |
| Income statement charge | (2) | – | (15) | (5) | – | (13) | – | (10) | (45) |
| (Charged)/credited to equity | – | – | (15) | – | – | – | – | 3 | (12) |
| At 31 March 2007 | 13 | – | 10 | 1 | 14 | 24 | – | 42 | 104 |
| Deferred tax liabilities | | | | | | | | | |
| At 1 April 2005 | – | (88) | (17) | (32) | (4) | (48) | – | (18) | (207) |
| Businesses disposed | – | 3 | – | – | – | 4 | – | 18 | 25 |
| Income statement credit/(charge) | – | 8 | 17 | 13 | 1 | 7 | – | (3) | 43 |
| At 1 April 2006 | – | (77) | – | (19) | (3) | (37) | – | (3) | (139) |
| Businesses acquired | – | (18) | – | – | (355) | (12) | (90) | (9) | (484) |
| Income statement (charge)/credit | – | (1) | – | – | 51 | 14 | (5) | 8 | 67 |
| Currency translation differences | – | – | – | – | – | – | 2 | (2) | – |
| At 31 March 2007 | – | (96) | – | (19) | (307) | (35) | (93) | (6) | (556) |
| Net deferred tax asset/(liabilities) | | | | | | | | | |
| At 31 March 2006 | – | (77) | 17 | (15) | (3) | – | – | 36 | (42) |
| At 31 March 2007 | 13 | (96) | 10 | (18) | (293) | (11) | (93) | 36 | (452) |

25 Deferred tax assets and liabilities (continued)

Unrecognised deferred tax assets and liabilities

The Group has only recognised a deferred tax asset on deductible temporary differences unused tax losses or tax credits to the extent that future taxable profits will be available against which the asset can be utilised. The assets recorded are after reviewing the financial forecasts of the Group's position, depreciation and potential capital expenditure for capital allowances. Where it is not considered probable that taxable profit will arise against which the temporary difference can be utilised, no asset has been recognised. Unprovided deferred tax on trading losses net of amortisation is £13 million (2006 £11 million) and on capital losses is £nil (2006 £45 million).

The Group obtained a current tax benefit of £16 million (2006 £115 million) from the utilisation of capital losses and a current tax benefit of £2 million (2006 £2 million) from utilisation of trading losses on which no deferred tax asset was recognised at prior year ends.

Of the unrelieved tax losses, £5 million have expiry dates ranging from 2 to 20 years.

In March 2007, it was proposed that the UK tax rate will reduce from 30% to 28% on 1 April 2008, which will result in a reduction in the Group net deferred tax liability of £19 million. Changes proposed to the UK Industrial Building Allowances rules commencing on 1 April 2008 will lead to an increase in the Group net deferred tax liability of £7 million.

26 Trade and other payables

| | Group 2007 £million | Group 2006 £million | Company 2007 £million | Company 2006 £million |
|------------------------------------|---------------------------|---------------------------|-----------------------------|-----------------------------|
| Current | | | | |
| Trade payables | 1,650 | 321 | — | — |
| Due to subsidiary undertakings | — | — | 955 | 728 |
| Other taxation and social security | 126 | 26 | — | 2 |
| Accruals and deferred income | 112 | 207 | 20 | 16 |
| Financial guarantees | — | — | 2 | — |
| Other payables | 224 | 78 | 1 | 8 |
| | 2,112 | 632 | 978 | 754 |

All amounts within current trade and other payables are due within one year.

| | Group 2007 £million | Group 2006 £million | Company 2007 £million | Company 2006 £million |
|----------------------|---------------------------|---------------------------|-----------------------------|-----------------------------|
| Non-current | | | | |
| Financial guarantees | — | — | 7 | — |
| Other payables | 30 | 30 | — | — |
| | 30 | 30 | 7 | — |

Notes to the financial statements (continued)

for the year ended 31 March 2007

27 Financial liabilities – borrowings

Outlined below is information regarding the contractual terms of the Group's borrowings. Further information on the Group's exposure to interest rate and currency risk is provided in note 28.

The carrying amount of financial assets and liabilities is as follows:

| | Group 2007 £million | Group 2006 £million | Company 2007 £million | Company 2006 £million |
|--|---------------------------|---------------------------|-----------------------------|-----------------------------|
| Current borrowings | | | | |
| Bank overdrafts repayable on demand | (169) | (43) | (14) | (185) |
| 2008 Senior notes 6.63% (US\$57 million) | (30) | – | – | – |
| €300 million floating Eurobond 2007 | (204) | – | (204) | – |
| Medium term notes | (7) | (4) | (7) | (4) |
| Loan notes | (1) | – | – | – |
| Current portion of finance lease liabilities | (22) | (20) | – | – |
| Bank loans | (123) | (116) | – | (102) |
| Financing linked to securitisation | (9) | – | – | – |
| | (565) | (183) | (225) | (291) |
| Non-current borrowings | | | | |
| £300 million Eurobond 2009 5.5% | (299) | (302) | (302) | (303) |
| €300 million floating Eurobond 2007 | – | (207) | – | (207) |
| 2009 Senior notes 6.67% (US\$113 million) | (60) | – | – | – |
| 2011 Senior notes 6.55% (US\$173 million) | (93) | – | – | – |
| 2011 Senior notes 6.07% (£30 million) | (22) | – | – | – |
| 2012 Senior notes 7.19% (US\$300 million) | (166) | – | – | – |
| 2017 Senior notes 7.01% (£50 million) | (54) | – | – | – |
| Medium term notes | (12) | (21) | (12) | (21) |
| Finance lease liabilities | (40) | (45) | – | – |
| Bank loans | (18) | – | – | – |
| | (764) | (575) | (314) | (531) |
| Total borrowings | (1,329) | (758) | (539) | (822) |
| Cash and cash equivalents | 404 | 856 | 290 | 774 |
| Total borrowings net of cash and cash equivalents | (925) | 98 | (249) | (48) |
| Derivative financial instruments – assets | 5 | 3 | – | 1 |
| Derivative financial instruments – liabilities | (128) | (1) | (2) | – |
| Net (borrowings)/cash | (1,048) | 100 | (251) | (47) |
| Available-for-sale investments | 55 | – | – | – |
| Financial guarantee | – | – | (9) | – |
| Trade payables | (1,650) | (321) | – | – |
| Trade receivables | 1,659 | 346 | – | – |
| Loans to customers | 97 | – | – | – |
| Loans to subsidiary undertakings | – | – | 701 | 708 |
| Loans from subsidiary undertakings | – | – | (40) | – |
| Owed by subsidiary undertakings | – | – | 1,540 | 1,215 |
| Due to subsidiary undertakings | – | – | (915) | (728) |
| Net financial (liabilities)/assets | (887) | 125 | 1,026 | 1,148 |

The Group's principal net borrowings arises from three sources:

1. A bond of £300 million (2006 £300 million), issued on 26 May 1999, was transferred from The Boots Company PLC to the Company on 20 January 2003 at its market value on that date of £309 million. For the Group, the bond carries a fixed interest rate of 5.5% per annum, and is due for repayment on 26 May 2009. The Group has an interest rate swap agreement converting £150 million (2005 £150 million) of the liability to a floating rate (see note 28). For the Company, the bond is held on the balance sheet at amortised cost.
2. A bond of €300 million (2005 €300 million) was issued on 19 October 2004 and is due for repayment on 19 October 2007. The bond carries a floating interest rate of three month LIBOR plus 0.35% margin.
3. The Group has issued Senior notes in US Dollars, Euros and Sterling, with a range of maturities from 2008 to 2017, with fixed rates and maturities shown in the table above. The fixed rate notes have been swapped to floating interest rates, using cross currency and interest rate swaps.

Loan notes totalling £1 million, classified within current borrowings, can be redeemed by the holders giving one month's notice before an interest payment date. However, if no notice is given, these notes will fall due at their maturity dates, which are between 2007 and 2014.

At 31 March 2007, the Group had a £9 million liability as a result of financing linked to securitisation. This is due to be repaid within 6 months of the balance sheet date.

27 Financial liabilities – borrowings (continued)

At 31 March 2007, the Group had available £875 million (2006 £600 million) of undrawn committed borrowing facilities

Maturity profile of financial liabilities before the impact of derivative financial instruments

| Terms and borrowings repayment schedule 2007 – Group | Total £million | 1 year or less £million | 1-2 years £million | 2-5 years £million | >5 years £million |
|--|-------------------|-------------------------------|-----------------------|-----------------------|----------------------|
| Fixed | | | | | |
| £300 million Eurobond 2009 5.5% | (299) | – | – | (299) | – |
| 2008 Senior notes 6.63% (US\$57 million) | (30) | (30) | – | – | – |
| 2009 Senior notes 6.67% (US\$113 million) | (60) | – | (60) | – | – |
| 2011 Senior notes 6.55% (US\$173 million) | (93) | – | – | (93) | – |
| 2011 Senior notes 6.07% (£30 million) | (22) | – | – | (22) | – |
| 2012 Senior notes 7.19% (US\$300 million) | (166) | – | – | – | (166) |
| 2017 Senior notes 7.01% (£50 million) | (54) | – | – | – | (54) |
| Medium term notes | (3) | – | (3) | – | – |
| Finance lease liabilities | (62) | (22) | (18) | (17) | (5) |
| Bank loans | (25) | (25) | – | – | – |
| Floating | | | | | |
| €300 million Eurobond 2007 | (204) | (204) | – | – | – |
| Medium term notes | (16) | (7) | (9) | – | – |
| Bank loans | (116) | (98) | (4) | (12) | (2) |
| Loan notes | (1) | (1) | – | – | – |
| Bank overdrafts | (169) | (169) | – | – | – |
| Financing linked to securitisation | (9) | (9) | – | – | – |
| Total borrowings | (1,329) | (565) | (94) | (443) | (227) |
| Trade payables | (1,650) | (1,650) | – | – | – |
| Derivative financial instruments – liabilities | (128) | (7) | (13) | (46) | (62) |
| Total financial liabilities | (3,107) | (2,222) | (107) | (489) | (289) |

| Terms and borrowings repayment schedule 2006 – Group | Total £million | 1 year or less £million | 1-2 years £million | 2-5 years £million | >5 years £million |
|--|-------------------|-------------------------------|-----------------------|-----------------------|----------------------|
| Fixed | | | | | |
| £300 million Eurobond 2009 5.5% | (302) | – | – | (302) | – |
| Medium term notes | (8) | (4) | – | (4) | – |
| Finance lease liabilities | (65) | (20) | (18) | (23) | (4) |
| Bank loans | (16) | (16) | – | – | – |
| Floating | | | | | |
| €300 million Eurobond 2007 | (207) | – | (207) | – | – |
| Medium term notes | (17) | – | (7) | (10) | – |
| Bank loans | (100) | (100) | – | – | – |
| Bank overdrafts | (43) | (43) | – | – | – |
| Total borrowings | (758) | (183) | (232) | (339) | (4) |
| Trade payables | (321) | (321) | – | – | – |
| Derivative financial instruments – liabilities | (1) | – | – | (1) | – |
| Total financial liabilities | (1,080) | (504) | (232) | (340) | (4) |

Notes to the financial statements (continued)

for the year ended 31 March 2007

27 Financial liabilities – borrowings (continued)

Currency profile

The analysis of financial assets and liabilities by currency (before the effect of currency hedging) is as follows

| | Total £million | Sterling £million | Euros £million | US Dollars £million | Other £million |
|------------------------------------|-------------------|----------------------|-------------------|------------------------|-------------------|
| 2007 – Group | | | | | |
| Bank overdrafts | (169) | (36) | (125) | – | (8) |
| Bonds | (503) | (299) | (204) | – | – |
| Senior notes | (425) | (54) | (22) | (349) | – |
| Medium term notes | (19) | – | (7) | – | (12) |
| Bank loans | (141) | – | (117) | – | (24) |
| Loan notes | (1) | (1) | – | – | – |
| Finance lease liabilities | (62) | (56) | (6) | – | – |
| Financing linked to securitisation | (9) | – | (9) | – | – |
| Total borrowings | (1,329) | (446) | (490) | (349) | (44) |
| Cash and cash equivalents | 404 | 337 | 39 | 4 | 24 |
| Available-for-sale investments | 55 | 7 | 48 | – | – |
| Trade payables | (1,650) | (828) | (676) | (35) | (111) |
| Trade receivables | 1,659 | 718 | 829 | 4 | 108 |
| Loans to customers | 97 | – | 94 | – | 3 |
| Derivative financial instruments | | | | | |
| – assets | 5 | 5 | – | – | – |
| – liabilities | (128) | (128) | – | – | – |
| Net financial liabilities | (887) | (335) | (156) | (376) | (20) |

| | Total £million | Sterling £million | Euros £million | US Dollars £million | Other £million |
|---|-------------------|----------------------|-------------------|------------------------|-------------------|
| 2006 – Group | | | | | |
| Bank overdrafts | (43) | (39) | (4) | – | – |
| Bonds | (509) | (302) | (207) | – | – |
| Medium term notes | (25) | – | (7) | – | (18) |
| Bank loans | (116) | (116) | – | – | – |
| Finance lease liabilities | (65) | (65) | – | – | – |
| Total borrowings | (758) | (522) | (218) | – | (18) |
| Cash and cash equivalents | 856 | 841 | 5 | 1 | 9 |
| Trade payables | (321) | (309) | (9) | – | (3) |
| Trade receivables | 346 | 330 | 9 | 2 | 5 |
| Derivative financial instruments | | | | | |
| – assets | 3 | 3 | – | – | – |
| – liabilities | (1) | (1) | – | – | – |
| Net financial assets/(liabilities) | 125 | 342 | (213) | 3 | (7) |

Finance lease liabilities

| Group | Minimum lease payments 2007 £million | Interest 2007 £million | Principal 2007 £million | Minimum lease payments 2006 £million | Interest 2006 £million | Principal 2006 £million |
|---------------------------------|--|------------------------------|-------------------------------|--|------------------------------|-------------------------------|
| Less than one year | 26 | 4 | 22 | 24 | 4 | 20 |
| Between one year and five years | 41 | 6 | 35 | 49 | 8 | 41 |
| More than five years | 17 | 12 | 5 | 5 | 1 | 4 |
| | 84 | 22 | 62 | 78 | 13 | 65 |

Under the terms of the lease agreements no material contingent rents are payable

| | 2007 £million | 2006 £million |
|--|------------------|------------------|
| Present value of minimum lease payments – Group | | |
| Less than one year | 25 | 23 |
| Between one year and five years | 36 | 46 |
| More than five years | 13 | 3 |

27 Financial liabilities – borrowings (continued)

Effective interest rates and re-pricing analysis

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at 31 March 2007 and the periods in which they re-price, including the impact of derivative financial instruments

| Group | Effective interest rate | Total £million | 6 months or less £million | 6-12 months £million | 1-2 years £million | 2-5 years £million | >5 years £million |
|---|-------------------------|----------------|---------------------------|----------------------|--------------------|--------------------|-------------------|
| Cash and cash equivalents | 5.1% | 404 | 404 | – | – | – | – |
| Bonds | | | | | | | |
| £300 million Eurobond 2009 – fixed rate | 5.5% | (299) | – | – | – | (299) | – |
| Effect of swaps | (0.1)% | (1) | (150) | – | – | 149 | – |
| €300 million floating Eurobond 2007 | 4.1% | (204) | (204) | – | – | – | – |
| Effect of swaps | (0.6)% | 1 | 86 | (85) | – | – | – |
| Senior Notes | | | | | | | |
| Senior notes US\$ – fixed rate | 6.9% | (349) | – | (30) | (60) | (93) | (166) |
| Effect of swaps | (2.1)% | (118) | (467) | 30 | 60 | 93 | 166 |
| Senior notes € – fixed rate | 6.1% | (22) | – | – | – | (22) | – |
| Effect of swaps | (0.5)% | – | (22) | – | – | 22 | – |
| Senior notes £ – fixed rate | 7.0% | (54) | – | – | – | – | (54) |
| Effect of swaps | (1.6)% | – | (54) | – | – | – | 54 |
| Medium term notes | | | | | | | |
| Euro floating rate | 4.1% | (7) | (7) | – | – | – | – |
| Effect of swaps | 1.7% | – | – | – | – | – | – |
| JPY floating rate | 0.9% | (9) | (9) | – | – | – | – |
| Effect of swaps | 5.1% | (1) | (1) | – | – | – | – |
| JPY fixed rate | 0.7% | (3) | – | – | (3) | – | – |
| Effect of swaps | 5.2% | (1) | (4) | – | 3 | – | – |
| Finance lease liabilities | 6.0% | (62) | (11) | (11) | (18) | (17) | (5) |
| Fixed rate bank loans | 8.1% | (25) | (13) | (12) | – | – | – |
| Floating rate bank loans (including loan notes) | 4.3% | (117) | (117) | – | – | – | – |
| Bank overdrafts | 4.0% | (169) | (169) | – | – | – | – |
| Financing linked to securitisation | 3.9% | (9) | (9) | – | – | – | – |
| Loans to customers | 4.9% | 97 | 93 | 1 | 3 | – | – |
| Other derivative financial instruments | | (3) | – | (1) | – | – | (2) |
| Net interest bearing financial liabilities | | (951) | (654) | (108) | (15) | (167) | (7) |

Bank overdrafts are repayable on demand. The interest rates applicable to bank overdrafts, bank loans and loan notes are all floating rates. The effective interest rates for these are very closely related to the relevant market interest rate plus any margin as at the balance sheet date.

Maturity profile of financial liabilities before the impact of derivative financial instruments

| Terms and borrowings repayment schedule 2007 – Company | Total £million | 1 year or less £million | 1-2 years £million | 2-5 years £million | >5 years £million |
|--|----------------|-------------------------|--------------------|--------------------|-------------------|
| Fixed | | | | | |
| £300 million Eurobond 2009 5.5% | (302) | – | – | (302) | – |
| Medium term notes | (3) | – | (3) | – | – |
| Floating | | | | | |
| €300 million Eurobond 2007 | (204) | (204) | – | – | – |
| Medium term notes | (16) | (7) | (9) | – | – |
| Bank overdrafts | (14) | (14) | – | – | – |
| Total borrowings | (539) | (225) | (12) | (302) | – |
| Derivative financial instruments – liabilities | (2) | – | (2) | – | – |
| Financial guarantee | (9) | (2) | (2) | (4) | (1) |
| Loans from subsidiary undertakings | (40) | (40) | – | – | – |
| Due to subsidiary undertakings | (915) | (915) | – | – | – |
| Total financial liabilities | (1,505) | (1,182) | (16) | (306) | (1) |

Notes to the financial statements (continued)

for the year ended 31 March 2007

27 Financial liabilities – borrowings (continued)

| Terms and borrowings repayment schedule 2006 – Company | Total £million | 1 year or less £million | 1-2 years £million | 2-5 years £million | >5 years £million |
|--|-------------------|-------------------------------|-----------------------|-----------------------|----------------------|
| Fixed | | | | | |
| £300 million Eurobond 2009 5.5% | (303) | – | (2) | (301) | – |
| Medium term notes | (8) | (4) | – | (4) | – |
| Floating | | | | | |
| €300 million Eurobond 2007 | (207) | – | (207) | – | – |
| Medium term notes | (17) | – | (7) | (10) | – |
| Bank overdrafts | (185) | (185) | – | – | – |
| Bank loans | (102) | (102) | – | – | – |
| Total borrowings | (822) | (291) | (216) | (315) | – |
| Due to subsidiary undertakings | (728) | (728) | – | – | – |
| Total financial liabilities | (1,550) | (1,019) | (216) | (315) | – |

Currency profile

The analysis of financial assets and liabilities by currency is as follows

| 2007 – Company | Total £million | Sterling £million | Euros £million | US Dollars £million | Other £million |
|--|-------------------|----------------------|-------------------|------------------------|-------------------|
| Bank overdrafts | (14) | (13) | – | (1) | – |
| Bonds | (506) | (302) | (204) | – | – |
| Medium term notes | (19) | – | (7) | – | (12) |
| Total borrowings | (539) | (315) | (211) | (1) | (12) |
| Financial guarantee | (9) | (9) | – | – | – |
| Cash and cash equivalents | 290 | 288 | 2 | – | – |
| Derivative financial instruments – liabilities | (2) | (2) | – | – | – |
| Loans to subsidiary undertakings | 701 | 685 | 2 | – | 14 |
| Loans from subsidiary undertakings | (40) | (32) | (8) | – | – |
| Due from subsidiary undertakings | 1,540 | 1,119 | 421 | – | – |
| Due to subsidiary undertakings | (915) | (888) | (26) | (1) | – |
| Net financial assets/(liabilities) | 1,026 | 846 | 180 | (2) | 2 |

| 2006 – Company | Total £million | Sterling £million | Euros £million | US Dollars £million | Other £million |
|---|-------------------|----------------------|-------------------|------------------------|-------------------|
| Bank overdrafts | (185) | (185) | – | – | – |
| Bonds | (510) | (303) | (207) | – | – |
| Medium term notes | (25) | – | (7) | – | (18) |
| Bank loans | (102) | (102) | – | – | – |
| Total borrowings | (822) | (590) | (214) | – | (18) |
| Cash and cash equivalents | 774 | 773 | – | – | 1 |
| Derivative financial instruments – assets | 1 | 1 | – | – | – |
| Loans to subsidiary undertakings | 708 | 688 | 3 | – | 17 |
| Due from subsidiary undertakings | 1,215 | 1,215 | – | – | – |
| Due to subsidiary undertakings | (728) | (650) | (78) | – | – |
| Net financial assets/(liabilities) | 1,148 | 1,437 | (289) | – | – |

27 Financial liabilities – borrowings (continued)

Effective interest rates and re-pricing analysis

In respect of income-earning financial assets and interest-bearing financial liabilities the following table indicates their effective interest rates at 31 March 2007 and the periods in which they re-price

| Company | Effective interest rate | Total £million | 6 months or less £million | 6-12 months £million | 1-2 years £million | 2-5 years £million | >5 years £million |
|--|-------------------------|----------------|---------------------------|----------------------|--------------------|--------------------|-------------------|
| Cash and cash equivalents | 5.3% | 290 | 290 | – | – | – | – |
| Bonds | | | | | | | |
| £300 million Eurobond 2009 – fixed rate | 5.5% | (302) | – | – | – | (302) | – |
| €300 million floating Eurobond 2007 | 4.1% | (204) | (204) | – | – | – | – |
| Medium term notes | | | | | | | |
| Euro floating rate notes | 4.1% | (7) | (7) | – | – | – | – |
| Effect of swaps | 1.7% | – | – | – | – | – | – |
| JPY floating rate notes | 0.9% | (9) | (9) | – | – | – | – |
| Effect of swaps | 5.1% | (1) | (1) | – | – | – | – |
| JPY fixed rate notes | 0.7% | (3) | – | – | (3) | – | – |
| Effect of swaps | 5.2% | (1) | (4) | – | 3 | – | – |
| Bank overdrafts | 6.3% | (14) | (14) | – | – | – | – |
| Loans to subsidiary undertakings | 5.6% | 701 | 701 | – | – | – | – |
| Loans from subsidiary undertakings | 4.3% | (40) | (40) | – | – | – | – |
| Owed by subsidiary undertakings | 5.8% | 1,540 | 1,540 | – | – | – | – |
| Due to subsidiary undertakings | 4.2% | (915) | (915) | – | – | – | – |
| Net interest bearing financial assets/(liabilities) | | 1,035 | 1,337 | – | – | (302) | – |

28 Financial instruments

Fair values of financial instruments – Group

A comparison of carrying values and fair values of the Group's financial assets and liabilities held to finance the Group's operations as at 31 March 2007 is set out below

| Group | Carrying value 2007 £million | Fair value 2007 £million | Carrying value 2006 £million | Fair value 2006 £million |
|--|------------------------------|--------------------------|------------------------------|--------------------------|
| Bonds | (503) | (499) | (509) | (510) |
| Senior notes | (425) | (426) | – | – |
| Medium term notes | (19) | (19) | (25) | (25) |
| Loan notes | (1) | (1) | – | – |
| Bank loans | (141) | (141) | (116) | (116) |
| Bank overdrafts | (169) | (169) | (43) | (43) |
| Finance lease liabilities | (62) | (74) | (65) | (72) |
| Financing linked to securitisation | (9) | (9) | – | – |
| Total borrowings | (1,329) | (1,338) | (758) | (766) |
| Cash and cash equivalents | 404 | 404 | 856 | 856 |
| Derivative instruments held to manage the interest rate and currency profile | | | | |
| – interest rate derivatives | (1) | (1) | 2 | 2 |
| – cross currency swaps | (121) | (121) | (1) | (1) |
| – foreign exchange forward contracts | (1) | (1) | 1 | 1 |
| Net (borrowings)/cash | (1,048) | (1,057) | 100 | 92 |
| Available-for-sale investments | 55 | 55 | – | – |
| Loans to customers | 97 | 97 | – | – |
| Trade payables | (1,650) | (1,650) | (321) | (321) |
| Trade receivables | 1,659 | 1,659 | 346 | 346 |
| Net financial (liabilities)/assets | (887) | (896) | 125 | 117 |

Fair values of bonds, available-for-sale investments and foreign exchange contracts have been determined with reference to quoted market prices. The fair value of the Senior notes is calculated using discounted cash flow methodology, based on third party estimates of the Group's credit spread above the benchmark swap curve.

The fair values of interest rate derivatives and cross currency swaps have been calculated by discounting the future cash flows of the individual contracts using the appropriate market interest curve and foreign exchange rate prevailing at 31 March 2007.

The fair value of bank loans, loans to customers and financing linked to securitisation approximate to their carrying value due to either their short term nature or being re-priced at variable interest rates.

All fair values are shown at their clean prices excluding accrued interest.

Notes to the financial statements (continued)

for the year ended 31 March 2007

28. Financial instruments (continued)

Credit risk – Group

The Group invests surplus funds in high quality liquid market instruments including money market deposits and money market funds. Such investments have an initial maturity no greater than three months. The difference between the book and fair value of these instruments is not significant.

The Group's exposure to credit risk is controlled by setting a policy for limiting exposure to counterparties which is reviewed annually. The objective is to reduce the risk of loss through default by counterparties, by spreading transactions, including bank deposits across an approved list of high quality banks and cash funds. Counterparty credit positions are monitored on a regular basis. The Group considers the possibility of significant loss in the event of non-performance by a financial counterparty to be unlikely.

At 31 March 2007 there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, at the balance sheet date.

Currency risk – Group

The Group is party to a variety of currency derivatives in the management of exchange rate exposures including foreign exchange contracts and cross currency swaps.

Forward exchange contracts

At the balance sheet date the total notional amount of outstanding foreign exchange contracts that the Group has committed to is as follows:

| Group | 2007 £million | 2006 £million |
|----------------------------------|------------------|------------------|
| Total foreign exchange contracts | 721 | 152 |

At 31 March 2007 the fair value of the Group's outstanding forward exchange contracts is a £1 million liability and is included in trade and other payables.

Movements in the fair value of all forward exchange contracts other than those designated and effective as cash flow hedges or net investment hedges are reported directly in the income statement.

Cross currency swaps

The Group has a number of cross currency swap contracts in place to manage the currency and interest rate risk of foreign currency denominated borrowings. At 31 March 2007, the fair value of the Group's cross currency swaps is a liability of £122 million (2006 £1 million liability). £102 million (2006 £1 million) of the liability relates to currency swaps designated as fair value hedges of fixed rate borrowings. Movements in fair value are reported directly in the income statement along with the exchange gain or loss of the hedged item. The remaining £20 million liability (2006 £nil) relates to currency swaps designated as net investment hedges of foreign currency net investments. Movements in fair value are deferred in equity until the underlying hedged investment is sold.

Currency translation risk – Group

The Group has significant foreign currency net investments denominated in Euro, Swiss Francs, Norwegian Kroner and Czech Koruna. The Group uses derivative financial instruments specifically cross currency swaps, forward foreign exchange contracts and foreign currency borrowings to hedge the foreign currency risk.

The effect of currency swaps and forward contracts to manage translation risk on borrowings net of cash and cash equivalents is shown below:

| Group | Before hedging 2007 £million | After hedging 2007 £million | Before hedging 2006 £million | After hedging 2006 £million |
|-----------------------------|---------------------------------------|--------------------------------------|---------------------------------------|--------------------------------------|
| Sterling | (232) | 252 | 321 | 124 |
| Euro | (451) | (1183) | (213) | (34) |
| US Dollar | (345) | 4 | 1 | 1 |
| Swiss Franc | – | (55) | – | – |
| Czech Koruna | (8) | (28) | – | – |
| Norwegian Kroner | 15 | (23) | – | – |
| Other | (27) | (15) | (9) | 9 |
| Total net borrowings | (1,048) | (1,048) | 100 | 100 |

Currency transaction risk – Group

The Group utilises forward exchange derivatives to hedge significant committed and highly probable future transactions and cash flows.

At 31 March 2007, the Group had outstanding forward foreign exchange contracts with a notional principal of £70 million (2006 £16 million) that are designated and effective as cash flow hedges of committed and highly probable future transactions. Fair value movements of these contracts are deferred in equity until the hedged transaction takes place. Forward exchange contracts with a notional principal of £7 million mature within 1-2 years. The remaining contracts all mature within 12 months of the balance sheet date.

28 Financial instruments (continued)

A £1 million loss has been deferred in equity as at 31 March 2007 (2006 £nil) in respect of these contracts, which is expected to be recycled through the income statement within 12 months of the balance sheet date. A loss of £1 million has been transferred to the income statement in respect of contracts designated as cash flow hedges that have matured during the 12 month period to 31 March 2007.

Interest rate risk – Group

The Group has a mixture of fixed and floating rate borrowings. Before the impact of derivative financial instruments, £814 million (61%) of borrowings are at fixed interest rates (predominantly relating to the Senior notes and £300 million Eurobond). The re-pricing risk of the fixed borrowings coincides with their maturity details of which can be found in note 27. The floating rate borrowings re-price within 6 months of the reporting date based on short term borrowing rates for the relevant currency.

The Group has an interest rate swap with a notional principal of £150 million to swap £150 million of the £300 million Eurobond from fixed to floating interest rates.

The fixed rate senior notes have been swapped to floating interest rates using cross-currency swaps for their remaining life.

The Group holds interest rate swaps with a notional principal of £153 million that are used to swap exposure from floating interest rates (principally hedging the £300 million Eurobond) to fixed rates.

After taking into account the impact of derivative financial instruments, £322 million (24%) of the Group's borrowings is at fixed interest rates, with all other borrowings re-pricing within 6 months of the reporting date.

A more detailed explanation of the Group's interest rate risk policy is detailed in the Financial review.

Derivative Financial Instruments – Group

Achieving hedge accounting under IAS 32 and IAS 39 is based on measuring the effectiveness of the derivative as a hedging instrument as well as fulfilling hedge documentation rules. The effectiveness test compares the change in the fair value of the designated derivative and the change in the fair value of the hedged item, to determine if this ratio falls within the permitted range of 80% to 125%. Any derivative that falls outside the permitted range is classified as held-for-trading. Gains or losses on the derivative are recognised immediately in the income statement except where the derivative is designated within an effective cash flow or net investment hedge relationship in which case the gains and losses are deferred in equity and are recycled through the income statement at the time that the hedged item is recognised in the income statement. The hedge accounting treatment is described further in the Accounting policies.

Where a derivative does fall within the permitted range but is not 100% effective, the ineffective element is recognised in the income statement immediately. This gives rise to a gain or loss which is recognised under Finance Income or Finance costs as appropriate. These gains or losses represent timing differences that will reverse over the life of the financial instruments.

Fair values of financial instruments – Company

A comparison of carrying values and fair values of the Company's financial assets and liabilities held to finance the Company's operations as at 31 March 2007 is set out below.

| Company | Carrying value 2007 £million | Fair value 2007 £million | Carrying value 2006 £million | Fair value 2006 £million |
|--|---------------------------------------|--------------------------------|---------------------------------------|--------------------------------|
| Bonds | (506) | (499) | (510) | (510) |
| Medium term notes | (19) | (19) | (25) | (25) |
| Bank loans | – | – | (102) | (102) |
| Bank overdrafts | (14) | (14) | (185) | (185) |
| Total borrowings | (539) | (532) | (822) | (822) |
| Cash and cash equivalents | 290 | 290 | 774 | 774 |
| Derivative instruments held to manage the interest rate and currency profile | | | | |
| – cross currency swaps | (2) | (2) | – | – |
| – foreign exchange forward contracts | – | – | 1 | 1 |
| Net borrowings | (251) | (244) | (47) | (47) |
| Financial guarantee | (9) | (9) | – | – |
| Loans to subsidiary undertakings | 701 | 700 | 708 | 709 |
| Loans from subsidiary undertakings | (40) | (40) | – | – |
| Owed by subsidiary undertakings | 1,540 | 1,540 | 1,215 | 1,215 |
| Due to subsidiary undertakings | (915) | (915) | (728) | (728) |
| Net financial assets | 1,026 | 1,032 | 1,148 | 1,149 |

Fair values of bonds, available-for-sale assets and foreign exchange contracts have been determined with reference to quoted market prices. All other fair values have been determined by discounting expected future cash flows at interest rates prevailing at 31 March 2007. All fair values are shown at their clean prices excluding interest accruals.

Notes to the financial statements (continued)

for the year ended 31 March 2007

28 Financial instruments (continued)

Derivative financial instruments – Company

The Company has used derivative financial instruments to hedge its and the Group's exposure to fluctuations in interest and foreign exchange rates. Derivative financial instruments are designated as hedges in line with the Group's risk management policies. All derivatives are measured at fair value. The only derivative financial instruments which are designated as a hedge relationship for the Company are fair value hedges. Gains and losses on these instruments are recognised in the income statement and the carrying value of the hedged item is adjusted to reflect movement associated with the hedged risks.

Any derivative that falls outside the permitted range of effectiveness should be classified as held-for-trading. Where a derivative does fall within the permitted range but is not 100% effective, the ineffective portion is recognised in the income statement immediately. This gives rise to a gain or loss which is recognised under Finance income or Finance costs as appropriate.

Loans held by the Company are measured at amortised cost except where the underlying transaction is designated within an effective fair value hedge relationship. In these cases the carrying value is adjusted to reflect movements associated with the hedged risk.

29 Analysis of movement in net (borrowings)/cash

Set out below is a reconciliation of the net (decrease)/increase in cash and cash equivalents to the (increase)/decrease in net (borrowings)/cash. Net (borrowings)/cash are defined by the Group as borrowings net of cash and cash equivalents and derivative financial instruments.

| | Group 2007 £million | Group 2006 £million | Company 2007 £million | Company 2006 £million |
|--|---------------------------|---------------------------|-----------------------------|-----------------------------|
| Net (decrease)/increase in cash and cash equivalents | (578) | 731 | (313) | 592 |
| Cash and cash equivalents outflow/(inflow) from decrease in debt and lease financing | 812 | 31 | 104 | (20) |
| Movement in net (borrowings)/cash resulting from cash flows | 234 | 762 | (209) | 572 |
| Borrowings acquired with businesses | (1,390) | – | – | – |
| | (1,156) | 762 | (209) | 572 |
| Finance leases entered into | (8) | (24) | – | – |
| Currency translation differences and fair value adjustments on financial instruments | 16 | 3 | 5 | 1 |
| Movement in net (borrowings)/cash in the year | (1,148) | 741 | (204) | 573 |
| Net cash/(borrowings) at 1 April | 100 | (641) | (47) | (620) |
| Net (borrowings)/cash at 31 March | (1,048) | 100 | (251) | (47) |

Set out below is an analysis of the movement in net (borrowings)/cash during the year.

| | Cash and cash equivalents £million | Borrowings within current liabilities £million | Borrowings within non-current liabilities £million | Derivative financial instruments £million | Net (borrowings)/ cash £million |
|--|--|--|--|--|--|
| At 1 April 2006 | 856 | (183) | (575) | 2 | 100 |
| Decrease in cash and cash equivalents | (452) | (126) | – | – | (578) |
| Decrease in borrowings | – | 448 | 364 | – | 812 |
| Borrowings acquired with businesses | – | (457) | (808) | (125) | (1,390) |
| Finance leases entered into | – | (4) | (4) | – | (8) |
| Other non-cash movements | – | (248) | 248 | – | – |
| Currency translation differences and fair value adjustments on financial instruments | – | 5 | 11 | – | 16 |
| At 31 March 2007 | 404 | (565) | (764) | (123) | (1,048) |

In the Group cash flow statement, cash and cash equivalents include bank overdrafts which are classified within borrowings within current liabilities in the balance sheet which amounted to £169 million at 31 March 2007 (2006 £43 million).

30 Net cash (outflow)/inflow on acquisitions and disposals

| | 2007 £million | 2006 £million |
|---|------------------|------------------|
| Acquisition of businesses | (96) | – |
| Net cash of businesses acquired | 76 | – |
| Disposal of businesses | 58 | – |
| Purchase of investments in associates | (2) | – |
| Borrowings acquired with businesses | (1,390) | – |
| Cash outflows on acquisitions and disposals – continuing operations | (1,354) | – |
| Cash flows arising from disposal of discontinued operations | (13) | 1,854 |
| | (1,367) | 1,854 |

31 Provisions

| Group | Refurbishment and reorganisation £million | Vacant property £million | Closure or termination of operations £million | Other £million | Total £million |
|-------------------------------------|--|-----------------------------|--|-------------------|-------------------|
| At 1 April 2006 | 111 | 10 | 28 | — | 149 |
| Businesses acquired | — | — | — | 5 | 5 |
| Provisions created during the year | 17 | 7 | 20 | — | 44 |
| Provisions utilised during the year | (50) | (4) | (4) | — | (58) |
| Provisions released during the year | (2) | — | (9) | — | (11) |
| At 31 March 2007 | 76 | 13 | 35 | 5 | 129 |
| Current | 35 | 6 | 31 | 3 | 75 |
| Non-current | 41 | 7 | 4 | 2 | 54 |
| | 76 | 13 | 35 | 5 | 129 |

Refurbishment and reorganisation

The refurbishment and reorganisation provision relates primarily to the UK Health & Beauty store refurbishments and supply chain reorganisation and the reorganisation of the French wholesale operation. The majority of these costs are expected to be incurred in the next two years. In respect of the store refurbishment programme estimates of expected costs have been based on a store-by-store survey and comprise management's view of lease obligations.

Vacant property

The vacant property provisions represent recognition of the present value expected net costs arising from vacant properties and sub-let properties. The exact timing of utilisation of these provisions will vary according to the individual properties concerned.

Closure or termination of operations

The provision for closure or termination of operations relates mainly to restructuring of Other Commercial Activities, supply chain configuration and the balance of the provision for the onerous supply contract following the disposal of Boots Healthcare International in the previous year. The majority of the costs are expected to be incurred within the next year.

32 Capital and reserves

| Reconciliation of movement in capital and reserves – Group | Share capital £million | Share premium £million | Shares to be issued £million | Retained earnings £million | Merger reserve £million | Capital redemption reserve £million | Other reserves £million | Shareholders' equity £million | Minority interests £million | Total equity £million |
|--|---------------------------|---------------------------|---------------------------------|-------------------------------|----------------------------|--|----------------------------|----------------------------------|--------------------------------|--------------------------|
| At 1 April 2005 | 183 | 2 | — | 1,096 | 311 | 27 | 1 | 1,620 | 1 | 1,621 |
| Total recognised income and expense for the year | — | — | — | 1,720 | — | — | (3) | 1,717 | (1) | 1,716 |
| Share-based compensation | — | — | — | 5 | — | — | — | 5 | — | 5 |
| Dividends to equity shareholders | — | — | — | (1,640) | — | — | — | (1,640) | — | (1,640) |
| Repurchase of own shares | (2) | — | — | (50) | — | 2 | — | (50) | — | (50) |
| At 1 April 2006 | 181 | 2 | — | 1,131 | 311 | 29 | (2) | 1,652 | — | 1,652 |
| Total recognised income and expense for the year | — | — | — | 430 | — | — | (5) | 425 | — | 425 |
| Share-based compensation | — | — | — | 9 | — | — | — | 9 | — | 9 |
| Dividends to equity shareholders | — | — | — | (149) | — | — | — | (149) | — | (149) |
| Businesses acquired | 179 | — | 11 | (31) | 3,661 | — | — | 3,820 | 12 | 3,832 |
| Disposal of own shares | — | — | — | 3 | — | — | — | 3 | — | 3 |
| At 31 March 2007 | 360 | 2 | 11 | 1,393 | 3,972 | 29 | (7) | 5,760 | 12 | 5,772 |

The retained earnings include the cost of the Company's own shares held by the Group in employee share ownership trusts. At 31 March 2007 the cost of own shares held by the Group was £134 million (2006 £119 million).

Shares to be issued

Shares to be issued reflects the fair value at the date of the acquisition of Alliance UniChem of ordinary shares expected to be issued in respect of outstanding share options.

Other reserves

Other reserves comprise

Translation reserve

The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations that are not integral to the operations of the Company as well as from the translation of liabilities that hedge the Company's net investment in foreign subsidiaries. The balance of the translation reserve at 31 March 2007 was a £13 million debit (2006 £2 million debit).

Notes to the financial statements (continued)

for the year ended 31 March 2007

32 Capital and reserves (continued)

Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred. The balance of the hedging reserve at 31 March 2007 was £nil (2006 £nil).

Available-for-sale reserve

The available-for-sale reserve includes the cumulative net change in the fair value of available-for-sale investments, until the investment is derecognised. The balance of the fair value reserve at 31 March 2007 was £6 million (2006 £nil).

| Reconciliation of movement in capital and reserves – Company | Share capital £million | Share premium £million | Shares to be issued £million | Retained earnings restated ¹ £million | Merger reserve restated ¹ £million | Capital redemption reserve £million | Total equity restated ¹ £million |
|--|---------------------------|---------------------------|---------------------------------|---|--|--|--|
| At 1 April 2005 | 183 | 2 | – | 1,043 | 2,880 | 27 | 4,135 |
| Profit for the year | – | – | – | 1,045 | – | – | 1,045 |
| Share-based compensation | – | – | – | 5 | – | – | 5 |
| Dividends to shareholders | – | – | – | (1,640) | – | – | (1,640) |
| Transfers | – | – | – | 757 | (757) | – | – |
| Repurchase of shares | (2) | – | – | (50) | – | 2 | (50) |
| Movement in own shares | – | – | – | (6) | – | – | (6) |
| At 1 April 2006 | 181 | 2 | – | 1,154 | 2,123 | 29 | 3,489 |
| Profit for the year | – | – | – | 694 | – | – | 694 |
| Dividends to shareholders | – | – | – | (149) | – | – | (149) |
| Businesses acquired | 179 | – | 11 | – | 3,661 | – | 3,851 |
| Transfers | – | – | – | (642) | 642 | – | – |
| Movement in own shares | – | – | – | (5) | – | – | (5) |
| At 31 March 2007 | 360 | 2 | 11 | 1,052 | 6,426 | 29 | 7,880 |

£6,426 million of reserves of the Company relate to Group restructurings and are not distributable. These are all held in the merger reserve.

The Company has not presented its own income statement as permitted by section 230 (4) of the Companies Act 1985. The Company reported a profit for the year of £694 million (2006 £1,045 million).

¹ As explained in note 20, the merger reserve as at 1 April 2005 has been reduced by £200 million. The transfer between merger reserve and retained earnings during the year ending 31 March 2006 has been restated from £957 million to £757 million. The Company's profit for the year ending 31 March 2006 has been restated from £845 million to £1,045 million.

33 Dividends

The following dividends to equity shareholders were recognised in the year:

| | 2007 | | 2006 | |
|--|-----------------|----------|-----------------|----------|
| | pence per share | £million | pence per share | £million |
| Final dividend – year ended 31 March 2006/2005 | 21.0 | 101 | 21.0 | 150 |
| Interim dividend – year ended 31 March 2007/2006 | – | – | 9.1 | 64 |
| Special dividend | 10.0 | 48 | 200.0 | 1,426 |
| | | 149 | | 1,640 |

The Board would ordinarily be recommending in the normal course of business a final dividend covering the period from 31 July 2006 until 31 March 2007. However, the terms of the recommended offer for the Company by AB Acquisitions Limited announced on 20 April 2007 are such that the offer price is inclusive of any final dividend. Accordingly, no such final dividend will be paid. However, if the Company is not acquired by AB Acquisitions Limited (or any alternative offeror), the Board intends that the Company pay in due course an interim dividend, in respect of the year ended 31 March 2007 of an amount equal to the final dividend that would have been paid.

34 Share-based compensation

The Group operates a number of share-based compensation schemes for employees. These take a variety of forms and details of active schemes are given below. On acquisition of Alliance UniChem all former Alliance UniChem schemes vested and were exercised on merger apart from the Save As You Earn scheme and certain Executive Share Option Plans as detailed below.

The Group operates an All Employee Share Ownership Plan (AESOP) for eligible employees. Under the free share part of the plan, employees in service for the whole of the preceding financial year are awarded a grant of free shares conditional on completion of three years further service from the date of grant and a profit target being met. Shares are held in trust for employees from the date of grant. The cost of this plan is calculated by charging the entitlement to shares based on the Group's estimate of the number of shares likely to vest. Fair value is determined by an external valuer by reference to the market value of the share at the date of the grant incorporating future dividends.

The Group also has a Long Term Bonus Scheme under which executive Directors and certain senior executives can receive ordinary shares if a performance condition based on Total Shareholder Return (TSR) is met. Further details of the scheme are set out in the Board report on remuneration. Awards are made from shares purchased in the market held in an ESOP trust. The performance condition is a market based condition. Fair value is estimated at the beginning of each performance period based on expected performance and thereafter adjusted only for the impact of leavers.

The Long Term Bonus Scheme was replaced with a new Performance Share Plan for performance periods commencing from 1 April 2005. Under the new scheme executive Directors and certain senior executives can receive ordinary shares if a performance condition based on TSR relative to a UK retail index comprising the FTSE 350 General Retailers Index and the FTSE 350 Food and Drug Retailers Index (weighted 50% each) or based on the Group's Earnings Per Share growth depending on the individual's award. Further details of this scheme are set out in the Board report on remuneration. Fair value for the TSR element is estimated at the beginning of each performance period based on expected performance and thereafter adjusted only for the impact of leavers. Fair value is determined by an external valuer using a "Monte Carlo Pricing Model" for the TSR element and by reference to the market value of the share at the date of the grant with future dividends included.

Under an Executive Share Option Plan executive Directors and certain senior executives have been granted options to subscribe for ordinary shares subject to a performance condition based on the Group's Earnings Per Share growth. Further details of the Plan are set out in the Board report on remuneration. New shares are issued to satisfy awards under this scheme (none have so far vested). Latest estimates of future EPS performance predict that none of the awards granted after 7 November 2002 are likely to vest. A number of options from certain Alliance UniChem Executive Share Option plans remain. These became exercisable on the acquisition of Alliance UniChem.

Under a Co-Investment plan executive Directors are entitled to invest up to 50% of their short term bonus for the previous year in Alliance Boots shares in return for a matching opportunity of up to 2:1 depending on Earnings Per Share performance over a three-year period. Short term bonus paid in respect of year ending 31 March 2006 was invested by some of the executive Directors. Further details of the scheme are set out in the Board report on remuneration.

The Group provides UK employees with the opportunity to participate in the Group's Save As You Earn (SAYE) scheme which allows qualifying employees the opportunity to make regular savings over a fixed period of three, five or seven years. These savings accumulate with interest at a guaranteed rate. At the end of the savings contract a bonus is added to the savings and participants have the option to use their savings to buy shares in Alliance Boots plc at a fixed price. In common with other UK companies, the option price is set at a 20% discount to the market price of the Company's shares at the date of grant. Exercise of an option is subject to continued employment. The Alliance UniChem SAYE scheme existing at the date of merger has been continued with the exercise price being adjusted to reflect being part of Alliance Boots. The fair value of options on the date of grant has been estimated by an independent third party using a proprietary valuation model based on the binomial option pricing model. The inputs into the model for options granted in the period were option price (£6.37), expected annual volatility (18-20%) based on historic volatility, expected dividend yield (3.7%), a share price of £8.07 and a risk-free rate (4.7-4.9%).

Notes to the financial statements (continued)

for the year ended 31 March 2007

34 Share-based compensation (continued)

The terms and conditions of the grants made after 7 November 2002 whereby all rights will be satisfied by the delivery of shares are as follows

| Grant date | Number of instruments | Vesting Conditions | Contractual life of shares/options |
|------------------------------------|-----------------------|---|--|
| Executive Share Option Plan | | | |
| 29 November 2002 | 63,842 | EPS performance target after three years (retested if necessary at the end of 4, 5 and 6 years) | 10 years |
| 23 June 2003 | 1,568,547 | As above | 10 years |
| 18 September 2003 | 272,925 | As above | 10 years |
| 4 December 2003 | 50,385 | As above | 10 years |
| 14 June 2004 | 1,444,474 | EPS performance target after three years (retested if necessary at the end of 5 years) | 10 years |
| 8 November 2004 | 35,981 | As above | 10 years |
| AESOP | | | |
| 27 June 2003 | 1,225,378 | Employment throughout the 3 year period from grant | – |
| 2 July 2004 | 1,021,063 | As above | – |
| 16 June 2005 | 1,107,830 | As above | – |
| 12 June 2006 | 881,883 | As above | – |
| SAYE | | | |
| 23 November 2006 | 1,461,946 | Employment over 3, 5 or 7 years | 31 July 2010 for 3 year plan, 31 July 2012 for 5 year plan and 31 October 2014 for 7 year plan |
| Long Term Bonus Scheme | | | |
| 1 April 2004 | 1,085,170 | Total shareholder return ranking against a peer Group of 10 other companies | – |
| Performance Share Plan | | | |
| 1 April 2005 | 1,094,796 | Total shareholder return relative to a UK Retail Index (FTSE 350) | – |
| 29 September 2006 | 192,186 | Total shareholder return relative to a UK Retail Index (FTSE 350) | – |
| 26 September 2006 | 2,099,361 | EPS performance over a three year period | – |
| Co-investment plan | | | |
| 13 July 2006 | 222,325 | EPS performance over a three year period | – |
| 28 July 2006 | 16,627 | As above | – |

34 Share-based compensation (continued)

The number and weighted average exercise prices of executive options granted are as follows

| | 2007 | | 2006 | |
|---|-----------------------------------|-------------------|-----------------------------------|-------------------|
| | Weighted average exercise price £ | Number of options | Weighted average exercise price £ | Number of options |
| Outstanding at the beginning of the year ¹ | 6 31 | 3,704,432 | 6 29 | 4,636 867 |
| Businesses acquired | 4 34 | 826,093 | — | — |
| Forfeited during the year ¹ | 6 26 | (1,212,854) | 6 26 | (932 435) |
| Exercised during the year | 3 67 | (19,980) | — | — |
| Outstanding at the end of the year ¹ | 5 84 | 3 297 691 | 6 31 | 3 704 432 |
| Exercisable at the end of the year | 4 35 | 806,113 | — | — |

¹ Included within these amounts were 1 261 323 options outstanding at the beginning of the year 494 010 options forfeited during the year and 767 313 options outstanding at the end of the year that were not recognised in accordance with IFRS 2 as the options were granted on or before 7 November 2002. These options have not been subsequently modified and therefore do not need to be accounted for in accordance with IFRS 2.

The exercise price range and average contractual life of executive options outstanding as at 31 March is as follows

| | 2007 | 2006 |
|-----------------------------------|----------------|----------------|
| Exercise price range | £3 67 to £7 10 | £5 76 to £7 10 |
| Weighted average contractual life | 5 0 years | 7 8 years |

The number and weighted average exercise prices of SAYE options granted are as follows

| | 2007 | |
|--|-----------------------------------|-------------------|
| | Weighted average exercise price £ | Number of options |
| Outstanding at the beginning of the year | — | — |
| Businesses acquired | £3 43 | 1 966 742 |
| Forfeited during the year | £5 27 | (66,938) |
| Granted during the year | £6 37 | 1,461,946 |
| Outstanding at the end of the year | £4 67 | 3,361,750 |
| Exercisable at the end of the year | — | — |

The weighted average fair value of SAYE options granted during the year was £2 02 per share

The exercise price range and average contractual life of SAYE options outstanding as at 31 March is as follows

| | 2007 |
|-----------------------------------|----------------|
| Exercise price range | £2 18 to £6 37 |
| Weighted average contractual life | 2 9 years |

The fair value at measurement date for equity instruments (other than share options) granted during the year was as follows

| | Weighted average fair value | 2007 £million | Weighted average fair value | 2006 £million |
|-----------------------------------|-----------------------------|---------------|-----------------------------|---------------|
| All employee share ownership plan | £7 55 | 7 | £5 95 | 7 |
| Co-investment plan awards | £7 59 | 2 | — | — |
| Performance share plan awards | £7 47 | 17 | £1 94 | 3 |

The total expense recognised in the year in respect of share-based compensation was £9 million (2006 £5 million) arising entirely from equity settled share-based compensation transactions

Notes to the financial statements (continued)

for the year ended 31 March 2007

35 Share capital

| | 2007 Number of shares million | 2007 £million | 2006 Number of shares million | 2006 £million |
|---|--|------------------|--|--|
| Ordinary shares of 37 ⁷ / ₃₉ pence each | | | | |
| Authorised | 1,288 | 479 | 807 | 300 |
| Allotted called up and fully paid | 968 | 360 | 486 | 181 |
| | | | 2007 Number of ordinary shares million | 2006 Number of ordinary shares million |
| In issue at 1 April | | | 486 | 731 |
| Repurchase of shares | | | – | (8) |
| Shares issued | | | 482 | – |
| Share consolidation | | | – | (237) |
| In issue at 31 March | | | 968 | 486 |

Shares issued

As consideration for the acquisition of Alliance UniChem 482 million ordinary shares were issued on 31 July 2006

Share consolidation

In the year ended 31 March 2006, after the sale of Boots Healthcare International, £1,426 million was returned to shareholders by means of a special dividend of 200 pence per share. A share consolidation was performed on 13 February 2006 in the ratio of 39 new shares for every 58 shares held.

Own shares

At 31 March 2007 the number of own shares held by the Group was 12 million (2006 9 million). These were held in the various employee share ownership trusts. The market value of these shares is £127 million (2006 £68 million).

36 Operating leases

The operating lease rental expense in the year was

| | 2007 £million | 2006 £million |
|--------------------|------------------|------------------|
| Land and buildings | 265 | 224 |
| Other | 8 | 10 |
| | 273 | 234 |

At 31 March 2007 the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases which fall due as follows

| | 2007 £million | 2006 £million |
|----------------------------|------------------|------------------|
| Less than one year | 246 | 204 |
| Between one and five years | 858 | 777 |
| More than five years | 1,282 | 1,386 |
| | 2,386 | 2,367 |

The Group leases a large number of its properties under operating leases. The leases run predominantly for periods from 1 to 25 years, with options to renew the leases at the end of the period. Lease rentals are increased in regular intervals to reflect market rentals. None of the leases include material contingent rentals.

Rental income from subleased properties was £12 million (2006 £11 million).

37 Commitments and contingent liabilities

Commitments

Future capital expenditure approved by the Directors and not provided for in these financial statements at 31 March 2007 was £39 million (2006 £61 million)

Contingent liabilities

Knoll Pharmaceutical Co ('Knoll') has been a defendant in a number of consumer class actions in 30 states of the USA, Canada and Puerto Rico. Knoll was the successor to Boots Pharmaceuticals Inc., formerly an indirect subsidiary of the Company, which was sold to the BASF Group under agreements made by the Company in March 1995. The Company was named as a defendant in some of these actions, which allege that the marketing of the product Synthroid did not comply with consumer protection and business practice laws. A settlement by Knoll of consumer actions and claims of insurers and state attorneys general in the United States has been approved, and a settlement of most of the actions in Canada has been approved. The Company asserted that the relevant courts in North America had no jurisdiction over it in these cases and this was approved by a state court in Illinois. In the light of current information, the Directors believe that the Company has good defences to such claims as may arise concerning Synthroid, including any that might be brought by BASF and, while the outcome of such claims as may arise remains uncertain, they believe that it should not have a material adverse impact on the Group.

38 Pensions

The Group operates a number of pension schemes in UK and overseas including both defined benefit and defined contribution schemes. The Company does not participate in, or sponsor, any of the Group schemes.

| | 2007 £million | 2006 £million |
|--|------------------|------------------|
| Amounts recognised in the balance sheet | | |
| Present value of defined benefit obligation | (3,787) | (3,524) |
| Fair value of plan assets | | |
| – bonds | 2,972 | 2,919 |
| – equities | 527 | 406 |
| – other plan assets | 262 | 143 |
| | 3,761 | 3,468 |
| Retirement benefit obligations | (26) | (56) |

| | 2007 £million | 2006 £million |
|---|------------------|------------------|
| Changes in the present value of the defined benefit obligation | | |
| At 1 April | 3,524 | 3,096 |
| Current service cost | 69 | 62 |
| Past service cost | 2 | 6 |
| Curtailments | (2) | (16) |
| Interest cost | 180 | 167 |
| Employee contributions | 20 | 17 |
| Business combinations | 267 | – |
| Transfers | 7 | – |
| Actuarial gains and losses | (161) | 300 |
| Benefits paid | (119) | (108) |
| At 31 March | 3,787 | 3,524 |

| | 2007 £million | 2006 £million |
|---|------------------|------------------|
| Changes in the fair value of plan assets | | |
| At 1 April | 3,468 | 3,059 |
| Contributions | 117 | 112 |
| Employee contributions | 20 | 17 |
| Expected return | 185 | 163 |
| Business combinations | 189 | – |
| Transfers | 7 | – |
| Actuarial gains and losses | (106) | 225 |
| Benefits paid | (119) | (108) |
| At 31 March | 3,761 | 3,468 |

Notes to the financial statements (continued)

for the year ended 31 March 2007

38 Pensions (continued)

The Group expects to contribute £90 million to its defined benefit pension schemes in the year ended 31 March 2008

| Expense recognised in the income statement | 2007 £million | 2006 £million |
|--|------------------|------------------|
| Current service cost | 69 | 62 |
| Past service cost | 2 | 6 |
| Curtailments | (2) | (16) |
| Interest on pension scheme liabilities | 180 | 167 |
| Expected return on pension scheme assets | (185) | (163) |
| | 64 | 56 |

The expense is recognised in the following line items in the income statement

| | 2007 £million | 2006 £million |
|---|------------------|------------------|
| Profit from operations | 69 | 65 |
| Profit on sale of discontinued operations | – | (13) |
| Finance costs | 180 | 167 |
| Finance income | (185) | (163) |
| | 64 | 56 |

| Amounts recognised in the statement of recognised income and expense | 2007 £million | 2006 £million |
|--|------------------|------------------|
| Experience gains and losses on assets | (106) | 225 |
| Experience gains and losses on the scheme liabilities | (20) | 10 |
| Changes in assumptions underlying the present value of the scheme liabilities | 181 | (310) |
| | 55 | (75) |
| Cumulative amount of actuarial gains and losses recognised in the SORIE | (4) | (59) |

| Principal actuarial assumptions at the balance sheet date | UK | 2007 Overseas | 2006 UK |
|---|------|------------------|------------|
| Discount rate for scheme liabilities | 5.4% | 4.8% | 4.9% |
| Inflation | 3.0% | 2.1% | 2.9% |
| Rate of general long-term increase in salaries | 4.5% | 2.6% | 4.4% |
| Rate of increase to pensions in payment | 2.9% | 1.6% | 2.8% |

| Expected return on plan assets | 2007 UK | 2006 UK |
|--------------------------------|------------|------------|
| Bonds | 5.3% | 4.8% |
| Equities | 7.5% | 7.5% |
| Property | 6.5% | 6.5% |
| Other net assets | 5.2% | 4.6% |

The expected return on plan assets of overseas pension plans was 5% to 6.9%. The expected rate of return on plan assets has been determined with reference to market returns at the balance sheet date. Actual return on plan assets was £79 million (2006 £388 million).

The mortality assumption used to value the majority of scheme liabilities is based on PA 92 tables projected to 2014 for pensioners and 2024 for non-pensioners allowing for short cohort improvements. This has been adjusted to take account of the actual experience of schemes where this data is of sufficient size. The impact of short cohort improvements has been included for the first time this year recognising the recent improvements in published mortality investigation data. The mortality assumptions will continue to be reviewed to ensure they remain appropriate.

38 Pensions (continued)

| | 2007 Currently aged 45 | 2007 Currently aged 60 | 2006 Currently aged 45 | 2006 Currently aged 60 |
|--|------------------------------|------------------------------|------------------------------|------------------------------|
| Projected life expectancy from age 60 | | | | |
| Male | 25.1 | 24.3 | 23.8 | 23.0 |
| Female | 26.9 | 26.1 | 25.8 | 25.0 |

A sensitivity analysis on the principal assumptions used to measure the scheme liabilities is as follows

| | Change in assumption | Impact on scheme |
|-------------------|----------------------|------------------|
| Discount rate | Increase by 0.25% | Decrease by 4.4% |
| Rate of inflation | Increase by 0.25% | Increase by 3.6% |

An increase of one year in the assumed life expectancy at age 60 would increase the defined benefit obligation by 3.4%

| Amounts for the current and previous two years | 2007 £million | 2006 £million | 2005 £million |
|---|------------------|------------------|------------------|
| Defined benefit obligation | (3,787) | (3,524) | (3,097) |
| Plan assets | 3,761 | 3,468 | 3,059 |
| Deficit | (26) | (56) | (38) |
| Experience adjustments on plan liabilities | (20) | 10 | 96 |
| Experience adjustments on plan assets | (106) | 225 | 60 |

Defined contribution schemes

The Group operates a number of defined contribution pension arrangements. During the year the Group contributed £8 million (2006 £4 million)

39 Related parties

Subsidiary undertakings

The principal subsidiary undertakings all of which were indirectly held were

| | Percentage held by Company | Percentage held by subsidiary undertakings | Country of operation | Country of incorporation | Main activity |
|---|----------------------------------|---|-------------------------|-----------------------------|---|
| Alleanza Salute Italia SpA | – | 100 | Italy | Italy | Pharmaceutical wholesaler and holding company |
| Alliance Healthcare – Repartition S A S | – | 99.9 | France | France | Pharmaceutical wholesaler |
| Alliance Healthcare Spo | – | 97.1 | Czech Republic | Czech Republic | Pharmaceutical wholesaler |
| Alliance UniChem Norge A S | – | 100 | Norway | Norway | Retail pharmacy operator |
| Alliance UniChem Plc | 100 | – | UK | England and Wales | Holding company |
| Apteka Holding ZAO | – | 96 | Russia | Russia | Pharmaceutical wholesaler |
| Boots Beauty International Limited | – | 100 | UK | England and Wales | Sale of Boots branded products internationally |
| The Boots Company PLC | 100 | – | UK | England and Wales | Manufacturing, marketing and distribution of healthcare and consumer products |
| Boots Opticians Limited | – | 100 | UK | England and Wales | Provision of opticians' services |
| Boots Properties Limited | – | 100 | UK | England and Wales | Property holding company |
| Boots Retail (Ireland) Limited | – | 100 | Ireland | Ireland | Retail chemists |
| Boots The Chemists Limited | – | 100 | UK | England and Wales | Retail chemists |
| De Vier Vijzels BV | – | 100 | The Netherlands | The Netherlands | Retail pharmacy operator |
| E Moss Limited | – | 100 | UK | England and Wales | Retail pharmacy operator |
| Holtung A S | – | 100 | Norway | Norway | Pharmaceutical wholesaler |
| Interpharm BV | – | 100 | The Netherlands | The Netherlands | Pharmaceutical wholesaler |
| Safa Galenica S A | – | 99.2 | Spain | Spain | Pharmaceutical wholesaler |
| UniChem Limited | – | 100 | UK | England and Wales | Pharmaceutical wholesaler |

As permitted by Section 231(5) of the Companies Act 1985 only principal undertakings are shown. A complete list of all subsidiary undertakings is filed with the Company's annual return.

Notes to the financial statements (continued)

for the year ended 31 March 2007

39 Related parties (continued)

Associates

The Group's principal associates were

| Company | Percentage interest in ordinary share capital and voting rights | Country of operation | Country of incorporation | Main activity |
|------------------------------------|---|----------------------|--------------------------|---------------------------|
| Alliance Healthcare S A | 49 | Portugal | Portugal | Pharmaceutical wholesaler |
| Andreae-Noris Zahn AG | 29.99 | Germany | Germany | Pharmaceutical wholesaler |
| Galenica A G | 25.5 | Switzerland | Switzerland | Pharmaceutical wholesaler |
| Hedef Alliance Holding A S | 50 | Turkey | Turkey | Pharmaceutical wholesaler |
| Pharmapartners B V | 40 | The Netherlands | The Netherlands | Pharmaceutical software |
| UniDrug Distribution Group Limited | 50 | UK | England and Wales | Pre-wholesaler |
| Unifarma Distribuzione S r l | 36 | Italy | Italy | Pharmaceutical wholesaler |

Transactions with associated undertakings, all of which are carried out on an arm's length basis were

| | 2007 £million | 2006 £million |
|-------------------|------------------|------------------|
| Revenue in year | 13 | – |
| Purchases in year | (9) | – |
| Amounts due from | 3 | – |
| Amounts due to | (1) | – |

The remuneration of the key management personnel of the Group is set out below. Details of the remuneration, long term incentive plan interests, shareholdings, share options and pension entitlements of individual Directors are included in the Board report on remuneration.

| | 2007 £million | 2006 £million |
|------------------------------|------------------|------------------|
| Short-term employee benefits | 7 | 5 |
| Post-employment benefits | 1 | – |
| Other long term benefits | – | 1 |
| Termination benefits | 2 | 1 |
| Share-based compensation | 1 | – |
| | 11 | 7 |

The Group has a related party relationship with its subsidiary undertakings and with its Directors and executive officers. Transactions between the Company and its subsidiaries have been eliminated on consolidation and are not disclosed in this note.

The Company has a number of loans and balances with its subsidiary undertakings. All balances are repayable on demand and are predominantly interest bearing. At 31 March 2007 loans to subsidiary undertakings totalled £701 million (2006 £708 million) and loans from subsidiary undertakings were £40 million (2006 £nil). Other amounts owed by subsidiary undertakings totalled £1,540 million (2006 £1,215 million) and amounts owed to subsidiary undertakings were £915 million (2006 £728 million).

Interest receivable on the interest-bearing loans and balances was £122 million (2006 £268 million) and interest payable was £42 million (2006 £184 million).

During the year the Company received a dividend of £10 million from a subsidiary company (2006 £1,000 million).

During the year, the Company received charges from another Group company for the provision of management services of £24 million (2006 £16 million).

40 Accounting estimates and judgements

In preparing the consolidated financial statements the management of Alliance Boots plc are required to make estimates and judgements. The matters described below are considered to be the most important in understanding the judgements that are involved in preparing these statements and the uncertainties that could impact the amounts reported in the results of operations, financial position and cash flows. The Group accounting policies are described in note 2.

Fair value measurement on a business combination

The measurement of fair values on a business combination requires the recognition and measurement of the identifiable assets, liabilities and contingent liabilities. The key judgements involved are the identification and valuation of intangible assets which involves estimation of future cash flows and the selection of a suitable discount rate.

Impairment of indefinite life intangible assets (including goodwill)

The Group has significant carrying values of goodwill and intangible assets, such as pharmacy licences and customer relationships following the acquisition of Alliance UniChem. Goodwill and other indefinite life intangibles, such as pharmacy licences, are held at cost and tested annually for impairment. Amortised intangible and tangible assets are tested for impairment where events show an indication of impairment. The impairment test involves estimation of future cash flows and the selection of a suitable discount rate. This requires an estimation of the value in use of the cash generating units to which the intangible assets are allocated (see note 17).

Measurement of defined benefit pension obligations

The Group accounts for pension costs relating to retirement plans in accordance with IAS 19 'Employee Benefits'. In applying IAS 19 the pension costs are assessed in accordance with the advice of independent qualified actuaries. This requires the exercise of significant judgements in relation to the estimation of future changes in salaries and inflation, as well as mortality rates, the expected return on assets and the selection of a suitable discount rate. More detail is provided in note 38.

Revenue

For retail sales, reimbursement of dispensing revenue from the National Health Service is estimated because the actual reimbursement is not known for three months after the month of sale.

In respect of the Boots loyalty scheme (the Advantage Card), a liability is recorded to estimate the proportion of the points issued which will be redeemed by customers.

Supplier rebates

The recognition of supplier rebates can require estimation when the reporting period end is not coterminous with the end of the predetermined period over which the rebate is earned.

Provisions

Provisions are recognised in the period when it becomes probable that there will be a future outflow of funds resulting from past operations or events which can be reasonably estimated. The timing of recognition requires the application of judgement to existing facts and circumstances which can be subject to change.

Estimates of the amounts of provisions recognised are based on current legal and constructive requirements, technology and price levels. Actual outflows can differ from estimates due to changes in laws, regulations, public expectations, technology, prices and conditions, and can take place many years in the future, and therefore the carrying amounts of provisions are regularly reviewed and adjusted to take account of such changes.

41 Post balance sheet events

After the balance sheet date, and as a pre-condition to AB Acquisitions announcing their formal offer for Alliance Boots, the Group has agreed in the implementation agreement to pay a break fee to AB Acquisitions of £106 million if a competing proposal is announced or the Board of Alliance Boots withdraws, qualifies or adversely modifies its recommendation of the transaction, and in either case the transaction lapses or is withdrawn.

Group financial record – IFRS

The Group financial record shows the statutory results of the Group for each financial year

Group Income statements for the years ended 31 March

| | 2007 £million | 2006 £million | 2005 £million |
|---|------------------|------------------|------------------|
| Continuing operations | | | |
| Revenue – continuing operations | 11,502 | 5 027 | 4 936 |
| Profit from operations before share of associates post tax earnings | 441 | 369 | 401 |
| Share of associates post tax earnings | 39 | – | – |
| Profit from operations | 480 | 369 | 401 |
| Finance income | 251 | 187 | 153 |
| Finance costs | (276) | (207) | (194) |
| Profit before tax | 455 | 349 | 360 |
| Tax | (89) | (45) | (105) |
| Profit after tax from continuing operations | 366 | 304 | 255 |
| Discontinued operations | | | |
| Profit after tax from discontinued operations | 21 | 1 470 | 11 |
| Profit for the year | 387 | 1 774 | 266 |
| Attributable to | | | |
| Equity shareholders | 387 | 1 774 | 265 |
| Minority interest | – | – | 1 |
| | 387 | 1 774 | 266 |

Group balance sheets as at 31 March

| | 2007 £million | 2006 £million | 2005 £million |
|----------------------------------|------------------|------------------|------------------|
| Assets | | | |
| Non-current assets | | | |
| Goodwill | 2,388 | — | — |
| Other intangible assets | 1,508 | 147 | 442 |
| Property plant and equipment | 1,671 | 1,268 | 1,453 |
| Investments in associates | 628 | — | — |
| Available-for-sale investments | 55 | — | — |
| Other receivables | 58 | 32 | 59 |
| Derivative financial instruments | 3 | 2 | — |
| Deferred tax assets | 4 | 55 | 65 |
| | 6,315 | 1,504 | 2,019 |
| Current assets | | | |
| Inventories | 1,360 | 594 | 713 |
| Trade and other receivables | 1,985 | 461 | 522 |
| Current tax assets | 2 | 14 | 12 |
| Cash and cash equivalents | 404 | 856 | 129 |
| Derivative financial instruments | 2 | 1 | — |
| Assets held for sale | 29 | 1 | 1 |
| | 3,782 | 1,927 | 1,377 |
| Total assets | 10,097 | 3,431 | 3,396 |
| Liabilities | | | |
| Current liabilities | | | |
| Borrowings | (565) | (183) | (184) |
| Trade and other payables | (2,112) | (632) | (658) |
| Current tax liabilities | (115) | (56) | (95) |
| Provisions | (75) | (62) | (12) |
| Derivative financial instruments | (7) | (1) | (1) |
| | (2,874) | (934) | (950) |
| Net current assets | 908 | 993 | 427 |
| Non-current liabilities | | | |
| Borrowings | (764) | (575) | (587) |
| Other payables | (30) | (30) | (51) |
| Deferred tax liabilities | (456) | (97) | (137) |
| Retirement benefit obligations | (26) | (56) | (38) |
| Provisions | (54) | (87) | (12) |
| Derivative financial instruments | (121) | — | — |
| | (1,451) | (845) | (825) |
| Net assets | 5,772 | 1,652 | 1,621 |
| Equity | | | |
| Share capital | 360 | 181 | 183 |
| Share premium | 2 | 2 | 2 |
| Shares to be issued | 11 | — | — |
| Retained earnings | 1,393 | 1,131 | 1,096 |
| Merger reserve | 3,972 | 311 | 311 |
| Capital redemption reserve | 29 | 29 | 27 |
| Other reserves | (7) | (2) | 1 |
| Shareholders' equity | 5,760 | 1,652 | 1,620 |
| Minority interests | 12 | — | 1 |
| Total equity | 5,772 | 1,652 | 1,621 |

Group financial record – UK GAAP*

The information below is presented on a UK GAAP basis, restated to show Boots Healthcare International as a discontinued operation

| | 2005 £million | 2004 £million | 2003 £million |
|---|------------------|------------------|------------------|
| Profit and loss account | | | |
| Group turnover from continuing operations | 4,935 | 4,795 | 4,594 |
| Discontinued operations | 534 | 530 | 726 |
| Total Group turnover | 5,469 | 5,325 | 5,320 |
| Operating profit from continuing operations | 421 | 490 | 509 |
| Discontinued operations | 81 | 60 | 51 |
| Group operating profit before exceptional items | 502 | 550 | 560 |
| Share of operating loss of joint ventures | (1) | (1) | (13) |
| Total operating profit before exceptional items including share of joint ventures | 501 | 549 | 547 |
| Exceptional items | (54) | 36 | (153) |
| Profit on ordinary activities before interest and taxation | 447 | 585 | 394 |
| Net interest (payable)/receivable and similar items | (20) | (5) | 104 |
| Profit on ordinary activities before taxation | 427 | 580 | 498 |
| Taxation | (124) | (168) | (192) |
| Profit on ordinary activities after taxation | 303 | 412 | 306 |
| Minority interests | (1) | (1) | (1) |
| Profit for the year attributable to equity shareholders | 302 | 411 | 305 |
| Dividends paid and proposed | (216) | (226) | (230) |
| Retained profit for the financial year | 86 | 185 | 75 |

| | 2005 £million | 2004 £million | 2003 £million |
|---|------------------|------------------|------------------|
| Balance sheet | | | |
| Intangible fixed assets | 284 | 282 | 301 |
| Tangible fixed assets | 1,593 | 1,499 | 1,517 |
| Net current assets | 502 | 587 | 630 |
| Creditors: Amounts falling due after more than one year | (589) | (383) | (402) |
| Provisions for liabilities and charges | (179) | (177) | (161) |
| Net assets | 1,611 | 1,808 | 1,885 |
| Represented by | | | |
| Equity shareholders: funds | 1,610 | 1,807 | 1,884 |
| Minority interests | 1 | 1 | 1 |
| | 1,611 | 1,808 | 1,885 |

* Unaudited