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WBA - Walgreens Boots Alliance Inc at JPMorgan Healthcare Conference

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Stefano Pessina *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

CONFERENCE CALL PARTICIPANTS

Lisa Christine Gill *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

PRESENTATION

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

Good afternoon. My name is Lisa Gill, and I'm the Health Care Technology and Distribution Analyst with JPMorgan. It is with great pleasure this afternoon that I'm sitting with Walgreens Boots Alliance. As you all know, they just reported last week so we're going to do a slightly different format, one that we've done the last 3 years, where we're going to go through a list of topics. We're -- also have a break out afterwards so you can ask questions as well. But to my left is: Chairman and CEO, Stefano Pessina; and to his left is the President of the U.S. Operations, Alec Gourlay. Thank you so much for joining me this afternoon.

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

Thank you. Thank you.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

So Stefano, we have talked about vertical integration now for 3 years running. I think many people in this room remember your analogy of the layers of the cake, and that there would be some crumbs left for people on the floor. So can we come back to your analogy? Things have continued to shift and evolve in the marketplace. We've heard of CVS making the proposed acquisition of Aetna. We've had a lot of other movements in the marketplace. You've closed or partially closed on some of the stores that you're buying with Rite Aid, but what are your general thoughts right now around vertical integration in the U.S. market and how Walgreens fits into that?

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

Well, we still believe that vertical integration is a good thing because it could simplify the supply chain of the drugs, it could make the very complicated, the U.S. system, more efficient. We have always said in the past that we were positive on vertical integration, but vertical integration could be achieved through M&A or just through a joint venture, so through commercial agreement. What is important, of course, is to do things that can create the value. When you make a deal, you have to put some money on the tables and you do it because you have the hope to see your money back, and probably multiply it by a certain factor. So if you can do a deal which creates value, the vertical integration of course, is a good thing for the market and it is a good thing for your company. This is why very often we think of doing joint ventures, so doing things where we don't have to spend a lot of capital and even though we reach just a part of the potential synergies, the value creation in relative terms is much higher. We are not against of course at all, big deals. If we had the opportunity to do a big deal, creating value and having the right return for the money that we spend, we would do it without any hesitation. But of course, we have also promised to our shareholders that we will never do a deal that we don't believe to be a good deal, a deal which create value. And when I talk of creating value, I am not talking of earning per share. Very easy to announce your earning per shares with the cost of capital -- with the cost of money that we have today, but the creation of value is something different, the creation of value is a high IRR, it's a positive EVA, positive after a few years, 3 or 4 years and not after 20 years. And this is -- has been always our philosophy, and we will continue to stick to it. This is why we have been able to deliver the growth that we have delivered year after year without any exception.



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Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

So if we think about that vertical integration, I think some people in this room probably know that you own a portion of AmerisourceBergen, 25%, 26% today. You have the joint venture with Prime Therapeutics in that specialty mail organization that you built there. What are some of the other pieces that you need, even from a partnership or maybe not go out and buy the whole company, where do you see other opportunities beyond distribution, beyond mail and specialty? When we think about things like health plans, you have a lot of different relationships in your retail business with health plans, but are there ways to work more closely with the health plan? Is there a way to own some component of that health plan so you can have more benefit to Walgreens and their shareholders?

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

For sure, there are, and you don't have necessarily to own pieces of the health plan, you can have joint venture on very -- on certain elements, and you can collaborate and create a lot of value. For sure, I believe that we have to be close to the health plans and why not? We can work together and have a joint venture on certain specific part of the business.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

So as we think about those types of relationships, I guess my next question would be for Alex is, we think about retailization of the consumer, we think about health care and we hear retailers like yourself and others talk about, we have 10,000 stores, we've got this square footage, a low-cost way to be able to treat patients. We heard Express Scripts just talk about some of the clinical programs that they have with you today, where their pharmacists are counseling patients, et cetera. How do I think about your store of the future from a health care perspective? Is it going to be more retail-based clinics? Will it be more services? How will that footprint look different than it does today from a health care perspective?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Thanks Lisa. Yes, I think we have done a lot of test and trials, really testing the customer behavior, to be honest about it, how comfortable are they receiving these services either from the pharmacist digitally, or in the store and also some of the services like lab, like optical and of course, the implant with MedExpress. And what we're discovering that, that almost all of these are getting the right customer reaction. So next phase then is how do you build the partnerships, the operating model and how do you create this space in a drugstore, so that you can actually put it all together? And what Stefano has spoken to in his closing remarks at our earnings call last week was we intend to really put all the things we've learned together in one area in the U.S.A., early summer, late spring, and start to put all these components in one place. We can see the whole box, and you can see the whole brand in one corner location. So that tells you we have what are, many of the components. It tells you what the capital costs required to be able to scale that when we get to the right point and also tells you we've been working on the retail side of the business to create the space to actually accommodate these services as well.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

And so that sounds like that will be pilot programs. Will it be a staged rollout? Or how do we think about the timeline of this concept we talk about today to being in, I don't know, what's the goal as far as a number of stores you would ultimately be in?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Yes, well again, the fantastic thing about our business is we do have more or less just under 10,000 pharmacists today. We do service more or less, in all of our assets, 10 million customers every single week -- that's every single day, sorry. And we do have digital assets that are really quite powerful. We announced we have 50 million downloads of our digital app. So scalability is not the issue. It's getting the model right that's the issue. So I think



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we'd probably need another, maybe another period of time, maybe 6 months, maybe 18 months to really understand all these components to get the right business model to be able to scale. Some will scale individually, some will scale collectively, but that's the work we're doing next.

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

And this is what we do normally. You see, we prepare very carefully and very methodically our next steps. We work for years, testing and putting things together, and after we roll it out quite quickly and look and what we have -- we are doing or we have done with FedEx, we have been working with them for 3 years to prepare. We knew 3 years ago where we wanted to go, how we wanted to prepare ourselves to cover the last mile and to be very close to our -- to all there or most of the American households and how we could reach them quite quickly in a matter, let's say, of hours and not over weeks. And we are preparing these, and now we are almost ready, but it's a plan that we have done some years ago. We are not in a hurry. We don't leave on announcement. We are working in a very systematic way.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

And again, just to put this in context, we scaled that initiative to all of our drugstores in less than 6 months and we were able to -- we haven't given the number back, I can assure you that the volume through December was very strong, without any marketing of people who not just collected parcels in Walgreens, but also dropped off in tons in Walgreens as well. So it's a part of the platform we're building for the new model in the U.S.A.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

A part of the strategy has been narrower preferred networks for retail pharmacies, and I think that on the earnings call the other day, there may have been some confusion around projections for calendar '18 when it comes to the number of scripts. So clearly, in calendar '17, you had a number of things that were favorable. The Department of Defense contract went in your direction. You won some incremental Medicare Part D pieces of business. So as we think about calendar '18 and we think about some of the shifts in Medicare Part D, I believe the answer to my question was that, it would be positive, but I just want to understand how we think about the fiscal year first, kind of first half, second half of that, right? Because clearly, your first part of your fiscal year was still in calendar '17, and how you're thinking about trends today in the U.S., when we think about pharmacy script trends and Medicare versus commercial? And so any thoughts you can share would be great.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Yes, absolutely. So we can absolutely confirm again that in the second half of the calendar year of '18 and the second half of the fiscal year of '18, which is slightly different for us, as you pointed, we will grow volume in the U.S. more or less at the same rate as the marketplace.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

And so the low single digits, is that right way to think about it?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Yes, low single digits. The marketplace grows 2%, 3%, so you can imagine we'd be growing around about that number. That's because of the fact that while it is pretty obvious why we lost the Aetna-preferred business now and also Silver Script is now up a bit as well. We still have fantastic partnerships in Med D with people at United and Humana, which are growing their growing business and they're growing with us. And also, and Med D itself is growing, of course, as I said, it's a facet of the market. So that's one aspect of it. The second aspect of it is, which is -- and this is why the Rite Aid deal was so important to this, is that we're looking to grow in overall market share in a nonorganic way through the purchase of the pharmacies of Rite Aid, and of course, we're buying, we've announced we've bought 357, when we announced that last week, and we're buying



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50 an evening, all the way through to the end of March. And they, of course, give us more capacity and more volume and more market share as well in this calendar year.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

So when you talked about that script growth of 2% to 3%, did that include anything of Rite Aid? Or Rite Aid would be on top of that?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Rite Aid is on top of that. Yes.

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

Of course.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

We needed to clarify that.

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

You're right. You are right.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

Another area of confusion was just on the generic procurement side. Can you give more color around what you're trying to get at out of generic procurement? We've -- obviously, Express Scripts talking about them being added to WBAD, the opportunity they had, that they would see more opportunity in '18. Was there something around that relationship, the way they came into the relationship for WBAD or was there something else around your procurement, your generic procurement in the quarter that you could give us more color around?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Let me take it first and pass off to Stef, the first strategy, so. The comments were made by George, similar accent, it was about wholesale, and again, the questions asked to me and I picked it up in the retail sense, so. We've always said this: With generic deflation as is, which is more or less from our point of view certainly, the same levels it was as year-on-year. Wholesale is a headwind. It's a tailwind for retail. And overall, it's a tailwind for our business. So that's what we -- that's what we're trying to clarify on the call. Looking towards the future, Stef, it was much closer to -- this market's developed and the work we're doing with Express and others.

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

But I have to tell you that the market has not changed. The trends of the market are the same. The deflation will continue to be there. You can -- you see that the risk -- the competition is not changing at all because the generic manufacturer were pushing that the FDA to approve the generics more rapidly, which the FDA is doing, but of course, as they are approving all the generics more rapidly, so the unintended consequence of the action of the generic manufacturer has been that there is some more competition on the market. And I can tell you that we have, more or less I believe, around 100 suppliers in the generics. And the competition is very strong. And we have not yet seen the Chinese manufacturers on the



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market, and we know those people quite well, relatively well. And I can tell you that the while 10 years ago when we first entered China, we could not really use their generics because the quality was not at the same level than the quality of the -- of our normal suppliers. Today, their quality is practically at the same level. And if -- when we will open the gate to the Chinese manufacturers, they will really -- they will really have the capacity to compensate any shortfall that we could have in the Western world. So it's a market that will be competitive for many, many years. While we could have one -- some shortages for certain molecules temporarily, but the trend will continue to be the same.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

To that point, Teva made the announcement about a month ago that they're reviewing their portfolio and that they would exit certain product classes. Do you believe that, that will have any impact on your ability to procure the product in a reasonable way for your drug retail side of your business, even without the Chinese coming into the market?

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

I have just said that we have around 100 suppliers. So there is such an overcapacity in the market today. Yes, I know that the generic manufacturers sometimes are under a certain stretch, but before we can see a different market for the generic, probably will take -- it will take some years. And I don't exclude that for certain molecules. You could have a temporary issue, but this would be a very limited problem, if any. I don't believe that we will have this problem, we and the other people in the market.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

This morning, you filed an 8-K with expectations around tax reform, \$0.30 to \$0.35, little better than we anticipated, we were thinking \$0.22. But there's a couple of components I wanted to just discuss: one, you talked incremental cash flow; and two, repatriation back to the U.S. So what are your thoughts? I mean, are you going to use this opportunity bring cash back to the U.S. and invest here, number one; and number two, I mean, \$200 million, obviously, not a lot of cash given the size of your company, but it is an incremental dollar amount, and I think of things of -- are there incremental investments you'd like to make that now you can make with this cash that won't impact earnings the same way?

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

Well, first of all, let me be precise. We said at least \$200 million, because the law is not completely clear, particularly on the, for the multinational like ourselves, with a lot of businesses outside the U.S. There are certain areas which are not completely clear, so we have given an indication, but we have not changed our guidance officially for the time being, because what we have given is an indication. And as always, and as we have to do, we have been always on the safe side. We have been prudent in our estimate, but we will have the final number when we will understand completely what is happening. So when we will have an idea of what we are really doing, we will decide what to do with the cash. But as you said, this would not change our strategy. We are always looking for new investments, for new deals. If we will find a good deal in the U.S, you can be sure that we will jump on it and we will use this cash and even much more cash to do the deal. But in the same way, if we will find a good opportunity as in when we have found recently in China, we will do it.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

Great. Maybe we can talk a little bit about Rite Aid and how it's gone thus far. You've talked a little about it from the perspective of the scripts that it'll have, but where are you in the process? Any surprises as you're moving through the process with Rite Aid?



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Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

No, it's been a really good start. We are very pleased with how the first stores are trying to spread across -- cut across. There is -- it's not straightforward, what we're doing -- and buying 50 shops every single night, and we being able to accommodate that into our systems into financial systems is not straightforward. It's working really well. In terms of the early indications of how the stores are performing, it's absolutely as we expected, a little bit here and there different, but in the round, it's exactly as we expected. And the teams continue to work really well together, with the right spirit, and we feel good about what we're seeing.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

I would be remiss if I didn't ask about Amazon. We talk about the different channels, we talk about omnichannels, we talk about competition. Stefano, I know you've talked in the past about Amazon as both being a potential competitor, but actually a potential partner as well. So what are your latest thoughts on Amazon? One, do you believe that they'll enter the pharmacy market; and two, if they do so, how would you anticipate that they enter the market?

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

We have not changed our mind. We believe that in the short run, they will not enter significantly our market. I cannot predict what will happen in 10 years, or even in 5 or 6 or 7 years. But in the short run, I don't believe that they will be particularly interested in this market. And in any case, you'll see the pharmacy network is the best network in the world. Everywhere in the world, even in a village in Africa, you can find a pharmacy. And before dismantling this network, probably we will need to see much more -- more time and also more capacity, because we are close to the family. And as we were saying before, now with the new organization that we are giving ourselves, we would be able to reach most of the American household in a, I don't say in a few hours, but in not more than 24 hours. So I am not particularly worried about a collaboration, about a partnership. Partnership means that you put certain assets or certain capacity or certain skill set together to share the benefits. If people are willing to share the benefit with us, we are open. If people want to use us, just to take our customers, of course, we have to defend our goodwill.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

I know most people here are U.S.-based shareholders and focus on the U.S. market, but you do have a business outside of the U.S. You've always talked about the fact that reimbursement is challenging, especially in the European countries. Can you just give us an update on your businesses and the overall reimbursement environment of what you're seeing in Europe right now, for both retail and wholesale?

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

Start with both.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Yes, Boots in the U.K. and retail. Yes, it's a bit of an old story, to be honest, because the U.K. government action has been very clear in the last 2 years, and they've taken that extra money from U.K. pharmacy. We've adjusted pretty much our operating model. We continue to work as a global company to bring additional benefits. So for example, we work in a very integrated way with the wholesale business in the U.K, and we continue to find new ways of integrating, taking efficiencies out of our supply chain and use it both for pharmacy and for retail in a similar way that we're doing here, but more advanced and have been there for longer. So we feel that we have the right cost base, we are rebuilding effectively the opportunity to expand our pharmacies when the opportunity comes, and as Stefano has said many times, we'll do that when the time is right. And at the moment, we're just waiting. Okay, becoming efficient, looking after customers, and we feel good of our position. We're very lucky the Boots brand in the U.K. is a very strong brand, both with its pharmacy business, with its front end, a very resilient brand. I would say the front end of the



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U.K. is also difficult. Again, Brexit has caused a number of currency issues that's translated into inflation, and we are well positioned to resist that and become stronger through this period.

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

The rest of Europe, I have to say that the pharmacy situation is a little better. Of course, for many years, the pharmacies have suffered in Continental Europe, but now with the decision of the Italian government to open up to pharmacy chains and to accept that the creation of chains and the multi-ownership of the pharmacies, I believe that other countries will follow. There are a lot of discussions in France about it, and this will open a new scenario in Europe about the pharmacy chains. And about the wholesaling business, it's business as usual, and the margins are more or less in the range of what they have been historically. We have had -- we, but I mean, the market, have had for a couple of years, a better, a better operating margin in wholesale. Now we have gone back toward, it was a traditional operating margin.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

I think we're out of time. We'll take questions across the hall in the Georgian room. Thank you very much.

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

Thank you very much.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Thank you.

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