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WBA - Q2 2020 Walgreens Boots Alliance Inc Earnings Call

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OVERVIEW:

Co. reported 1H20 sales growth (including 0.5% currency headwind) of 2.7% and 2Q20 sales growth (including an adverse currency impact of 0.4%) of 3.7%. 2Q20 GAAP EPS (including a negative impact) was $1.07.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Walgreen Boots Alliance, Inc. Second Quarter 2020 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions) I would now like to hand the conference over to your speaker today, Gerald Gradwell, for the prepared remarks. Please go ahead.

Gerald Gradwell - *Walgreens Boots Alliance, Inc. - SVP of IR*

Good morning, ladies and gentlemen, and welcome to our second quarter earnings call. We, here at Walgreens Boots Alliance, are strictly adhering to the recommended social distancing, so we're doing this call with our executives in different locations, and I would ask you to bear with us if you experience any minor delays or mixed audio quality on the call.

On the line with me today is Stefano Pessina, our Executive Vice Chairman and Chief Executive Officer of Walgreen Boots Alliance; James Kehoe, our Global Chief Financial Officer; and Alex Gourlay, Co-Chief Operating Officer of Walgreen Boots Alliance.

Before I hand you over to Stefano to make some opening comments, I will, as usual, take you through the legal safe harbor and cautionary declarations.

Certain statements and projections of future results made in this presentation constitute forward-looking statements that are based on our current market, competitive and regulatory expectations and are subject to risks and uncertainties that could cause actual results to vary materially. We undertake no obligation to update publicly any forward-looking statement after this presentation whether as a result of new information, future events, changes in assumptions or otherwise. Please see our latest Form 10-K for a discussion of risk factors as they relate to forward-looking statements, and note in particular that these forward-looking statements may be affected by risks related to the spread and impact of the coronavirus COVID-19 pandemic.

In today's presentation, we will use certain non-GAAP financial measures. We refer you to the appendix in the presentation materials available on our Investor Relations website with reconciliations to the most directly comparable GAAP financial measures and related information. You'll find a link to the webcast on our Investor Relations website at investor.walgreensbootsalliance.com. After the call, this presentation and webcast will be archived on the website for 12 months.

I'll now hand you over to Stefano.

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

Thank you, Gerald, and good morning, everyone. Clearly, today, everyone's attention is very focused on the global COVID-19 pandemic. As you would expect, our priority has to be to protect the health and well-being of our customers and our people. And we focus on playing our part to address the needs of the communities we serve and the key part of the healthcare system in many countries around the world, forming part of the frontline of healthcare delivery.

Our teams are working tirelessly to provide medicines and advise to our patients and to ensure the supply chain operates as well as possible in these testing times, both to our own pharmacies and our other wholesale customers.

So I want to start today by thanking our people personally and on behalf of my fellow management and Board members for their outstanding effort and dedication despite frequently facing extremely challenging situations in the service of their communities. And for our customers, I want to assure you that we will continue to work hard to help you manage your health and get through these very difficult times. I, myself, alongside of all our executive team, have been very focused on facilitating and coordinating our response to the current pandemic over recent weeks, and will continue to do so until we can see the end of the immediate need. But I can assure you that despite the challenges of this difficult time, we continue to exercise our usual management control of all areas of our company.

That said, as you have seen from our announcement today, we have had a quarter slightly ahead of our expectations, which James will take you through in details in a moment. And we have continued to make good progress in the delivery of our 4 strategic priorities, which we remain convinced will give us the capabilities we need to allow our business to thrive in the long term.

While we deal with the immediate priorities, we continue our work to deliver our strategic initiatives and drive our company forward. However, the current situation might lead to some delays in the work to renew and refocus our business.

We reported the second quarter performance, demonstrating the company was well on track to deliver against our expectation for the full year. It is, however, much too early to confirm the full financial impact of the actions we are taking to address the COVID-19 virus, that James will explain.

I will ask James to give you an overview of the second quarter results. And then, me and Alex will discuss the impact of COVID-19 so far. James?

James Kehoe - *Walgreens Boots Alliance, Inc. - Executive VP & Global CFO*

Thank you, Stefano, and good morning. Adjusted EPS was $1.52 in the second quarter, 7.3% lower than prior year on a constant currency basis. Overall, the second quarter came in better than we expected, with the upside coming from our U.S. retail business and better cost management in the U.S.

As I flagged on our last earnings call, we were facing 2 major headwinds in the second quarter: the year-on-year bonus impact and the true-up of a reimbursement contract. I highlighted the second quarter adjusted EPS headwind of around 13% for these 2 items combined.

In Retail Pharmacy USA, we delivered sequential improvement in both prescription growth and retail comps. Retail Pharmacy International continued to be held back by a challenging U.K. market, and Pharmaceutical Wholesale delivered yet another strong set of results. The Transformational Cost Management Program remains very much on track, and we continue to expect annual cost savings in excess of $1.8 billion by 2022.

As with our first quarter, cash generation was very strong in the second quarter. Free cash flow for the first half of the year was $1.8 billion, and this was almost $1.4 billion better than prior year.

Turning now to guidance. Stefano has already mentioned that we were well on track to confirm our full year adjusted EPS guidance. Second quarter EPS was ahead of our expectations. We delivered sequential improvement in our U.S. sales comps and a majority of our business initiatives were on track, including cash generation and the Transformational Cost Management Program.

However, given the many rapidly changing variables related to the COVID-19 pandemic, right now, we are not in a position to accurately forecast the future impacts of COVID-19. While the situation is temporary, it is quite difficult to develop informed projections about the severity and duration across multiple markets. I will come back to the COVID-19 topic in a few minutes.

Let's now look at -- in more detail at the results. Second quarter sales were up 3.7%, including an adverse currency impact of 0.4%. On a constant currency basis, sales rose 4.1%, including a headwind from store optimization of around 0.5%.

We did see increased demand in the last few days of the quarter as a result of the COVID-19 pandemic, but it did not have a material impact on the quarter's results. We estimate a favorable sales impact of around 10 basis points of growth.

Adjusted operating income declined 12% on a constant currency basis, mainly due to a lower pharmacy gross margin in the U.S. and the year-on-year bonus impacts, partly offset by the benefit of the Transformational Cost Management Program and solid growth from our U.S. retail business. Adjusted EPS was $1.52, a constant currency decline of 7.3%.

Our share repurchase program contributed 2.6 percentage points of growth, and this was partly offset by a 0.5 percentage point headwind from tax rate. GAAP EPS declined 14% to $1.07, including a negative impact from our share of AmerisourceBergen's impairment of PharMEDium.

Let's turn now to the financial highlights for the first half of the year. Sales increased 2.7%, including a currency headwind of 0.5%. On a constant currency basis, sales were up 3.2% mainly due to U.S. pharmacy sales and strong performance from Pharmaceutical Wholesale. Bear in mind that the constant currency growth rate includes a headwind from store optimization of 0.4%. On a constant currency basis, adjusted EPS declined 6.5%. Our share repurchase program contributed 3.2 percentage points of growth and a lower tax rate contributed 2.4 percentage points as we benefited from discrete tax items.

Now let's look at the performance of our divisions, starting with Retail Pharmacy USA. As this is a leap year, our second quarter results have benefited from one extra day of sales. We have adjusted all comp sales and comp prescription numbers to include only the first 28 days of February.

Sales increased 3.8% in the quarter with improved comp growth in both pharmacy and retail. The result was held back by a 70 basis point impact from our store optimization programs. Total comp sales increased 2.7%, a sequential improvement of 110 basis points versus the first quarter.

Adjusted gross profit declined 3.7%, entirely due to a lower pharmacy margin and only partly offset by higher retail gross profit as a result of improved margin delivery across all key categories. Absolute adjusted SG&A spend was 0.8% lower than prior year as the Transformational Cost Management Program savings more than offset the year-on-year bonus impact of 2%, higher investments in IT and digital of 0.4% and general inflationary pressures.

Adjusted SG&A was 16.9% of sales, an improvement of 0.8 percentage points versus prior year. Adjusted operating income declined 12.9%. This was negatively impacted by the year-on-year bonus impact, the true-up of a reimbursement contract and incremental investments in digital and development. In total, these had an impact of around 17 percentage points of operating income growth.

Now let's look in more detail at our pharmacy business. Total pharmacy sales increased 5.3% versus prior year, reflecting higher brand inflation, comp script growth and strong growth in central specialty, partly offset by the store optimization program. Central specialty sales continued to grow nicely, up 17.7% versus prior year. Comp pharmacy sales were up 3.7%, and comp scripts grew 4.9%, compared to 2.8% growth in the first quarter, aided by improved Medicare Part D performance and a favorable cough, cold, flu season. Market share for the quarter was 21%, down 50 basis points versus last year, including the negative impact of our store optimization programs.

Adjusted gross profit decreased year-on-year as the impact of script growth and procurement savings was more than offset by reimbursement pressure. As a reminder, the second quarter included the contract true-up I mentioned earlier, with an impact of around 60 basis points on gross margin.

Turning next to our U.S. retail business. Retail sales declined 0.3% in the quarter, entirely due to store optimization. We delivered sequential improvement in comp retail sales in the quarter. Comp sales increased 0.6%, and excluding tobacco and e-cigarettes, comps were up 1.9%.

The cough, cold, flu season was favorable this year and contributed around 80 basis points to the growth rate. While increased demand as a result of the COVID-19 pandemic was not material to WBA's overall result, it did contribute around 40 basis points of growth for the U.S. retail business.

The sequential improvement in sales growth was led by our flagship health and wellness business, which grew 6.7%; and by personal care, which was up 2.3%. Beauty was flat in the quarter, but was up 0.9% in the first half. Adjusted gross profit increased low single digit, coming from solid comp growth and higher gross margin across all key categories.

Turning next to Retail Pharmacy International, and I'll talk to constant currency numbers. Sales declined 1.7% due to challenging market conditions in the U.K., civil unrest in Chile and a decline in Chinese tourists to Thailand.

Boots UK pharmacy comp sales increased 1.8% in the quarter with favorable NHS reimbursement phasing, partially offset by lower script volume. Boots UK comp retail sales declined 4.6% in a declining U.K. market. Overall, we held market share in our categories, led by continued strong share gains in premium beauty. Adjusted operating income was down 24% mostly due to lower retail sales volume and margin in the U.K. with over 7 percentage points due to the year-on-year bonus impact and higher technology investments.

Turning now to the Pharmaceutical Wholesale division, which I'll also discuss in constant currency. The Pharmaceutical Wholesale division delivered another strong quarter, with sales up 8%, led by emerging markets and the U.K. Adjusted operating income increased 5.2%, reflecting strong revenue growth and a higher contribution from AmerisourceBergen, partially offset by lower gross margin.

Turning next to cash flow. Free cash flow was strong, with $1.8 billion delivered in the first half of the year, up an impressive $1.4 billion on the same period last year. This reflects strong working capital performance of $1.8 billion and a prior year headwind related to cash tax payments of $290 million. We did see some favorable timing in the quarter, and we expect this will reverse during the course of the third quarter.

Lastly, we have increased our purchases in key categories as we realign with recent demand spikes. This may lead to some volatility in inventory levels during the course of the third quarter.

Let's turn now to our Transformational Cost Management Program. We are well on track to deliver in excess of $1.8 billion in annual cost savings by fiscal 2022. On smart spend, we have moved quickly. We are conducting significant contract renewals and goods not for resale, with further savings potential as we implement new operating models with these vendors.

Interestingly, this can be a win-win also for the vendors. We are bundling our scale, reducing the number of suppliers and offering larger volume of business in return for lower cost and outcome-based contracts that drive long-term business value.

On smart organization, we've simplified the field organization structure in Boots UK and are conducting end-to-end operating model reviews across all of our businesses. We have closed 116 of the 200 Walgreen stores targeted for closure and 40 of the 200 Boots UK stores.

We are moving swiftly ahead on shared services. We have already started the implementation of a new IT operating model, and we are transitioning activities to Tata Consulting Services. As I've said before, the savings generated through our Transformational Cost Management Program will allow us to fund the investments needed to create new and innovative business models. Save to Invest to Grow.

However, it is important to highlight that COVID-19 is having a short-term impact on a number of enterprise initiatives. We have temporarily refocused select resources from the Transformational Cost Management Program to work on mitigating the COVID-19 impacts that are facing us right now, and we are selectively deferring investments.

One example here is that we are delaying our SAP rollout in the U.S. as it would not be prudent to roll out new systems in the stores when our team members need to be 100% focused on delivering world-class customer service in a challenging operating environment. Nevertheless, we remain confident that we will deliver or exceed our long-term cost-saving goals.

Now I'll hand it over to Alex.

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

Thank you, James. First, I'll update you on some of the initiatives we have undertaken in the quarter, both in the U.S. and the U.K. I'll then go on to discuss the impact of COVID-19.

Starting with U.S. retail. The grocery trials we're undertaking with Kroger are performing well. As a reminder, we're trialing different approaches in our 50 pilot stores from the full Kroger Express offer with ambient and fresh produce to an ambient-only range. Also, Kroger continues to trial Walgreens health and beer ranges in 17 of their Knoxville stores. Our joint buying group is up and running, and we will update you further on the partnership as things progress.

Leveraging our digital partnerships and the investments we have made in data capabilities, we are now starting to realize the benefits of a new personalized marketing approach, which generated an approximate sales lift of 1% in the quarter.

Also in the quarter, our flagship No7 brand performed well, up around 7%, supported by a nationwide TV campaign. In U.S. pharmacy, the Walgreens Express service, which allows patients to order scripts online, pay in advance and collect in store at a dedicated checkout line, is now being used by over 1 million patients.

Turning next to primary care. All 5 VillageMD locations are now open. With UnitedHealthcare, as expected, we've opened 4 of the 14 targeted resource centers. And with partners in Primary Care, we have opened 2 locations in the quarter, taking the total to 5. We are pleased with the progress of all 3 partnerships to date, and LabCorp is now operating in 109 Walgreens sites across 12 states, as planned.

Turning to additional initiatives, which continue to gather momentum. Our Save A Trip Refill program now has over 3 million members signed up, an increase of 4% since the first quarter. We are now including Save A Trip Refills in our calculation of Walgreens' digitally initiated sales. The combined total was up around 7% versus the same quarter last year.

Our Find Care platform now has 32 healthcare providers spanning 48 services, and visits increased to 2 million in the quarter, up 40% since the first quarter. Also in the quarter, we participated in a funding round of a healthcare engagement platform, b.well, which complements Find Care.

Our Walgreens app has now been downloaded 62 million times, up 22% year-on-year in the quarter and up 12% year-to-date.

And finally, with Microsoft, we are making strong progress, including moving app locations to the cloud. In particular, we moved our SAP Hana s4 application to the cloud, which was a significant achievement.

Next, Boots UK. Our actions this quarter have been focused on Premium Beauty and acceleration of the operations, particularly in healthcare. We've launched an innovative online pharmacy solution with LIVI and Boots.com. Customers will be able to book video consultations with general practitioners and follow-up sessions with Boots pharmacists, initially in-store and, in the future, online.

We continue to gain market share in Premium Beauty in the quarter, and we introduced 9 new beauty brands, including Huda Beauty, taking our total number of new brands to 48. We have successfully digitalized the Boots Advantage Card, which now has 1.2 million users. And we've also accelerated usage of the Boots app, with downloads increasing 76% in the quarter versus last year. The app now has 3 million active users, which we believe makes the largest pharmacy health and beauty app in the U.K., and Boots.com continue to see strong growth with sales up 23% in the quarter. Of course, we've seen huge changes in the U.K. in the past 10 days or so as a result of COVID-19.

So now I would like to provide some context. Before I start, I want to express my heartfelt thanks to all my colleagues, who have done so much to work together and collaborate with others to take care of the communities we serve in this extraordinary moment. It makes me very proud to work for this pharmacy-led healthcare company.

As a healthcare company, we are on the front line of the pandemic. And our #1 priority is the safety and well-being of our customers, patients and colleagues. We are well positioned across the many markets we operate in to provide healthcare in the community through our stores and our distribution networks. And our colleagues are working tirelessly to provide medicine, services, and advice.

To ensure we meet the needs of our customers and patients, we are keeping our stores and pharmacies open. We're working to keep essential products in stores, provide additional materials to help ensure they are clean and operate to state and federal COVID-19 guidance, and we've expanded the use of our drive-through locations.

We're also focusing on home delivery. We waive delivery fees for eligible prescriptions in both the U.S. and the U.K., and we're offering free delivery on walgreens.com. And on Tuesday, we announced expansion of our partnership with PostMates with on-demand delivery now available in over 7,000 pharmacies nationwide. We're also expanding the availability of our digital services to connect with our customers through Find Care and a 24/7 pharmacy chat.

We've seen strong growth in many essential categories in the month of March, including online pharmacy on walgreens.com, as we focus on home deliveries of prescription items, healthcare and daily living products. And more recently, as a consequence of the temporary restrictions on movement, we have noticed less consumer spending in discretionary items, such as beauty, photographic and seasonal, and the drop-off in foot traffic.

We're also working closely with governments and business partners. In coordination with the U.S. government health officials, we are working to provide drive-through testing sites. And in the U.K., Boots is working with the NHS and Department of Health to provide COVID-19 testing for key workers and to provide support a number of other ways during this crisis.

And both Walgreens and Boots are providing customers with official government advice through dedicated e-mails, our websites and in-store information. We're also working with health plans, physicians and governments to provide access to medications. Here in the U.S., this includes 90-day refills and early refill authorizations.

In short, we're doing all we can to reduce the stress on our customers, and we want to thank all our partners, who are being very helpful in this endeavor. As you know, we have a very broad footprint, reaching communities throughout our nationwide pharmacy network and through our online services.

In the U.S., we have a convenient access to critical essential items. We have a wide range of over-the-counter health and wellness products and a consistent supply of pharmaceutical drugs.

In summary, we are fully committed to giving our communities as much support as we can in these very uncertain times. As I said upfront, our people in the front line are doing fantastic and critical work, and we must also support their health and wellness. To do this, we're taking a number of actions, including providing expanded temporary benefits for certain team members, protective measures and well-being resources.

I would like to finish where I started by giving my heartfelt thanks to everyone who's providing care to the communities we support at this critical moment. Back to James.

James Kehoe - *Walgreens Boots Alliance, Inc. - Executive VP & Global CFO*

Now I would like to provide some context around the potential impacts from the COVID-19 pandemic.

Clearly, the full impact of COVID-19 won't be known for months. However, what's important right now is that we are proactively managing the immediate challenges and playing an important role for our customers. However, the situation is quite fluid, and we expect considerable volatility as the situation evolves over the coming weeks and months.

At present, we're seeing a number of puts and takes. In the U.S., we saw very strong sales in the first 3 weeks of March as customers accelerated their purchases across multiple categories. However, we are now seeing declining sales trends, especially in quarantined areas.

While it is difficult to predict future sales, realistically, we expect to see future destocking by our customers, and short-term sales may be negatively impacted by lower foot traffic. This is particularly evident in discretionary categories, such as beauty and photo, as customers redirect spending to everyday essential categories.

Let me talk you through what we saw in March. While we have not yet closed the books for March, we do have good visibility to our sales performance.

In Walgreens, comp retail sales grew by around 14% in the month led by 32% growth in health and wellness and 28% growth from our grocery category, partially offset by declines in discretionary categories, such as beauty and seasonal. But there were 2 very distinct periods in March. We delivered comp sales growth of 26% in the first 21 days of the month. However, post March 21, the comp sales trends turned negative with the last week of the month running at a mid-teens rate of decline. Obviously, if this trend continues for an extended period, it will quickly offset the sales uplift seen in the first 21 days of March.

Prescriptions saw similar trends, though less pronounced, with declines post March 21 reflecting the pull forward of scripts into the earlier part of the month and lower foot traffic. In the U.K., we also saw strong initial sales trends. But the U.K. is now effectively on lockdown, and this has led to a significant decline in high street footfall.

Again, we are seeing a similar trend in discretionary items with a significant decline in our beauty business. And we have deferred key growth initiatives. For the moment, we've halted new product launches, and we've postponed the planned rollout of our beauty halls to new locations.

In March, our U.K. sales declined by around 8%. Mid-single-digit growth in pharmacy did not offset a mid-teens decline in retail sales.

But it is the exit trends that are concerning. Retail sales declined by 65% over the last 10 days as high street foot traffic reduced significantly and consumers diverted spending away from discretionary products.

That being said, we are confident that this is a temporary situation and we would expect to see some stabilization of sales trends over time, given that our pharmacies are designated essential services and are, therefore, among the few retail locations remaining open.

Additionally, in line with current advice, we have closed our opticians and hearing care businesses in the U.K., except for 22 optician hubs providing emergency treatments. Once the restrictions are removed, we will rapidly reopen our 600 stores and expect a reasonably quick recovery.

With regard to other businesses, we have seen a spike in demand across our main Pharmaceutical Wholesale markets throughout the month of March. Our hospital supply business contributed to an increase in sales in the high teens on the back of additional investments to support customer demand.

Generally, we saw increased demand in March across other retail markets with the exception of Thailand, which has been heavily impacted by a significant decline in tourism from the key Chinese market. On the flip side, our China retail JV is performing very well and we are seeing significant revenue upside.

Turning to costs. We estimate an overall cost impact of around $65 million in March, mostly relating to employee benefits and store operations and supply chain costs. A number of these costs may not repeat in future months. Future cost impacts are highly dependent on the duration of the pandemic across multiple markets, the available assistance from governments and our ability to mitigate costs.

You're also well aware of the stock availability restrictions in a number of categories. And we have significantly increased our purchases across a number of key categories to provide availability of critical products for our customers. Obviously, we may see some impact on inventory levels as supply and demand realign over the coming months.

Finally, and importantly, managing through COVID-19 requires a huge investment of time and resources across the entire enterprise. Faced with the current situation, we are very focused on mitigating COVID-19, and sometimes we are pulling resources and management time away from other value-added activities.

So it's clear that there are a lot of moving pieces. After seeing buoyant sales trends in the first 3 weeks of March, we have begun to see some negative trends as lockdowns are put in place. However, we do expect the COVID-19 impact on March month to be broadly neutral, with revenue upside in the U.S. offsetting higher operational costs and significant sales declines in the U.K.

As we look forward, given the number of moving parts, we cannot provide reliable estimates as to the potential impact of COVID-19 for the fiscal year. It is highly dependent upon the severity and duration of the pandemic across multiple markets.

Finally, I would highlight that this should be a temporary situation. And what's important is that we are proactively managing the impacts, while continuing to make progress against our strategic priorities. Our fundamentals are sound, and we are convinced we will exit this global crisis in a strong position.

Let me now pass it back to Stefano for his closing comments.

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

Thank you, James. So as I said in my opening comments, the quarter we have reported today has been slightly ahead of our expectation, but it is too early to know what the net impact of the COVID-19 pandemic will be on our performance for the year as a whole. You have heard from Alex and James about some of the work our teams are doing across our company to address the current situation and support the communities we serve. The situation we are in emphasizes the importance of community pharmacy playing a very active frontline role in the wider delivery of healthcare in the heart of the community. This is precisely why a strong and healthy community pharmacy sector is a vital part of any effective healthcare systems. It is why we are also so committed to the sector and continue to invest in it. We must remember that the current restrictions in our market are temporary. Over the coming weeks and months, they will change. And eventually, we will return to a more normal operating environment.

As pharmacy operators, our priority is to provide the medication and healthcare products that people need to manage and maintain their health. Keeping those pharmacies open and well stocked is vital. And it is also important to remember that in many areas, the truly local convenience retail offering in our stores is also an important service to the community. To do that, the importance of the supply chain cannot be overstated. Our own pharmacies and stores cannot operate without regular and reliable supplier of medicines and goods. It is a foundation of our business and of the great many other businesses we serve as a wholesaler or distributor. Maintaining this essential supply into the very heart of the community has been key to our global response to the current crisis.

As you might expect, our pharmacies are not only facing the significant increases in demand for medication, personal care and preventative or protective products but also a material increase in people seeking advice and information from our team. And we are operating services on a local level to ensure that those that are self-isolating, in addition to those who face difficulties getting to our pharmacies, have access to the medicines they need. We are working closely with governments, regulators, states and local and national health systems to ensure we are doing what we can to use our resources and infrastructure to support the fight against the coronavirus. And in a number of countries, we are already operating testing stations to provide virus testing for key workers, services we would expect to expand as and where we can.

Our experience in addressing the challenges of the virus reiterates to us the need of the way pharmacy operates to evolve so that we are even better prepared to play an enhanced role in the provision of healthcare looking forward. We have understood this for some time and believe that the combination of a strong local presence, supported by an efficient and reliable global supply chain with state-of-the-art logistics and with new thinking, analytics, artificial intelligence and insight of a truly digitalized organization and a truly omnichannel customer interaction is the future for pharmacy. This is why we see it as so important to deliver on our key strategic priorities to bring together the elements of this future pharmacy service and prepare us for the opportunities we face. I am convinced that this is the way forward for our business and that we are well positioned to come through this current period well and emerge as an even stronger business that we have to date.

At a time of great uncertainty for all of us, locally and globally, for our customers, team members and our investors, we are in a good position to meet the immediate challenges we face and to invest in the future. Seeing this organization in action, providing service and care in the heart of communities as a key part of the national healthcare infrastructure in a period of great public need confirms my belief in the importance of the role that we play and give me even greater confidence in the future of our business.

Thank you. Now we will take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from George Hill from Deutsche Bank.

George Robert Hill - *Deutsche Bank AG, Research Division - MD & Equity Research Analyst*

Glad to hear that everybody's kind of sequestering themselves well to stay safe and appreciate on the color -- all the color on March. I guess, Alex and James, I'd ask, you talked about the acceleration in scripts sharply in the first part of the month in March and kind of falling down in the last week. I guess is there a way to normalize what the script trend looks like for March? And then if we look at the last week, has the growth just slowed? Or have scripts actually gone negative? And I have a very brief follow-up.

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

George, it's Alex here. It's really hard. I mean, during the prepared remarks, James has given a lot of, I think, detail on what we know, and we don't have a lot to add to that. What we think has happened is people have to forward their scripts and got bigger quantity of scripts just as the situation began to develop, particularly in the middle 2 weeks of March. And therefore, we think there's been some stockpiling, if you like, of prescriptions. But really, it's too early to tell if there's any fundamental change to trends. We don't think there has been. But as we said in the prepared remarks, we really don't know yet. And of course, we're keeping a very close eye on the situation.

James Kehoe - *Walgreens Boots Alliance, Inc. - Executive VP & Global CFO*

Yes. It's a little tricky, but we get -- we estimate on a phase cost-adjusted basis, it's probably mid-single digit, pretty similar to the second quarter but a fairly significant uplift in the first 20 days of the month and falling off. It does fall off into negative territory, but that's actually a direct result of lower footfall and people actually respecting the instructions to stay at home. I think we'll get more stability as we look forward into the future months.

George Robert Hill - *Deutsche Bank AG, Research Division - MD & Equity Research Analyst*

That's helpful. And then maybe a brief follow-up is you guys have the benefit of doing business in some of the countries that are further up the infection curves as it relates to COVID-19. I guess is there any way to extrapolate what has happened in countries like Italy kind of into the United States and what those implications for the business would be?

James Kehoe - *Walgreens Boots Alliance, Inc. - Executive VP & Global CFO*

I think you'll find that many markets are quite different, and I'm not sure you should use them as analogs. So what we saw in China, which was the market that was first hit, is it's a business that was growing high teens, a 4. It ramped up at the peak of the crisis to be up in the 50% growth. And right now, as it's back to stability, it's actually still growing very strongly, actually above high teens. So I think what we've seen in China is remarkable. It is consistent and increased demand for pharmacy products.

We don't have a big presence in retail in the -- in Italy, so we can't see it more directly. But I don't think China should be taken as an analog for the U.S. And let me pass it over to Stefano because he has a -- probably has a point of view on this.

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

Yes. Well, I have followed, especially in Italy, I would say, day by day, and I can tell you that the lockdown had quite a significant impact on the pharmacies. Initially, the pharmacy were doing very, very well, up to 70% versus prior year. And after the lockdown, of course, has made difficult for people to go to the pharmacy. So -- and they are now trying to use all the stocks, let's say, they had at home, and they go to the pharmacy just if it is strictly necessary. So we can see a substantial reduction in the sales of the pharmacies, but we see slowly this creeping up. And we have also to say that the lockdown in Italy has been quite extreme. People who are found in the street and they don't have a good reason to be there are fined at EUR 5,000. So it's a big -- of course, it's a big incentive to stay at home.

Now probably at the end of this month of April, the lockdown will be reduced. Apparently, they want to start to relax this lockdown because the economy's suffering dramatically, as you can imagine. And we will see, for sure, the sales in the pharmacy pick up quite strongly, even because the people will be out of stock.

Operator

Your next question comes from Michael Cherny from BofA Securities.

Michael Aaron Cherny - *BofA Merrill Lynch, Research Division - Director*

I echo George's comments, hope everyone is staying safe during this. I want to dive a little bit into the cost side. It was an odd dynamic you have in place on -- you mentioned all the investments that you're making to help people within the stores to promote cleanliness, et cetera. At the same time, in the event that these revenue trends were to be slightly longer than the incredibly short-term dynamic, there could be some potential or desire or need for flexing the costs side. Given the sheer magnitude of uncertainty you're seeing right now and especially across the U.S., a lot of these rolling shutdowns and rolling closures, how do you prepare some of that variable costs side across your business to account for the lack of demand you might see in some of these areas that are especially going through the newer levels of shutdown? And is there any level of variability that you do want to pursue alongside also the investments you're making within the cleanliness of the stores and the employee base?

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

Michael, it's Alex here, and thanks for the question. I hope you're also doing well and safe. I think that's -- it's a great question because it goes to the root of what Richard Ashworth and the team have done, I think, fantastically well in the U.S. and [indiscernible team in the U.K. by having to react day-to-day. I'll give you a couple of examples to bring it to life. For example, in the Las Vegas Strip, we have a number of very strong stores. But you can imagine that, that strip is now closed. And therefore, we've had to -- as you say, we've had to adjust our cost base and take care of our people in these very strong stores in that marketplace, yet, there are other markets where the number of prescriptions being sold, number of customers seeking advice have increased. There's also our online businesses, which have increased remarkably. We gave some stats in the prepared remarks, and we've been really adjusting quickly to make sure that we can service customers in different ways, as we said, through our PostMates relationship, through increasing capacity in our online warehouses and making sure that we are able to accommodate more people in the areas of the country where people are coming during this period of time. So we are doing both sides of this rapidly. We have a very flexible model, and Richard and team are driving that very strongly. There are other areas, and I may pass on to James now to maybe speak about some of the other areas, which are maybe more fixed costs, where again, we are absolutely looking to see what we can do with these fixed costs and expecting support from partners as well.

James Kehoe - *Walgreens Boots Alliance, Inc. - Executive VP & Global CFO*

Just as an example, they -- we -- I think your question is a good one. The $65 million, we don't expect to continue into future periods because a number of things will happen. We'll get more efficient in how we're managing the day-to-day operations in the new environment. And the second thing is we will be taking cost-containment measures because we have to try and mitigate the impacts on the cost side. So we would guess and is literally at this stage is we would say the $65 million next month would come down to a $30 million to $40 million range, and that is assuming a full shutdown. If the shutdown was to continue into June, we then would actually -- into May, we would actually project that we could offset all the incremental costs because by that stage, we would have found areas of mitigation.

One example here in the U.K. is you will have noted from our prepared comments that our opticians' practices were basically closed, and we're quite a big player with 600 stores within stores in the U.K. And we have furloughed every store and all the employees, and the British government basically pays 80% of the cost of the furloughed employees up to $2,500 a month. So the actions are being taken. They're pretty rapid, but I think you're right. The costs can't be allowed to increase into perpetuity, so we will have to find offsets. And I hope that answers your question.

Michael Aaron Cherny - *BofA Merrill Lynch, Research Division - Director*

No, it does, James. And then one very quick additional question just for you. Any commentary on the planned capital deployment, share repurchases? Any thoughts around the dividend? Just anything there that might be adjusted or changed based on what you're seeing right now?

James Kehoe - *Walgreens Boots Alliance, Inc. - Executive VP & Global CFO*

Yes. Good question. Some of our competitors have made immediate moves. We've had robust discussions about it in here. We remain convinced as to the long-term capability of the company to come out of this stronger. We're very confident in our cash flows. And you saw the quarter we had, like Q1, we did $1.8 billion in the first half, and we're $1.4 billion on what we did this time last year. So we're probably right now over delivering against the working capital programs we set out. We'd said we were going to take out about $1 billion of working capital. The year-to-date benefit was $1.8 billion. Some of that is phasing, but we're feeling very good about the cash position.

We did note, however, the commercial paper markets dried up pretty quickly, and we put our backstops in place as quickly as that. And we're actively in the market, talked to banking partners, and we've -- just yesterday, we secured a bilateral funding of about $750 million. So we are putting in place what we internally called black swan funding for events we actually don't think will happen, but we're quite conservative on that point of view.

Given that context, we're actually very happy with our capital structure. We're very happy with our capital allocation policy. And we've decided for the moment to continue with the share repurchase program, which you'll recall last year, we repurchased $3.8 billion. This year, it's $1.7 billion, which is already 50% below what we were doing this time last year. So we're already lower.

And on dividends. This is a company that's increased dividends since -- I think has paid the dividend since 1934, and our dividend policy is extremely clear, which is to increase dividends every year. And it's a simplistic policy, but we have no intention of changing that policy in the short term. And this is all on the basis of we believe in the strength and the tremendous work -- tremendous cash flow generation capability of the company.

Operator

Your next question comes from Ricky Goldwasser from Morgan Stanley.

Rivka Regina Goldwasser - *Morgan Stanley, Research Division - MD*

Yes. My question is focused on the testing. You mentioned that you're doing some testing, some drive-through the area. But as screening is becoming an increasing area of focus, when do you think you'll be able to get up and running? What type of volume and what type of form do you think you can accommodate?

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

Thanks, Ricky. It's Alex here. In the U.S., we have the pilots in place in the Chicago land area. It's doing about 150 tests a day, and we're very much under the direction of the government, and we're working very closely with the government. And we're waiting really to see exactly what their plans are to accelerate the testing on the screening, as you said. So really, we don't have a lot more information at this stage. Things are under review constantly every single day. Senior people are having conversations with officials from the government, both at the state and the federal level. And we will play our part. We will do all we can to make sure that we are there to test people if it's appropriate to do in Walgreens premises using Walgreens personnel. Another point here is that, of course, our people have stepped forward and volunteered to do this, which, again, is a great example of the commitment we have as a company to America.

I think, Stefano, do you want to make some comments on testing as well? I know you've also been involved.

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

Yes. You probably know that many people are now working on new tests and vaccine. And I believe that in very short term, we will have new opportunities and new tests that would be much easier and much quicker. And many of these tests or probably some of these tests will be able to be self-administrating. So the reality, at that point, we will be able to really have a mass screening.

Until we don't have this kind of test, of course, the operation of testing people will be necessarily relatively slow. You see what is happening, even in countries that have had this emergency for 1 month or more. And you see that the level of testing, of course, is, in relative terms, higher than in the U.S. but is not still a mass screening. Until we don't have new test, I don't believe that we will be able to test a big part of the population.

Rivka Regina Goldwasser - *Morgan Stanley, Research Division - MD*

Okay. And just one quick follow-up. You gave a lot of detail on what you're seeing on the front end and the decline you're seeing in beauty and groceries. So can you just remind us, kind of like give us a sense of the margin profile of the discretionary products that you're seeing decline versus the back end in the pharmacy script?

James Kehoe - *Walgreens Boots Alliance, Inc. - Executive VP & Global CFO*

Sorry, and maybe I'll ask Alex to weigh in. One thing I do want to emphasize is that the performance we're seeing is actually very consistent or I would even say slightly better in some categories than the rest of the retailers who remain open, and I don't want that to be lost on people. So we were up 21% -- 26% in the first 21 days in the U.S. And frankly, there was that feeling of euphoria across the business. The key driver in here is our health and wellness business, which is our flagship, and that's up in the 30% range in that year-to-date period -- actually, on the full month period.

So any -- I think a good way to think about this is any margin we lose on the beauty business, and I think beauty in the month of March was down about 9%. And then the health and wellness business was up 30-plus percent. Both of those businesses have a similar gross margin, so they're equally profitable. And then the food grocery category, which was up 28% in the month, so quite a large increase, that has a margin of about, I would call it, 7 to 8 points lower than either beauty or health and wellness. So I think they -- there are category shifts. The margins will be slightly impacted but not to the extent some retailers pointed out. We -- because our health and wellness business is the -- probably the most profitable business, and that's growing the fastest in the current environment.

And then the falloff, obviously, in the second half -- second -- last 10 days, we attribute totally to the shutdowns that occurred. It's actually good to see the people stay at home. That's a positive thing. We believe there'll be a gradual comeback to this, even when there is a slowdown. So if we are looking into April, we don't think the last 10 days are the best reflection of what will happen in April. We think April will be probably down, but there will be recovery as stocks work their way out of the system and people start going back to their -- some of the old purchasing behaviors. So we're actually quite pleased with the performance compared to the market, and we won't be seeing the same kind of margin issue as some other players.

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

Yes. My only item, and James covered it well, Ricky, I think that this is temporary. There's a very clear moment in time when the lockdown happened okay, maybe happened on different days and sometimes different weeks. For example, Florida, more or less, goes to full lockdown I think today. But this, we think is a temporary situation, and we believe that the evidence is very clear that discretionary spending will come back, particularly in areas like beauty, which are really well-known for being a place where people spend when things are tougher. So again, I don't have anything to add to the detail James has given, but I think I would just add to the point this is temporary.

Maybe just turning a bit to the U.K., if that's okay. The U.K., as you know, is a much bigger beauty business. And the beauty business has been doing very well in recent times in the U.K. And also, it's much more of a high-street business. And the situation in U.K. was almost a complete lockdown, except for grocery and pharmacy and healthcare, when it kicked off. So therefore, we are seeing more impact in the U.K., as James has commented on his prepared remarks, but again, we believe that business will come back when the temporary situation in the U.K. is also over.

Operator

Your next question comes from Lisa Gill from JPMorgan.

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

I just really want to better understand 2 things. So I agree this will be temporary. Obviously, nobody knows the exact time line. But as we come out of COVID-19, what do you think some of the recent trends that you're seeing, whether it's digital, demand for home delivery, that will stick going forward? And what does that potentially mean for your business would be my first question.

And then secondly, there is this belief that's emerging that, exiting COVID-19, we could move more towards a recessionary environment here in the U.S. What are some of the lessons you learned from back in that 2008, 2009 time frame to really prepare your business? And what are your thoughts if we are to move towards a recessionary environment?

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

So I think I'll hand -- I think Stefano would like to take that question, first of all.

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

Yes. I will answer to the second question first. At that time, we had just bought Boots. And we found that sticking to our fundamental we had a very good outcome. We focused on what we were doing in the stores, in improving the service. We didn't try to reduce cost too much because we wanted to be able to deliver a good service and to be ready when the market changed, and this proved to be very, very successful. And while many other companies were having problem, we did, in reality, very well. So one of the things that we have learned is that you don't have to panic. You have to accept certain temporary costs and keep the organization working.

On the timing, it depends. If the coronavirus will go back, let's say, in a short period of time, let's say 1 month, then we will have, I'd say, a thunderstorm, and people will go back to their habits quite soon. If we will have a hurricane and not a thunderstorm, the world will be different later on. Many things will have changed. The habits of people will be different. And for sure, also, many industry will be hit in a dramatic way, other industries like ours. We are mainly pharmacies, mainly dealing with drugs, with medicines or with diseases, other industry will suffer less. But for sure, they will have to change the way they work.

In reality, we are always working in this direction. We have said for the last year or so, maybe a couple of years that we want to digitalize the company. We want to really change the way we work, focusing more on the customers. And at least this strategy, we prove to be the right strategy even more. We did a right strategy, in any case. But if the environment will change substantially, this strategy will be even more important.

James Kehoe - *Walgreens Boots Alliance, Inc. - Executive VP & Global CFO*

I wonder if I could just add something, Lisa. I think it's important to point out that we're operating from a relative position of strength. We're coming out of a quarter where we actually did what we said we would do in terms of getting our sequential comps in the U.S. back where they need to be. We beat the EPS, which was coming out of the U.S. retail business and good cost control. Our cash flow performance is excellent. So we're sitting here looking at this, and we have the crisis in front of us.

We do believe, and I think your question is a good one, we do need to turn this into an advantage. This has proven what we've known that having convenient, 9,000 convenient locations across the U.S. is a strength. It's also what we've seen is we saw in the quarter that we accelerated mass personalization in the U.S. and got 100 basis point uplift. I think we will find ourselves dramatically accelerating our digital journey over the next 6 to 12 months. And what we found is it's amazing what technology stuff we could get done in 2 weeks in a crisis when we needed to help the average consumer and how long we normally take to get it done, so I think there needs to be -- it will generate enhanced agility across the entire industry, and I think it will speed up our digital agenda. And I think you're right. There is a transformation coming.

I think the other part, and you're kind of alluding to it, I think the recession entirely depends on the duration of the lockdown. And then the -- secondly, the size of the stimulus in the U.S., I'm not underestimating the ability of the U.S. economy through stimulus to really regenerate economic growth very strongly. And I think the one thing we've seen out of past recessions, and it's not a worldwide comment, is that the most resilient consumer in the world is in the U.S. market. So I'm not -- that's not what we're hoping for, but I think that you will find a fairly rapid rebound. And I think the general size of the stimulus in the U.S. is massive, and it's the right thing to be doing to ensure that the economy stays on the top.

So I'm not saying I'm not concerned. What I was saying is the right moves are being taken. That being said, I think there will be a re-rating here. And you look at that, the market has changed substantially. And when we're on the phone rounding up backup debt facilities, we're emphasizing that our relative credit rating is far stronger than some other sectors right now. And there will be a re-rating. People will start examining the assets in the market and say, "Well, hold on a second, stable cash flow." So this is why we do feel that we will come out stronger in terms of rating of the company from debt capacity, the ability of the company to weather a storm like this. And you're right that we have to turn it into now to accelerate our long-term digital agenda and against our 4 strategic priorities. So I totally agree with your point.

Operator

And your last question comes from Steven Valiquette from Barclays.

Steven James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

So within the investment community, the discussion around the potential risk of prescription drug supply shortage seem to be more topical about 4 to 5 weeks ago versus what it is today. But nevertheless, are you able to discuss any new initiatives that Walgreens has in place within WBAD to potentially prevent any prescription drug shortages across your operations globally? And are there any issues related to export bans out of certain APAC countries in particular? Or is that not really an issue for you?

James Kehoe - *Walgreens Boots Alliance, Inc. - Executive VP & Global CFO*

Sorry, Steve.

Gerald Gradwell - *Walgreens Boots Alliance, Inc. - SVP of IR*

Can I just confirm you're asking about -- you're asking what initiatives we've put in place to guarantee the supply chain. Is that right?

Steven James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Yes, correct. Yes. Just risk of any sort of drug supply shortages. This is more topical maybe a month ago versus today. But yes, that's really the question. Sorry if there's any sort of echo or background. I hear an echo as well.

Gerald Gradwell - *Walgreens Boots Alliance, Inc. - SVP of IR*

Yes. No. That's fine. Alex, do you want to take that?

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

Yes, sure. Steve, I think you also asked about prescription growth in the first part of your question, so I'll start there. I think as we said already, Q2 was good from our point of view. We're able to move our growth forward in normal times, as James described, to just under 5% growth in comparable scripts. And also, I think we had a reasonably good Med D season on January 1, which was important to us given that that's about 1/3 of the marketplace. So going into the COVID crisis, we felt our growth was improving, and the trends were improving.

In terms of supply -- in terms of initiatives, sorry, you asked that question. We mentioned Save A Trip Refill express pass, and we're working on many other digital initiatives, as Stefano has said, to allow customers to use their downloaded app to manage their prescriptions in really transparent ways. So there's more to come, including, of course, home delivery, which we're now accelerating as well.

In terms of the U.K., a similar patterning as well with growth in terms of the use of online pharmacy. Again, that was in the (inaudible).

In terms of supply chain, we feel good at the moment in the next 3 to 6 months that we've got our APIs in terms of the components of generics in the right place and some prepared products and also with a more global wholesale supply chain. Alliance Healthcare, again, we've got good visibility and great partnerships with pharma companies. And again, there are the odd products like paracetamol and some other products, but the majority of products look to be in good supply at this moment in time.

Steven James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

If you can hear me, at the drug manufacturer level, have you witnessed any notable changes in pricing strategies over the past month or 2 related to the supply and demand gyrations from COVID-19? Or would you say everything has been pretty consistent on the pricing front at the manufacturer level?

James Kehoe - *Walgreens Boots Alliance, Inc. - Executive VP & Global CFO*

Yes. Stefano?

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

No, no. Really, the manufacturers are behaving very well, I would say, in this moment. They are keeping their prices steady, and we see also that they are trying to do any possible effort to supply the market. In Europe, for instance, we have a very big selling market. So we will sell a market -- the distributor that the manufacturers use to deliver to the wholesalers and to the pharmacies, to the hospital. And this -- we can say that the wholesalers are asking us to stock in order to be ready to satisfy the market. So I would say that, in this moment, we don't have a real problem.

Of course, for some specific molecules, paracetamol, for instance, some specific products, there is a shortage just because the demand has been everywhere in the world, so strong that there is no ability to manufacture immediately to step up in manufacturing facilities to satisfy the demand. But these are just a few cases, and they are not really impacting the overall supply in the market.

Gerald Gradwell - *Walgreens Boots Alliance, Inc. - SVP of IR*

Okay. Thank you, Stefano. That's actually all we have time for today. Thank you to our speakers. I would say to everyone, I know we didn't get your questions. As ever, the IR team will be available to take calls. Because we are working from multiple locations, we do have to schedule calls rather than just bring them -- have them coming in. But if you want to give us a call, we'll be happy to draw calls with as many people as we can to follow up over the coming days.

Thank you very much, indeed, to everyone for participating, and we'll speak to you next quarter.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.
