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WBA - Q3 2018 Walgreens Boots Alliance Inc Earnings Call

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OVERVIEW:

Co. reported 3Q18 adjusted diluted net EPS of $1.53. Expects FY18 adjusted diluted net EPS to be $5.90-6.05.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Walgreens Boots Alliance, Inc. Third Quarter 2018 Earnings Conference Call. (Operator Instructions) I would now like to turn the call over to Gerald Gradwell, Senior Vice President of Investor Relations. Please go ahead.

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

Good morning, ladies and gentlemen, and welcome to our 2018 third quarter earnings call. As usual, I'm here today with Stefano Pessina, our Executive Vice Chairman and Chief Executive Officer of Walgreens Boots Alliance; and Alex Gourlay, Co-Chief Operating Officer of Walgreens Boots Alliance and President of Walgreens. And this quarter, for the first time, we would like to welcome James Kehoe, our Global Chief Financial Officer, who joined us at the beginning of the month.

Before I hand you over to Stefano to make some opening comments, I will 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. Except to the extent required by the law, 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 Forms 10-K and 10-Q for a discussion of risk factors as they relate to forward-looking statements.

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 for reconciliations to the most directly comparable GAAP financial measures and related information.

You will 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 will now hand you over to Stefano.

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

Thank you, Gerald. Hello, everyone. I must start today by welcoming James as our new Global Chief Financial Officer, a role for which he is perfectly qualified, and say how much I am looking forward to working with him.

I would also like to thank George Fairweather, who is here with us today. Despite stepping down as CFO, he will remain with us working, albeit fewer hours, on business and corporate development projects. George has made a huge contribution to the company over now 16 years, and it has been a pleasure to work closely with him to many greater ventures and challenges. George has worked tirelessly for the company and has delivered true value for shareholders.

It is characteristic of George that when he wished to stand down as CFO, he brought his usual diligence to helping find an extremely well-qualified successor and went out of his way to plan an extensive handover. But as I say, George is still very much with us both in body and spirit. And so while I am delighted to welcome James and look forward to his contribution in the coming year, I thank George for his work to date and look forward to his continued contribution as well after he has been allowed a short vacation.

So we are 3 quarters of the way through the year, and we are here reporting a respectable overall performance. It has been a quarter of continued hard work toward putting in place the elements of our strategy to grow our presence and maintain our relevance in the various markets we serve. We have made solid progress against our strategic goals. It has only been a matter of weeks since we hosted our public webcast sell-side event. So today, I will only cover a few key highlights.

We have taken further steps in our work to enhance the relevance of our stores here in the U.S. as true community hubs with an attractive range of services and products. As you know, the development of health care services within our stores is a priority for us, and we are continuing to make good progress identifying and structuring strategic partnerships that offer a balanced and high-quality range of services to our stores.

We have announced the ties with Humana in the Kansas City area to bring full primary care clinics into our stores for the first time, to complement the nurse practitioner and urgent care clinics we have been working with and evaluating to date. Given the profile of Humana's patient population, these new clinics are intended to be heavily focused on supporting those who will benefit most from readily available community-based care and are an excellent fit to our existing services.

We are also continuing to look for ways to further enhance our retail offering in store by enhancing and focusing our merchandising and services as well as improving our procurement and customer insights in convenience retailing. Our strategic partnership with FedEx is continuing to grow and strengthen, and we are now rolling it out across the acquired Rite Aid stores.

Internationally, in China, we have completed the sale of a percentage of our holding in Guangzhou Pharmaceutical Company and shortly expect to receive the final approval for GuoDa.

And of course, we are continuing the work to upgrade our systems and processes. This will not only keep us up to date, but will also create a platform for further development. We expect this to drive our efficiency and understanding of our business and markets as well as the overall customer experience.

In this, as is our way, we are once again looking at how potential partnership could allow us to build on the work we have been doing internally.

We are also looking at how working in partnership could give us the potential to engage with leaders in technology to help us review and rethink how we deliver a true omni-channel experience for our customers. And out in an ever-changing world, we remain at the core of their daily lives.

So, we have made solid progress in the quarter, and I am convinced that all the work we are doing today will deliver benefits in the future.

Of more immediate relevance is the significant share buyback authority we have announced today, $10 billion, coupled with a 10% increase in our dividend. While our top priority for deployment of cash is value-enhancing corporate development investments, the open-end duration of this share buyback program provides us with the flexibility to return cash to shareholders.

This is a sign of our confidence in the continued performance of our company. It reflects that we are confident we will continue to generate strong cash flows, and that this cash flows will give us the flexibility to deliver on our strategic investment aims while returning excess cash to shareholders.

Before James goes through the key quarterly numbers, Alex will take you through some of the things we are doing today. Alex?

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

Thank you, Stefano, not just for the introduction, but actually for the very good summary of where we are here in the U.S. As we explained at our webcast sell-side analyst event, we have made a lot of progress behind the scenes with financial efficiency, structural changes and efficiencies at the central and operational level, and of course, in both supply chain and procurement benefits.

We are continuing this work, and there's still a lot we can achieve in all of these areas.

It is a nonstop process, as every improvement, however small, often leads to another one. As you know, we have been improving both the capture and use of data on our businesses and our customers' shopping habits and preferences.

We're now in a strong position to start thinking about the types of services and retail offerings we want to have in our stores.

Our action to reprice pharmacy over the past few years was a key part of this.

Our work showed we were not pricing comparatively to the market and did not have enough regular volume going through our pharmacies to optimize our in-store economics. As a result, we did the math. We spoke to our payer partners, and we addressed the situation.

While we still have more to do, we are making good progress as we have seen our market share continue to grow.

Since the formation of Walgreens Boots Alliance, our market share has grown by more than 300 basis points. Similarly, all insight validated what we had heard anecdotally, that our pricing for convenience retail needed to be more competitive, in part because we had not moved with the market and in part because of changing consumer expectations.

We have come up with a new environment to test some of our ideas in a geographical area where we can try them out without interfering with other stores in the network and without the results of the trials being impacted by other stores.

Of course, we now have a test best setup for those areas we need to study in a degree of isolation, but this does not necessarily mean we're going to test all concepts in this area.

We are continuing to trial concepts across America and will over time work to validate what products price ratios work, what is right in terms of the ideal number and mix of SKUs, and the different blend of elements we could put in our stores.

This is important. It not only improves our customer offerings in retail but also identifies how and where we can free up space to deploy the range of services we aim to provide in our stores.

In the quarter, LabCorp opened a number of clinics in our Gainesville stores, as part of the extension of the trials we have been running with LabCorp in the last months. These clinics have performed well.

As this relationship continuously prove advantageous for both partners, we are looking at how we can expand the service further and faster throughout our network.

Also coming out of the work in Gainesville is the early success of a trial we've been undertaking with Sprint. This offers their services with their own expert staff alongside our customer service associates. Despite the comparatively limited timing and nature of this trial, it is proving very promising, and we are already discussing the potential to expand the trial beyond Gainesville.

As Stefano has said, our partnership with FedEx continues to grow from strength to strength. Volume through the stores has continued to increase steadily, and we now have a FedEx offering in the majority of our portfolio.

New high-profile customers have signed up to the FedEx "Hold at Walgreens" at Walgreens service, that has already proved increasingly popular with many customers.

Stefano also mentioned the new strategic partnership with Humana, to trial full primary care clinics in our stores, to complement the drop-in and urgent care clinics already available. These clinics will accept the majority of Medicare Advantage insurance plans.

If we and Humana decide to expand this trial and roll out these clinics to a wider estate, it would bring us the additional benefit of broadening the access of primary care through our stores to a wider population of customers.

Humana's customer base is heavily skewed towards Medicare patients, a group we serve extensively. These patients are less likely to access the other types of clinics that we have in our network, which are primarily cash-pay.

Elsewhere, it has been business as usual for us, but good business, given the markets and stage we are at in the year.

While it's hardly new news, we have also made further good progress with the integration of the acquired Rite Aid stores. Clearly, our numbers this quarter reflect the contribution from these stores. The work to properly integrate them into the network is progressing well, and we have already begun to trial a number of conversions to the Walgreens format.

As at the end of last week, we had closed 131 stores under our store optimization program, successfully retaining customers to plan and transferring their pharmacy files to our stores nearby.

We have continued to make progress with the updates in our core systems and processes.

In pharmacy, we have continued to grow overall script numbers despite the Medicare Part D network changes that you are already aware of.

The Medicare Part D selling season for 2019 has just finished. And despite the current dynamic nature of this market, we are feeling positive about our prospects.

Additionally, our script numbers will be boosted by a year-on-year contribution from the acquired Rite Aid stores.

Our current work on digital is also continuing to be well received. Our app has now been downloaded around 52 million times.

And in the third quarter, around 22% of Walgreens' retail refill scripts were initiated through digital channels, up over 2 percentage points versus the comparable quarter last year.

We've also recently launched "Find Care Now", a digital navigator for health services on the Walgreens mobile app and walgreens.com. "Find Care Now" guides customers to the most convenient, cost-effective and relevant health care options in their local area, provided by Walgreens and our health care partners.

And as I've said, the work in stores, both on identifying new services and initiatives and on updating our retail and furthering the development of our beauty offering, keeps driving on.

Underlying all of this work is a move to update and modernize some of our basic operating models, to renew the focus on the customer and promote a customer-centric approach to everything we do.

This clarity of focus can bring us many benefits, far beyond the improved relationship with our customers and the improvement in economic performance that typically offers.

It allows us to streamline the running of our stores and the supply chain, and forms a structure within which we can integrate all aspects of customer contact to provide a truly omni-channel experience. It also allows us more direct management and agile decision-making and revitalizes a culture that will benefit our customers, employees and suppliers while creating a strong yet responsive platform for future development.

So, it has been a quarter of simply continuing the hard work to deliver the efficiency, growth and evolution of our business through initiatives that can all be linked back in some way to one or more of our core strategic principles, as we have heard Stefano describe so often before: to drive growth and consolidate volumes through organic growth, partnerships or acquisition; to control costs, optimizing financial efficiency and leveraging our financial strength; to differentiate ourselves where we can through value, quality of service, exclusivity or innovation -- and our owned brands form another strong point of differentiation; to build a portfolio of complementary businesses across a broad geography, to provide protection from the unique cycles in any one area; and to reinvest for both organic and external growth and foster a portfolio of opportunities to give us multiple levers for growth.

And now I'd like to welcome James to our company, and he will update you on the numbers.

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

Thank you, Stefano and Alex, and I'm delighted to be here today. We are pleased with our overall progress this quarter. The results were broadly in line with our expectations, and we continue to expect to have a solid year.

Today, we raised the lower end of our fiscal 2018 guidance, and we now expect adjusted diluted net EPS growth of 16% to 19%.

Turning now to the quarterly results. On a reported basis, our key profit metrics were up in the quarter. Sales advanced 14%, including the impact of the acquired Rite Aid stores. Adjusted operating income was up 1.7%, and adjusted diluted net earnings increased 5.6%. Importantly, adjusted diluted net earnings per share increased 15% to $1.53 per share. This strong growth benefited from last year's share repurchase program, a lower tax rate and growth in adjusted operating income.

GAAP diluted net earnings per share increased 26.2%. The key differences between GAAP and adjusted EPS are the cost-transformation program in the comparable quarter last year and a downward revision in our transition tax accrual.

The adjusted effective tax rate for the quarter was 16.7%. This was 2.4 percentage points lower than the same quarter last year due to the impact of U.S. tax law changes.

Turning now to our results for the first 9 months of fiscal 2018. Here, again, our key profit metrics were up. Sales advanced 11.4%. Adjusted operating income growth was 4.6%, and adjusted diluted net earnings per share increased by a strong 19.8% to $4.54 per share.

Let me now turn to Retail Pharmacy USA. Total sales and adjusted gross profit increased versus the comparable quarter last year, with sales and adjusted gross profit growth in both pharmacy and retail. Retail Pharmacy USA sales were $25.9 billion, up 15% over the year ago quarter, mainly due to the acquired Rite Aid stores and central specialty.

Comparable store sales decreased by 1.2% entirely due to retail.

Adjusted gross profit was $6.1 billion, up 7.7% over the year ago quarter, reflecting growth in both pharmacy and retail and benefiting from the contribution from the acquired Rite Aid stores.

Adjusted SG&A was 17.8% of sales, an improvement of 0.9 percentage points compared to the year ago quarter. On the same basis, adjusted SG&A as a percentage of sales has improved for 20 consecutive quarters.

This resulted in adjusted operating income increasing by 2% to $1.5 billion.

As you review the numbers, please bear in mind the following factors. First, these results include the acquired Rite Aid stores for almost 2 months, and these stores have a higher cost mix. Second, we are incurring additional costs due to the Rite Aid Transition Services Agreement. This means that we do not expect our fiscal '18 adjusted EPS to be significantly impacted by Rite Aid. And finally, our adjusted operating income growth was held back by a $109 million curtailment gain in the prior year relating to an amendment to post-retirement benefits.

Now let's look in more detail at pharmacy, where we have continued to make good progress. Total pharmacy sales were up significantly, increasing 19.3%. This was primarily due to higher prescription volume from the acquired Rite Aid stores and central specialty. Excluding Rite Aid and Prime contributions, the business is growing nicely at mid-single digits, led by specialty. On a comparable basis, pharmacy sales were in line with the year ago quarter, with brand inflation offset by reimbursement pressure and the impact of generics.

The number of retail prescriptions filled on a 30-day adjusted basis, including immunizations, increased by 11.8%. And our third quarter market share increased to 22.4%, up 190 basis points compared to last year. On a comparable basis, prescriptions filled were in line with the year ago quarter. The positive impact of our strategic pharmacy partnerships was offset by the Medicare Part D network changes.

As in the first 2 quarters, we delivered higher pharmacy gross profit. This was achieved despite ongoing reimbursement pressure and a higher proportion of specialty, which, this quarter, adversely impacted pharmacy gross margin by about 180 basis points. As Alex mentioned, we are feeling positive about the Medicare Part D selling season for 2019, and we also expect to see an increased year-on-year contribution from the acquired Rite Aid stores. We would expect these factors to be reflected in our prescription numbers.

Turning next to retail.

Retail sales increased 5.2%, reflecting the sales contribution from the acquired Rite Aid stores. Comparable retail sales declined 3.8% as we continue to focus on delivering improved margins. The sales decline was greater than we experienced in the first half of the year, mainly due to a slowdown in the health and wellness category in the third quarter as we face weaker cough, cold, flu and allergy sales.

The year-on-year sales evolution reflects our continued focus on improving retail profitability through both promotional optimization and procurement efficiencies. As a result, retail gross profit and percentage gross margin are both higher than in the comparable quarter last year.

Remember that this was the last quarter before we start lapping the promotional optimization program.

We were also pleased that sales in the beauty category increased this quarter, reflecting strong performance in the beauty differentiation stores, which continued to outperform our non-beauty differentiation stores.

Next, let's look at Retail Pharmacy International. Retail Pharmacy International sales declined 2.1% on a constant currency basis as market conditions continued to be tough. Comparable pharmacy sales decreased 1.7%, with Boots UK down 2%, mainly due to lower prescription volume and government funding. Comparable retail sales declined 1.3%, with Boots UK 2.1% lower in a challenging marketplace. Adjusted operating income was down 9.3% on a constant currency basis. Over 80% of the decline was due to phasing of certain SG&A expenditures. The remaining decline reflects lower gross profit, largely offset by cost-containment measures.

Turning now to our Pharmaceutical Wholesale division. Sales increased by 4% on a constant currency basis. This was behind our estimate of market growth due to market conditions in certain continental European countries, partially offset by strong performance from emerging markets and in the U.K. Adjusted operating income was up 0.4% on a constant currency basis, reflecting higher adjusted earnings from AmerisourceBergen. Excluding AmerisourceBergen, generic procurement margin and cost inflationary pressure more than offset the favorable impact of higher sales.

Moving now to cash flow. We continue to deliver strong cash flow. Operating cash flow in the quarter was $2.2 billion, up $354 million on the comparable quarter last year, reflecting lower cash taxes paid and higher operating income. During the quarter, our working capital inflow was $344 million, reflecting continued improvement in inventory management. Cash capital expenditures were $317 million. We continued to invest, to develop and differentiate our core customer proposition and upgrade our IT systems. This resulted in free cash flow of $1.9 billion compared to $1.6 billion in the comparable quarter last year, and this brings our year-to-date free cash flow to $4.4 billion.

Today, as Stefano mentioned earlier, we announced a new $10 billion share repurchase program. The program does not have an expiry date. But absent large M&A, we would expect to complete the program during the course of the next 3 years. After due consideration, we have also announced a 10% increase in our quarterly dividend to $0.44. The increase reflects our refined dividend policy, which quite simply is to increase our dividend each year. In fact, today's dividend increase marks the 43rd consecutive year of dividend increases.

On a related topic, we have agreed to sell our minority interest in Premise Health, and we expect the deal to close in July. This has been a good investment for us, and we expect to book an after-tax gain of approximately $270 million. We do look forward to maintaining our commercial relationship with Premise Health, both as their exclusive pharmacy partner and as a corporate customer.

Turning next to guidance. We have revised our EPS guidance for fiscal year 2018 and now expect adjusted diluted net earnings per share to be in the range of $5.90 to $6.05 compared to our previous guidance of $5.85 to $6.05. This guidance equates to adjusted EPS growth of approximately 16% to 19% versus fiscal year 2017.

So in summary, we had a solid quarter with adjusted EPS up 15% year-on-year, bringing our year-to-date adjusted EPS growth to 19.8%. We are also making progress on our strategic initiatives, and our dividend increase and new share repurchase program demonstrate our commitment to shareholder returns.

Thank you, and I'll now hand you back to Stefano.

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

Thank you, James. So as you have heard, a solid quarter and a good outlook. For us, change is about opportunity, growth and creating value. It is an essential part of our daily lives, and the constant need to change and reinvent our company is an indication of how core it is to the lives of the people we serve.

Our task is to stay relevant. And as people's lives change, we must make sure we change with them. That is why we are developing our omni-channel offering and working on our plan for our U.S. stores to create hubs in the communities we serve, with an attractive range of services and products.

We remain convinced about the value of our presence in the community and of the strong relationship our extraordinary local teams have built in their communities.

We remain convinced about the opportunity the company has and our ability to deliver on those opportunities.

We remain convinced that being the most efficient, convenient and differentiated provider of the highest-quality services in the communities we serve will position us to meet and beat the competition and continue to grow both operationally and financially.

We remain confident in our immediate prospect as you can tell from our guidance for the year. We remain committed to creating value for our investors and using that for future growth, or realizing it, as you can see from our $10 billion share buyback program and dividend policy.

Most of all, however, we remain absolutely convinced about the strength of our company and its potential to deliver real value growth, not just this year, but for many years to come.

Thank you. We will now take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Lisa Gill with JPMorgan.

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

I just wanted to ask a couple of questions around the gross margins in the quarter. Can you talk about what the headwind was from: one, Rite Aid. I know that they carry a lower gross margin; two, the specialty business? Just trying to parse out how we think about your core business gross margin. And then secondly, as we think about script growth being flat in the quarter on a same-store sales basis, how do we think about that going forward? I remember, in January, you've kind of talked about your core business expectation that, that would maybe be more like 3% to 4%. So I just want to try to square those 2 things.

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

Lisa, it's Alex here. I'll start with script business first of all. With 4% so far this year, as you know, underlying on the 7% last year so -- and we continue to really grow share in pharmacy, 300 basis points since WBA was actually formed. So we feel pretty good with record market share to a 2.4, albeit in this quarter, driven by nonorganic through an organic growth. And in terms of in the quarter, we saw the gains we had with strategic partnerships with Prime and with United, balanced out by the lost we had at Aetna specifically in terms of that moving from -- structure from preferred to nonpreferred. And I think, as James said in his prepared remarks, we're feeling okay about the selling season for '19 in Med D. And we have the extra volume coming in from Rite Aid next year as well. So one of our key strategy is to consolidate volume and grow volume, and we feel good about that over the long term. So I think script volume is more affected by the Aetna business than we had expected, but underlying, we feel pretty confident going forward and continue to drive good value to the marketplace. And the partnerships continue to grow rather than decline outside of that particular partnership. In terms of margin, I think we said before about 190 basis points with you in the specialty business, more or less.

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

Yes.

Unidentified Company Representative

180.

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

180. Sorry, 180 to the specialty business. And that's through with the major bulk of the situation in the margin, along with the cost, the SG&A cost and mix within the Rite Aid business. Remember, we had that 2 months of Rite Aid acquired in the quarter, which was -- obviously impacted that margin.

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

So just to -- James here. Just to confirm that, the margins in the U.S., our gross margin were down 140 basis points in the quarter. And that's entirely 190 basis points due to the specialty business. And if -- as you look at the growth profile in the U.S. business, if you take out the Rite Aid growth, plus the Prime business, the actual organic sales were up 6% in the quarter, which is quite impressive actually. However, the majority of the growth this quarter came out of the actual specialty business. And this created the adverse mix on the margin. But the margins on the specific businesses are fine. The issue is we have a mixed impact in the quarter.

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

And this is Stefano, if you will allow me. In reality, it's very difficult to compare the business this year with last year because the structure of our business has changed, and that's the reality. So we try, of course, to guide toward the work, but it's a different structure. And so when we compare, it's difficult to understand aside what is happening.

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

And Stefano, it was announced this morning that Amazon is buying a small company called PillPack. I know you've said in the past, you don't expect them to be a big player or have a lot of impact on your business. I'm just curious as to your initial thoughts around this small acquisition by them.

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

Well, we knew, of course, that the company was for sale. It had been for sale for a while. We have followed these companies, following everything, the top trends in our market. And to be honest, as we are also working in that direction, of course, one of the things that we are doing is to prepare mainly different services for our customers. We were not particularly worried, and we are not particularly worried. Of course, we are not complacent. We know that we have to change the level of our services to the customers, and we are working quite hard on that direction. But we are not worried. Because at the end of the day, it's still a small company. Yes, it's a -- it is a declaration of intent from Amazon, let's say so, but you see, their pharmacy work is much more complex than just delivering certain pills or certain packages. And I believe -- I strongly believe, as I have said, even before in my closing remarks, the role of the pharmacies, so the physical pharmacies, is that we continue to be very, very important in future. And yes, there is a lot of emotion, these kind of things that vary, but we have to compare the emotion with the fact. And the fact is that we have grown since the merger. We have delivered 15% and more of growth in earnings per share. We have delivered a strong cash flow. We have increased our cash flow substantially. And we are in good health and ready to continue to grow in future. Can you -- Alex, can you say something?

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

Yes, Stefano. Obviously, we've followed this company. And we offer this service locally through our physical pharmacies. We have that service plus many others that we support with communities, with -- and as technology changes, we are continuing to invest in technologies that support patients there and in these circumstances that are home and in special care. So I think we are confident that we can compete, more than confident, to be honest, Lisa. And of course, we're building out our services around these in a local community basis aside as Stefano said.

Operator

Our next question is from Ricky Goldwasser with Morgan Stanley.

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

A couple of follow-up questions here. And firstly, on the PillPack-Amazon acquisition. And Stefano, obviously, when we think about the market, we think about the convergence of those, the digital (inaudible) and the traditional brick-and-mortar. So from your perspective, this Amazon move and move, as you know also, is focused on the patient population that is a high user of drug with more kind of the electronic population. Does that accelerate your time line in unveiling the strategic initiative? And does it kind of like change your thoughts about deploying capital into M&A, or at least the pace you should deploy that capital?

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

I have always said that we have to separate the emotions from the facts. We don't see any reason to be worried. We are not complacent. I repeat this. We have a clear plan. And I believe that we will continue with the execution of our plan. If we did M&A just under the pressure of emotions, without respecting our financial discipline, at the end, we will destroy value. And sooner or later, I would pay -- we would pay for it. So I believe that, as you know, as we have always said, we are open for M&A at the right price. If we can buy something and see the return for what we buy, we would do it. We would not do something just because we feel that we have to do something. We know that our plans are quite solid. We know exactly what is our strategy. We have the means and the abilities in the company to execute our strategy. And this is what we'll do. You will never see us panicking or acting under the pressure of the emotion.

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

Do you think that today's announcement though might mean that some of the other players in the market there is some potential partners of you that might be more willing to come to the table now?

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

What can I say? Let's see. We are always open. Our door is always open. Provided that they -- the people who come through that door are sensible, we are always ready to welcome them.

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

Great. And then lastly, just a follow-up on specialty. You talked about specialty as one of the biggest contributors to the year-over-year growth. Can you just give us a little bit more color on where you are in the progression with the purchasing with Express Scripts, with Prime, and what do you estimate your specialty market share is now?

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

Ricky, it's Alex here. The relationship with Express is a very good one. The buying group has just been set up. And obviously, we remain confident that working together with another major brand in the marketplace will bring better value for us and to our customers and to our peers. So it's early days. And so far, so good. We continue to develop our specialty strategy, and I can't give you market share, of course, because it's not something we report specifically. But we have 2 models. We have a model of central specialty that we do with AllianceRx, and then we have the community model where we continue to invest in small community specialty pharmacies close to where patients live and to where doctors practice. And it has proven to be very successful, and we continue to grow that brick-and-mortar out there as part of our strategy. And we think these 2 things together, with the right relationships and the right partnership philosophy, it will allow us to continue to grow in a very important marketplace for us. And last but not least, there is the relationships that we have with the global manufacturers. Ornella Barra, my Co-COO, has built this with Stefano over many years, and we continue to work very closely. For example, we have increased the number of LDDs as a result of our local and global relationship.

Operator

Our next question is from Ross Muken with Evercore.

Elizabeth Hammell Anderson - *Evercore ISI Institutional Equities, Research Division - Associate*

This is Elizabeth Anderson in for Ross. I was wondering if you could comment on -- if you're -- there have been a number of questions about gross margin pressure so far. But so far, you've been able to really offset it with a very good degree of OpEx management. I was wondering if could comment on the sustainability of that and how you sort of view the OpEx management opportunities going forward.

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

Yes. We remain very confident that we can remain very efficient. We have always have opportunities, as I said, in my prepared comments. The investments we're making in information technology will improve our processes, and we continue to really focus on -- in it. And I think we said this really since the beginning of Walgreens Boots Alliance, we come from the European market as most of us, where we are used to reimbursement pressure. And therefore, we plan for efficiencies, and we plan for investment and efficiencies, importantly, in advance to make sure that we can remain competitive. And we continue to scale. I mean, scale is really important to us. An addition of the Rite Aid stores early on this year gained us more opportunity, both on synergies and also on scale. So again, we remain confident, Elizabeth. And that's part of our job. That's what we do.

Elizabeth Hammell Anderson - *Evercore ISI Institutional Equities, Research Division - Associate*

Perfect. And then speaking of your European experience, could you kind of give us a little bit more color on your thoughts on the U.K. and EU businesses, both on the retail and wholesale side, just in terms of what you're seeing in terms of market challenges and then reimbursement pressures and consumer spend?

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

Yes. Thanks. I'll pick up the U.K. Particularly, Boots in the U.K., a business I know very well. Again, it's no secret that Brexit -- is known to be Brexit, and the government are reacting really to increasing health care costs in the U.K. And pharmacy was impacted directly about 1.5 years ago. We see that this -- 2 things happening. We see an unusual period of reimbursement pressure, which has come through, and also a reduction in volume of prescriptions as the government is encouraging through the doctors to not prescribe so many things available outside of a normal pharmacy for some conditions. So these things are impacting both the margin and the volume in this space. Clearly, we are also looking in terms of how do we work more closely with our wholesale business. We have a very, very strong position in wholesale in the U.K. And we continue to work on efficiency in the supply chain and work very closely, as I said, already with Ornella and her team to make sure that we really bring services that manufacturers want to the marketplace. So we work as usual in these conditions. We're used to it. And this is a phase, for sure, we're coming through, which has been more challenged than usual, but will remain our strong business. And we have a lot of opportunities in the future.

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

On the wholesaling business, I would add that, of course, the pressure that the pharmacies have on the government, of course, is reflected on the wholesale by this (inaudible), of course. And wholesaling business is difficult -- relatively difficult, more difficult than in the past, let's say, in Continental Europe, particularly in Germany and in France. It's very good in the emerging markets, very good in Turkey, very good in Egypt, very good in other market like Romania. And overall, the fact that we have put a portfolio of businesses gives us a certain stability, and that this business is quite predictable. You'll see that they're quite stable over the year, a little more, a little less. And of course, but we have to take into account that the contribution of the business is not just the cash, the substantial cash that the wholesaling business is generating because it's a cash-generating business, of course. So -- but also the fact that we see our relationship with the suppliers, we see our relationship -- and their volumes are contributing quite substantially to our purchasing power. And you'll see that the importance of certain part of the business like we [built] that it's substantially is part -- is managed by the people of wholesaling. The importance of this business for the group is very, very important. And also, the wholesaling business has another important function for us, and this is Alphega. Alphega is a virtual pharmacy chain. As in most of Continental Europe, the pharmacy chains are not allowed. We have a virtual chain, a kind of very low franchise, if we can define it like that, of 6,500 pharmacies across many countries, many European countries. And of course, this is improving our overall business, strengthen our overall business because where we don't have our own pharmacies, we have Alphega. And also where we have our own pharmacies there in the U.K., we still have almost 8,000 Alphega partners. So overall, the importance of the business is not just on the cash that it delivers, which is quite significant, not just on the profit it delivers, which is stable, but on the different additional services and opportunities that it creates for the business overall, for the group.

Operator

Our next question is from Robert Jones with Goldman Sachs.

Nathan Allen Rich - *Goldman Sachs Group Inc., Research Division - Research Analyst*

This is Nathan Rich on for Bob this morning. Stefano, maybe to start, how are you thinking about the longer-term strategic positioning of the company, given how the industry appears to be changing around you with the deal that was announced today and some of the vertical deals that are in process? And how does that change the way you're thinking about the type of assets that you might need to add on to the current business as you think about the future?

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

Well, we know very well that the space is changing. We have said this very clearly. We have said this since we are there -- are here. We know that the space is changing, and we have tried to steer this business toward those changes. As we said many, many times, we had to create the platform on which we could build these changes because we had to reorganize the business after the merger 3 years ago. And I believe we have done it. We have reorganized everything practically in this business. You have seen that we have increased our profit substantially, our cash flow substantially. So we have created a strong business. And I can assure you that we are working toward adopting this business to the future needs of the market is what we have said. We have just said this in our remarks. And so I believe that we don't have to change our strategy because our strategy is exactly what you were -- got exactly what you were saying, and this has been -- and this is what we are working towards. Alex, maybe you can add something?

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

Thanks, Stefano. Nathan, yes. All we're doing right now, as Stefano said, we've really spent the last few years taking care of reorganizing the business, in other words, looking forward. And all of our efforts and energies and a lot of our monies have now been spent on test and trials, as I described in the prepared remarks. And it's -- we're really, really doing some really interesting work with customers, so all of our effort is really looking forward and making sure that we are still relevant to more or less what we are today in the U.S. as the customer and the markets change. So it's really enjoyable, but we're going on with it.

Nathan Allen Rich - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Okay. And maybe just to follow-up, looking at SG&A in the U.S. business this quarter, costs were down, I think, almost $60 million sequentially despite having the full impact of Rite Aid stores for most of the quarter. And I think you said that those were a higher-cost mix. So can you maybe just give us a little bit more detail about what drove the decline in SG&A? And how importantly, how we -- when we look forward, how we should think about the run rate, thinking about having the full Rite -- the stores -- the Rite Aid stores on for a full quarter, excuse me, and also the wage increases that you've previously announced?

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

Yes, Nathan. Really, as I've said to Elizabeth, I mean, we have programs that span 2, 3 years, where we're working on efficiencies. And we have many opportunities across stores, central offices, I guess, not for resale. And the list goes on. And I think the costs are consistently coming down because we're consistently working on it.

THOMSON REUTERS

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

And it's James here. I just want to add one point. The result is actually quite more impressive because we're cycling through this onetime curtailment benefit in the prior year period, so not only were the results, as you've said, quite impressive, but we were cycling through these onetime items. I think, as you look forward, as Alex said before, we also have the opportunity to make the Rite Aid stores more efficient and generally the management overall. As I come on board, I would reflect that they have done extremely strong work over the past, I would say, 8 or 9 quarters, but there's always opportunities in any business. And I'm actually quite impressed by the focus in the business, making sure that G&A is tightly managed. There is continuing programs. So part of my job is to make sure that continues as well.

Operator

Our next question is from George Hill with RBC.

George Robert Hill - *RBC Capital Markets, LLC, Research Division - Analyst*

And I guess I wanted to talk a little bit about the share repo announcement, and I guess I wanted to ask how do you feel about the share repo as it relates to timing. Is this something where you guys would step up the timing on the $10 billion to an ASR? And do you feel like the -- does the repo announcement kind of limit your deal optionality? And I guess, maybe just thinking about capital deployment priorities going forward and, I guess, given it looks like the stock is going to open up weak today. Stefano, you highlighted not being emotional about how you work that would affect the capital deployment, but you must also recognize when an opportunity present itself.

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

Yes. It's James here, and then maybe I'll pass it on to Stefano. And I think I'm relatively new but coming onboard, the capital deployment options are quite clear. One is internal investment. Two is partnerships and/or M&A. And then it is the dividend and share repurchase. Don't let it be lost on you that we're communicating the dividend and the share repurchase at the same time. As we look at the program, I'll respond directly to your question is, I think if I was to make an assumption, we will pursue the program, absent major M&A, over the course of the next 3 years. And I think you can work that out for yourself. It doesn't have an expiry date because we do want the flexibility if the right transaction comes along. We are pretty convinced though about the strong cash generation. And just look at what happened in the quarter, up from $1.6 billion last year to $1.9 billion this year is pretty impressive. We expect that to continue, so I think we need to walk and chew gum. We should be able to do deals and return cash to shareholders, and that's the essential communication that Stefano has given in his prepared remarks.

George Robert Hill - *RBC Capital Markets, LLC, Research Division - Analyst*

Okay. And if I could have a quick follow-up for Alex. I'd say, Alex, can you, I guess, talk anecdotally about what's going on with current script trends with some of the larger payers? I imagine this was the quarter where we saw the final tail on AllianceRx. I don't know if can talk about, like, are you still seeing a boost from the Optum relationship, like how quick has the follow-up been from SilverScript going preferred? We know that kind of the Aetna business is going away. Like, I guess, any color that you can give us on sources of scripts and where scripts are walking out the door would be helpful.

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

Yes, sure. George, I think, I said it before to Ricky and to Lisa, we're -- we just closed the [NTCs] for 2019 in terms of the contracting. And we feel good about that. James said that in his prepared remarks. We continue to grow with Optum and United in our bigger business. And we also continue to do well with Prime. So all these things are proving to be successful. The issue we've had is really Aetna moving preferred to nonpreferred.

Operator

Our next question is from Erin Wright with Credit Suisse.

Erin Elizabeth Wilson Wright - *Crédit Suisse AG, Research Division - Director & Senior Equity Research Analyst*

Great. Could you just speak to your relationship with AmerisourceBergen and just give us an update there? And what are some of the limitations as well as opportunities under the current ownership structure? I guess, what more can you do with Amerisource here?

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

With Amerisource, we have a very, very good relationship. We work together well. We are happy overall, and I believe that they are as well. At the time being, we don't see an absolute need to change the situation. Of course, things could change over time, but for the time being, we are happy as we are.

Erin Elizabeth Wilson Wright - *Crédit Suisse AG, Research Division - Director & Senior Equity Research Analyst*

Okay. And can you give us an update or speak to what your initial thoughts are on the potential implications from the drug pricing blueprint and some of the commentary from the new HHS secretary just on general drug pricing and potential changes to rebate structures?

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

Yes. I mean, I think, we support price transparency. We've been very consistent with that from Day 1. And really, that's what the HHS is saying. So to support it, we had pharmacies there on the day -- on Capitol Hill to understand their recommendations. And it's too early to tell the impact, to be honest, with things like rebates, but we remain supportive of giving the customers more visibility and giving them a simpler and easier pharmacy and health care system.

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

I believe -- I am convinced that if we had a more transparent system, overall, the pharmacies could be better off because we are an element in the chain of distribution drugs. An element that is making -- giving their service at a reasonable rate. And so I believe that whatever the system would be, even a system where we would be paid by a cheaper service could improve our situation because on one side, that probably we would have similar margin or just a smaller margin, but it would tell us to streamline in a more transparent world, to streamline our cost quite substantially. So we are very in favor of a full transparency.

Operator

And I'm showing no further questions. I would now like to turn the call back to Gerald Gradwell for any further remarks.

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

Thank you very much, indeed. Thank you, everyone, for participating in the call. We, the IR team, are around to take any further questions you may have and anything we didn't get to on the call today. But thank you all, and we will speak to you again in the -- at the fourth quarter. Thank you.

Operator

Ladies and gentlemen, thank you for participating in today's conference. You may now disconnect. Everyone, have a great day.