THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

WBA - Q1 2016 Walgreens Boots Alliance Inc Earnings Call

EVENT DATE/TIME: JANUARY 07, 2016 / 1:30PM GMT

OVERVIEW:

Co. reported 1Q16 net sales of $29b, net earnings attributable to Co. of $1.1b and diluted EPS of $1.01. Expects FY16 adjusted EPS to be $4.30-4.55.

THOMSON REUTERS

CORPORATE PARTICIPANTS

Gerald Gradwell *Walgreens Boots Alliance, Inc. - SVP IR & Special Projects*

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

George Fairweather *Walgreens Boots Alliance, Inc. - EVP, Global CFO*

Alex Gourlay *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

CONFERENCE CALL PARTICIPANTS

Mark Wiltamuth *Jefferies LLC - Analyst*

Lisa Gill *JPMorgan - Analyst*

Ross Muken *Evercore ISI - Analyst*

Robert Jones *Goldman Sachs - Analyst*

George Hill *Deutsche Bank - Analyst*

Ricky Goldwasser *Morgan Stanley - Analyst*

David Larsen *Leerink Partners - Analyst*

John Heinbockel *Guggenheim Securities LLC - Analyst*

Scott Mushkin *Wolfe Research - Analyst*

Eric Bosshard *Cleveland Research Company - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Walgreens Boots Alliance, Inc., first-quarter 2016 earnings conference call. (Operator Instructions) As a reminder to our audience, this conference is being recorded.

Now I would like to turn the floor over to Gerald Gradwell, Senior Vice President of Investor Relations and Special Projects. Sir, you have the floor.

Gerald Gradwell - *Walgreens Boots Alliance, Inc. - SVP IR & Special Projects*

Thank you, and good morning, everybody. Welcome to our fiscal 2016 first-quarter earnings call.

Today, Stefano Pessina, our Executive Vice Chairman and Chief Executive Officer, and George Fairweather, Executive Vice President and Global Chief Financial Officer, will take you through our results in greater detail. Also joining us on the call and available for questions is Alex Gourlay, Executive Vice President of Walgreens Boots Alliance and President of Walgreens.

You can find a link to our webcast on our Investor Relations website at investor.walgreensbootsalliance.com. After the call, this presentation and a webcast will be archived on our website for 12 months.

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 law, we undertake no obligation to update publicly any forward-looking statements after this presentation, whether as a result of new information, future events, changes in assumptions, or otherwise. Please see our latest Form 10-K and other filings for a discussion of risk factors as they relate to forward-looking statements.

As a reminder, today's presentation includes certain non-GAAP financial measures, and we refer you to the appendix of the presentation materials available on our Investor Relations website for reconciliation to the most directly comparable GAAP financial measures and related information.

Please note that we've streamlined aspects of the presentation used in reporting our results this quarter. Much of the underlying detail remains available in the appendix, and you should refer to the appendix for that additional information. With that I will hand the call over to Stefano for some opening comments.

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

Thank you, Gerald. Good morning, everyone, and welcome to our first-quarter 2016 earnings call. I am pleased to report that today I start with a comparatively strong first quarter, as we expected. Our ongoing work to control costs across the Company and improve adjusted operating income margin is growing earnings overall, with adjusted diluted net earnings per share attributable to Walgreens Boots Alliance up 32.1% compared with the year-ago period to $1.03. Although it is early days, we are on track to deliver against our expectations.

In addition to the encouraging organic results from all three of our divisions, we continue to work hard to develop the Company. We have taken a significant step forward with our proposed agreement to acquire Rite Aid, and we remain focused on building new partnerships. In December, after the quarter end, we announced the fulfillment agreement with Valent which, we believe, will enable consumers to conveniently access the Valeant's product at lower cost. I will come back to this later, but now will hand over to George to take us through the financial performance for the quarter.

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO*

Thank you, Stefano. Good morning, everyone, and good afternoon to those listening in Europe.

Starting with the first-quarter highlights, net sales were $29 billion, up 48.5% on the same quarter a year ago, largely due to the inclusion of Alliance Boots. On a GAAP basis, operating income was $1.5 billion. Net earnings attributable to Walgreens Boots Alliance were $1.1 billion and diluted EPS was $1.01.

On an adjusted basis, operating income was $1.7 billion up 53.8%. Net earnings achievable to Walgreens Boots Alliance were $1.1 billion, up 51.1%, and adjusted diluted EPS was $1.03, up 32.1%.

These results are, of course, not directly comparable with first-quarter of fiscal 2015 due to the Alliance Boots transaction in December 2014 and the resulting changes in segmental reporting. Key factors driving our performance versus the same quarter last year were the Alliance Boots transaction and growth in the Retail Pharmacy USA division.

Total Retail Pharmacy USA sales were $20.4 billion, an increase of 4.2% over the same quarter a year ago. Sales on a comparable-store basis increased by 5.8%, driven by strong pharmacy volume and mix. Total sales growth was lower than comparable-store sales primarily due to the sale of our infusion business and store closures during the past year.

Adjusted gross margin at 27% was 30 basis points lower, primarily due to ongoing pharmacy margin pressure. This resulted in $5.5 billion of adjusted gross profit, up 2.7%.

Adjusted SG&A was $4.2 billion, a decrease of 2.1%. This reflects the meaningful progress made in our cost-savings program while maintaining our customer experience.

The division's adjusted operating income was $1.2 billion, up 11.2%, giving an adjusted operating margin of 6.1%, up 40 basis points. Excluding Walgreens' share of equity earnings in Alliance Boots in the year-ago quarter, adjusted operating income for the division grew by 22.9%.

Turning now to look in more detail at pharmacy, pharmacy sales were up 6.7% for the quarter. 231 million prescriptions were filled on a 30-day basis, including immunizations, an increase of 4.1%.

On a comparable-store basis, pharmacy sales increased 9.3%, with comparable scripts build up 4.7%. Overall, we are pleased with our top-line growth, especially given the weak start for the cough-cold-flu season this year. According to IMS Health, the reported incidence of flu across the USA declined by 10.7% compared with the year-ago quarter.

Our increase in comparable-store scripts was driven by our Medicare Part D growth strategy, where we grew market share, and a greater focus on customer care. This resulted in our refill prescription market share on a 30-day adjusted basis increasing by approximately 20 basis points over the year-ago quarter to 19.2%, as reported by IMS Health.

Consistent with our expectations, we experienced pressure on pharmacy gross margins. These were negatively impacted by lower third-party reimbursements, an increase in Medicare Part D mix, our continuing strategy of driving 90-day prescriptions at retail, and the mix of specialty drugs, which carry a lower margin percentage. This was partially offset by additional brand-to-generic drug conversions.

Although we continue to anticipate gross margin pressure, we remain confident in our ability to grow the pharmacy part of our business over time. Our strategy to deliver this is to drive access to critical programs, such as Med Part D, through building deeper payer relationships and through developing innovative partnerships, such as our recently announced agreement with Valeant.

Since the quarter end in December, our pharmacy sales were impacted by the continuing weakness in the cough-cold-flu season.

Retail sales decreased by 90 basis points over the first quarter of fiscal 2015, with sales in comparable stores down 60 basis points. This was primarily due to a reduction in unprofitable promotions as we increasingly focus on our key health and beauty categories.

Additionally, as part of our strategy, we transitioned seasonal items away from holiday decorations, which were historically sold on Black Friday and in the November run-up to Christmas, with higher-quality giftable items that sell throughout the holiday season. This led to an anticipated fall in sales in the quarter.

While gross margin was essentially flat, overall retail profitability increased due to the lower costs. Since the quarter end, December comparable retail sales were relatively flat with positive results from our strategic shift to health and beauty, wellness, and seasonal categories offset by the weak cough-cold flu season.

We believe that our fundamental shift towards health and beauty is resonating with our customers and is an important point of differentiation. Having conducted pilots in over 400 stores, we're excited for the positive results we have seen, particularly for No7 and Soap & Glory. As previously indicated, we are expanding our differentiated beauty offering to approximately 2,000 stores with the rollout planned to begin in summer 2016.

Turning now to our Retail Pharmacy International division, which is pharmacy-led health and beauty retail businesses in eight countries, the biggest business being Boots in the UK. Total Retail Pharmacy International sales for the quarter were $3.5 billion, pro forma constant currency comparable-store sales being up by 2.2%. Adjusted gross profit was $1.5 billion, with an adjusted gross profit margin of 42.6%.

Adjusted SG&A was $1.2 billion, the division's depreciation charge marginally benefiting from purchase price accounting refinements in the quarter. Adjusted operating income was $315 million, the adjusted operating margin of 8.9% being higher than in the seasonally weaker fourth quarter, as we expected.

On a pro forma constant-currency basis, comparable pharmacy sales for the division were up 3.8%. Comparable retail sales up 1.3%.

Boots UK's comparable pharmacy sales increased by 3.5% mainly as a result of additional high-value drugs dispensed in its hospital pharmacies, higher average volume, higher average item value, and growth in pharmacy services such as flu vaccinations. Comparable retail sales growth at

Boots UK was 80 basis points, growth coming mainly from Boots.com, albeit at a lower rate than in previous quarters as in August Boots anniversaried its improved order online, collect in store offer.

Cosmetics were the best performing retail category in the UK, led by a strong performance in premium, No7, and Liz Earle, which we acquired in July. In November, we added another exciting brand to our portfolio, Sleek MakeUP, which has a young and ethnically diverse customer base. Sleek is currently sold in over 100 Boots stores (technical difficulty) doing with Liz Earle.

Outside the UK we delivered particularly good comparable sales growth in Mexico and in the Republic of Ireland. Benavides in Mexico, while currently a lower operating margin business than Boots, is a key priority for expansion, and we're working hard to find innovative ways to accelerate our store opening program.

Since the quarter end, December performance has been encouraging. Boots UK's retail sales growth was higher than in the first quarter due to a strong online performance. Sales of our exclusive range of seasonal gifts were particularly good.

Turning now to our Pharmaceutical Wholesale division, overall, the Pharmaceutical Wholesale division performed in line with our expectations during the quarter. Total sales were $5.8 billion. On a pro forma constant--currency basis excluding acquisitions and disposals, comparable sales increased by 3.1% over the same quarter in 2015. This was slightly ahead of our estimated market growth, weighted on the basis of our country wholesale sales. As in the prior quarter, sales growth was particularly strong in Norway; and we continued to see good growth in Germany and Turkey, two of our largest markets.

Adjusted operating income was $166 million in the quarter, and the adjusted operating income margin was 2.9%.

Combined net synergies in the quarter from the Alliance Boots program were $288 million, so we are very much on track to deliver our goal of reaching at least $1 billion in fiscal 2016. As I said on the year-end call, we continue to identify and action many other synergies which are simply not practical to quantify, as they blend into our core operations. At the same time, we're continuing to make good progress to deliver our $1.5 billion cost-savings program and remain on track to achieve this target by the end of fiscal 2017.

Operating cash flow in the quarter was $732 million, reflecting our typical seasonal build in inventories. As I said on the last call, we continue to seek ways to deliver further working capital efficiencies, particularly in the US.

Capital expenditure in the quarter totaled $340 million, which was just below the amount spent in the fourth quarter of last year. This reflects our drive, which I again talked about on our last call, to invest in key areas that develop our customer proposition, including information technology. Free cash flow for the quarter, therefore, netted to $392 million.

Since our Rite Aid announcement, we've made good progress with the funding. In December, we completed the placement of $5 billion term loan facilities and the syndication of a new $7.8 billion bridge facility. These new facilities replace our previously reported $12.8 billion bridge facility commitment. Drawings are, of course, subject to closing of the acquisition.

Let me now conclude with some comments on guidance for fiscal 2016. As you will have seen in this morning's press release, we've raised the lower end of our fiscal 2016 guidance by $0.05 per share to a range of $4.30 to $4.55. This continues to assume no material accretion from the agreement to acquire Rite Aid, the previously announced suspension of the balance of the $3 billion share buyback program, continuation of our normal anti-dilutive buyback program relating to stock incentives, and no significant changes in currency exchange rates.

Please remember that we have currency translational exposure based primarily on movements in the pound sterling versus the dollar. Not only does this impact our adjusted operating income and EPS, but it can also cause quarterly volatility in the sales gross margin and SG&A item lines. The guidance I have just provided reflects current currency rates and so factors in a headwind of around $0.03 since we provided our initial fiscal-year 2016 guidance back in October.

I'll now hand you back to Stefano.

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

Thank you, George. The Company has performed well overall in the first quarter, and I want to come back to that in a moment. I would like first to update you on a few of the things that we have been working on in the quarter and since its [progress] that has not had a direct impact on the quarterly performance and the review.

As you have heard, we are not assuming our proposed acquisition of Rite Aid will provide any material accretion (inaudible) of 2016. But I would reiterate that this transaction is progressing as we expected and planned.

We continue to anticipate completing the acquisition in the second half of calendar-year 2016. The transaction remains subject to approval by Rite Aid's shareholders, regulatory clearances, and other customary closing conditions.

Rite Aid have issued their proxy and their stockholders meeting to approve the transaction is scheduled for February 4. We are continuing to work closely with the regulators. You will have seen, as we expected, that we have received a second request from the FTC for additional information. This is a standard part of the regulatory process in connection with the FTC's review.

Shortly after the announcement of the proposed acquisition, we appointed a highly experienced integration team which has been up and running since the end of November. They are now well underway on preliminary planning work.

In December, we also announced our agreement with Valeant Pharmaceuticals. This agreement, though new to the US market, has some similarities to the way we work with a number of pharmaceutical companies in Europe. It is a very good example of how we can transfer existing experience and understanding from one market and [direct it] to another.

The two main parts of the agreements combine to provide Valeant with the opportunity to serve a far wider patient base at a significantly lower cost, and the potential to both grow their business and improve convenience and service levels at an overall saving to the healthcare system. From our point of view, we have the potential to offer patients the medications they want and they have been prescribed with a high standard for counseling and therapy in a method that makes good use of our infrastructure and professional capabilities.

So as we look at our business today and what we have seen happen in our dynamic and changing markets, it [serves] a number of global themes that I have believed to be inevitable for some time. In healthcare we are continuing to see increasing demand on the existing system for both preventative and therapeutic treatment. This is only compounded by inflationary pressure of new, innovative, and correspondingly high-cost (inaudible).

In [desires] to mitigate this pressure and provide more and better care at lower cost, our pharmacy stands out as being one of the most convenient, flexible, and lowest cost means of meeting the challenges which the system faces. Our agreement with Valeant demonstrates how we can use our pharmacy network to improve access and service level while reducing costs in the healthcare system.

As we have seen in Europe and elsewhere, we believe that when we work in close alignment and true partnership with Valeant in the sector we can achieve immense benefit, both in service level, therapeutic care, cost savings, and of course in financial reward for both our partner and our self. This is why I want the partnership to become a characteristic by which our Company will be known, as good partnerships deliver real value.

As you know, our Pharmacy services operate in close alignment with our Retail division. In Retail, we are at the beginning of a journey, to focus on our customers' true needs and to differentiate our Retail offering.

We have seen the real changes taking effect. And supported by good operational disciplines, these will deliver growth for the future.

Like all other retailers, we have also seen an acceleration in the US in customers moving towards omnichannel retail, with online shopping working in parallel and integrated with the physical store. This is a trend we have seen in many of our markets, most particularly in the UK, where we have adapted our model to embrace this trend. We must now decide how to deploy our (inaudible) and experience to maximize the opportunities which this trend presents worldwide.

Today, we have delivered what I believe to be a strong performance for the business in a process of transformation. Looking forward, there is no doubt that we still have a lot of work to do within our core businesses to optimize them for their existing markets, to introduce new products, services and ways of working, and to further enhance our spending with our customers.

These are fundamental drivers that I believe will help us to deliver the long-term earnings growth that we are confident to achieve. As a company, we continue to look at new areas of business to add to our portfolio; we continue to find opportunities complementary to our core operations professionally, commercially, and geographically, that will help us grow the business and enhance its financial performance.

Ultimately, our success relies on the quality and commitment of our people globally. Their experience, expertise, and drive will improve our business every day. The commitment I see from our team gives me great confidence that we will deliver what we have seen for fiscal 2015 and beyond.

Now let's open up for questions. Gerald?

Gerald Gradwell - *Walgreens Boots Alliance, Inc. - SVP IR & Special Projects*

Thank you. Brian, we are now ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Mark Wiltamuth, Jefferies.

Mark Wiltamuth - *Jefferies LLC - Analyst*

Hi, good morning. I wanted to dig a little bit on the Boots side of the business. You have a shift in strategy there where you're focusing more on top-line growth rather than margin. Wanted to see: what's the progress there on the margins at Boots?

And then I wanted to ask a little bit about what you think about the opportunity to turn around Rite Aid longer term.

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

Well, first of all, we have not shifted our strategy. We are pursuing both sales and margin.

Of course, you don't have to judge on a single quarter. We have a program which has been designed over many years, and we are managing the Company in the long term. Whilst we try to be as good as possible each single quarter, but this is not our ultimate aim. Our ultimate aim is to transform this Company.

So from time to time, we will see the prevalence of the sales or the prevalence of the margin. And maybe you, Alex, can respond to this.

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

Yes, thanks, Stefano. Yes, obviously, I know Boots very well from the past, and I think that where we are in Boots is a pretty good space. I think as Stefano has indicated, Boots is really well established in the UK, an enormously loyal customer base, which I [find] the team they are successfully growing.

So for the first time in many years they're starting to grow (inaudible) forward and grow customer base in Boots UK using an omnichannel strategy. So the same great products, the same great positioned stores, the same great people who (technical difficulty) for many years. But now we're expanding and using the new technologies customers are engaging with both here in the US and also globally, but particularly in the UK, I think George has said already.

In terms of Rite Aid, we're feeling pretty good about Rite Aid. They announced their results (technical difficulty) to me. We know there's five years and things they've done also in their front end in growing sales that we can learn from as well.

As always, the idea here is to put the Companies together in a way that allows us to really get the best practice from both Companies here in the USA, while importing some of the best ideas from other markets.

Mark Wiltamuth - *Jefferies LLC - Analyst*

Do you think you'll have to put a lot of capital into the stores to drive the turnaround in the Rite Aid base?

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

Again, we are really in the early stages. We know this space very well. Our team in Walgreens obviously knows the Rite Aid space extremely well, and we don't think this is a big problem.

They have had a good investment program in about 2,000 of their stores already, over 2,000. And we believe that with appropriate investment and importantly, as George said, appropriate returns we can get the right sales and margin mix in Rite Aid over time.

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

But what is important -- Stefano again -- what is important to understand is that we couldn't have a better time for this deal. Because in reality we are already investing a lot of capital to transform Walgreens, from the stores in Walgreens. And so at the end, this will be just an extension -- the integration of Rite Aid will be just an extension of the work that we are doing at Walgreens.

If we had done this in three years' time, probably we would have had to start from scratch. Now, we will just continue in the work that we have to do in any case.

Mark Wiltamuth - *Jefferies LLC - Analyst*

Stefano, now that you've done this big horizontal acquisition, do you think there's a possibility of going vertical with your acquisitions moving forward and maybe contemplating a PBM transaction?

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

Yes, you know what I think. I couldn't have been clearer since the very beginning. I have seen this market and I am really convinced that vertical integration is a necessity for this market, [by] market. It is part of what we have to do to reduce -- to control the costs in the healthcare arena.

Any kind of vertical integration is good. It depends on the opportunities that we will have. It depends on the availability of partners.

And also there are many ways to have a multiple -- a vertical integration. You can have a merger, which of course is the perfect way. But you can also have a commercial agreement, a very strong commercial agreement, and very strong partnerships. And as we have said many times, we are always open even for a partnership.

Mark Wiltamuth - *Jefferies LLC - Analyst*

Okay, thank you.

Operator

Lisa Gill, JPMorgan.

Lisa Gill - *JPMorgan - Analyst*

Great, thanks very much and good morning. Stefano, can I just follow up on what you just said around a strong commercial agreement or a partnership as it pertains to a PBM? Is that something that we should expect to see Walgreens announce with one or maybe more than one PBM, as we think about putting together partnerships -- in your word -- over the next 12 to 18 months? How do we think about putting this into context and your overall thought on strategy?

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

I would like to give you an answer because this will mean that I would have a clear idea and a clear target for the next period. Unfortunately, you have to realize that we have just done a deal; we have to digest the deal that we have done.

We have to look around. And at the right time, when we will be prepared, we will tell you which kind of deal and when we can execute the deal.

But we have done two big deals in less than one year. Give us the time to organize our selves.

(inaudible) at the [time], let's be clear, it's a problem that we are very rarely [seek] and we know what we can digest, what we can approve. So at the right time we will come back to you.

Lisa Gill - *JPMorgan - Analyst*

Okay. Then secondly, when you talk about the Valent deal, you talked about the fact that you view this as a first stepping stone and maybe some other opportunities in the market. So I guess I have to questions there.

The first would be: Do you have specific manufacturers you're discussing opportunities with today?

And then the second part is for George. Is there any contribution in the updated guidance from the new Valeant relationship?

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

Well, the first part of the question I can tell you that we are -- again, we have just done this deal. We have to execute properly this deal. We have to show that we are absolutely able to manage this kind of relationship, as we have demonstrated many, many times in Europe; and after we will think about a potential deal if we will find other partners.

Lisa Gill - *JPMorgan - Analyst*

Any financial contribution?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO*

Yes, on guidance, obviously guidance includes everything for this fiscal year. I just would point out, obviously, that we are only shortly going to commence and start to roll out the Valeant program. And of course as ever when you bring in new programs, there's various startup costs that have to be incurred when you go down a new route.

So, yes. Yes, yes, it's included; but recognize that we're pretty well halfway through the year, and this will be ramped up really starting relatively shortly, but will take some time to ramp up.

Lisa Gill - *JPMorgan - Analyst*

Thank you for the comments, and I look forward to seeing you next week.

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO*

Look forward to seeing you too, Lisa.

Operator

Ross Muken, Evercore ISI.

Ross Muken - *Evercore ISI - Analyst*

Good morning, gentlemen. On the cost side in the US business, it looked like versus what we saw on the fourth quarter you made some great progress. I think there you had maybe had some upfront costs at the end of the year.

Can you just help us understand in terms of the progression? It's pretty obvious on the synergy side how well you're doing. But on the larger plan, the $1.5 billion plan, what are some of the examples of projects where we see more of the upfront savings? And then how do we think about some of the longer-dated projects that will deliver maybe some value there over the next, I don't know, 18 or 24 months?

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

Yes, hi, it's Alex here. Hi, Ross. Yes, some of the examples which are maybe more the operational examples, we've spoken about these before. Obviously, we've confirmed the [turn] of stores and we're well over halfway through that program, and that's going fairly well.

We have reduced some opening [areas] as appropriate to make sure that we're able to give better care when more customers are actually in our stores. We've swapped our photo labs for dry photo labs using digital technology; and obviously that's been a great success on the cost side but also important in the growth side as well.

So these are some of the structural changes that we've been doing so far. But there is some nice work I think in centralizing a lot of pharmacy operations which allows our pharmacists to give more attention and care to customers at the counter, while reducing cost substantially in the cost to fill.

And all of these are programs that we continue to run into the future. We're not short of ideas. We have a very strong operational and IT team here, and we're working on all the things we can do to reduce workload throughout the Company but particularly our stores, so we can take better care of our customers. And we've got a lot more to go at, both in the plan and other ideas that we will develop over the next period.

So we believe these are sustainable changes. We believe, importantly, the customer care numbers that we measure internally are going up as well. So removing work, taking better care of customers, taking back costs out, and starting now to reinvest back in the costs that are most important to the customers: have more people in our shops to serve them, as appropriate; and obviously getting the value proposition right as well for customers both in pharmacy and also in the front end.

So that's where we're on the cost program: bang on track, and more to come, and developing opportunities for the future.

Ross Muken - *Evercore ISI - Analyst*

Maybe getting back to the broader based question on vertical integration, I think as, Stefano, you said, merger is always preferred; and that makes sense, because then you have control. On the other side, going on Lisa's question with maybe agreement or partnership or something of the sort, what do you need to have accomplished in something like that?

And what are the challenges in making sure the economic benefit to the two sides are equivalent, and that both parties are working for the good of each other and the customer? What are maybe conceptually the things that you need to get out of it?

And then I stated some of the obvious challenges, but what are some of the others in terms of not having necessarily control over the whole relationship and only hoping that your partner, whomever that may be, participates in the same way? Obviously you got there on Valeant and you've done it before; so I would just love some broader context.

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

First of all, let me say that I have never, ever spoken about control. What we want is to do something which creates value -- long-term, sustainable value. We have never spoken about control.

We have done many, many deals where at the end we have lost the control, and it's by chance that many of our mergers have come back. And this was not the design. It was just the force of things.

When you merge a company, when you merge two companies, you have one company; and of course, all the people of the previous two companies are members of the new company. You have just to try to select the best people for the best hope.

And the people can come from everywhere. So we have never, ever -- I can tell you, I can assure you, never, ever done a deal with the idea of controlling the resulting company, first of all.

Secondly -- so we are open to any merger; we are open to a merger where we could have the control, a merger where we could cede the control, a merger of equals. We would be open to everything which would create, I repeat, substantial and sustainable value immediately and in the future for the Company. This is for the merger.

For the commercial partnership, of course, you can imagine many, many different kinds of commercial partnership. Valeant is a really good example, but there are other kind of partnerships that you can do on the cost side, on the margin side, creating synergies that you can share.

And there is not a model. Every time you have to discuss and you have to see what is the best way to create value and how to share the value.

But if you approach these discussions with an open mind, maybe sometimes it's possible to find a solution. Alex, you have seen many of these joint ventures, commercial joint ventures in the past, so you can say something maybe.

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

(inaudible) I think that the thing that's important here is to create the win-win. For example, in Valeant what we see is the opportunity to really take friction out for customers and patients and doctors and pharmacists so they can spend more time with patients, and therefore patients win. So the whole idea behind Valeant -- as I think Stefano said at the introduction -- really is about taking friction and cost out of the interactions between healthcare professionals and giving more time to customers.

We're becoming more of a services company. We've been faced with things which have to with the job of pharmacists, which is providing -- actually dispensing and making sure people understand their drugs properly. And that is great for pharmacists and great for profession. We've committed, as they, as we all have committed to over time ensuring that we independently monitor, that we deliver more costs in the system as a result of working differently together.

That's an example we're developing in the US, and we will take our time to get this right and make sure that we implement in a way that is appropriate for the systems that we work in, in America. There's lots of examples in Europe I wish we could go into as well, in terms of not just retail locally in a way that creates win-wins and ensures that we deliver better care at lower costs. And that's really what the partnership strategy is all about.

Ross Muken - *Evercore ISI - Analyst*

That's super helpful on my end, and I as well look forward to seeing you guys next week. Thank you.

Operator

Robert Jones, Goldman Sachs.

Robert Jones - *Goldman Sachs - Analyst*

Thanks so much. I actually had a PBM question as well. I know you guys don't provide specific timelines for the large PBM contracts; but based on previous public announcements, it would seem that you're about three to four years into the contract with the three largest PBMs.

So I'm just curious. Is there anything you can share as far as how we should be thinking about timelines for renewals, and maybe directionally how you feel reimbursement might match up relative to historical reimbursement rates?

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

Hi, it's Alex here. Hi, Robert. Again, we don't discuss these contracts openly, so I can't comment on the timelines. What I can comment on is that our strategy is to improve access: access to customers and access by having good partnerships, as we said before, with everyone in the marketplace. I think, as we probably said, we are working hard with all of the major partners to improve access and also to drive the business forward.

You look at the performance of Part Med D and you see again it's been a successful strategy. We are well set up again for this season.

These are annual contracts in the main. They are becoming more sophisticated, as we also know, being paid of course on services within these contracts. And again we're determined to give better value, better care within these contracts.

And we're starting to gently but progressively improve relationships and grow share. As George has said we grew share again in the quarter, which we're pleased with; but we know we have a lot more to do.

So that's where we are. We are feeling more confident in relationships with the PBMs. We are feeling more confident as we give better value to the market in terms of both price and quality of care. We get a better return. And we'll continue to develop our strategy over the months ahead.

Robert Jones - *Goldman Sachs - Analyst*

That's great. I guess just maybe go outside the US for my follow-up, really solid performance in the Retail International segment both from a sales and EBIT perspective. But if I look at the constant currency, same-store sales growth there was about 2.2%, a step down from what you've seen the last several quarters.

Then on the flip side, the EBIT margin came in much higher than we've seen, significantly higher than what we've seen in the last three quarters. Could you maybe just help us walk through some of the dynamics at play in the Retail International business?

What's driving, outside of same-store sales growth, the strong sales performance? And then on the margin what's contributing to that upside, and how sustainable could that level be as we look across the next three quarters of fiscal 2016?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO*

Okay, I'll try and have a go at this. There is always an element of mix. But I think that one of the factors that I tried to draw in is obviously we're continuing in -- the biggest business is Boots in the UK; it's the biggest business in the division. They're continuing to perform well.

As I said, we had -- in looking at the sales where omnichannel is and Boots.com in particular is a very important part of our growth strategy. We did in the summer anniversary just at the beginning of August our much faster online collect-in-store offer, so we've seen the impact of the growth of that coming through; then the anniversary; then we brought in some new development.

So we saw this improvement coming then back up again into the December numbers, which together with the strong gifting meant that we've had a good Christmas in what's been a particularly competitive environment. So in those businesses, it's really about having a differentiated front of store offer and then increasingly supported by omnichannel.

Of course, in Boots in the UK we're able to piggyback on the Alliance Healthcare distribution system to do that. So if you look at Boots' performance -- and certainly it's still early days. We're just starting to see some of the figures from our competitors on the High Street; but I think what's coming through pretty clear is that Boots is continuing to be a real winner there.

In terms of the margin, really two points. One, there is always a seasonal impact, given the importance of the retail part of our offerings in Retail Pharmacy International. Of course, we started to see the buildup in November, because it tends to be that people start their Christmas shopping a little bit earlier in Europe than would be the case here in the United States.

So there is a seasonal element and then, as I said also in the presentation, we got a little bit of a benefit in this quarter from the finalizing of the -- we're working towards finalizing our purchase price adjustment to the fair values that you have to do on the acquisition of Alliance Boots. We got a little bit of benefit there which helped the margin in this quarter that we won't see when you come and look at the same first quarter in 12 months' time.

The key factor is the seasonality. Of course as we look towards the second quarter where we've got the very important holiday trading, the December results and into early January, you'll also see the benefit of that coming through when we're on the next call.

Robert Jones - *Goldman Sachs - Analyst*

Got it. Okay, thanks.

Operator

George Hill, Deutsche Bank.

George Hill - *Deutsche Bank - Analyst*

Hey, good morning, guys, and I appreciate you taking the question. I guess this one is either for Alex or George. As we think about the Valeant deal, I guess can we talk about the economics of that deal, I'd say versus you guys and then using the regular wholesaling channel?

Is this structure more economically attractive for you and for them, as we've heard a lot of the midsize manufacturers scream a bit about the fees that are paid to wholesalers? I'd appreciate any color.

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

Hi, George. It's Alex here. Yes, again as I think we've said it's about taking friction and cost out of the system. For sure, we have an infrastructure here in the USA of the pharmacists; and of course in this deal importantly there will be independent pharmacies in this deal as well, because we wanted to make sure that we give customers proper access to the good products that Valeant has. And within that we have the ability, therefore, to distribute as well as fulfill the prescription, and that's what we intend to do in this occasion.

But as Stefano said before, every single partnership we work with, at least on meds, we look at how do we create a win-win for our partner and what's important to them, and how do we use our infrastructure, our assets, in whatever country we operate in to make that so. So what we do here is we provide great care and a service model to our pharmacies, to our pharmacists, to the patients; and then we distribute these drugs at this occasion as a fulfillment.

Each one will be different depending on the circumstances. And as Stefano said already, we will test this model properly to make sure that it is appropriate and does work in the US.

George Hill - *Deutsche Bank - Analyst*

Okay. Then maybe the quick follow-up would be just to get on Rite Aid. Given that you guys have gotten your second request, I guess anything in the conversations thus far that would indicate whether you guys have any changes on store divestiture expectations?

Synergy expectations seem to still be intact. But I guess as it relates to divestitures, are you guys still thinking the number is less than 500?

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

We don't have any reason to change our view. As I have said before, we're working with the relevant [targets] in order to speed up the process if possible of course. For the time being, we cannot add any comment to what we have said. We are still confident that this will go through in the terms that we have anticipated.

George Hill - *Deutsche Bank - Analyst*

Okay. I appreciate the color. Thanks, guys.

Operator

Ricky Goldwasser, Morgan Stanley.

Ricky Goldwasser - *Morgan Stanley - Analyst*

Yes, hi. Good morning and congrats on a very good quarter. A couple of questions here.

The first one, if we think about the contract with Valeant, we can also think about it as a form of vertical partnership, right, that helps reduce cost by removing like the distributor from the equation. So when you think about tightening relationships between you and manufacturers and like bypassing the distributor, do you think that this is something that theoretically can be extended to other manufacturers, or these will be like one-offs?

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

Hi, Ricky. Yes, I think as George said before, many manufacturers are looking for more efficient ways to get to the market, to get their products to the customer and to the patient. So again, Valeant came with that request to us, and other manufacturers may or may not come with that request to us, and we'll look at each case individually.

So for sure it's really the same answer, I apologize, as we gave to George. Which is, we have a great infrastructure in the USA; we have a very strong logistics operation in the USA; we have good expertise in wholesaling coming from (inaudible) division across the rest of the globe, particularly in Europe.

And we will always do our very best to take cost out of the system, to do a better job for customers, and do a great job for our partners. So we're opening to these opportunities, but we've got to make sure that this one actually works and does work in America. And we'll take it from there.

Ricky Goldwasser - *Morgan Stanley - Analyst*

Okay. Then I'd say that the tone of this conference call is a lot more positive than your last conference call. So have you seen something in the marketplace or internally that makes you feel better now on the business trends than you were a few months ago?

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

No. We were confident. We have been confident for all the time we have been here. If we had not been confident we wouldn't have done this deal.

We have done this deal knowing that we were going through a period of, let's say, substantial work that we -- to really be able to exploit all the opportunities which were there, which are here, which will be here, we have to do a certain work. And this is what we are doing.

So maybe it's possible that sometimes we are more or less good in our presentations, but this doesn't depend on our mood. It depends maybe on our physical condition; I don't know. (laughter) But not on our mood.

Our mood has always been positive, is still positive. And we still believe there is [confidence] in what we're doing. If by any chance we changed our mind, we would feel obliged to tell you; but I can assure you we are as positive as we were one year ago.

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO*

You can take from that, Ricky, that I found a reasonable coffee shop with good pastries this morning before the call.

Ricky Goldwasser - *Morgan Stanley - Analyst*

There's nothing like American coffee, right? Okay. Thank you very much.

Operator

David Larsen, Leerink.

David Larsen - *Leerink Partners - Analyst*

Hey, guys. Congratulations on a good quarter. Can you talk a bit about the adjusted gross margin in Retail USA? It looks pretty good to me, 27.0%; that's actually up a bit sequentially. The year-over-year compression of about 39 basis points, that shows some improvement in the rate of compression relative to the past couple quarters.

So can you talk about the reimbursement that you're seeing in the Part D networks, also the commercial plans? And then, what impact is generic inflation having on those margins? Thanks.

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

Thanks, David. Hi, it's Alex here. I think that the first thing I would say, it really is as anticipated. So this is really as we expected.

Generic inflation, going to the last part of the question first, is not material. So therefore, we are feeling pretty good about this, and this is factored into ongoing guidance going forward.

The trends beyond that really are the same trends. We have ongoing reimbursement pressure as we work with the market to lower costs. They are more or less as we expected, and the trend continues in the same fashion.

It's something we're used to in Europe, as we said before. I've worked in Europe for many, many years, and it's a trend that we expect to see, because as healthcare expands and government pays more and patients pay more then you've got to work to become more efficient within the market. And that's what we commit to doing.

On the front-end margins, we are pleased with the profitability as we continue to swap out old products. As George said in his introduction, we took out all of the order home decoration products, which primarily sell in November; and we are replacing these with more giftables.

This was really the first year of that transition. We had great support from some of our partners. We have more plans to shift that mix next Christmas.

And also importantly we have [view] 2,000 where again we're shifting the mix towards more beauty products, owned brand beauty products, from Ken's organization with the launch of these products in over one-half -- 1,000 extra stores to get to 2,000 stores by somewhere around Christmas next year.

So the trends are very similar, to be honest. We are pretty predictable.

Maybe the one that was a bit less predictable was promotional markets where, again, we gave great promotionals through the autumn; so we've had to adjust that a little bit after that period. Of course, that's important to stay in a market and stay prepared, which we are doing.

So really the trends are the same. We adjust as we go, but the fundamentals are the same.

David Larsen - *Leerink Partners - Analyst*

Would you expect this 27.0% gross margin to continue or improve for the rest of the year in Retail USA?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO*

As you'll appreciate, we don't give forecasts at that level. I'll really reiterate what Alex is saying: we expect, as we see in Europe, ongoing reimbursement pressures. There's obviously a little bit of growth in specialties as well, which I talked about, which of course has got a high unit margin but lower percent. So there will be some of these mix effects continuing to go through.

What we've got to continue to do is drive the efficiency and the productivity. It's absolutely the way of life.

What we're really focused on if we come back is looking at the operating margin end to end. That's where I know Alex and I are very, very focused.

Coming back to the Retail example, Alex just talked about a lot of the promotional work that we talked about created a lot of inefficiency in the stores and a lot of cost. So what you've actually got to do is drive the efficiency out as well as focusing just on the gross margin, because what's important is to be able to grow our operating margin from the business over time as well as our top line.

David Larsen - *Leerink Partners - Analyst*

Okay. Then just one more quick one. Assuming the Rite Aid deal does close, I think what I heard maybe last quarter was that you would expect the deal to be accretive in year one. Can you give any more color around that?

Like, what exactly does that term accretive mean? Would that be about and beyond what the Rite Aid earnings would normally layer in? Just any more color around that would be really helpful.

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

We have given you the level of synergies. We have said $1 billion of synergies. We still said we are into that number.

Of course, the synergies will be down, day after day since the time when we will be able to execute the merger. You can really value for these [guesses] from these how much of these synergies will be possible in the first year.

We said that we would need two or three years to deliver this $1 billion, so you can see. We have given an indication.

To be honest, we don't want to be more precise because we don't know exactly the terms. We don't know exactly how many pharmacies we will have to divest; we will know exactly how many pharmacies we could consolidate. So we don't want to be more precise for the time being; but overall, you have an indication.

David Larsen - *Leerink Partners - Analyst*

Okay, that's super. Very helpful. Thanks a lot and congrats on a good quarter.

Operator

John Heinbockel, Guggenheim Securities.

John Heinbockel - *Guggenheim Securities LLC - Analyst*

I guess for anybody, but particularly Alex, there would seem to be -- one of the ways the Rite Aid deal is going to work really well are the learnings that you can pick up from them; and obviously there's a lot of potential there. Obviously they do the loyalty card differently than you; they do the Wellness Ambassadors, the Care Coaches.

What are the one or two things that you look at from afar and are intrigued by, where there might be some earnings that are particularly applicable to your store base?

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

I think the first thing is this company has managed with very limited resources for some time and has done it very well, and I think that's a great discipline. It's a discipline, to be honest, the Walgreens team has picked up really quickly in the last 12, 18 months.

I think it's (inaudible) also the Walgreens organization to use money wisely. But again we have an opportunity I think to learn even more about that, given the level of cash that Rite Aid didn't have in the last period. So that's the first one.

I think related to that, secondly, to your point, they've invested wisely in their best stores. And they are getting -- from the numbers that the team speak about, and you will confirm, they're getting nice lifts in their (inaudible) stores.

To be honest, as we review some of the stuff we did in the Well Experience we hadn't been successful in the past, maybe two or three years ago, with some of these lifts. We're now getting better lifts.

I guess I think if we can put these lessons together we can make better use of our capital and get better lifts in the front end. And of course with (inaudible) really some really great products coming out of the global sourcing organization from Alliance Boots that (inaudible) mentioned, [same] with beauty, developing into healthcare, into seasonal gifts. We put these three things together.

So we are very open. Partnership is about openness, curiosity to learn, and that team has done a good job in these two dimensions in particular.

John Heinbockel - *Guggenheim Securities LLC - Analyst*

Do you have a view to, again from afar, the Gold customer or Silver customer, the nature of that loyalty program, which is very unique relative to a lot of loyalty programs in the US? Is that something that's particularly intriguing as something to give your effort a bit of a boost?

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

Yes, we had a start at (inaudible) Walgreens. I mean, the loyalty card here is only three years old. We have 85 million active customers on the card; we have now got almost 28 million, I think it is, save up Everyday Points, which was only launched in May.

So we're very curious about how that card works in the marketplace, and we'll certainly take our time to understand it and see what benefits it could bring to our partnership.

John Heinbockel - *Guggenheim Securities LLC - Analyst*

Sure. All right. Then maybe just for George, on the $1.5 billion cost-reduction program, have you seen -- was there any benefit in the first quarter? Have you seen anything to date?

And then if you think about how that breaks out 2016 and 2017, is that more back-end loaded or front-end loader?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO*

We're just really working through the program, so every quarter we're getting more benefit coming through. I think we said we were broadly at the halfway stage at the year end, and we're just working methodically through it with Alex's team.

We're pleased with the progress and very much on track to deliver this program. Of course, once we're through this program, we will always seek new ways to drive further efficiencies. It's just got to be a way of life for our business going forward, just as we've done in the UK, just as we've done successfully in Boots over a number of phases.

John Heinbockel - *Guggenheim Securities LLC - Analyst*

Okay, thank you.

Operator

Scott Mushkin, Wolfe Research.

Scott Mushkin - *Wolfe Research - Analyst*

Hey, guys. Thanks for taking my questions. I had two, and it goes to the Valeant deal that was signed.

Some of your PBM partners have been on the record saying that they thought the deal was kind of the opposite of what you guys portrayed; it increased costs to the system. So I want to ask you why you think their point of view is so different.

Then the second question is, as you look at these partnerships, is Valeant the -- obviously you thought it was the right partner. I'm trying to -- I guess I would ask why.

And then I had a follow-up question on something else.

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

Yes, hi. This is Alex here, Scott. We are determined to implement this well, and we're determined to be very transparent about what the real costs are as a result of this partnership. As I think we said in our statement that we have employed (inaudible) team to independently review this.

So we are working very closely not just with Valeant but with our PBM partners to understand their concerns, and we will take care of these concerns. We're not looking to disrupt the system and terms of what they are trying to do to lower costs. We're trying to take costs out of the system which will help them to lower costs for their payers. That's our intention.

Of course when you introduce something new to the market and some new thoughts, there's always people who maybe think differently about it. But we are determined to implement this well and make it work.

In terms of why Valeant, well, because of the fact that they came to us and they asked us: would we be able to keep their [adama] business in particular with the situation that we're in? We did appropriate due diligence and we decided that this is a good opportunity to take some of the lessons that the team, particularly Ornella's team in Europe, had learned about the attractive pharmacy model in wholesale.

So we saw the opportunity to lift and shift our best practice in Europe into Valeant. And they liked the idea, and they walked through it pretty quickly and got to a good place in that pretty short period of time.

They are a great team to work with, and we wish Mike a very speedy recovery. The team themselves are very engaged and working with us very well, and we will do all we can to make sure that any concerns are taken care of and are independently reviewed.

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO*

And, Stefano here, don't forget that they have accepted to reduce their price, which is really, I would say, quite exceptional particularly here in the US. And they have accepted it because they have understood that a new model which should cost less should deliver benefits to the customers, to the final patients.

And this is very important. This shows that this need of new ways of working, the innovative way of working, is really understood. It's important that it's understood.

Someone has to start, and we are very happy that we'll be able, I hope, to demonstrate how this model will work in the US and how this model could reduce cost for the final customer.

Scott Mushkin - *Wolfe Research - Analyst*

Right, makes sense.

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

(multiple speakers) I know it's a big subject, but remember we are both global companies. Valeant are a global company. They are operate in many markets that we operate in. We have great infrastructure across many markets, as Stefano and George and others have explained. So we believe once we implement this well in the US there are other opportunities for us to work in a partnership with Valeant.

A 20-year deal was unusual, but it was there because we wanted to make sure that over time we generated a great platform not just here in the USA. But also they are very good quality products, to make them more available to their brands and maybe even some of their own brands possibly in the European and other markets. So this is a much broader deal than just Europe.

So to come back to why Valeant, there is a second reason: because they are a very good company with good expertise on a model which is a very, very efficient R&D model.

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

And also, as you know, we at Boots are very focused on skincare and we have many products in this area. We're a market leader in this area, and Valeant has also many products and many patents and intellectual properties in this area. And the collaboration could really improve the quality of our relevant products.

Gerald Gradwell - *Walgreens Boots Alliance, Inc. - SVP IR & Special Projects*

Okay, Brian, I think we have time for one more question.

Operator

Eric Bosshard, Cleveland Research.

Eric Bosshard - *Cleveland Research Company - Analyst*

Thank you. Two things, if I could. First of all, SG&A performance -- SG&A dollars in the US I think grew in 4Q a little more than expected and improved in 1Q. Curious of the difference between that, and how we should think of that going forward.

Then secondly, I think you said the retail margin was flat in the quarter in the US. It seemed like you had done some things to improve profitability. Curious on the color there, and how we think about that line as we move forward.

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

Before I answer the two questions I would like to attract your attention to what I have said at the very beginning of this [call]. In reality, you don't have to measure up for the quarter taking all the different elements of our Company quarter by quarter.

We have a long-term project. We are following this project independently on the quarter, and so you will see sometimes better rewards or KPIs, and these will not be always the same. You have to judge on the whole, and you see that on the whole we will continue to progress, as we have clearly demonstrated in the last four quarter.

Every quarter we progress, and it's a mix of everything we do. The gross margin is important, but at the end of the day, what is really important is the operating margin; it is the earning, the profit that we can extract from an operation.

Sometimes you have to sacrifice the gross profit because the [lower] increase in the gross profit or in the gross margin can be very expensive but to achieve a level cost or another cost. So we have always a holistic view and this, our holistic view, is extended over a long period of time and not over a quarter.

Maybe you can answer in detail. But this is the logic, the philosophy.

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

Maybe if I give a specific example in photographic, [tipping] the point that Stefano is making. In photographic we reduced substantially our operating costs by removing more expensive-to-maintain, more difficult-to-use, and requiring more people to use them, wet labs, the old labs. We removed all of that very quickly, in a period of about 18 months across all our states and replace them with a new digital technology which, in essence, reduces the gross margin actually but actually, because of the operating cost advantages of that system, drives two things.

It drives volume. We had a very strong volume right through the period, and as part of the about-flat sales that George mentioned, in holding [the November] period, that was a driver up the way of sales.

And also we have been able to offer better value to customers, and we're very pleased with the performance in that category. We have really driven a big differential.

And that's been also transported to Boots as well. Boots are using the same platform with the same effect now in the UK. So that's a great example of what we mean by operating margin.

In terms of costs going forward, we remain confident in our cost plan. We're on track (technical difficulty) people's attitude towards this has been fantastic. The teams have done a great job, and customer care scores are up because we're taking workload out.

So going forward, you should expect to see the same activities. Now how they fall quarter to quarter, as Stefano said, sometimes varies depending on a number of factors. But the strategy we're implementing is a very clear strategy, and we're very pleased with the progress.

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO*

I'll just emphasize on top of that really that we're very disciplined in the way that we look at returns, be it from capital, be it from revenue, revenue expenditure. It's really back to what we said earlier: we're very focused on creating real, real shareholder value. So that means driving out cost inefficiencies as fast as we possibly can in a way that still keeps the focus on the customer.

But equally, we're perfectly willing to invest, invest in either capital or invest in revenue expenditure, where we're confident we can get a good return; and we will always do that. It will mean therefore from time to time we will get the variations between the various categories.

The important thing is to continue to drive up our overall returns and deliver long-term, sustained shareholder value. And of course there will always be seasonal variations. It's the nature of our business.

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, President of Walgreens*

(technical difficulty) just on seasonality of sales, that point is an important one, which is (technical difficulty) substantially varying over 10% in the quarter just past. And if you look at the publicly available information, it's continued to a similar if not higher trend in the last few weeks as well. So again, seasonality is a big flex in our business, always has been, always will be.

But one year we have a benefit maybe from seasonality; one year we have less benefit from seasonality. So we feel very confident our strategy is working and we will feel very confident through the quarter, as Stefano said, we will see that coming (technical difficulty).

Gerald Gradwell - *Walgreens Boots Alliance, Inc. - SVP IR & Special Projects*

Thank you. Ladies and gentlemen, that was the last question we have time for on the call. Thank you for joining us today. Feel free to reach out to Ashish, myself, or any of the IR team if you have any further questions.

And I hope you all have a good day. Thank you very much indeed.

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

Thank you very much.

Operator

Ladies and gentlemen, this does conclude today's program and you may all disconnect. Everybody have a wonderful day.
