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WBA - Q1 2019 Walgreens Boots Alliance Inc Earnings Call

EVENT DATE/TIME: DECEMBER 20, 2018 / 1:30PM GMT

OVERVIEW:

Co. reported 1Q19 GAAP EPS of $1.18 and adjusted EPS of $1.46.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Walgreens Boots Alliance Incorporated First Quarter 2019 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference, Mr. Gerald Gradwell, Senior Vice President of Investor Relations and Special Projects. Sir, you may begin.

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

Good morning, ladies and gentlemen, and welcome to our first quarter earnings call. I'm here today with Stefano Pessina, our Executive Vice Chairman and Chief Executive Officer of Walgreens Boots Alliance; James Kehoe, our Global Chief Financial Officer; and Alex Gourlay, Co-Chief Operating Officer of Walgreens Boots Alliance and President of Walgreens.

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

Certain statements and projections of future results made in this presentation constitute forward-looking statements that are based on our current market, competitive and regulatory expectations and are subject to risks and uncertainties that could cause actual results to vary materially.

Except to the extent required by the 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 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 this call, the presentation and webcast will be archived on the website for 12 months.

I'll now hand you over to Stefano.

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

Thank you, Gerald, and hello, everyone. Today, we have as a company reported a solid set of quarterly results. Our businesses are used to working in challenging market conditions, but in some of our markets, we have experienced the most difficult trading environment that I can remember. Given this backdrop, it is a testament to the tenacity and determination of our teams that we have reported increased sales, net earnings and earnings per share.

We have continued to build on our partnerships. In the quarter, we have started some new partnerships, and we have begun testing a number of new initiatives. Alex will talk to you about this in a few minutes, but it is important to point out that these partnerships cover the all spectrum of our business in health care, beauty, convenience, retail, logistics and services.

I'm also particularly excited by our new strategic partnership with Verily, in which we will become the first choice of retail pharmacy development and commercial partner for them. Given the complete health care focus of Verily and the leading edge nature of much of the work that they're doing, this is a fantastic opportunity to bring these products and programs to a wide patient population quickly and efficiently, to the benefit of the patients and the payers at the same time.

Going forward, the agreement with Verily will see us collaborate closely on the development of new products and concepts, trialing programs among our employee base, while preparing plans for wide public commercialization. This partnership is not just designed to broaden the range and reach of our offering, but also to help us accelerate the transformation of our own businesses and to prepare our company for the future. It is a further step in our plans to accelerate digitization, with much more to follow.

Digitization of the company is a huge challenge but also a significant opportunity. We are still developing our plans, but we will connect better with the consumer, improve the operations of our stores, simplify what we do today, and our digital capabilities will make us fit for the future. And of course, we are continuing to invest in our core IT systems to improve core processes and operations. Alex will tell you more about our partnership with Verily in a few moments.

Of course, a key part of preparing for the future is establishing the right cost base, structure and infrastructure for the business, as we look to the future in an increasingly automated and digitized world.

James will tell you about the new program we are putting in place to achieve this, but first, I will ask him to take us through the quarterly results. James...

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

Thank you, Stefano, and good morning, everyone. Overall, we delivered a solid set of results in the quarter. GAAP EPS increased 45% to $1.18 per share and adjusted EPS increased 14.1% on a reported and constant currency basis. Operating cash flow in the first quarter was $460 million. This reflected seasonal working capital investments and the integration of the acquired Rite Aid stores. And we are confirming our full year guidance, with 7% to 12% growth in adjusted EPS on a constant currency basis.

Now let's look at the results in more detail. Sales increased 9.9%, including the currency headwind of 1.5%. On a constant currency basis, sales were up 11.4%, reflecting the acquisition of the Rite Aid stores and organic sales growth of 4.3%.

Adjusted operating income declined 3.3%, and there are a couple of factors playing out here. Firstly, you will recall that we guided to $150 million of incremental store and labor investments in 2019. The first quarter investment was $30 million and this reduced adjusted operating income by 165 basis points. Secondly, we had a weak quarter in the Retail Pharmacy International segment and this reduced adjusted operating income growth by 390 basis points.

Approximately half of the Retail Pharmacy International variance was due to weak U.K. market conditions, with the balance due to exceptional events that distort year-on-year comparisons.

Adjusted EPS increased 14.1% to $1.46 per share, driven by 8 percentage points from U.S. tax reform and a 4 percentage point contribution from our share repurchase program. GAAP EPS increased 45% to $1.18 per share. The prior year period included the impairment of our equity method investment in Guangzhou Pharmaceuticals and a loss from the company's equity earnings in AmerisourceBergen.

Now let's look at the performance of our divisions, starting with Retail Pharmacy USA. Sales were up 14.4%, reflecting the acquired Rite Aid stores and solid organic sales growth of 4.6%. Adjusted gross profit increased 6.1%, reflecting mid-single-digit growth in both pharmacy and retail, including the contribution from the acquired Rite Aid stores.

Adjusted SG&A spend increased 8.1%, entirely due to the acquired Rite Aid stores. Excluding Rite Aid, adjusted SG&A spend declined 2.6%, driven by continued strong cost discipline, which more than offset our previously announced investments in store wages and strategic initiatives. Adjusted SG&A was 18.2% of sales, an improvement of 100 basis points compared to the year ago quarter. On the same basis, adjusted SG&A as a percentage of sales has now improved for 22 consecutive quarters.

Adjusted operating income increased 0.1% in the quarter. As you look at the quarter, please remember that it includes $30 million of store and labor investments, which reduced profit growth by around 220 basis points. Adjusted operating margin was 5.4%, 0.7 percentage points lower than the prior year due to reimbursement pressure and the continued shift to specialty.

Now let's look at more detail at pharmacy. Total pharmacy sales increased 17.5%, mainly reflecting Rite Aid, with organic growth coming in at 7.6%. Our central specialty business grew 50% year-on-year and comp pharmacy sales increased 2.8%. The number of retail prescriptions filled on a 30-day adjusted basis, including immunizations, increased 11.4%.

We saw continued improvement in comp prescription growth. Compared to the fourth quarter of fiscal 2018, comps improved sequentially, up 2% this quarter versus 1.3% last quarter. Prescription growth benefited from the transfer of scripts from our Rite Aid stores, and this largely offset the Medicare Part D network changes. In addition, last year's comps benefited from a 60 basis point impact from hurricanes.

This led to first quarter market share of 22.4%, up approximately 180 basis points compared to last year.

Pharmacy gross profit increased mid-single digit versus prior year. The pharmacy gross margin evolution reflected the continued shift to specialty, which accounted for around 180 basis points and reimbursement pressure. These factors were partially offset by procurement savings.

Finally, we will begin to lap the margin dilutive FEP specialty contract in January 2019.

Turning next to our retail business. Retail sales increased 6%, reflecting the sales contribution from the acquired Rite Aid stores. Comp retail sales declined 3.2%, impacted by 2 key factors that explain around 290 basis points. Firstly, we continued to de-emphasize select products and this impacted performance by 180 basis points, with approximately 150 basis points due to tobacco. Secondly, we were facing a tough year-ago comp number that was boosted by the impact of hurricanes and a very strong cough-cold-flu season. Together, these were approximately 110 basis points.

Retail gross profit increased mid-single digit, and excluding Rite Aid, retail gross margins expanded 60 basis points. This quarter, we have continued to expand our partnerships in health care, beauty and convenience, and Alex will talk about these later.

Turning now to Retail Pharmacy International, which, as usual, is in constant currency. Sales decreased 3.6% in a challenging U.K. market. Excluding the impact of the divestiture of our Boots Contract Manufacturing business and a change in loyalty accounting, sales decreased 2.3%.

U.K. comp pharmacy sales declined 3.5%, mainly due to temporarily higher prices in the prior year caused by shortages in certain generic drugs. Boots U.K. comp retails sales declined 2.6%. Improved market share performance was more than offset by a very weak retail environment. SG&A costs increased slightly compared to last year.

Adjusted operating income declined 34.6%. Approximately half of the decline was due to the weak U.K. market conditions and the balance was due to exceptional items and phasing, including the prior year divestment, the change in loyalty accounting and the timing of pharmacy payments. Clearly, we expect significantly improved performance in the coming quarters.

With sales being down in line with the market, we are taking steps to improve our operational performance. Overall, however, we were competitive in the quarter. We estimate that the traditional retail market declined by 5.9% in the categories in which we operate. Excluding the impact of the Toys "R" Us bankruptcy, we estimate the market declined by 3%, but we did gain market share in the quarter, and the trend is improving. We've invested in online growth and Boots U.K. online sales increased in the low teens.

Several important initiatives are underway to improve our revenue performance. In pharmacy and health care, we're developing a true omnichannel experience in stores and online. In beauty, we're continuing to develop our online and in-store offerings. We will be launching new and innovative leading beauty brands, and in the second half, we're looking to modernize the experience in our beauty halls starting with our top 25 stores.

We will align our cost base with the new market dynamics and this will be addressed as part of our global cost program.

Turning now to the Pharmaceutical Wholesale division, which we'll also discuss in constant currency. The division delivered another solid quarter, with sales up 6.6%, led by continued strong growth in emerging markets. Adjusted operating income increased 3.1%, reflecting higher sales and a higher contribution from AmerisourceBergen.

Turning next to cash flow. Operating cash flow was $460 million. Free cash flow reflects higher seasonal working capital investments and $177 million due to the acquired Rite Aid stores. Good management of both receivables and inventories led to a further reduction in our cash conversion days. Cash capital investment was $470 million, $92 million higher than prior year, including the impact of Rite Aid store conversions.

Let's turn now to our guidance for the year. We are confirming our full year guidance and expect constant currency adjusted EPS growth of 7% to 12% in fiscal 2019. As a reminder, this guidance includes select store and labor investments of $150 million, an EPS headwind of 2%. And, share repurchases contribute around 5% to EPS growth.

While we are not providing updated guidance, we have included a currency sensitivity analysis in the appendix. As of today, currencies result in an adverse EPS impact of approximately $0.07 compared to $0.04 at the time of our original guidance announcement.

Overall, as we look forward, we expect to be back-end weighted as cost savings programs kick in, in the latter part of the year. Additionally, currency is quite volatile right now, especially in the short term.

Last quarter, I mentioned that our guidance for the full year included savings from upcoming strategic cost management programs. And we would now like to update you on our current thinking.

We've had a rigorous focus on cost reduction since WBA was set up 4 years ago. And we've made strong progress. The first phase delivered significant synergies from the merger. For example, by combining head offices and creating our generic purchasing office. The second phase focused more on operational efficiency in supply chain and in our store operations. In addition, we boosted our retail margins through aggressive promotional effectiveness and SKU rationalization. And in the third phase, leveraging our investment in systems and processes and recognizing the change in customer behavior, we aimed to simplify our operations and reduce the cost of running the business. While we've made solid progress, we're only halfway through the systems investments and there is still a lot more to be done.

And finally, we do have a good track record of controlling SG&A. As I've just mentioned, in our Retail Pharmacy USA division, we have now reduced adjusted SG&A as a percentage of sales versus the year-ago quarter for 22 consecutive quarters.

We are now launching a new phase of transformational cost management. This program will allow us to counteract margin pressure, create a lean operating model and fuel the investments to make WBA agile and fit for the future.

Encouragingly, we see significant opportunities over a multiyear period.

The program is multifaceted. Firstly, we will continue to optimize performance within each division. Secondly, we're launching new global programs to implement smart spending and smart organization. And finally, we're embarking on a digital transformation across the company. The program starts now and scales up over time.

We're moving quickly to optimize divisional performance. We're already restructuring our retail businesses in Chile and Mexico to address low margins in both markets. The pace has been impressive, with the programs largely executed in less than 3 months. Although the cost savings here are relatively small, it shows our agility and speed in addressing the cost structure.

And in our Pharmaceutical Wholesale division, we will improve the effectiveness of our warehouse network and commercial operations to improve profitability in select markets. We expect this part of the program to deliver savings of between $65 million and $75 million per annum. Onetime costs are expected to be between $150 million and $170 million, of which the cash component will be around 90%. The returns are attractive.

More importantly, we're undertaking a global review of our cost base and have engaged Accenture to assist in this. We have just started a global smart spending and smart organization program, and we will adopt a zero-based approach. We are starting with a 16-week assessment phase to review and validate the size of the price.

The program will build on ongoing initiatives and a strong track record, especially in the U.S. Initially, we will focus on our largest markets, the U.S. and U.K. and our global functions, followed by our other markets.

Finally, and as Stefano covered upfront, we aim to digitize the enterprise to drive enhanced capabilities and lower operating costs.

We are targeting in excess of $1 billion in annual cost savings by the end of the third year and we target attractive returns on the overall project. Expect regular updates as we work through the various initiatives.

Thank you, and I'll now hand you over to Alex.

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

Thank you, James, and hello, everyone. Before I look at the individual initiatives we have underway, I would like to remind you of the overall objective of the work we're doing in our retail businesses, most particularly, in Walgreens.

Our ambition is to enhance our customer focus to the point where we contribute positively to every aspect of our customers' lives. We cannot be all things to all people, but we aim to have something in our offering that can contribute to all the areas of a customer's daily life that are important to them and that we can provide in a convenient way.

By true convenience, I mean a combination of 3 things. The first is clearly our traditional convenience, the physical proximity to a customer. At any time in their daily lives, they're almost certainly going to be within easy reach of a Walgreens. This gives us a huge advantage. We are there when our customers need us.

The second element of convenience really builds on the first. In the world we live in today, we must create a company that can interact with our customers, however, wherever and whenever is right for them. We can't wait for them to come to our stores. We must be able to interact with them on their phone, online, via an app, which can fit on any technology platform, on their watch, or through voice technology to the speakers in their family room, kitchen or car, whatever is right for them.

I'm not talking about just having state-of-the-art website or app, it's more than that. It's about making sure that we as an organization are geared up to completely integrate the physical world with the particular and personalized interfaces they have access to and want to use.

We have a huge head start in getting this right. Our physical proximity means we already course our hand to translate the digital world into real physical action, be that in the delivery of goods or services.

Of course, the final element of convenience is a true and properly curated convenient retail offering. This means the right products at the right price, but not every product at the absolute lowest price.

The basis of our customer proposition must be the right mix of convenience, services and specialist retail. Getting this right ensures customer loyalty and underpins the strong values that our brand stands for.

You're seeing our approach to this in the partnerships we're developing. We're building under own experience and expertise in pharmacy, health care and health and beauty retailing, by bringing new brands and services to our customers through a series of partnerships with experts in their relevant fields. Working with partners who have the best-in-class expertise and offerings, we are setting new standards for delivery of goods and services in the retail pharmacy channel and in the marketplace as a whole.

Although we're in early stage in many of these initiatives, customer response so far has been positive.

Our work to develop our healthcare offer in-store is accelerating, with the deployment of further LabCorp locations at Walgreens patient service centers. It is still very early days for the trial we're doing with Humana in Kansas City of the Partners in Primary Care clinics in-store. We're starting to validate the business model and the economics of the clinics, but patient response has been very promising, and I believe there is a good chance that this may provide a template for primary care in many of our stores.

Our partnerships with Birchbox, Sprint Telecom, and most recently, Kroger, each in their different ways, show how working with experts has the potential to truly differentiate our customer offering in store.

Working with FedEx is a clear demonstration of how we can grow these partnerships beyond just a retail offering to enhance and expand on our own services. The announcement of our next day delivery service nationwide was another first in customer service from Walgreens.

Turning to international retail. Boots continues to be strongly positioned in the U.K. both as a brand and as a mass pharmacy-led health and beauty specialist.

However, we recognize the need to modernize our customer proposition and the team has started to work on this already, in particular focusing on new products, propositions and the in-store beauty experience, while personalizing and digitalizing further the whole Boots experience.

To enable these necessary changes, the team are also looking at shifting where we invest today, aligned to the company's overall cost transformation plan.

Then, of course, there is our new relationship with Verily, as their new partner to develop, pilot and bring to market products and services through pharmacy.

This partnership starts with offering the already successful OnDuo diabetes management service, which comes out of Verily's joint venture with Sanofi, to our employee base, to help them manage their health, improve their quality of life, and provide better service and support, at a lower cost.

We're also enthusiastic about kicking off a medication adherence pilot project that will explore new data and device technologies. Adherence is arguably one of the most costly real-world barriers to improving patient outcomes.

These are just the first of a number of initiatives in the pipeline with Verily in the management of chronic conditions. We also hope to look at opportunities in disease state monitoring.

It is exciting to have the opportunity to be a part of the innovative development work that Verily is doing, and in the future has the potential to be a strong and important partnership for both companies.

I'm also pleased to say that we've expanded our relationship with Alibaba, by beginning to roll out the ability to use Alipay in our stores in the U.S. We have already enabled the system in 25 stores and plan to offer payment by Alipay in at least 3,500 stores in the USA by the end of February.

This has particular significance for our valuable Chinese customer population, who can now not only buy our products via our dedicated store in Alibaba's Tmall in Asia, but will now be able to shop in the U.S. using Alipay as it with their home.

The Alipay system not only processes payments internationally, but identifies places for customers where it is accepted, and allows target promotions via the platform, enabling us to market directly to these customers in a highly focused and personalized way.

So you can see, overall, we are following a theme. All that we are doing fits into an overall plan, in developing our offering and our structure to offer materially enhanced, focused, and over time, more personalized and bespoke service to each and every one of our customers.

And of course, as we increasingly use technology to achieve our overarching aims, we're generating a wealth of data and understanding that will allow us to become even better at how we deliver all these things to our customers, and more efficient company over time..

The use of data is another area where we're working quickly to transform and enhance our company. As Stefano has mentioned in the past, this is another opportunity where we're actively looking at how partnership can accelerate our work.

So that is the latest updates on our retail transformation. I'll now hand you back to Stefano.

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

Thank you, Alex. So you have heard how we are looking to the future and actively building the capabilities, partnerships and perhaps the most importantly, a mindset that we will be the springboard for the future growth of our company.

Of course, what we are doing here is a continuation of the process of change that we have been pursuing for some time. But as the pace of change accelerates in our markets, it is important for us to increase our own pace of change. We must remain architects of our own destiny, rather than have our future defined by others.

Our markets are changing around the world.

While the drivers that are fueling this are different in retail and pharmacy, the importance of transforming our businesses to address these changing markets is equally key to both areas.

The initiatives that we have spoken about today have already begun to impact the businesses, improving efficiency, reducing costs and reshaping our company to better support our future growth.

As Alex has said, our future builds on our strength, our physical reach and our health care focus. These are the foundations of our relationship with our customers, the patients, the payers and the healthcare providers.

Today, you have heard how we plan to bridge the transition to the future, while maintaining our economic growth by reducing our costs and deploying technology more creatively in our business, and doing these in an efficient and effective way.

We believe the transformation program that we have announced today has the capacity to counter the trading pressures we are facing in a number of our markets.

It will support our growth until the work we are doing to change and update our offering and engage new income streams in healthcare has matured enough to compensate for the inevitable pressure of reimbursement in pharmacy and until our work to differentiate our consumer offering delivers growth in retail.

So, all in all, this was a quarter of progress within the company and solid financial performance overall.

This, I believe, sets the tone for the year as a whole as we work to deliver on the initiatives we have underway.

As ever, we have a lot of work to do and there are many moving parts, both in our markets and in our company, but I remain confident that we have available to us all we need to deliver for our customers and investors, and to do what is needed to ensure the future of this company as a strong, healthy and prosperous business, improving the lives and well-being of the communities we serve for many years to come.

Thank you. Now we will take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from George Hill with RBC.

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

I guess, James, my first question for you would be on the billion-dollar cost savings program that you guys have outlined., I guess, can you talk about expected costs to deliver the program, maybe sources of the synergies by region? And how much do you think flows to the bottom line versus gets reinvested in the business?

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

It's James here. Yes, so at this stage, we're announcing the intention on the program and some parts of it are confidential. So what we've given you is the key first step and we've shown you the metrics of some of the initial downsizing in both the Mexico, Chile and in Pharmaceutical Wholesale. So we have a pretty good grasp on this part of it. We've quantified the onetime costs relating to that and we took a charge in Q3 of $30 million and we've actually completed the actions in Chile and Mexico. I don't want to give the exact number, but we have an internal rate of return on this combined program just as the initial part of it of 40% to 50%. So the returns are highly attractive and our decisions are extremely DCF driven. The second big part is, what we call, smart spending and smart organization. And we've engaged Accenture to assist, and they've a certain tool set, which is zero-based budgeting. And we have estimates -- initial estimates from them as to the potential size of price that's possible. What we haven't estimated yet is the magnitude of the cost to implement. And what I would say and is -- rather than you extrapolate the first part of the program, the first part of the program includes some warehouse consolidations. It includes exiting some stores which are more expensive. When you do zero-based budgeting and you reduce travel cost or consulting cost, the cost to implement is 0 and the savings come very, very quickly. As you move into organizational aspects, the costs increase, and you could plan on anywhere between 6 months and 1 year of severance, but we have no estimate yet as to how much would come from people cost as opposed to non-people cost. What we have is large comfort around the $1 billion that we've put in place and our job is actually to beat it. So what will happen going forward, we started the 16-week assessment. At the end of that

16 weeks, we will have enormous transparency and granularity. We will know who spends what on what, down to the lowest level on who spends on travel and consulting, and we will start rolling out savings programs immediately after the 16 weeks. What we will do after the 16, we'll confirm the size of price that we intend to target. So that's is number two. The last step is digitization of the company. That's more complex. It involves engaging partners to help in the journey. One example this morning was Verily. It's one piece of the puzzle. There are other pieces that will come together reasonably quickly. It involves fixing core systems, transporting our technology from today's technology to new technologies. The estimates on that are tough to call. We have large ambitions related to this that are not included in the $1 billion per se because they're tough to quantify. So I guess, in summary, we're extremely comfortable on $1 billion over 3 years, and that's an annual cost saving number. And we expect to hit it by the end of the third year. We expect to come back to you, I'll call it, 4 to 6 months, with detailed onetime costs on implementation. And then, don't extrapolate the first piece of the program in terms of onetime costs. Some of the savings -- and typically, I have done 2 of these programs before. Typically, out of $1 billion, at least 70% comes from non-people costs. And the cost to implement travel and consulting are 0, but if you start looking up the placement of your offices and moving offices, then it becomes more expensive. So it all depends on the actions the leadership team intend to take, and those actions we'll determine in the next 4 to 6 months.

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

Okay. And if I might have a quick follow-up for Alex. I guess, Alex, I know the Humana partnership in Kansas City is early. But I guess, can tell us anything you've learned thus far about how it's progressing? And maybe the economics for Walgreens and kind of what the Blue Sky case for that partnership looks like?

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

This is Alex. I mean, the key thing is, reaction of the customers or the patients to having a primary care center focus on seniors in a pharmacy. So the convenience factor is obvious and is really coming through. We've connected the pharmacists more and more to the health care professionals through just a physical location. So the end-to-end care for individual patients are really clear, particularly in Medicare Advantage. And the atmosphere has become more of a health care atmosphere than a convenience atmosphere as well. So these are just anecdotal, but we're really pleased with how this is going and the relationship between the companies that are very positive in terms of that location. In terms of, as we look forward, we think that across the USA, we will be able to do a number of these locations as a hub-and-spoke idea. And we have a number of really great properties, which are in corners of America, which would have the population that -- the population supports our pharmacy, but not necessarily a strong front end as the world has changed. So we think that one of the obvious things we can do here is to utilize the space better, like I mean between more of the health care hub and destination. So far so good. Really, really early days, but encouraging from the point of view of engaging customers, particularly seniors in their health care needs.

Operator

And our next question comes from Steven Valiquette with Barclays.

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

So last quarter, you talked about at least 3.5% core operating profit growth within the overall EPS growth guidance of plus 7% to plus 12%. I guess, I'm just curious, given the minus 4% profit decline just towards the end of the fiscal first quarter, it can be assumed you could still hit the low end of that target for the full year. And also, can you just confirm, maybe in terms of percentage points or some other variable, just how much savings may be recognized in fiscal '19 from this new cost-cutting program within the guidance?

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

Okay. I'll answer another question as well, which is, how do we think about the strategic cost management or transformational cost management. One is, we see it as a multiyear program that consistently will help us to offset reimbursement pressure in the market. It's been the concern out there, which is how much more SG&A can you reduce in the business to help offset gross margin changes. So we see it as enabling our long-term targets, not incremental to the long-term targets, and the program gives us increasing confidence in our ability to deliver consistent EPS growth over multiyear periods. So getting back to the first quarter, we're not giving guidance. We're not changing our guidance on the full year. So we remain comfortable with the guidance range we would -- we gave out at the beginning of the year. And as the -- after 1 quarter, it's far too early to call. But let me try and dissect the first quarter because it is fair and our operating income was down. EPS was up 14%, and there were 2 key drivers. One is, tax reform generated a favorability of 8%. So we were boosted by taxes. Our massive cash generation allowed us to redeploy and repurchase shares and that generated 4%. But as you look at the operating income of 3%, there's 2 big factors in there. One is, we're reinvesting in the U.S. business. And I did call out that cost approximately 165 basis points on the total corporation. The other one is, we did have a couple of unusual events that we did historically in the RPI segment. And these are things like we sold a Boots Contract Manufacturing business, and with the benefit of hindsight, we should have restated our adjusted results. We changed loyalty accounting in the U.K. in line with USCC guidance. And with the benefit of hindsight, we should have restated. Those 2 items alone account for almost 200 basis points. So we kind of have these 200 basis points plus another 165. So all of the decline on operating income is due to these items. Now that's not an excuse, right? But we're less perturbed by the 3% in the quarter because we're cycling through some tough distortions. As you look forward, we think the plan will be, as I said in my comments, will be somewhat back-end loaded. And what I'd suggest you to do is go look at the evolution of operating income by quarter in the prior year. In our last year, we had a very strong first half and a somewhat weaker second half. So we feel more comfortable in the second half because we're going to be lapping quite low operating income growth in the second half. And actually, quarter 1 and quarter 2, we delivered average operating income growth last year of 5%. So we're lapping some fairly high numbers in the prior year period. So all I'm saying is, this is how you should maybe think about it first half, second half, and we have an easier comparison when we get into the second half of the year. But in terms of guidance, we're just confirming we didn't do a replan on the basis of quarter 1. We feel comfortable, we understand the quarter 1 progression, and we have some distorting items year-on-year that make the quarter messy to present, but it doesn't push us off track on any of our goals. So thanks.

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

Stefano here. And I remind you that we have never missed the guidance.

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

It is pretty impressive.

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

When we do a guidance, we think very carefully about it.

Operator

And our next question comes from Lisa Gill with JPMorgan.

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

Alex, I just wanted to go back to some of the comments around the partnership and maybe have James as well give some thoughts around the margin of these new relationships versus the traditional business. So I know -- I appreciate your comments, it's going to take time. I appreciate that. We think about Humana. We think about LabCorp and some of the others. But when I think about how to model this out several years from now, will the margins from these relationships be equal to what we have in the traditional business, better than or will it be a hindrance to the margins we see today?

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

I think the way to think about it is that we've been reducing and cutting in the main unprofitable SKUs and reducing less profitable cash trees. That's what we've been doing for the last 3 or 4 years. As James said in his prepared remarks, higher sales, so we've been already clearing the space really to introduce the new offers. So, of course, we have tight IRR and investment guidance and we always have had those and will have. So I think it is fair to assume, as we start to scale and roll these initiatives, they will be accretive to the overall profitability of the books, otherwise we wouldn't do it, to be honest. The second thing I would think about is the whole footfall driver. In my prepared remarks, I spoke a lot about the proximity to customers, and customers more and more are loving small boxes, easier-to-navigate parking lots and driving just more convenience in their lives. And we're really focusing in on how do we drive more customers, not just through mobile technology, but also into very convenient locations to go about their daily lives. It's probably the best example because the most mature example is FedEx, where the growth we're now seeing through the whole Walgreens platform, which is now virtually in every Walgreens, including the Rite Aid stores we have just purchased, including Puerto Rico. The growth there is substantial in terms of number of people coming to pick up their parcels and drop off their parcels. That's one example which is now more material. So again, I wouldn't discount the impact of footfall and heal on the core health and beauty cash trees going forward as well. So this is real transformation of the drug store model. It's early stages, but we continue to be encouraged that when you put the right products with the right expertise behind it and good value, our convenience is a natural advantage for us in the marketplace.

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

And you will see. Look at Verily, Verily is a fantastic company, as you know, because they're very innovative, they're investing a lot in new solutions. And at a certain point, they have felt the need of the opportunity to have a better link with people to really dialogue with the real patients, the physical patients. And so, naturally, they've thought of us because we have this attitude that (inaudible) and to use the fantastic footprint that we have to help other people to develop their idea to sell their products. And if we can become, if we want a hub for health care, particularly, in future, this would be a point of reference for the industry. And this is what we try to do. And of course, you can imagine that if we will be able to be even more a point of reference than we are today, of course, our future will be quite good.

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

As you think about this and you think about this transformation, what's the time line of the transformation? Is this 3 years? Is this 5 years? Is this 10 years? How do we think about it from an investor perspective?

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

It will take years. Let's say years. Whether this will be 3 or 5 is difficult to say because many of this take a lot of time to come to real fruition, and we have also to understand and to analyze, and of course, the fact that we are doing an incredible effort to digitize the company there and to use the digitalization for not only improving the efficiency of the company, but also to offer many, many more services to our customers. So we make all these processes simpler and we'll accelerate this process.

Operator

Our next question comes from Ross Muken with Evercore.

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

This is Elizabeth in for Ross. I was wondering if you could unpack a little bit more the sources of the same-store prescription growth in the U.S.

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

This is Alex here. Yes, I think, as we said in previous earnings updates, (inaudible) DCs in last year starting Jan 1, 2018. It wasn't as we'd hoped for. We went from preferred to nonpreferred specifically in the Aetna book of business. That was worth quite a chunk of scripts and market share. We uninvested that 1/1/19 and we obviously will be through that phase. In addition to that, we've been able to continue to see great partnership with UnitedHealth in Med D, and again, I think lastly, it's been good for 1/1/19, has been a good contributor to '18 as well. And on top of that, of course, we are working in a more preferred relationship with Cigna for the first time on 1/1/19 as well. So on the fastest-growing book of business, Med D, I think, we're going to be in a better shape than we were this year and probably growing in the market, which is, of course, what we intend to do if not of the market. And other areas of partnership with Prime goes from strength to strength in the commercial book of business. And of course, that's another important market for us. And so we're feeling pretty good about next year relative to this year. You've seen the trend has improved, with some good operational initiatives in terms of adherence and initiatives along with generic switching and 90-day programs as well. All of these have worked well. And of course, on top of that, we've been very pleased with the retention of prescriptions in the acquired Rite Aid books of business as well. So overall, we think we're going to have a solid year in '19, and feel good about, particularly compared to Med D in '18.

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

Perfect. That's helpful. And one quick follow-up and more of a housekeeping question. What is your overall U.S. same-store sales to total non-pharmacy or front end for the quarter?

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

It was -- I think it was -- it was all sales.

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

Because I noticed you gave an organic number, but it didn't seem like that was a same-store sales equivalent anymore?

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

Yes, the 4.6% organic has 2 components. We got the overall same-store, which I believe is around 1%, and then you got the specialty business. The specialty business is growing at 50%. So as you look at the numbers, the organic is boosted by specialty. You've got really solid pharmacy gains that we're growing 2% versus -- which is sequentially much better than the quarter 4 performance. So actually quarter 4 was up 1.3%, but it was boosted by hurricanes. You take that out 60 basis points, there is quite a significant step up in performance versus Q4.

Operator

And our next question comes from David Larsen with Leerink.

David M. Larsen - *Leerink Partners LLC, Research Division - MD, Healthcare Information Technology and Distribution*

Can you talk about results in the Retail International division? Operating income was behind our expectations. How long will the reimbursement rate pressure last over in the U.K.? And what are you doing to offset that?

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

This is Alex here. So I think the reimbursement pressure in the U.K. has been consistent for years, I had experience there and this is no exception. I think the thing that's different a little bit is the -- for the first time we've seen prescription items actually flat to slightly down in the marketplace. I think government has also been working to take items off the national formulary that used to be on it and asking customers to pay for it over-the-counter. So I think that's probably the one change I have seen in the last period, which again contracts volume. But the thing to remember on the positive side, there is a global sum in the U.K. (inaudible) business. And on top of that, the global sum is shared among stores with a registered pharmacy. So, therefore, overall, we can manage to quite a straightforward formula, which is that we know that we're going to have to become more efficient year-after-year-after-year, and it's a pretty steady track going forward. The big issue in the Retail International business at this time is really the performance directly of our retail business, and as I think James described very well in prepared remarks, the half that issue was driven by market conditions. As James said, we actually are getting more comfortable with our performance in terms of market share, and we believe in the major market, we grew market share in the quarter. But obviously, the market is very down. The other half of the issues in Retail International business in the U.K. was driven by one-offs, and James described them really well. We have that payment changes from the NHS payments. It's actually a timing issue. We had a change in loyalty. We came from loyalty which was unofficial change that we followed. And thirdly, we had the sale of BCM. So again, I think Boots Contract Manufacturing, all of these are the other side...

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

Just to emphasize, I want to be clear on pharmacy, year-on-year in pharmacy is entirely due to generic drugs shortages in the prior year that artificially boosted the prior year. We're not losing share. And actually, we have no reimbursement pressure because the U.K. government has confirmed year-on-year funding across the broad industry. And then if you go to the retail business in the U.K., we gained share in all 4 categories. Now the problem is, the category declines accelerated in Q4, and that's something we're watching closely. It's been a very weak season in the last few months and you can read it in all the headlines in the U.K. But I want to emphasize our share is quite strong in the U.K.

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

And also in terms of actions, James mentioned the cost program, which is going to be important. And secondly, we're really reimagining our beauty offer. We have new products and new brands coming in, in the future that we signed up. And of course, as Stefano has mentioned and James mentioned, the digitalization, it's a big opportunity as well.

Operator

And our next question comes from Michael Cherny with Bank of America Merrill Lynch.

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

Just to kind of wrap up a lot of the thematic questions you've been asked today, particularly around the partnership model, as you think, about all the various ones and the various different stages they're in and, Stefano, I know you said you think 3 to 5 years is your kind of intermediate time line for the store transitioning. At what point do we start to see that incremental contribution from the financials of the partnerships? I'm not just talking about people coming into the store, but any specific fees, any specific revenues that you're generating specifically from some of these partnerships start to manifest itself? And are there any at this point that are big enough in order to really move the needle on your operating profit?

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

Well, they will start to contribute when we will be able to hold them over in quantities. Of course, if we have 15 stores or 20 stores, there will not -- the contribution is there, but it's really small. When we will have thousands of stores, then we will start to see the contribution. For instance, for FedEx, we have a contribution, which is -- of course, it's not billions, but it's significant. And these will be the case for all the partnership that we will be able to allow once we will be convinced that these partnerships are profitable. And this is why it takes some time for us to test a partnership, but we are not rushing. We prefer to wait, but to be sure that the partnership is profitable because we have to invest certain capital to expand those partnership to many, many stores and they usually turn on our capital. So at the end, all those partnerships will have a significant contribution to what we do direct and not just indirect, as Alex was saying, that, of course, it will be also important, but direct contribution.

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

And just one quick clarification, if you don't mind. Regarding the second half weighting, James, is that referring specifically to EBIT performance, EPS performance, or both?

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

It primarily relates to adjusted operating income. I think that's the best measure of the challenge in lapping the numbers. So first half, second half, you could look at it by quarter. But also, Q1 and Q2 EPS on an average basis was higher than the second half EPS, but it's a more market comparison when you actually look at the adjusted operating income.

Operator

And our last question comes from Erin Wright with Crédit Suisse.

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

Can you give us an update on the MedExpress relationship with United and Urgent Care? Is that a relationship progressing according to plan? And is that something you expect to -- or plan to continue going forward?

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

It's Alex here. Yes, we're testing in the ground and as I said the last time, so we're waiting to see exactly how it performs. That was always a plan with Optum and United Health, sorry, was to do that. And they're performing roughly as we'd expected in terms of what we're seeing. But we never -- we have not made any more decisions of expansion or doing things differently at this stage.

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

Okay. Great. And then can you share your thoughts on commentary out of Washington as well as some of the other commentary from pharmaceutical manufacturers related to branded price inflation trends and your exposure overall to that metric? How that impacts margins and profit dollars?

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

Yes, sure. I mean, I think the market numbers are quite clear. The level of branded inflation has reduced over the last period, and that's continued. And also, we think that will -- that seems to continue into future as the political pressure and the consumer pressure to go on plays out. With genetics, again, we're seeing less deflation, but there is still a deflation in the marketplace. So clearly, both these together adds a little bit to reimbursement pressure, but it's something that we're used to and it's something that we plan for in our guidance.

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

You have to remember that in the end, we have -- our job is to distribute -- to deliver prescription and to distribute drugs. So at the end, we're remunerated for these kind of job and even if prices will go down, we will have in any case a level of remuneration for what we do. So over time, the market -- whatever the price is, the market will level and will remunerate us for the work that we do for our job. It's -- I don't say that we are independent on the price of the drugs, but we are less dependent than other players.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program and you may all disconnect. Everyone, have a wonderful day.