OVERVIEW:
Company Summary
CORPORATE PARTICIPANTS

Manmohan Mahajan  Walgreens Boots Alliance, Inc. - Executive VP & Global CFO
Mary Langowski  Walgreens Boots Alliance, Inc. - Executive VP & President of U.S Healthcare
Rick Gates  Walgreens Boots Alliance, Inc. - Senior VP & Chief Pharmacy Officer of Walgreen Co.
Timothy C. Wentworth  Walgreens Boots Alliance, Inc. - CEO & Director
Tracey D. Brown  Walgreens Boots Alliance, Inc. - Executive VP, President of Walgreens Retail & Chief Customer Officer
Chris Deyo  Walgreens Boots Alliance, Inc. - Group VP of Financial Planning and Analysis

CONFERENCE CALL PARTICIPANTS

Charles Rhyee  TD Cowen, Research Division - MD & Senior Research Analyst
Eric R. Percher  Nephron Research LLC - Partner & Research Analyst
George Robert Hill  Deutsche Bank AG, Research Division - MD & Equity Research Analyst
Kevin Caliendo  UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare IT and Distribution
Lisa Christine Gill  JPMorgan Chase & Co, Research Division - Analyst
Michael Aaron Cherny  Leerink Partners LLC, Research Division - Senior MD

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Walgreens Boots Alliance Second Quarter 2024 Earnings Conference Call. (Operator Instructions) Please be advised today’s conference is being recorded.

I would now like to hand the conference over to your speaker today, [Chris Deyo], Group Vice President, Finance Planning and Analysis. Please go ahead.

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Chris Deyo  Walgreens Boots Alliance, Inc. - Group VP of Financial Planning and Analysis

Good morning. Thank you for joining us for the Walgreens Boots Alliance Earnings Call for the Second Quarter of Fiscal 2024. I’m Chris Deyo, Group Vice President of Financial Planning and Analysis, filling in for Tiffany.

Joining me on today call are Tim Wentworth, our Chief Executive Officer; Mary Langowski, President of U.S. Healthcare; and Manmohan Mahajan, Global Chief Financial Officer. In addition, Rick Gates, Senior Vice President and Walgreens Chief Pharmacy Officer; and Tracey Brown, President of Walgreens Retail and Chief Customer Officer, will participate in Q&A.

As always, during the conference call, we anticipate making projections and forward-looking statements based on our current expectations. Our actual results could differ materially due to a number of factors, including those listed on Slide 2 and those outlined in our latest Form 10-K filed with the Securities and Exchange Commission.

We undertake no obligation to publicly update any forward-looking statements after this presentation, whether as a result of new information, future events, changes in assumptions or otherwise. You can find our press release and the slides referenced on this call in the Investors section of the Walgreens Boots Alliance website.
During this call, we will discuss certain non-GAAP financial measures. These measures are reconciled to the most directly comparable GAAP financial measures, and the reconciliations are set forth in the press release. You may also refer to the slides posted to the Investors section of our website for reconciliations of non-GAAP measures to the most comparable GAAP measures discussed during this earnings call. We encourage you to review the comparable GAAP measures and reconciliation to non-GAAP values in the other earnings materials we provided.

I will now turn the call over to Tim.

Timothy C. Wentworth - Walgreens Boots Alliance, Inc. - CEO & Director

Thanks, Chris, and good morning, everyone. WBA's second quarter operational results were in line with our expectations despite continued challenges in the U.S. retail environment. Adjusted EPS of $1.20 reflects good execution and cost discipline in our U.S. Retail Pharmacy segment, continued strong performance in International, our first quarter of positive adjusted EBITDA in U.S. Healthcare and positive impacts from tax planning benefits.

During the quarter, we recognized a $5.8 billion after-tax noncash goodwill impairment charge, net of noncontrolling interest, related to our investment in VillageMD. This charge is excluded from any of our adjusted non-GAAP earnings measures. We are narrowing full year adjusted EPS guidance to a range of $3.20 to $3.35. This guidance reflects a challenging retail environment in the U.S. and our decisions to both wind down the sale-leaseback program and to sell additional shares of Cencora in a further effort to simplify our financial reporting.

We expect these impacts to be partially offset by execution in Pharmacy Services and tax favorability. We have recently solidified our leadership team, which I believe has the capabilities and commitment to best lead WBA into its future.

Once again, I'm excited to welcome our newest WBA leaders who were announced this quarter: Elizabeth Burger as Chief Human Resources Officer; Lanesha Minnix as Chief Legal Officer; and Mary Langowski as President of U.S. Healthcare. They join Manmohan Mahajan, who was confirmed as our Chief Financial Officer; and Beth Leonard, who was named our Chief Corporate Affairs Officer in rounding out our Executive Committee.

Together, our executive committee is comprised of individuals that bring an established track record of operational excellence and are all based together in Chicago, working to drive collaboration and acting with urgency to drive results. Over the next 3 months, we will continue the intense review of our portfolio of assets in an effort to ensure that each contributes to the growth we aspire to deliver and drives our go-forward strategy to be the leading retail pharmacy and health services partner that creates deep relationships and trust.

Let me share further detail on the progress happening across our businesses to date. In our U.S. Retail Pharmacy business, we are navigating a challenging backdrop and exploring innovative pathways to boost profitability and growth. Within retail, our U.S. customer is confronting considerable pressure from multiyear inflationary trends and depleted household savings with U.S. household debt at record levels and delinquency rates on the rise.

Our shopper is making deliberate choices to seek value resulting in channel shifting behavior. We're responding to these market dynamics by making investments in key value items and focusing our capabilities to engage with customers in an intelligent, targeted way. Additionally, we have implemented initiatives to improve front-end performance.

We are leaning into the massive and timely opportunity to increase own brand penetration now standing at 17.1%, up 95 basis points year-over-year. We expect that we can further expand with a meaningful margin advantage over national brands. We plan to deepen our partnership with a reduced set of national suppliers, carefully selecting who we work with alongside our own brands.

Operationally, we're intensely focused on the customer experience and meeting customers where, when and how they want to shop. That means enhancing the experience not only in-store but ordering online for pickup in-store and also same-day delivery, where over 80% of orders are received in less than an hour.
Additionally, we are empowering our store managers and field leaders to share in our company's anticipated growth and increase their ability to impact areas that matter most to their stores and their customers. To do this, we are realigning incentives in an effort to place much greater weight on individual store performance.

Moving to Pharmacy. We delivered another quarter of strong execution with outperformance in pharmacy services led by our vaccines portfolio. While market growth was slower than originally anticipated, we maintained market share. Our 11 micro fulfillment centers currently support 4,600 stores, which is over half our footprint. Earlier this year, we talked about pausing the rollout of additional micro-fulfillment centers as we work to optimize the model that gives our pharmacists and technicians the ability to spend more time on customer-facing activities and less time on core dispensing.

We’re seeing benefits such as improved NPS scores, patient retention and adherence. Not only is this better for the patient, it improves team member retention and talent acquisition as they perform more of the clinical activities that they are so well trained to do. We are focused on creating an environment that makes us the practice setting of choice for pharmacists.

In fact, earlier this month, we kicked off our first Dean’s Advisory Council meeting with the mission of reenergizing and evolving the definition of community pharmacy as demand for pharmacy services increases while the industry faces a pronounced labor shortage. We are on a mission to achieve provider status for our pharmacists given their influence which was so clearly highlighted during the pandemic.

This would allow them to be reimbursed for providing select health care services to patients. These are highly trained clinical professionals just 5 miles or less for most Americans, whose scope of practice goes well beyond dispensing medications and includes immunizations, patient counseling and point-of-care testing for infectious diseases.

As an example of what is ultimately possible, in the U.K., the NHS Pharmacy First Service, which launched on January 31, expands the role of Boots pharmacists throughout England to advise and prescribe for the treatment of 7 common health conditions. This model serves as a use case of new ways to fully deploy pharmacists’ capabilities to lighten the burden on the broader health care system.

Speaking of value, there is real opportunity for change and transparency in reimbursement models to help slow the inflationary pressures on drug prices and our patient’s wallets. We already operate in the number of cost-plus and other alternative reimbursement models very successfully and welcome any model that reimburses us for the unmatched value we provide patients.

We are having more active and constructive conversations with PBMs and other payers around cost-plus models. Many of these discussions are still in early stages, but they share a general theme. There is value to all from a transparent, predictable model where what patients pay at the counter is rationally tied to the cost of the drug. We don’t expect an industry shift to happen overnight as there are a number of dynamics that need to be worked out, but it’s especially encouraging to see PBMs and payers open to these models.

Now turning to U.S. Healthcare. We have reached an important milestone delivering our first ever quarter of positive adjusted EBITDA and another quarter of significant year-on-year growth. Shields continues to deliver strong top and bottom line performance as their differentiated model is driving significant value for health system partners, which has resulted in several recent long-term extensions. VillageMD’s actions to accelerate profitability, including recent rightsizing of their cost structure, optimizing their clinic footprint and growing patient panels, are driving improvement in adjusted EBITDA.

Full-risk lives grew by 19% year-on-year in the second quarter. As Village prioritizes density in their highest opportunity markets, they decided in January to exit a total of approximately 160 clinics inclusive of the 60 that had been previously communicated. As of today, they have already exited 140 locations. Manmohan will discuss in more detail our recent reevaluation of our investment in VillageMD.

Shifting to International. The business once again performed well, demonstrating strong and consistent execution highlighted by meaningful retail comp growth at Boots UK and a 12th successive quarter of market share gains.
Finally, let me offer further detail on the progress of our swift actions to rightsize the WBA cost structure and increase cash flow across the company. We have a very high degree of visibility into the $1 billion in cost savings this year as actions already taken to date will account for a significant majority of the total. We’re driving savings primarily in our U.S. Retail Pharmacy segment in 3 ways: organizational initiatives, including support office workforce reductions, location optimization, and additional pharmacy and retail operating model improvements.

We are also working to improve cash flow by prioritizing projects and capital spend. In the first half, CapEx was $250 million lower than the prior year period. We are on track to deliver a $600 million reduction for the full year and $500 million in working capital benefits in fiscal 2024.

Next, I’d like to introduce Mary Langowski, to say a few words. She will then hand it over to Manmohan to review our financial results in further detail.

Mary Langowski - Walgreens Boots Alliance, Inc. - Executive VP & President of U.S Healthcare

Thank you, Tim. Good morning, everyone. I’m excited to join you all today, and I’m thrilled to be a part of this iconic company. I’ve spent 25 years in the health care, government and retail sectors. My career is focused on leading teams to unlock new areas of growth, commercialize new products and health care services and accelerate execution through financial discipline.

I’ve been fortunate to have worked with some of the most successful Fortune 50 and health care growth companies that have sought to embrace and drive change to improve the health care system. At CVS Health, I led and executed a strategy to expand health care services, leveraging the company’s core assets, including leading aspects of CVS’ acquisition of Aetna.

Most recently, I was CEO of Solera Health, a leading digital health technology company serving payers and employers, where I led a transformation of the business, launching new condition product lines, a new technology platform and a new economic model to support sustained growth.

My vantage point of working across providers, pharma, payers and retail has made one thing clear. Very few companies have the platform access and reach of Walgreens. Since the announcement, I have heard from health plans, health systems and others who see an opportunity to partner with Walgreens. They know the value of our community presence, the role our pharmacists can play and the need for higher touch, more frequent and lower-cost engagement to drive better health outcomes.

Health care is changing and consumer expectations are changing. In the face of that, we believe Walgreens is still the best position to be the most convenient entry point into the health care system. And our position as an independent partner able to work with any health plan or PBM is a true strength that we will capitalize on.

Finally, I want to congratulate the team on achieving positive adjusted EBITDA in U.S. Healthcare this quarter. It’s a significant milestone, and we will continue to build on this progress to drive value for our shareholders, customers and patients. Thanks to Tim and the Board for this opportunity.

I’ll now turn it to Manmohan.

Manmohan Mahajan - Walgreens Boots Alliance, Inc. - Executive VP & Global CFO

Thank you, Mary, and good morning, everyone. Overall, second quarter operational results were in line with our expectations. Sales grew 5.7% on a constant currency basis. U.S. Retail Pharmacy increased 4.7%, International was up 3.2% and U.S. Healthcare delivered pro forma sales growth of 14%.

Adjusted EPS of $1.20 increased year-over-year by 2.8% on a constant currency basis, reflecting improved profitability in our U.S. Healthcare segment, impact of cost savings, and a lower adjusted effective tax rate, offset by the lower U.S. retail performance and lower sale leaseback gains. The lower adjusted effective tax rate reflects the initial recognition of a deferred tax asset in certain international jurisdictions.
GAAP net loss for the second quarter included a $5.8 billion noncash impairment charge related to Village MD goodwill. During the fourth quarter of fiscal ‘23, we disclosed that our annual goodwill impairment test for our Village MD reporting unit resulted in its fair value exceeding its carrying value by a narrow margin. As a result, we have been closely monitoring the performance of the business for potential indicators of impairment.

In February, we received a downward revised longer-term forecast from Village MD management, including the impact of closing approximately 160 clinics, inclusive of the 60 previously communicated slower-than-expected trends in patient panel growth and multi-specialty productivity and recent changes in Medicare reimbursement models. These impacts were partly offset by actions taken in an attempt to rightsize the cost structure.

Given this revised forecast, we performed an interim test of VillageMD reporting unit goodwill that resulted in a fair value below its carrying value. Accordingly, we recognized a $12.4 billion noncash goodwill impairment charge prior to the attribution of loss to noncontrolling interests. On an after-tax basis and net of 47% noncontrolling interest, this resulted in a net loss of $5.8 billion in the quarter. And this charge is excluded from non-GAAP earnings measures.

The fair value of the business was determined using a combination of the income and market approaches. The impairment charge is due to the lower than previously expected longer-term financial performance expectations, challenged market multiples for Village MD’s peer group, which have continued to decline and increased discount rates.

As a reminder, our share of VillageMD’s net assets carrying value also included a $2 billion gain recognized on the equity interest owned by the company immediately prior to the acquisition of majority equity interest in Village MD during the first quarter of fiscal ‘22. This goodwill write-off is noncash, and we do not believe it will have a significant impact on our financial position or our ability to invest across businesses going forward.

During the first half of fiscal ‘24, we have seen positive financial impacts from the recent actions taken by Village MD management team to accelerate profitability. We believe the focused approach on improving performance in core markets as well as rightsize the cost structure will provide VillageMD a platform for future growth. The second quarter also included a $455 million noncash impairment charge related to certain long-lived assets in the U.S. Retail Pharmacy segment.

As part of a deep-dive exercise over the last several months, we concluded during the quarter that instead of continuing to build a new technology platform for pharmacy operations in the U.S., it would be better to modernize our existing system over time with new capabilities in an agile and capital-efficient manner with much lower disruption risk. As a result, we recognized the charge against the underlying software and development assets.

Finally, similar to last quarter, we recognized a $474 million gain on the sale of Cencora shares, partly offset by a $396 million after-tax noncash charge for fair value adjustments on variable prepaid forward derivatives related to Cencora shares.

Now let’s move on to the first half highlights. Sales increased 7.2% on a constant currency basis. Adjusted EPS declined 20.5% on a constant currency basis due to softer U.S. retail performance and lower sales leaseback gains, partly offset by improved profitability in U.S. Healthcare and a lower adjusted effective tax rate.

GAAP net loss was $6 billion compared to a loss of $3 billion in the first half of fiscal ‘23. As I explained earlier, the first half of fiscal ‘24 included certain noncash impairment charges. The prior year period included a $5.4 billion after-tax charge for opioid-related claims and lawsuits partly offset by a $1.4 billion after-tax gain on the sale of Cencora shares.

Now let me cover U.S. Retail Pharmacy segment. Note that all comparable figures are on a leap year adjusted basis for all segments. Sales grew 4.7% year-on-year driven by brand inflation in pharmacy prescription volume and a higher contribution from pharmacy services, which was partly offset by a 4.5% decline in the retail business.

AOI declined 29.5% versus the prior year quarter due to lower retail sales volume, elevated levels of shrink and lower sale leaseback gains, partially offset by continued progress on cost savings initiatives. Looking ahead, we are winding down the sale leaseback program, and we do not anticipate...
any material benefit going forward. Sale leaseback gains, net of incremental rent expense, were an approximately $125 million headwind to AOI in the quarter.

Let me now turn to U.S. pharmacy. Pharmacy comp sales increased 8.7%, mainly driven by brand inflation, volume growth and contribution from pharmacy services. Comp scripts grew 2.9%, excluding immunizations, in line with the overall prescription market. The ongoing impact of Medicaid redeterminations continued to negatively impact overall market growth.

Pharmacy Services performed better than expectations, driven by our vaccines portfolio. Pharmacy adjusted gross profit was down slightly versus the prior year quarter with margin negatively impacted by brand mix impacts and reimbursement pressure net of procurement savings.

Turning next to our U.S. Retail business. We continue to see a challenging retail environment with a shift in discretionary spend away from the drug channel as consumers seek value. Comparable retail sales declined 4.3% in the quarter.

There were 3 main drivers. First, as consumers continue to pull back on discretionary spending, we saw an impact of approximately 170 basis points from weaker sales in holiday seasonal and general merchandise categories.

Second, as expected, we saw a weaker than normal respiratory season, which directly impacted comparable sales by approximately 90 basis points.

Third-party data showed flu, cold and respiratory activity was down 6% compared to the prior year quarter. In addition, as cough, cold, flu serves as a primary trip driver, there was also an incremental impact from the lower attachment sales.

Lastly, weather conditions in January led to a headwind of approximately 40 basis points in the quarter. Retail gross margin declined year-on-year, impacted by higher shrink partly offset by benefits from category performance improvement program.

Turning next to the International segment. And as always, I will talk in constant currency numbers. The International segment again exceeded our expectations in the quarter. Total sales grew 3.2% with Boots UK increasing 3% and Germany wholesale up 5.3%. Segment adjusted gross profit increased by 3.2%. Adjusted operating income was down 32%, entirely due to lapping the real estate gains in the year ago period with underlying growth offsetting inflationary pressures.

Let's now cover Boots UK in detail. Comp pharmacy sales were up 1.7%. Comp retail sales increased 5.9% and with all categories showing growth, led by beauty and personal care. Across formats, destination health and beauty, flagship and travel locations performed particularly well. Boots.com sales increased 16.8% year-on-year and represented over 17% of our U.K. retail sales.

Turning next to U.S. Healthcare. The U.S. Healthcare segment delivered its first quarter of positive adjusted EBITDA. This was the third consecutive quarter of significant year-on-year improvement in adjusted EBITDA. Second quarter sales of $2.2 billion increased 33% compared to the prior year quarter, aided by the acquisition of Summit Health. On a pro forma basis, segment sales increased 14%. Village MD sales of $1.6 billion grew 20% on a pro forma basis. The year-on-year increase was driven by same clinic performance and growth in full-risk lives.

Shields sales were up 13% as new health system contracts and expansion of existing partnerships led to an over 40% increase in the number of patients on service in the quarter versus the prior year. Adjusted EBITDA was $17 million, an improvement of $127 million compared to last year, mainly driven by Village MD and Shields. We believe VillageMD continues to make progress to accelerate profitability by right sizing its cost structure and growing its patient panel. Shields saw robust adjusted EBITDA growth compared to the prior year period.

Turning next to cash flow. Operating cash flows in the first half of fiscal '24 was negatively impacted by roughly $700 million in payments related to legal matters, $380 million entity premium contributions related to Boots' pension plan and underlying seasonality. Capital expenditures declined by $250 million versus the first half of fiscal '23.

As a result, free cash flow was down by approximately $2 billion versus the prior year. We expect second half free cash flow improvement compared to the first half driven by several factors. First, we expect lower payments related to legal matters in the second half of fiscal '24. Second, we remain on track to reduce capital expenditure by approximately $600 million year-over-year.
Third, we expect to deliver working capital improvement of $500 million during fiscal ’24. While we did see some benefit of these initiatives during the first half of ’24, we expect the majority of these benefits will impact the second half. Lastly, similar to prior years, we believe the underlying working capital seasonality in the U.S. Retail Pharmacy and International segments will have a favorable impact on the second half of the year compared to the first half.

I will now turn to guidance. We are narrowing our fiscal ’24 adjusted EPS guidance to $3.20 to $3.35. The updated range incorporates a challenging U.S. retail environment, lower sale leaseback gains and reduced Cencora equity income, offset by the execution in pharmacy services and a lower adjusted effective tax rate.

On the tailwinds, we continue to see strong execution in our pharmacy services business, which has delivered results ahead of our initial plan to date. In addition, we now expect our adjusted effective tax rate to be under 5%.

On the headwinds, we expect the challenging retail backdrop will continue to negatively impact our U.S. retail sales in the short term. We now expect fiscal ’24 retail comp sales to be down approximately 3%. Second, with the early wind down of the sale-leaseback program, no material gains are expected in the future.

Third, the block sale of Cencora shares in February will reduce equity earnings going forward. Lastly, as discussed with the first quarter results, we forecast slightly lower market growth in U.S. pharmacy business compared to our initial guidance.

Importantly, based on the progress made in the U.S. Healthcare segment through the first half, we continue to expect segment adjusted EBITDA to be breakeven at the midpoint of the guidance range. This represents an increase of $325 million to $425 million over fiscal ’23.

Next, I will provide additional details on the factors impacting earnings in the second half. In the second half, we will be lapping adjusted EPS of $1.66 in prior year period. We expect several key factors to impact the year-over-year comparison.

First, the wind down of the sale-leaseback program is expected to be a significant headwind in the second half. Second, we will lap incentive accruals reduction in the third and fourth quarter of fiscal ’23.

Third, our updated guidance implies a higher tax rate over the remainder of the year. The U.S. Healthcare segment remains on track to achieve $165 million of year-over-year adjusted EBITDA improvement in the second half based on the midpoint of the guidance range. And finally, within our U.S. Retail Pharmacy business, we expect year-on-year improvement in the second half driven by cost savings initiatives.

With that, let me now pass it back to Tim for his closing remarks.

Timothy C. Wentworth - Walgreens Boots Alliance, Inc. - CEO & Director

To wrap up, we have hard work ahead of us in our journey to simplify and strengthen WBA, but we are encouraged by our progress. This team has a clear mandate to act with everything on the table to put our business on the right track. We are well positioned to drive capital-efficient growth rooted in our retail pharmacy footprint and build out an asset-light health services strategy to deliver care for communities and create value for partners.

We've kicked off our strategic planning work. Over the next 3 to 6 months, this team is undergoing an in-depth analysis to determine the actions necessary to achieve what we believe will be the optimal portfolio with a focus on maximizing growth potential and generating cash flow. We are reviewing every business through a longer-term lens focused on strategic fit, synergy potential, financial upside and new or complementary capabilities.

We are taking a thoughtful approach fueled by a sense of urgency to finding opportunities to unlock value or validate existing pathways. In my 5 months with WBA, I have been most impressed with our 330,000 team members’ commitment to our company. In my experience, it’s very hard to
get that. That pride is foundational to our future growth, ability to consistently execute and create sustainable long-term shareholder value. That dedication also gives me and our team great confidence in our future.

Now I would like to open the line for questions. Operator?

**QUESTIONS AND ANSWERS**

**Lisa Christine Gill - JPMorgan Chase & Co, Research Division - Analyst**

I have a multipart question. I just really want to start with your comments where you talked about boosting profit and growth. You talked about new reimbursement models. You talked about provider status. So you talked about a lot of different things that you think can come into play. Can you maybe just talk about your line of sight and timing to get there? Would be the first part.

And then secondly, I want to say welcome to Mary. Mary, as we think about the profitability and we think about capitation and the commitment of Village in the capitated markets, the comments were made today around the number of closings now, 140 locations closed. Can you maybe just talk about what you see as the future of capitation?

And then putting that all together, I just really want to understand how to think about the progression going into ’25. Tim, I know you have a big strategic review coming. I know you’re not ready to give guidance on ’25. But are there kind of some building blocks to think about when we think about the progression of the back half of ’24 going into ’25?

**Timothy C. Wentworth - Walgreens Boots Alliance, Inc. - CEO & Director**

Thanks, Lisa. A lot there. So I’ll take the first part and probably have Rick Gates add a little color. We’ll have Mary take your few questions, then Manmohan go ahead and talk about the back half of the year into ’25.

In terms of new reimbursement models, growth, et cetera, et cetera. Clearly, as we said I think last quarter, we’re now just coming into the ’25 conversations that are more structured with payers, particularly PBMs as it relates to reimbursement.

And what I would say, which is what I’ve said in my prepared remarks as well, is we are having very constructive conversations as well as ad hoc conversations with certain payers which continue to lead me to believe and our team to have confidence that there are multiple ways for us to create value for payers and that the pressures on reimbursement — that there’s a clear acknowledgment, let me say it that way, that just playing the way we’ve been playing for the last 25 years is not going to work.

And I think everyone acknowledges that in the conversation of how we help the PBMs win in their marketplaces with this drive to higher transparency, more member friendliness and so forth, really actually aligns us quite well in those conversations. I don’t know, Rick, if you want to take -- add any color to those conversations, your team is obviously very close to them.

**Rick Gates - Walgreens Boots Alliance, Inc. - Senior VP & Chief Pharmacy Officer of Walgreen Co.**

Yes. Lisa, this is Rick. And I’ll just add, we are just in earnest starting up the calendar year ’25 negotiations. But I will say you also talked about some of the expanded services. We have gotten traction not only on our adherence based programs and our performance against those to continue to get more adherence based contracts going forward. Vaccines have been a very strong part of what we’re doing.
But we’re working very closely in the selling cycle right now when it comes to testing, test and treat as we expand those opportunities across the country as well, and that’s a state-by-state really process that we’re going through until there’s a federal provider status, which Tim talked about in his remarks.

Timothy C. Wentworth - Walgreens Boots Alliance, Inc. - CEO & Director

And then -- and thanks, Rick. So bottom line, Lisa, in this area, we’re realistic. We know that the longer-term structural changes that are very likely to occur will take multiple years, and we’re prepared -- we’re also working with our distributor to reconfigure the way that we work with them to ensure that we are, again, making sure that the value that flows to us as well as through us is what it should be.

Mary, I’ll let you just briefly comment on Lisa’s second question.

Mary Langowski - Walgreens Boots Alliance, Inc. - Executive VP & President of U.S Healthcare

Thanks, Lisa. I’ll just say -- reiterate what I said in my opening remarks, that payers and health systems are approaching us and are very interested in working with Walgreens to help them drive MedEx savings. We’ve got unmatched assets in the marketplace given our reach with consumers, and that’s something that a lot of the traditional players in the health system don’t have. So we’ll be working with them and having conversations in the coming months.

Timothy C. Wentworth - Walgreens Boots Alliance, Inc. - CEO & Director

We had some of those underway. I expect them to accelerate meaningfully with Mary’s arrival. And by the way, this is an appropriate time for me to also thank John Driscoll. In my prepared remarks, I did not do that. And of course, John actually helped me find and recruit Mary. John did a lot of terrific work during his time here at WBA. I look forward to continuing to work with him in a different role as an adviser through the end of the year. So thank you to John.

And then finally, Manmohan, I’m sure Lisa is not the only one with the question as it relates to the second half. And so you take that.

Manmohan Mahajan - Walgreens Boots Alliance, Inc. - Executive VP & Global CFO

Sure, Tim. So Lisa, this is Manmohan. As you think about the building blocks for ‘25, let me start by saying, we’re not providing FY ’25 guidance on this call. As you heard in Tim’s prepared remarks, we are working through a strategic review with the executive team in place now and a detailed 3-year plan. And so we will share that input over the next 3 to 6 months.

But let me share some themes as you think about the second half and as you think about ‘25. In terms of second half, a couple of things to point out that I think are obvious and you understand. One is we do not expect any meaningful contributions from sale leaseback in the second half. And so it’s pretty clean in terms of not including any sale leaseback gains from that perspective.

And second is the lower adjusted effective tax rate, the timing of that played out for us in the second quarter. And so we do expect a much more normalized tax rate in the second half. Now as you think about bridging into ’25, a couple of things to consider.

First, U.S. Healthcare growth, you see that we’re maintaining our guidance on adjusted EBITDA which is at the midpoint of the range, $375 million increase year-over-year in fiscal ’24. And so we do see, as we look ahead into ’25, we do see growth continuing in healthcare.

Village, we expect to continue to drive growth as they focus on the core markets as well as continue on their cost actions that they are going through this year. So that’s one part. Shields obviously continues to grow throughout the year, and we do expect them to continue to grow into fiscal ’25.
Second, cost savings, the actions we have taken in the first half will have a ramp-up effect in the second half. We’re not done yet. We continue to make decisions to rightsize our cost structure here at WBA. And so we do expect a wraparound effect of that into fiscal ’25.

Third, retail business in the U.S., as I shared in my prepared remarks, we have seen headwinds persisting for longer than expected in the U.S. retail environment. And we have lowered our expectation for the second half or for the full year fiscal ’24 to a negative 3% comp.

Now within that, we do expect slight improvement over time in the second half as the actions that Tracey and the team are taking will take hold and will drive certain level of improvement. So you have to think about what that is going to be into ’25.

And then maybe the last piece on this is our business does have some seasonality. And so pharmacy services business, which has really performed strong throughout the first half, that does generate significantly higher contributions in the first half compared to the second half of the year.

Cough, cold, flu season does have both impact on our pharmacy business in the U.S. as well as on the retail business in the U.S. and the timing of that on a more normalized basis does play out more in the first half than in the second half. And lastly, just on the seasonality piece, another example is Boots, which does have higher contributions in holiday seasons in the first half. So you got to factor those. I just want to make sure you have those themes.

Operator

Our next question comes from Charles Rhyee with TD Cowen.

Charles Rhyee - TD Cowen, Research Division - MD & Senior Research Analyst

I wanted to drill down a little bit more on the retail segment, U.S. retail here. Tim, you talked about a number of things, right, trying to increase own brand, realign around a number of national brands as well. Maybe can you talk about how quickly some of those can be implemented here, particularly as you think about realigning around fewer national brands, like how long would that process take?

And then you mentioned that vaccines has been leading in the pharmacy services part of the business. Is there any way you can give us a sense on when we look at U.S. retail AOI maybe not quantitatively, but qualitatively to a sense of how you would split the contribution between, let’s say, pharma services, traditional front end and pharmacy?

Timothy C. Wentworth - Walgreens Boots Alliance, Inc. - CEO & Director

Thanks, Charles. To your second question, we’re not prepared today to break that out. Obviously, we build from that. And I think over time, we’re going to be looking to give you incremental visibility to key operating metrics that would help you model some of that out. What I can tell you is the vaccine and test and treat and so forth portfolio is very meaningful in terms of our overall back of the store reimbursements and our growth.

If you think about it, it’s actually quite amazing, 5 to 10 years ago and let’s go 10 years ago, pharma had pretty much abandoned vaccines on a large-scale basis. A lot of the companies had moved away. There was not a strong, strong incremental demand. Today, we see it as one of the key areas of innovation inside pharma companies.

And the exciting part for us that is underappreciated is that in every case, those companies look to their core ability to get to patients as being able to leverage what we do at Walgreens and what our industry does. And we have a unique position in that the conversations I have with the CEOs of major pharma companies that are driving these innovations suggest to me that, that model where we’re paid fairly for the work that we do at the back of the store is a model that the future not only needs, but it’s going to reward our shareholders.

As it relates to U.S. retail, I’ll turn it over to Tracey other than to say -- that is one of a number of key areas for us, the idea of SKU rationalization alongside of growing private label. I think you’ve got to look at both of those things, and we are moving rapidly on a lot of things.
We announced last week a change in store manager compensation for 2024. Initially, that was thought it needed until '25 to get it right, and we found a way to get it done now so that we could unleash the energy of our key field-based leadership in our stores. And so what I've seen is our ability -- and we saw it during COVID, our ability to execute quickly when we've got a goal, when we've got a clear ability to create value is something that I've actually been pleasantly surprised by since I've joined the company.

And Tracy has been leading the -- along with -- I've terrorized a few national brands myself in a few meetings lately, in terms of saying that we're looking for partners, and we aren't going to be a partner to everybody. We want somebody that is going to be everything to us rather than something for everyone.

So with that, Tracey, do you want to give a little color on the whole national brand strategy?

Tracey D. Brown - Walgreens Boots Alliance, Inc. - Executive VP, President of Walgreens Retail & Chief Customer Officer

Yes. Good morning, Charles. Yes. So as it relates to our own brand expansion, as Tim has indicated, we have been accelerating this at a rapid pace. And if you've been tracking, our own brand penetration has been growing quite nicely.

To your question around how quickly, there are some things that we can do very quickly. One of those, again, Tim mentioned around embracing and incentivizing our frontline team members to really showcase their own brand products and what is important to the consumers in their market.

The second is, in terms of store reach and shelf depth, we can move on those quite quickly. And then the third area is around new product innovation. And this is the part that actually takes a little bit longer. But just to give you a little bit of color, we launched 37 new products in Q2.

And what this means for us is as the consumers' behavior continue to focus on looking at value and finding own brand and being willing to lean into own brand, this is working out quite nicely for us. We are feeling quite good about the level of depth that we can go with own brands.

Operator

Our next question comes from Eric Percher with Nephron Research.

Eric R. Percher - Nephron Research LLC - Partner & Research Analyst

I appreciate the commentary on pharmacy services and reimbursement model. So a follow-up for Tim and Rick. It's interesting to hear you call out looking beyond payer and PBM to the manufacturers and this core ability to get to patients. I'd love to get your updated view on LillyDirect. And if the goal is to expand access, does it make sense to include retail, do you view it possible to have direct relationships given PBM contracts? Any perspective there would be appreciated.

Timothy C. Wentworth - Walgreens Boots Alliance, Inc. - CEO & Director

Sure. Thanks. I'll start and turn it over to Rick. First of all, I would prefer that Dave and the Lilly team talk about their strategy. But that being said, first of all, I'd point out we have a direct relationship with literally every American. And it may not be in their funded benefit in all cases, but they come into our stores for a lot of other things.

And so I love where we start when it comes to looking at programs where pharma companies may want to go direct to patients for a particular product where the normal supply chain reimbursement model, et cetera, isn't working effectively. I think if you look at the GLP-1s, for example, the adherence on those drugs over a reasonable periods of time is not what I believe anybody would hope for. Not the patients, not the payers to the extent that that's a paid-for product and certainly not the innovators.
And so we are uniquely positioned to be a partner. It's one thing to have a distribution partner. It's another thing to have a clinically aligned partner that can actually help a patient work their way through safely because I believe the companies that made these products also want to ensure that they retain a high safety profile. Otherwise, there will be other issues downstream, which are not what anybody would want.

So we think we are a natural partner for those things. And Rick, I'll let you add any color there, but -- from our perspective, again, our ability to work on a product basis, direct with pharma is unencumbered by any of our other relationships. Rick?

Rick Gates - Walgreens Boots Alliance, Inc. - Senior VP & Chief Pharmacy Officer of Walgreen Co.
Yes. The only thing I'd add is you said we have relationships with every consumer who walks into our store, we have a relationship with every pharma company. And I think what they see with us is that we are a natural partner. We roll up our sleeves. We help them solve what they're really trying to solve for.

And I think that's a natural place for us to fit because we are an independent provider. If you think about it that way, we don't have any other assets vertically integrated. And so I think we're a natural partner for them. And I think they see us as a willing partner to help them really drive programs in the market.

Eric R. Percher - Nephron Research LLC - Partner & Research Analyst
Was this what drove the comment on your distributor relationship profile changing?

Timothy C. Wentworth - Walgreens Boots Alliance, Inc. - CEO & Director
No, really nothing to add. I mean we've had a long-standing relationship with Cencora. I did prior in another life. And that relationship has always got to be organic and dynamic because the market changes.

And while a long-term relationship is a great context into which to operate, it's important that as well, we sit down as we do with Cencora and look at not only where is it working, but where might it work a bit better, and more importantly, over the next 3 years, where are the changes in the marketplace likely to manifest, and how do we make sure that we retain a contemporary and a competitive situation as it relates to our cost structure, as it relates to the services that we receive, as it relates to the things that we can provide as a good partner.

So all of those things are things that we throw on the table. And I look forward to working with how my team does with Bob in his new role, I congratulate Steve, who had a terrific run there and was a great partner for me over a lot of years, but again, you can't just sit still, and we're not going to.

Operator
Our next question comes from Kevin Caliendo with UBS.

Kevin Caliendo - UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare IT and Distribution
I wanted to talk about the sort of second half guidance and what it implies as we think about the headwinds and tailwinds from that base into fiscal '25. So if we take that sort of midpoint, $1.42, there's no sale leasebacks there. Presumably, tax would be a headwind? Or would it sort of be -- I guess what I'm asking like some headwinds and tailwinds from that base, whether it's tax, we understand core is probably going to be a headwind, maybe 340B?
And then the second question that I have above and beyond taking that run rate is, was there any effect from the changes in PBM reimbursement, like the timing for the retail segment because of DIR fees going away, meaning did it change the cadence at all or impact the cash flows at all?

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**Manmohan Mahajan** - Walgreens Boots Alliance, Inc. - Executive VP & Global CFO

Yes. Let me take the guidance first, and then Rick can talk about DIR a little bit more. So from a guidance perspective, as you think about the midpoint of the range you're calculating in the second half and thinking about '25, the first, on the tax rate side, we expect fairly normalized tax rate for the second half. We did have a significant benefit that we recognized in the second quarter and timing of that played out here. So that, I think, is -- there is no more headwind from taxes if that's your starting point for fiscal '25.

And then, yes, as I said, I think a couple of themes to consider. First is U.S. Healthcare growth, significant growth expected. We're maintaining guidance in fiscal '24. And as we look out, we do see growth continuing, both at Shields as well as at Village as they concentrate on their core markets and continue to drive the cost down in the business.

Our own cost savings initiatives. We've talked about $1 billion of cost savings in the year, and now we're on track to achieve that. And there are actions that we'll continue to take in the second half. And so you will see a wraparound benefit into '25 as well as the new initiatives that will continue on cost efficiency side.

I talked about retail, negative 3% comp expected for the year as we thought about the second half guidance or second half implied guidance. And so we do see, however, it improving over time slightly. And so going into '25, the actions that Tracy just talked about and team is taking, they will take hold. And I think that we do expect some improvement in '25 for that.

And then seasonality, I think you got to factor in as well. You talked about earlier in the call around vaccines portfolio. Obviously, there's seasonality there. Cold, cough, flu, there's seasonality there, and Boots there is seasonality there. So those are maybe some of the themes that you want to consider.

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**Rick Gates** - Walgreens Boots Alliance, Inc. - Senior VP & Chief Pharmacy Officer of Walgreen Co.

Yes. And just to answer on the DIR fees and the impacts that we might be seeing there, outside of, obviously, cash flow, which obviously works its way out throughout the year. We really aren't seeing a negative impact on reimbursement.

By and large, what we're seeing is that we're contracting for the rates that we were performing against either historically and/or even if there was a negative impact on reimbursement, we're signing pay-for-performance contracts that we have the ability to overperform on. So I would say that DIR fee has been really neutral to us when you look at it from a reimbursement perspective.

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**Operator**

Our next question comes from George Hill with Deutsche Bank.

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

And I kind of have a couple of what I call kind of brief quick questions. First, for Rick, I guess I would ask, when we think about potential changes to the reimbursement model, you touched on this, I guess, could you talk about the push and pull a little bit on those discussions. Manmohan, I guess I would ask just if you could make a quick comment on earnings cadence between fiscal Q3 and Q4.
And Tim, I know I’m throwing in a lot here, but just kind of an update on portfolio strategy. A lot of us look at the company and do some of the parts analysis -- there’s an argument to be made that you’re getting the core U.S. business for free, given the value of the other assets, kind of just want to know how you’re thinking about the portfolio and how you unlock value.

Timothy C. Wentworth  -  Walgreens Boots Alliance, Inc. - CEO & Director

Great. Thanks. I’ll have Rick take the first part of your question, and then I’ll have Manmohan take the second, and I’ll take the third.

Rick Gates  -  Walgreens Boots Alliance, Inc. - Senior VP & Chief Pharmacy Officer of Walgreen Co.

George, thanks for the question. And the push pull when it comes to some of the reimbursement model changes, I would say we obviously work with PBMs hand in hand to understand what payers are looking for in a marketplace and the ecosystem. If, obviously, they’re looking for a standard-based reimbursement model, it’s an AWP-based model, we have those with them. If they’re looking for cost-plus models or other types of reimbursement models, we work with them to make sure they have those solutions to go to payers that may be looking for it.

So right now, I think it’s an opportunity for us to continue to put different types of models in the market and then see what payer uptake really looks like and then really try to advance those models as we move forward.

Manmohan Mahajan  -  Walgreens Boots Alliance, Inc. - Executive VP & Global CFO

Yes. From a cadence perspective, I think what we’re looking at here is fairly balanced here in third and fourth quarter. And then finally, the portfolio...

Timothy C. Wentworth  -  Walgreens Boots Alliance, Inc. - CEO & Director

Let me be real clear, because I don’t think it was ambiguous, but we have been, over the last several months, digging deeply into the core business as well as every piece of our portfolio. Obviously, the big chunks you know what they are and what their brand names are and so forth. But also looking at our store footprint, looking at, as you heard before, our suppliers and our assortment, looking at manager compensation, looking at workflow design and pharmacies and working with deans as well as looking at our automation.

And -- but when you step back to the large piece, to your sum of the parts question, obviously, we’re very conscious of the fact we have about a half a dozen things that need to either fit, they need to synergize, they need to offer upside in a long-term runway for growth, either by themselves or perhaps combined with other things. They need to unlock capabilities that we would otherwise not be able to have unlocked or else we need to find a better place for them.

And so from our perspective, I can tell you that, for example, Mary on the U.S. Healthcare side, which has its own collection of assets independent from Boots and Shields and CareCentrix and the businesses that you know that we have, Mary has been doing a complete strip down of every one of those businesses and looking at, is it staffed right, is it built for growth, do the market support growth. And this is going to culminate in part, and let me be really clear, I don’t want to send a message that there’s some big bang coming.

But when we sit down with our Board at the end of April, we are going to give them outside in context about the forces in health care over the next 5 to 10 years. We’re going to then look at how does that impact the people that we serve, both the payers, the health systems, the consumers, the patients, pharma companies, and then we’re going to make a series of either recommendations or next steps so that the Board is very clear where we’re headed in some things.

We have some things already underway as part of this as we go from examining things to testing markets and so forth. I’m not going to get detailed at this point about that other than to say, again, it’s dynamic, it is across the company, and I’m super excited to have a fully staffed executive committee based here in Chicago to do it alongside me.
Our next question comes from Michael Cherny with Leerink Partners.

Michael Aaron Cherny - Leerink Partners LLC, Research Division - Senior MD

So maybe along the lines of the push and pull between your previous guidance versus the updated guidance. Just a couple of things. First, on the dynamics behind the retail decline, I know you talked about same-store growth, but are you seeing any changes in what you’re expecting on economics on a same-store script basis in the back half of the year?

And then just on the healthcare AOI as well. I know you highlighted the strong EBITDA performance. I would have thought with the accelerated pace of VillageMD closures that you might see a better second half ramp. Is there any other puts and takes we should think about within the healthcare business that leads to the dynamics of your current expectations versus year-to-date performance?

Timothy C. Wentworth - Walgreens Boots Alliance, Inc. - CEO & Director

I'll have Manmohan take that.

Manmohan Mahajan - Walgreens Boots Alliance, Inc. - Executive VP & Global CFO

Yes, sure. So look, as you think about the second half implied guide, a couple of factors to consider. And I'll go through in order. Retail is the biggest factor from a second half perspective. We have seen the challenging environment continues to persist for longer than expected. And so we are lowering our expectation. I think we were at low single digits, now we're expecting negative 3% comp. So that is going into it.

Our decision to early wind down the sale-leaseback program, as well as our decision to sell Cencora shares through block trade versus using a VPF structure, variable prepaid forward structure is creating additional headwinds as I think about the guidance we provided last quarter. So those are 3 headwinds. And the offset to that from a full year perspective is obviously one of the factors is the favorable tax rate we have in the year.

Now the timing of that has played out in the second quarter. Now you had some specific questions on the script and how do we think about that. If you think about the second quarter, our comp script growth ex-immunization of 2.9%, fairly consistent with where market was, we're holding our share. And as we think about the second half of the year, we expect us to continue to grow in line with the market and hold the share. So that's kind of the expectation we have on the script side.

On healthcare, Village continues to take decisions to rightsize their cost structure and think about their clinical footprint and they did make the decision to exit certain more locations. To us, we are very pleased with reaching the first quarter of positive adjusted EBITDA in the segment. We want to be -- we want to take a prudent approach for the next half. And so therefore, we just continue to maintain the guidance we have.

Thank you. Ladies and gentlemen, this does conclude the Q&A portion of today's conference. I'd like to turn the call back over to Tim for any closing remarks.

Timothy C. Wentworth - Walgreens Boots Alliance, Inc. - CEO & Director

Thank you, operator. And thank you for your questions and your time today. As we close, I just want to just quickly remind you what you've heard today. Our second quarter operational results were in line with our expectations despite continued challenges in the U.S. retail environment.
We drove solid execution. I’m very, very proud of the team and cost discipline in our U.S. Retail Pharmacy segment with continued strong performance in International, and we had our first quarter of positive adjusted EBITDA in U.S. Healthcare.

Now driven by our recently solidified leadership team, I would remind all of you that there -- one member of the team actually is starting in 2 weeks. But basically, now we're all around the table. We are -- we have come together to be committed to an intense review in the coming months and to the hard work that's going to ensure that each asset in our portfolio advances our expansion into the fastest-growing areas of health care.

And as you saw this quarter, we are willing to revalue things that we take a second look at and make difficult decisions, and we're going to do that not in one big bang, but as it becomes obvious to us on a situation-by-situation basis that we can act. And as I said before, everything is on the table as we identify opportunities that unlock value, validate existing pathways and lead WBA into a successful future. We look forward to continuing to keep you updated on our progress. And again, thank you.

Operator

Ladies and gentlemen, this does conclude today's presentation. You may now disconnect, and have a wonderful day.