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EDITED TRANSCRIPT

WBA.OQ - Q2 2022 Walgreens Boots Alliance Inc Earnings Call

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OVERVIEW:

WBA reported 2Q22 YoverY constant currency sales growth of 3.8%, GAAP EPS of $1.02 and adjusted EPS of $1.59. Co. also reported YTD YoverY constant currency sales growth of 5.7%.

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PRESENTATION

Operator

Good morning. My name is Chris, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the Walgreens Boots Alliance Second Quarter 2022 Earnings Conference Call. (Operator Instructions) Thank you. Tiffany Kanaga, Vice President, Global Investor Relations, you may begin.

Tiffany Kanaga - *Walgreens Boots Alliance, Inc. - Vice President-Global Investor Relations*

Good morning. Thank you for joining us for the Walgreens Boots Alliance earnings call for the second quarter of fiscal year 2022. I'm Tiffany Kanaga, Vice President of Global Investor Relations. Joining me on today's call are Roz Brewer, our Chief Executive Officer; James Kehoe, our Chief Financial Officer; and John Standley, President of Walgreens.

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 Forms 10-K and 10-Q 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. The slides and the press release also contain further information about non-GAAP financial measures that we will discuss today during this call.

I will now turn the call over to Roz.

Rosalind Gates Brewer - *Walgreens Boots Alliance, Inc. - CEO & Director*

Thanks, Tiffany, and good morning, everyone. Walgreens Boots Alliance once again delivered strong results in the second quarter. Sales increased 3.8% in constant currency or high single digits on a core basis, excluding the negative impact of AllianceRx Walgreens and the positive M&A activity in Walgreens Health. Adjusted EPS grew 26.5%. Our good performance reflects execution across each of our business segments.

Our U.S. retail sales comp of 14.7% was the highest in over 20 years, above even last quarter's record, and we are seeing significant recovery in our international markets. At the same time, we are building our next growth engine, Walgreens Health, which is on pace toward its long-term target. And of course, we continue to serve communities with COVID testing and vaccinations to fight the pandemic.

During the quarter, we also undertook important actions to advance our strategic priorities and to ensure our asset portfolio is strongly aligned. We initiated a review of the Boots business, and this process is progressing well.

Looking ahead, we are maintaining our full year adjusted EPS guidance of low single-digit growth, which we raised in January. Our outlook incorporates healthy fundamentals in our core business as demonstrated with robust sales and earnings growth year-to-date, balanced against ongoing investments in our growth initiatives and our people.

We are delivering against our Investor Day commitments as laid out in October. We're moving quickly to execute our vision of consumer-centric, technology-enabled healthcare solutions, which extend well beyond the pharmacy walls. As we begin to offer a care delivery experience that improves health outcomes and lowers cost for patients, providers and payers, we are well positioned to drive accelerated sustainable value creation.

Next, I want to take a moment to review Walgreens initiatives to provide local communities with access to important resources during the pandemic and as we navigate the recovery into an endemic scenario.

In the U.S., we administered 11.8 million COVID-19 vaccinations within the quarter and over 62 million to date. Our pharmacy team members are healthcare heroes. The majority of our patients and customers see their pharmacists more than they do any other healthcare provider, and we recognize their tireless dedication and contributions to the pandemic response.

The Omicron wave in December and January also drove elevated levels of COVID testing, both in-store and at home. We completed 6.6 million in-store COVID tests during the quarter and over 27 million to date. In addition to our drive-thru testing at no cost to patients, we've now launched convenient at-home COVID PCR test collection kits with LabCorp at no cost nationwide. This is particularly important for uninsured, socially vulnerable and medically underserved populations, who continue to be among those most impacted by COVID. And as we all start to resume normal activities, Walgreens will remain a partner to our communities to ensure safer connections and improve mobility.

Our leadership in vaccines and testing is just one way that we are becoming the leading partner in reimagining local healthcare and well-being for all.

The second quarter included significant progress towards each of our 4 strategic priorities. Let me update you on our latest initiatives, and then spend a moment on the drivers of execution at Walgreens Health.

First, we are transforming and aligning the core business and building a pharmacy of the future that will enable and support our healthcare strategy. We saw continued momentum online in the second quarter with digital sales up 38% in the U.S. or 116% on a 2-year stack basis. Same-day pickup orders accelerated sequentially to 3.9 million orders. We have also enrolled over 96 million myWalgreens members, up nearly 11 million since the fourth quarter. We are now focused on activating members through personalized omnichannel messaging and offers.

Additionally, our alternative profit streams are performing well, including our media advertising business, which launched a year ago and is running ahead of expectations. We continue to see digital media as a significant opportunity for us.

Finally, we have 3 automated micro fulfillment centers open and are on pace to have 22 by the end of fiscal '24, driving significant efficiencies and cost savings over time. We expect these centers to ultimately cover 40% to 50% of prescriptions for pharmacy served, removing routine tasks and excess inventory from the local sites.

Second, we're building a platform of technology-enabled healthcare solutions with the consumer in mind, which is well positioned to fuel our next phase of growth. Nearly half of our store footprint will have a healthcare touch point between our organic Walgreens Health corners and the co-located clinics with VillageMD. VillageMD has now opened 102 co-located clinics, and the rollout has accelerated to an average pace of 1 opening every 3 days for calendar year 2022. On the health corners front, we remain on pace to have 100 sites in operation by year-end.

Third, we are refocusing our portfolio and optimizing capital allocation. We continue to apply a rigorous strategic lens to our equity investments and explore all options to unlock value. Recently, we have gained full ownership of the AllianceRx Walgreens business and our German wholesale JV, creating greater agility ahead. We have also announced the strategic review of our Boots business. This process is progressing well, and we will pursue an outcome that maximizes value.

Finally, we are building a diverse winning team that will underpin our strategic priorities. Our deep and experienced bench is executing our strong results today and implementing the bold steps necessary to drive growth ahead. We are making rapid progress towards building out Walgreens Health with a clear path to a run rate of more than $4 billion exiting fiscal year 2022, well on our way to our goal of $9 billion to $10 billion in sales by fiscal 2025. We will improve health outcomes and lower cost for payers and providers by delivering care through owned and partnered assets.

The goal is to support the patient journey across the entire care continuum through omnichannel solution. This is why you see these complementary assets spanning primary care through VillageMD, specialty pharmacy through Shields and post-acute care through our pending CareCentrix investment.

The health corners play an important role in addressing care gaps through our health advisers. Today, Blue Shield California and Clover members can walk in and have access to clinical services like A1C testing, colorectal cancer screening and blood pressure monitoring. I'm particularly moved by stories of these patients receiving emotional support while navigating what can be an overwhelming and impersonal experience in U.S. healthcare.

Much like our pharmacists, our health advisers are becoming trusted neighborhood sources of education, recommendations and connections that can help our patients to better manage their wellness. This is a transformational process to become a leader in value-based care as only Walgreens can do through our trusted customer relationships, local knowledge and deep data insights. We will leverage our strong footprint and independent standing to offer uniquely consumer-centric solutions for our communities.

We are executing on our vision today. Our partnership with VillageMD positions them to be one of the largest and most differentiated primary care providers in the U.S. The collaboration is a significant growth catalyst, driving 1,000 co-located clinics across more than 30 markets by 2027. VillageMD is in 22 markets today, most recently expanding to Boston, Jacksonville and Tucson in February; Denver in January; and San Antonio in December. VillageMD's care delivery model is highly scalable with attractive unit economics over time.

Shields continues to rapidly expand its platform, representing specialty patients across more than 30 disease states with more than 70 health system partners nationwide. In November and February, Shields inked new deals with 2 significant health systems with geographic reach in the Northwest and Northeast U.S. Importantly, WBA and Shields are collaborating to identify instances where their networks intersect to combine Shields' operational expertise with WBA's robust nationwide pharmacy network.

In our organic Walgreens Health business, we are pleased with the rollout of our Health Corners with Blue Shield California and Clover, where we are gathering tremendous insights. We are in the process of signing on incremental partners, and we will initiate the next wave of 9 health corners in California in April.

We also continue to refine the consumer app, adding new features to increase access, engagement and convenience. Overall, we are tracking well against our key milestones for Walgreens Health and remain very excited about our growth potential. We are executing across our balanced plans for fiscal 2022 as we build the strong foundation for a sustainable low teens EPS growth. We are reimagining healthcare and well-being for all with a clear path towards accelerated value creation.

With that, I'll hand it over to James to provide more color on our results and our outlook.

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

Thank you, Roz, and good morning. We had an excellent quarter with focused execution across all of our businesses. Adjusted EPS was $1.59, ahead of expectations and on a constant currency basis, up 26% versus prior year. We continue to execute strongly in COVID vaccinations and testing. Our U.S. retail comps were the highest in 20 years, and our international markets continue to recover nicely. And we increased our investments to build out our Walgreens Health business with an EPS impact of 5 percentage points in the quarter.

Operating cash flow was $1.1 billion in the quarter with free cash flow of $669 million. And finally, we are maintaining our full year outlook of low single-digit growth in adjusted EPS.

Let's now look at the results in more detail. Second quarter sales advanced 3.8% on a constant currency basis. Strong growth from Walgreens and the International segments and sales contributions from Walgreens Health more than offset a 570 basis point impact from the sales decline in AllianceRx Walgreens. Overall, if you exclude the negative impact from AllianceRx and the positive M&A activity in Walgreens Health, core sales growth was high single digits.

Adjusted operating income increased 35.9% on a constant currency basis, driven by strong gross profit performance in both pharmacy and retail in the U.S. and a continued rebound in international sales and profitability. Adjusted EPS was $1.59 in the quarter, a constant currency increase of 26%, driven entirely by adjusted operating income. The result was held back by a higher tax rate, which reduced EPS growth by [15] percentage points.

[GAAP to] EPS decreased 4.1% to $1.02, reflecting a charge to the company's equity investments related to the impairment of minority investments as well as lapping a $191 million gain on the partial sale of our investment in Option Care Health in the year-ago quarter. Now let's move to the year-to-date highlights.

Year-to-date sales advanced 5.7% on a constant currency basis, including a 400 basis point negative impact from AllianceRx. Without this impact, year-to-date sales growth was 9.7%. Adjusted operating income increased 42% on a constant currency basis, reflecting strong adjusted gross profit growth across pharmacy and retail in the U.S. and the continued rebound in international segment sales and profitability.

Adjusted EPS advanced 39%. GAAP EPS increased by $4.54 to $5.15, reflecting a $2.5 billion after-tax gain in the first quarter related to the valuation of our prior investments in VillageMD and Shields as well as lapping a $1.2 billion charge, net of tax, from the company's equity earnings in AmerisourceBergen in the year-ago period. Now let's move to the U.S. segment.

Sales increased 1.2% in the quarter, with a strong performance from Walgreens more than offsetting a 680 basis points headwind from a 43% sales decline in the AllianceRx specialty business. Comparable sales advanced 9.5% in the quarter. Adjusted gross profit increased 13.7%, with both pharmacy and retail growing in the low teens. Strong sales growth and favorable mix was only partially offset by lower reimbursement rates and higher shrink in distribution costs.

Adjusted SG&A spend increased 8.3%, primarily due to investments relating to vaccinations and labor, partially offset by savings from the Transformational Cost Management Program. SG&A as a percentage of sales increased 120 basis points to 18.3% of sales, and this was almost entirely due to an adverse mix impact as a result of AllianceRx. Adjusted operating income growth of 37% was entirely due to strong gross profit performance.

Now let's look in more detail at U.S. pharmacy. Pharmacy sales declined 3.3%, held back by a 9.1 percentage point negative impact from AllianceRx. Comparable pharmacy sales were up 7.3%, while comp scripts increased 4.7%, with COVID-19 vaccinations accounting for 275 basis points of the script growth. We completed 11.8 million COVID-19 vaccinations in the quarter and administered 6.6 million COVID-19 tests.

Pharmacy benefited in the quarter from improved seasonal scripts as well as higher-than-expected flu immunizations. However, scripts continued to be challenged by temporary operating hour reductions due to labor shortages and a surge of Omicron-related absences. Pharmacy adjusted gross profit grew nicely as strong sales growth at Walgreens and favorable profit mix more than offset reimbursement pressure.

Turning next to our U.S. retail business. Comp retail sales increased 14.7%, the highest increase in more than 20 years. Excluding tobacco, comps were [up] 15.7%, and with OTC test kits contributing approximately 690 basis points of growth. Compared to the second quarter of 2020 pre-COVID levels, comp sales were up mid-teens.

We saw broad growth across all categories, led by a 43% growth in Health and Wellness, driven by at-home COVID-19 tests and cough cold flu. Transactions were up 9.5% and discretionary categories performed well, with Personal Care comp sales growing 9.7% and Beauty growing 6.5%. While gross margin declined slightly, strong sales growth drove low teens growth in gross profit.

Turning next to the International segment. And as always, I'll talk to constant currency numbers. Sales increased 7.5% in the quarter, reflecting the ongoing recovery and strong execution across our retail portfolio, particularly in Boots U.K. where sales advanced 15%. Adjusted operating income was $226 million in the quarter, up 60% versus prior year, led by sales growth and tight cost control.

In Germany, the integration of the McKesson wholesale business is very much on track, with operational synergy benefits running ahead of schedule. Let's now look in more detail at Boots U.K.

Comparable pharmacy sales increased 3.6%. Stronger demand for services contributed to the increase with sales up almost 75% year-on-year, benefiting from COVID-19 testing and vaccinations as well as new online healthcare services. Comp retail sales increased 22%, despite the headwind created by the Omicron variant. This reflected strong commercial execution and a recovery from strict restrictions in the comparable quarter. Market share strengthened across all categories, with Beauty performing particularly well.

Boots.com sales declined in the quarter as footfall at our physical stores increased 52%. However, the Boots.com business remains in a very strong position, with sales up 60% compared to the pre-COVID levels. More than 15% of total U.K. retail sales comes from our digital channel, up from around 9% pre-COVID, with an increasing proportion of sales originating from our mobile app.

Turning next to Walgreens Health. As mentioned last quarter, our majority investments in Shields and VillageMD closed on October 29 and November 24, respectively. Segment sales were $527 million in the quarter, with $446 million from VillageMD and $81 million from Shields Health.

Walgreens Health AOI was a loss of $77 million in the quarter. Organic investments increased sequentially and accounted for $31 million of the $77 million operating loss. Investments at VillageMD more than offset the profit contribution from Shields Health and led to a $46 million AOI loss from majority investments. VillageMD sales advanced 145% on a pro forma basis, and they are executing against the planned investments to grow the business and to quickly expand the clinic footprint. Shields delivered a strong quarter. Pro forma sales growth was 63% with improved operating margins, driven by growth from new and recently signed contracts and from expanding our value-add proposition with existing health system partners.

Let's now look at some of the key metrics for Walgreens Health. We are on track to meet our December 2022 goal of 2 million lives and more than 100 Walgreens Health Corners, with 47 already up and running. The next wave of 9 locations is scheduled to launch in California in April. The rollout of VillageMD continues with 94 co-located clinics opened at the end of the second quarter, up from 81 at the end of the first quarter. As of today, we have 102 co-located clinics opened, progressing towards our goal of 200 by the end of calendar year 2022.

Our fiscal 2022 sales goal is now at $2.2 billion, given a delay in the closing of the CareCentrix investment. There are no changes to our underlying sales assumptions. And as you can see, VillageMD and Shields are delivering impressive growth with pro forma combined sales growth of 128% in the quarter.

Turning next to cash flow. We generated $1.3 billion of free cash flow in the first half of the year, $550 million below prior year, as we cycled through some exceptional headwinds. Strong growth in operating income was offset by the working capital impact of a decline in the AllianceRx Walgreens business, the year-over-year impact of COVID-19-related government support and increased capital expenditures behind key growth initiatives, including the rollout of new automated micro fulfillment centers, the VillageMD footprint expansion and continued omnichannel and digital investments.

Turning now to full year guidance. We are maintaining our full year guidance of low single-digit growth in adjusted EPS. We have, however, raised our estimate for the base business from 5% to 7% growth to 6% to 8% growth to reflect strong U.S. front-of-store performance and increased testing revenue. This upside is being reinvested in building out our healthcare business, which now represents an estimated 5 percentage point headwind to EPS growth compared to 4 percentage points previously.

In summary. We are confirming our full year EPS guidance of low single-digit growth. And I would remind you that this is better than our original guidance provided at the start of the fiscal year.

With that, let me now pass it back to Roz for her closing comments.

Rosalind Gates Brewer - *Walgreens Boots Alliance, Inc. - CEO & Director*

Thank you, James. Let me be brief so we can take as many questions as possible. We are executing well with another strong quarter, marking another step in our transformation. We are making significant progress across our strategic priorities. Our team members continue to amaze me with their dedication and talent, as I visit many of our stores and offices across our regions. It's because of their hard work that Walgreens Boots Alliance has been recognized with recent honors such as being named to Fast Company's List of the World's 50 Most Innovative Companies, and Time's 100 Most Influential Companies.

Our team members, in particular, provide me with deep conviction, that we have what it takes to truly reimagine healthcare and well-being for all and deliver long-term value creation.

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

QUESTIONS AND ANSWERS

Operator

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

Lisa Christine Gill - *JPMorgan Chase & Co, Research Division - MD, Head of U.S. Healthcare Technology & Distribution Equity Research and Senior Research Analyst*

First, I just wanted to start, James, with your comment that you said the quarter was ahead of your expectations. But when I think about the next several quarters, were there things that were pulled forward into this quarter, would be my first question. And how are you thinking -- you made a comment about testing. I would assume testing was very strong in January and February, but what have you seen more recently when we think about your higher revenue due to testing? Is that just because of what you saw in the most recent quarter or expectations going forward?

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

Yes. So no, when we -- I made the comment about ahead of expectations, I believe we're maybe $0.20 ahead of consensus. But versus our internal forecast, we were about $0.08 ahead. And where we saw continued buoyancy was on retail. Front of store continued, particularly in the first 2 months of the quarter, and then secondly, on testing, as Omicron was peaking. So those were the 2 items that drove our beat versus internal forecast, which I said was about $0.08. Now we've seen a fairly -- we've seen a slowdown, obviously, since then, and maybe I'll pass it over to John Standley for a couple of comments on what he's seeing currently.

John T. Standley - *Walgreens Boots Alliance, Inc. - Executive VP & President of Walgreens*

Well, I guess the part of the big news there really is just we did start vaccinating the fourth shot yesterday. So what was slowing down has kind of picked up a bit here in the last 24 hours as far as the vaccine goes.

I think on the testing, it did slow down as we came through the holidays in January, into February and now into March. But there is -- there has been still a steady business there for travel and those people still needing to test. So down quite a bit, but a nice steady stream still ongoing.

Lisa Christine Gill - *JPMorgan Chase & Co, Research Division - MD, Head of U.S. Healthcare Technology & Distribution Equity Research and Senior Research Analyst*

And John, just as a follow-up. We hear pharmacists as a provider, and I know you've been a big proponent of this, and we absolutely agree that throughout the pandemic, that the pharmacists have been on the front line. But what does that really mean? Does that change reimbursement? Does it change their role when we think about them from a healthcare perspective?

John T. Standley - *Walgreens Boots Alliance, Inc. - Executive VP & President of Walgreens*

Yes. It's a pretty important point. And we did -- I know Roz was in DC a couple of days ago, we did get a piece of legislation moving here just in the last week, that's the Equitable Pharmacists Access Bill. And that's a -- really around provider access and our ability to bill under Medicare Part B for services around testing and treating influenza, strep and things like that. And I really think that's a pretty sizable addressable market today. That's honestly largely moved out of primary care physicians anyway and gone into convenient care. But it's -- I think it just -- there's a real opportunity in our business to have a really convenient solution.

We provide access, obviously, close to 9,000 locations. And I think our pharmacists and our technicians are more than capable, as we've shown during the pandemic, of delivering these kinds of services. That's a pretty big game changer if we can gain access to that market and in terms of how we grow our business and in terms of the value we can provide to the communities we serve.

Operator

Our next question is from Steven Valiquette with Barclays.

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

So just regarding the Boots business and the ongoing strategic review of that asset, just a couple of interrelated questions. First, can you remind us where this asset stands at the moment? Just on how much the profitability in fiscal '22 is impaired by COVID versus the pre-COVID baselines? And if I missed this, are you able to disclose how much of the International segment operating profit of $226 million this quarter is specifically related to the Boots' asset that's under strategic review?

Rosalind Gates Brewer - *Walgreens Boots Alliance, Inc. - CEO & Director*

James, I'll turn that one over to you on Boots.

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

Okay. Let me just pick the last of your question. First, (inaudible) is Germany. And Germany doesn't make very much money. It's a wholesale business. It's driving a lot of favorable synergies in the go-forward position. But right now, it's only marginally profitable. So you could presume that the majority of the profitability in the International segment is related to the U.K. business. I'm sorry, the first part of your question? (inaudible)

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

Yes, James, you might have alluded to this a little bit during the prepared remarks. But as we think about just the profitability of that segment in fiscal '22, where does it stand like your profitability on pre-COVID baselines? Are we well above? Are we still a bit low? Are we kind of in line? Just any rough percentage around that might be helpful just to frame it.

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

No, I think we're still quite a bit below, call it, the 2- or 3-year stacks. Foot traffic hasn't fully recovered in the U.K. I think it's like 15% below where it was 2 years ago, just in terms of foot traffic. The U.K. reacted -- so first of all, they had a fabulous quarter given that they had a big spike in Omicron in the quarter, and it's a very foot-traffic driven business. And the traffic shifts really quickly. So look at the quarter they just had, and foot traffic was actually up 52%, but it still remains about 15% below where it was 2 years ago, right? So it hasn't fully recovered.

And I think if you cycle back a couple of conference calls, what we said was we expect the Boots U.K. business to broadly get back to the pre-COVID levels when they're exiting 2022. I would say that if you actually looked at it on a sales basis, it will be 2023 year before Boots fully gets back to pre-COVID levels. So there's a lot of good growth ahead in the U.K. and International segment driven by that. And they've done a spectacular job of cost control.

And then secondly, the other part that I don't think we get credit for is boots.com in the U.K. That's 60% growth on a 2-year stack basis. And I don't think there's many retailers in the U.K. that have a dot com business that represents 15% of sales. So this is a business that used COVID as a time to reinvent itself and exit much, much more strongly than it went into COVID. So this is a business with massive momentum and it's well positioned for the future, and has a large and fast-growing dot-com business. So we're very happy with it. But as I said, your question is a good one. It won't fully recover until fiscal year '23. So there's a lot of positive growth ahead.

Operator

The next question is from Elizabeth Anderson with Evercore.

Elizabeth Hammell Anderson - *Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst*

In terms of -- you talked about sort of reinvesting in the healthcare business, when you were talking about the components of the second half EPS numbers. One, could you talk about sort of where those -- what those increased investments are? And then two, can you talk about your sort of where you're seeing labor costs come in versus your expectations? I know that you sort of pointed to that as a driver of SG&A. And obviously, it's well known the costs are going up. I just wanted to understand sort of how that's trending as we move through the fiscal year.

Rosalind Gates Brewer - *Walgreens Boots Alliance, Inc. - CEO & Director*

Elizabeth, thanks for the question. I'll start off with Walgreens Health, and then I'll ask members of the team to join in. But from a Walgreens Health perspective, we continue to invest. As you all know, we made the investments in VillageMD, CareCentrix and Shields. We're pleased with where we are with those investments, and we're integrating where it would make sense in our healthcare continuum. So that work is ongoing, and we're satisfied in that respect.

We did mention, when we were at our Investors Day back in October, that we would continue to invest in the business, and we'll continue to do that. And I will also mention that we're seeing really good performance, particularly in our specialty pharmacy area with Shields. And so that would be ongoing. I'm going to ask James to talk with any further detail on Walgreens' Health with the investments. And then, John, if you could take it from there.

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

Yes, just quickly, Elizabeth. Basically, what we said is we will maintain guidance. We took up guidance on the base business, and we increased the investment on healthcare from 4 percentage points of EPS to 5 percentage points. And one is to send a clear message that we're serious and we're making strong progress. And as we're in the second half of the year, there's a fairly big shift between first half and second half. Second half is about 7% of EPS headwinds coming from the investments in healthcare. Specifically, what were we doing? We've increased slightly and VillageMD has increased slightly its investments behind the opening of the co-located clinics.

You'd recall in the last conference call, we raised the guidance for the full year from 160 clinics in the calendar year to 200. But now we're just aligning a bit the expenses and the phasing of those rollouts. So probably is a longer-term positive just readjusting expenses in the short term. The other thing is we're really doubling down on the organic investments to meet the requirements of Blue Shield California and Clover. We're making strong progress against both of those. So call it a reinforcement of expenses exiting the year because we're resolute here. We want to exit the year stronger than when we entered. So this is all about investing in the future growth of the company. And John, maybe I'll pass it over to you on the labor question.

John T. Standley - *Walgreens Boots Alliance, Inc. - Executive VP & President of Walgreens*

Yes. I think I'd just make a couple of comments. One, I'm really excited about the investments that we're making in the Walgreens business. We're really deep into our micro fulfillment strategy and rollout. And as we've talked about previously, this is really a program we're rolling out to support our pharmacists and get work out of our store, and free up team member time to really provide additional services in the pharmacy. So I'm really excited about that investment and the progress that we're making there.

And we touched on with Lisa earlier about some of the potential value drivers there. I think there's just a lot of upside there for us in the future. So super excited about that. And there's other investments that we're making in the business in addition to that, around pharmacy with automation in our call centers and things like that to improve the experience and take other work out of the stores and out of the pharmacy.

On the labor side, as we've talked about over several quarters, we have made some really significant investments here. We raised our starting wage across the company to $13 last fall and we moved up to $15 in the fall of '23. And we also made changes to our tech. Starting wages went to $15 in the fall into $16.50 this coming fall. And I think we talked about where we were with some investments. Last quarter, we had about $120 million of investments that we've made for wage premiums and hard (inaudible) stackers with pharmacists as well as recognition bonuses that we paid to really recognize our team members for really the hard work and dedication that they've shown here through the pandemic. And I think as we look forward on where we are versus our expectations related to all of that, I think we included in our updated guidance here about a $40 million of additional expense in the back half of the year. So pretty close to what we expected.

Operator

Our next question is from A.J. Rice with Credit Suisse.

Albert J. William Rice - *Crédit Suisse AG, Research Division - Research Analyst*

I wondered, obviously, you're rolling out at a nice pace, both the health centers, the Walgreens Health Centers as well as the VillageMD, and you've got a number of that are co-located. I wonder if you could -- if it's possible to start to talk or provide a little more information on how that is impacting the retail operations. Or can you point to increased script volume or increased foot traffic in the front end that you can attribute to, either the co-located VillageMD or the health centers? How that's changing the profile of the stores on those ones that have the co-located offerings?

Rosalind Gates Brewer - *Walgreens Boots Alliance, Inc. - CEO & Director*

Thank you, A.J., for that question. So first of all, it's still early days for us in terms of the number of VillageMD clinics and to see that transfer of script volume over to the stores. What's more important here is that just to remind everyone that this is a primary care physician practice. And what we're really building are key relationships, the relationship with the consumer between the primary care physician and the pharmacist. And that's where we're seeing the greatest uptick right now is in patient satisfaction and access to healthcare and neighborhood markets. And so we'll continue to look at this and look at script uplift. But right now, the focus is really on gaining the confidence and creating new relationships in the marketplace.

The other thing I will tell you is as we see these expand across the U.S., I will tell you, after having walked several of them and watched the patient feedback, it's comforting to see just how much engagement we're getting with the patient. And also, too, it's actually great for our pharmacists because they are much more engaged with the patient and the customer because they have the information coming over directly from the primary care physician's office, just inside the building. So we'll continue to update you as we see those numbers come in from script count growth, but it's still a little bit too early for that.

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

Yes. And just to add on to that, just to give you some perspective, I want to clarify. You'll see 2 benefits as we go forward. One is we're absolutely convinced on script uplift. We're just not providing the number on a quarterly basis, and we'll do a more comprehensive update in the future. The other one not to underestimate and this is more an impact on Village's performances. They have a lot of older practices where a pharmacist and a doctor together managing the patients, deliver lower medical costs than just a primary care physician by themselves.

So the other big hypothesis that has to play out in the co-located stores is the combined effort of our pharmacists together with a primary care physician in managing down the cost of healthcare over time. And as I said, they have strong evidence on their stand-alone clinics, and that will translate over time to improve health outperformance on the clinics they've collocated with us.

So there's a bunch of KPIs we're watching very, very closely. But bear in mind, it takes 2 years for a clinic to get up to kind of a reasonable level of operations, so -- and achieve a breakeven. So it does take time for the statistics to come through. But we're absolutely convinced that both of these will be in great territory over the coming year or 2.

Operator

The next question is from Charles Rhyee with Cowen.

Charles Rhyee - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Maybe I want to ask, as you previously kind of talked about that, in addition to Blue Shield of California and Clover, that you're engaging with a number of interested parties to get to the 2 million lives goal by the end of this year. Can you kind of give us a sense of what type of folks you're speaking with? And kind of characterize where you are in those discussions? And perhaps how close you might be to signing some?

Rosalind Gates Brewer - *Walgreens Boots Alliance, Inc. - CEO & Director*

Yes. So, thanks for that question. So we had committed that we would have 5 significant relationships by the end of the year. And I will tell you that we have 2 of those, 1 in Blue Shield of California and then the other 1 with Clover. There's a third one that we've just recently signed and we'll be announcing shortly here. So we feel like we're on a really good track record here in terms of how we are looking at these entities and moving them forward.

The other significant piece is that we are adding Health Corners out in California to support the current relationships with Blue Shield of California and also with Clover. So we've got more of the Health Corners coming on. And as -- just as a reminder, those Health Corners, they are becoming the health advisers in the community and provide something on top of when you think about the work we're doing with VillageMD.

So we are encouraged and really aggressive in developing these relationships, and we have a commercial team that is working alongside to make sure that these come online, and then we do the work that we need to do to bring the Health Corners up to speed to support them. So we'll hit the 5 contracts that we talked about at the beginning of the year.

Charles Rhyee - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Great. I appreciate that. And just a follow-up. If we think about the work you do with Health Corners, the partnership with Shields, VillageMD. Clearly, we saw with COVID testing a real rise in people doing at-home testing. Have you thought about the role of at-home diagnostics has? And how that would fit within sort of the Walgreens Health business that you're building?

Rosalind Gates Brewer - *Walgreens Boots Alliance, Inc. - CEO & Director*

Yes. We learned a lot during the COVID testing process, and I think we talked earlier about the work we're doing with LabCorp to provide at-home COVID tests. So it's giving us a real bright light into what more we can do in this space. I know that John Standley's team is developing a lot of the work around diagnostics and at-home testing through our retail business. I don't know, John, if you wanted to add anything more to that question.

John T. Standley - *Walgreens Boots Alliance, Inc. - Executive VP & President of Walgreens*

No, I do think it's a big opportunity and an excellent way for us to engage with our chronic patients to help them manage their disease states. So I think there's plenty of good upside here, and more of these types of tests are becoming available all the time. So we are working closely with a lot of pharma and manufacturers to try and gain access to those capabilities as they come to market.

Rosalind Gates Brewer - *Walgreens Boots Alliance, Inc. - CEO & Director*

The only other thing I would add to that, too, is that the discussion earlier around being able to test and treat in our stores, it's not only against the COVID virus. But it's also, just imagine if there's a strep throat diagnosis, our pharmacists, hopefully, will be able to test that in store, which we currently do and then treat them, send the patient home. And so while that's not in-home testing, it is creating an opportunity for the patient to take care of themselves and recover in a home setting.

Operator

The next question is from Brian Tanquilut with Jefferies.

Jack Garner Slevin - *Jefferies LLC, Research Division - Equity Associate*

It's Jack Slevin on for Brian. I just want to look at the '22 guidance and really use that and where we stand with the back half of the year as a jumping off point when we look at '23. So when you look at what you're implying with the guidance and acknowledging that it sounds like there's some upside maybe from fourth boosters or fourth shots, but at the higher end of the guidance, it's about $1.79 of EPS in the back half of the year.

Historically, you've done roughly 50% or a little bit lower than 50% of your EPS in the back half of your fiscal year. So when I bridge from, call it, $3.60 to $3.70 of EPS that's implied on a full year basis from that back half guide, can you just help me look at the back half of this year, bridging to that $5.15 of EPS that you sort of put a stake in the ground around at Investor Day and how we get there based on back half performance?

Rosalind Gates Brewer - *Walgreens Boots Alliance, Inc. - CEO & Director*

So Jack, let me start off by -- I'm going to start really talking about '23 and then any specifics on the second half of the year and the guidance that we've already provided. Maybe this will create a broader discussion for us. But first of all, we're not providing any guidance for fiscal year '23. But we are exiting the year with a real position of strength. We're executing on what we said we would do, including the raising of our fiscal '22 guidance that we did just not too long ago. You'll see a few things in the numbers here.

We indicated that we would make some strategic moves here and make some further investments, but we're really positioned in '23 to continue to deliver on our Walgreen Health investments. When you think about it, the growth in Walgreen Health is about 125% in the quarter. We'll hit a $4 billion run rate level of sales as we exit the year. And we still have long-term plans to hit a $9 billion to $10 billion number in 2025.

But the one thing I do want to mention is around -- if you look at the fiscal '22 guidance, there's some additional detail in there. We had incremental people investments in pharmacy, around $158 million. That's roughly about $0.14 of EPS above our October guidance. We had minimum wage increases in the October guidance. And with just looking at that, that's about a 2% EPS headwind in the second half of the year.

We also -- just looking at inflation, inflation is on the rise. So we expect to pass through most of that and inflationary impacts and some impacts in the short term also. So when you look at this, I just want to summarize that we're not going to give guidance for '23. We came out of the quarter strong, and we're managing through the second half.

James, anything you want to add on the second half?

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

Yes. Jack, I think as you look to it, we said before versus our internal estimates, we beat in the second quarter by about $0.8 and so we're reinvesting that. We believe we've got a bunch of exciting growth opportunities, particularly in Walgreens Health, probably to fund exiting the year. But I think as you look in the second half, bear in mind a couple of things is -- and I'm going to give you 2 numbers. It's the EPS growth in Q3 and Q4 of last year. So in Q3, which was the peak of vaccinations, we grew EPS 97%. That's a pretty -- that's what we're cycling through. Now in Q4, we grew 26%. So the average is somewhere in there in the 60% range. So those are what we're cycling.

And I think it shouldn't really come as a surprise to most of you on the phone, if you've done the math on vaccinations and the contribution last year, what we're facing in the second half of the year is we're lapping vaccinations, and our best estimate of that is around the 20% headwind in the second half. So it's almost (inaudible).

The second part is the labor investments that John mentioned before, 5 percentage points and the last one is Walgreens Health, 7. So the Walgreens Health has been signaled well in advance. The vaccinations, we all knew about what we delivered last year. And the only real new news in the second half is this 5% of labor investments.

That being said, I don't want to go out and say that the guidance is conservative, but we haven't factored in the impact of the fourth shot for the over 50s. We're still assessing how much that is worth. Could it be 2 million, 3 million, 4 million vaccines? It's probably, in the midpoint, maybe 3. So is there $0.05 to $0.08 of upside there? Yes, there probably is.

But between now and the end of the year, a lot of stuff can change. Things I'm excited about, though, I recently went through a review on inflation. We have basically offset all the inflationary impacts, and that includes a massive increase in the cost of international ocean freight, which is one of the biggest headaches in the -- for most retailers right now. So we're sitting in a fairly decent position with regards to inflation.

We think our model will work, and we're looking forward and quite optimistic about the future. And the front of store has had a spectacular year. Okay, we've had a fair amount of assistance from the OTC tests, but we over delivered there. We executed very strongly. So maybe, John, you could give some insight into the front-of-store plans we have on own brand and other areas into next year. So we're quite excited, Jack, as we look forward into '23, but we're not getting into the game of giving '23 guidance in every conference call. John?

John T. Standley - *Walgreens Boots Alliance, Inc. - Executive VP & President of Walgreens*

Yes. I'll just pick that up. I mean, I think a couple of things. We're -- obviously, we talked some about myWalgreens and mass personalization. I think we've done a great job here. We have a lot of upside with our program here and kind of where we're going between that program and the Walgreens advertising group and the different things that we're working on there. So I think just from an omnichannel experience, some of the capabilities we've built and where we can go here over the next couple of years, I think a lot of potential and exciting upside for us.

As James mentioned, we're very focused on our own brand. We think we have an opportunity to expand in additional categories in the store, but also develop in existing categories, the own brand offering. And we're making some good investments there in terms of how we go to market and how we position it within the store. We're pretty excited about the things that we're doing there.

And then I think we talked a little bit about the fact that we are taking a very careful look at a lot of our merchandising and where we're going for the future, inside the box from a front-end perspective. So if we look at that, there hasn't probably been a full store reset in most of these stores, maybe ever since they were built. So we have a pretty big, we think, merchandising opportunity ahead of us on the front end as well. So it'll just be a couple of things, James, I'd call out.

Operator

The next question is from George Hill with Deutsche Bank.

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

I guess I was going to ask another question about Walgreens Health. If I look at the presentation versus the prior quarter, it looks like you guys are ratcheting back full year revenue expectations pretty sharply, despite increasing the number of co-located clients. I was wondering if you could just put a little more color around the expectations there and kind of what's driving the revision?

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

Yes, we should have probably made that clear. It's only due to CareCentrix. We've had some regulatory follow-up questions. And the closing, we previously assumed would be actually at the end of the previous quarter. So we're just delayed in terms of closing. There's absolutely no impact on long-term projections here. I would actually say quite the opposite.

Just look at the pro forma sales growth that we're seeing on the 2 businesses, VillageMD growing 145% and Shields, which is actually a more mature business than even VillageMD, growing at 63%. So Shields is probably substantially ahead of the original plan we have in mind and Village is very much on the track. And we can't get involved in anything CareCentrix is doing right now because the acquisition hasn't closed, but our understanding is they're doing quite well as well.

So we're actually really excited because this pro forma sales growth (inaudible) 128%. That's why we're investing in exiting the year. We may be going in next year with a $4 billion-plus run rate company with a target within 3 years to be up $10 billion, approaching $10 billion. And the more we get our arms around this and the more we get into it, the more we're convinced these are very easily achievable targets.

Operator

That will conclude our question-and-answer session. I'll turn the call over to Roz Brewer for any closing remarks.

Rosalind Gates Brewer - *Walgreens Boots Alliance, Inc. - CEO & Director*

So thanks, everyone, for your time and your interest in WBA. I'm really glad we were able to take several questions today and cover a range of topics, including the continued success we're seeing in our core business, particularly vaccinations and testing. I think you've recognized the momentum in our International segment, our significant progress in our healthcare business and also, too, the new ways that we're serving our patients and our customers even further. So we're really pleased that you recognize that.

I couldn't be more excited about where we're heading right now and we're pleased that the great work of our teams can be seen in our strong quarter. We'll continue to execute well across our strategic priorities and keep you up to date on those. But we're really confident in our actions and the plans that we have to exit fiscal 2022 in a position of strength, much stronger than before the pandemic, which was our plan all along. As we build our growth engine and really try and drive this sustainable value creation we've been talking about, we'll keep you posted. We've got work ahead of us, but we're encouraged and excited. So thank you, and talk to you again real soon.

Operator

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