REFINITIV STREETEVENTS

EDITED TRANSCRIPT

WBA.OQ - Q4 2022 Walgreens Boots Alliance Inc Earnings Call

EVENT DATE/TIME: OCTOBER 13, 2022 / 12:30PM GMT

OVERVIEW:

WBA reported FY22 adjusted EPS of $5.04 and 4Q22 GAAP loss per share of $0.48. Expects FY23 constant currency sales growth to be in low-single-digits and 2-4%, excluding COVID-19 headwind, and adjusted EPS to be $4.45-4.65.

CORPORATE PARTICIPANTS

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

John Driscoll *Walgreens Boots Alliance, Inc. - Executive VP & President of U.S. Healthcare*

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

Tiffany Ann Kanaga *Walgreens Boots Alliance, Inc. - VP of Global IR*

Rick Gates *Walgreens Boots Alliance, Inc. - Senior VP of Pharmacy and Healthcare*

CONFERENCE CALL PARTICIPANTS

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

Ann Kathleen Hynes *Mizuho Securities USA LLC, Research Division - MD of Americas Research*

Austin Jason Gerlach *Wolfe Research, LLC - Research Analyst*

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

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

Eric R. Percher *Nephron Research LLC - Research Analyst*

Erin Elizabeth Wilson Wright *Morgan Stanley, Research Division - Equity Analyst*

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

John Wilson Ransom *Raymond James & Associates, Inc., Research Division - MD of Equity Research & Director of Healthcare Research*

Kevin Caliendo *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare IT and Distribution*

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

Michael Aaron Cherny *BofA Securities, Research Division - Director*

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

Taji Milan Phillips *Jefferies LLC, Research Division - Equity Associate*

PRESENTATION

Operator

At this time, I would like to welcome everyone to the Walgreens Boots Alliance Fiscal Year 2022 Earnings Conference Call. (Operator Instructions) Tiffany Kanaga, Vice President, Global Investor Relations, you may begin your conference.

Tiffany Ann Kanaga - *Walgreens Boots Alliance, Inc. - VP of Global IR*

Good morning. Thank you for joining us for the Walgreens Boots Alliance Earnings Call for the Fourth 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 Driscoll, President of our U.S. Healthcare segment. Rick Gates, Senior Vice President of Pharmacy and Healthcare at Walgreens, will participate in Q&A.

Today's call will be approximately 2 hours in length, including Q&A. Let me note that we will be referring to our segments by their new names, U.S. Retail Pharmacy, International, and U.S. Healthcare. The renaming did not result in any change to the composition of the segments. Additionally, all references to the COVID-19 headwind include U.S. vaccines, drive-through tests and OTC tests.

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 statement 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. It's great to be with all of you today, and it's hard to believe a whole year has gone by since our Investor Day last October. As I said to you then, and I'm deeply committed to being as open and transparent as possible about our business. We have scheduled a longer call this morning to provide a more in-depth update and also to spend additional time on Q&A to hear from you. I'm looking forward to reviewing our execution over the past year. We delivered ahead of our expectations in fiscal year '22 and are well underway in our transformation to a consumer-centric healthcare company.

Today, we'll also provide much greater visibility to the road ahead. Our fiscal year '23 adjusted EPS guidance of $4.45 to $4.65 is down year-over-year largely due to lapping COVID-19 execution. However, we expect strong 8% to 10% core growth to underpin our results. We are rapidly scaling U.S. healthcare, already raising long-term sales targets with a clear path to achieve profitability starting in fiscal year '24.

It's early, but our strategy is working. We are making good progress on each of our 4 priorities. We're simplifying and strengthening the company. Our numerous accomplishments this year, despite a difficult operating climate, bolster our confidence in accelerating to our long-term algorithm of low teens adjusted EPS growth. We have a winning team and winning assets to unlock sustainable shareholder value as we reimagine local healthcare and wellness for all.

As you'll remember from last October, we introduced 4 strategic priorities: first, transform and align the core business; Second, build our next growth engine, U.S. healthcare; third, focus the portfolio and optimize capital allocation; and fourth, build a high-performance culture and a winning team. Our 4 key priorities capture value across both core retail pharmacy and growth spaces in healthcare. We are already delivering consumer-centric primary care services, improving the patient experience and health outcomes while lowering cost and leveraging our assets across the care continuum to treat the whole person.

We are executing through our unique strength in our hyper local footprint and trusted iconic Walgreens' brand. At the same time, we're reinforcing our capabilities for the journey. We have and we'll continue to take measured and strategic actions to optimize our portfolio. We are also evolving our team with new talent, new skills and fresh ideas but with a singular focus on driving real value for our patients and [for our] communities, our people and our shareholders.

Let me review fiscal year '22 progress against each strategic priority. First, I'm pleased to say that we broadly exceeded our strategic goals across the core Retail Pharmacy business despite a challenging macro environment. Our script count is the one soft spot for the year to call out. I'll talk more about how we're addressing that in a moment. However, we still surpassed our U.S. and International adjusted operating income targets with very good execution in the front end.

U.S. and Boots U.K. retail comp sales were both strong, with the U.S. up 6% and Boots up 19%. Several of our initiatives are continuing to gain traction. U.S. digital sales grew 37% for the year on top of 74% growth in 2021. myWalgreens membership surge passed a big milestone reaching 102 million customers. And I'm encouraged by the innovation and growth happening at our owned brands program.

I am also proud of our significant U.S. retail margin expansion up over 100 basis points, while many other companies like big-box retailers are under pressure because they are more dependent on big ticket items. We are seeing meaningful contributions from alternative profit streams at $125 million in income for the year, including Walgreens Advertising Group with 35% growth. And you'll remember that we raised the target for our transformational cost management program last quarter to $3.5 billion with an expanding funnel of cost savings initiatives.

In the pharmacy, Walgreens team members have proven that they are highly trusted healthcare resources. We administered 35 million vaccinations in fiscal 2022 well beyond our expectations. With demand for pharmacy services at an all-time high due to COVID-19, we have seen a tightening in the labor market for pharmacists and pharmacy technicians.

This has unfortunately led to staffing shortages in some of our markets. In turn creating a headwind for prescription growth. Scripts were up a softer-than-expected 1.4% in fiscal year '22. We are focusing investments to return about 3,000 stores to normal operating hours, which I expect will drive script volume recovery as we move through fiscal year '23.

We're seeing positive staffing trends with 11 straight weeks of net pharmacist head count increases. We have also opened our eighth automated microfulfillment center and are now supporting 1,800 total stores. Our pace is somewhat slower than expected, in part due to supply side construction delays, but I'm pleased with the performance of the centers we do have up and running. These facilities remove routine tasks and excess inventory from the pharmacy, which is expected to reduce working capital by over $1 billion over time.

Let me take a moment to address the historic macro challenges that are affecting our customer. With inflation at 4-decade highs, consumers are expressing uncertainty about the future and seeking value. At the same time, we know that health and wellness will always be a priority and increasingly so after COVID-19.

A McKinsey study from last month showed that around 50% of U.S. consumers now report wellness as a top priority in their day-to-day lives, a significant rise from 42% just 2 years ago. We're leveraging our footprint, our digital capabilities, our consumer insights and our essential services to drive overall retail pharmacy growth. We have a resilient core business with a mix that over-indexes to need now categories, and we are better positioned now than we were in prior periods of economic turbulence.

Our execution during the pandemic is just one example of our pharmacy services at the center of our communities and as part of an integrated healthcare experience. In the U.S., we have administered nearly 72 million COVID-19 vaccinations and completed over 34 million PCR and antigen tests to date.

Second, we've improved the customer experience, and it's showing every day through offering strong value, better in-stock conditions and increased service levels. We've been managing inflation and collaborating closely with suppliers. We're maintaining price versus competitors and meeting our customers with robust in-stock levels that are above last year despite supply chain constraints. The products we sell are sourced from a wide variety of domestic and international vendors. The team is also deploying advanced forecasting and replenishment technology, including AI.

The outcome is a better, more dependable shopping experience for our customers during these turbulent times and stronger results for our retail business.

Finally, we expect reimbursement pressure on payer contracts to be predictable, as fiscal year '22 was in line with plan. We've already locked in 95% of payer contracts through calendar year '23.

Turning to our next strategic priority. We're making important strides and consistent progress in building our next growth engine, the U.S. Healthcare segment. Let me start with CareCentrix. With our announcement on Tuesday that we are accelerating full ownership, we are very well positioned in the home care market. And if the initial acquisition of a 55% stake had closed in line with our original time frame, we would have achieved our $3 billion to $3.2 billion sales goal in fiscal year '22.

Next, VillageMD and Shields continue to realize tremendous top line growth, driving pro forma total growth of 75% for the year. We've added 3 strategic partners for Walgreens Health; Blue Shield of California, Clover and Buckeye, bringing the number of lives covered above our calendar '22 year-end target of 2 million. VillageMD is leading the way in value-based care for the nation with over 340 clinics now open, including about 150 co-located with Walgreens on pace towards 200 by the end of calendar year '22.

Remember that we raised the target from 160 back in January. We're also adding health corners on schedule with 70 now on the way to 100 by the end of '22. Through our accelerated rollout, VillageMD already covers 433,000 lives under value-based arrangements, including 161,000 Medicare and MA value-based lives. At the same time, CareCentrix has 19 million total contracted lives, and Shields is partnered with 75 health systems. Our healthcare strategy is now coming to life and far from just being in the planning stages, it is well underway and can be seen in our best-in-class assets. We are moving swiftly to implement our vision of consumer-centric tech-enabled healthcare solutions that improve outcomes and lower costs for patients, providers and payers.

Over the course of the past year, we also took several actions to better align our investment portfolio with our strategy. These decisions will fund our continued growth and simplify the business. In addition to building our partnerships with VillageMD, Shields and CareCentrix, we also completed a thorough review of the Boots business. Our decision to pause the process was a reflection of challenging financial market conditions, and the Board and I remain confident that the business carries strong fundamental value.

We continue to have sufficient access to capital to accomplish all that we need to do as demonstrated by our ability to opportunistically monetize portions of our portfolio. Recent transactions involve AmerisourceBergen, unlocking $900 million; Option Care Health with $360 million in proceeds; and GPC at $150 million. There is good financial flexibility through our total portfolio, and we are entering fiscal year '23 on a clear trajectory to a simpler, more streamlined company. Additionally, we increased the dividend for the 47th consecutive year in July, and we remain committed to growing the dividend over time.

Finally, I want to cover our progress on our fourth strategic priority. We have evolved our operating model, expanded expertise on our Board, hired new leaders and made critical investments in our winning team. We have restructured our executive committee to align with best practices in healthcare.

In recognition of the central role of technology in healthcare, we have taken several actions. We reconstituted our Board's Finance Committee as the Finance and Technology Committee, appointed IBM's Global Chief Data Officer, Inderpal Bhandari, to the Board and named our next Chief Information Officer. Beyond that, we have named over 10 senior executives since the start of fiscal '22, including a new structure for U.S. Retail Pharmacy.

It's always been important to me to prioritize our most meaningful assets, which is our team members. I have no doubt that investments in our people will yield large rewards as we recruit and retain the very best talent, which will allow us to recover our script count growth and enhance our customer experience.

At the support office level, we're pleased to announce incremental measures to align compensation with our strategic ambitions and shareholder interest by adopting a relative TSR metric in our long-term incentive plan for fiscal year '23. We are all invested in, and accountable for, the success of our company.

At our stores, we invested an incremental $190 million dedicated to our pharmacy staff in fiscal year '22 primarily in premium pay and bonuses. Fiscal year '23 will include further investments in our pharmacy team of $265 million as we made good progress in returning stores to normal operating hours. As a reminder, this is in addition to the minimum wage increases we announced last year, which, consistent with prior guidance, represent a year-over-year impact of $260 million in fiscal year '23, building to $450 million over the 3-year period.

As we discuss these investments in our team members, let me take a moment here to stop and fully appreciate how important their work is. Just as the crisis level impact of the pandemic has started to subside, we've seen tragedy strike with the Hurricanes in Florida and Puerto Rico. Our teams, as they always do, responded decisively on behalf of their communities and really rose to the occasion.

My message to our colleagues on the front line is thank you, once again, from all of us at WBA, and we're so very proud of your leadership.

Now let me go into more detail on the deep and talented bench of leaders at WBA. Most recently, we were excited to announce on Tuesday that John Driscoll has joined our team as President of our U.S. Healthcare segment. Our U.S. business is now organized under 3 leaders, Healthcare under John Driscoll; Pharmacy under Lee Cooper from Shields; and Retail under Tracey Brown. John has more than 25 years of expertise, including as President of Castlight Health, a healthcare tech company, Group President for new markets at Medco, a $70 billion PBM that spun out of Merck; and Founder and Chair of the Surescripts e-prescribing network, the first cross industry collaborative with competing retail, PBM and health plans.

Lee previously served as CEO of GE Healthcare in the U.S. and Canada before leading Shields for rapid expansion. He has demonstrated proven success in driving growth, creating omni-channel customer experiences, establishing high-performance cultures and executing with excellence.

And already in just 1 year at WBA, Tracey has made major strides in our customer experience. Tracey's team is creating highly personalized offerings for our consumers across our digital and physical assets.

We are confident in the road ahead with the right team leading us through hard decisions today.

We exceeded expectations in fiscal year '22, successfully managing our resilient core business. While there are macroeconomic challenges, we are executing well and expecting strong core growth of 8% to 10% in the year ahead. We are scaling our winning assets to accelerate growth and profitability of our U.S. Healthcare business.

We are investing in strategic talent and capabilities, and we're taking strong action to simplify our portfolio. Our strategy is working to strengthen the business and build a solid foundation for sustainable shareholder 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. Overall, we had a good finish to the year with fourth quarter results slightly ahead of our expectations. We continue to drive strong execution across all of our operating segments and rapidly expand our U.S. healthcare business.

As a reminder, we are lapping a very strong prior year when adjusted EPS grew 28%, boosted by COVID-19 vaccinations. Year-over-year comparisons are also impacted by higher investments in the U.S. Healthcare segment, including the acquisition of a majority stake in VillageMD.

Sales declined 3.2% on a constant currency basis. Excluding the negative impact from AllianceRx and the positive contributions from healthcare M&A, constant currency sales growth was around 2%. Adjusted EPS was $0.80 in the quarter, a constant currency decrease of 30% entirely driven by the decline in adjusted operating income and partly offset by a lower tax rate.

Solid gross profit performance in U.S. retail and the continued rebound in international were offset by the lapping of peak COVID-19 vaccinations in the year ago quarter and planned growth investments in U.S. healthcare. GAAP earnings per share was a loss of $0.48, which compares to earnings per share of $0.41 last year mostly due to a $780 million noncash impairment charge in Boots UK and higher charges related to the transformational cost management program, reflecting incremental store closures. Please note that the Boots impairment charges were related to trademarks and licenses and were mostly due to the impact of higher discount rates.

Now let's move to the full year financial highlights. Full year sales increased 1.2% on a constant currency basis. However, if you exclude the 5.5 percentage point negative impact from AllianceRx, and positive contributions from U.S. healthcare M&A activity, core sales growth was a healthy 6%. Adjusted EPS was $5.04, a constant currency increase of 3.4% and above our initial guidance of flat EPS. Furthermore, the result included a 5.5 percentage point headwind from the build-out of the U.S. healthcare segment. In summary, full year core sales grew by 6% and adjusted EPS increased 3.4%.

Now let's look at the U.S. Retail Pharmacy segment. Sales decreased 7.2% in the quarter as we lapped a very strong prior year comp of 8%, and we faced a 7.8 percentage point headwind from AllianceRx. Adjusted operating income declined 36% lapping strong prior year results when AOI grew 16%, including significant COVID-19 vaccinations. Strength in U.S. retail and continued cost savings were offset by higher labor investments and lower results in U.S. pharmacy.

For the full year, AOI was up slightly, reflecting solid core sales growth. Now let's look in more detail at the U.S. Pharmacy.

Pharmacy sales declined 8.8% entirely due to a 10.4 percentage point impact from AllianceRx. Comparable pharmacy sales were up 3% despite lapping a very strong 8.9% growth last year. Comp scripts declined 3.5%, and excluding immunizations, comp scripts were flat, which compares to a 4.2% growth in the prior year.

We completed 2.9 million COVID-19 vaccinations in the fourth quarter, well below the 13.5 million vaccinations in the prior year quarter. And this trend was generally in line with our expectations. Pharmacy performance in the quarter benefited from improved trends from seasonal scripts and maintenance medications. However, scripts remain challenged by temporary reductions in store operating hours due to staffing shortages. Operating hour limitations impacted scripts by about 270 basis points in the quarter with a full year impact of around 180 basis points.

As Roz mentioned, actions have been taken to address the staffing challenges, and we are encouraged by the positive hiring trends over the past 11 weeks. This gives us confidence that we can recover script volume as we move into next year. Overall, looking on a 3-year stack basis, which normalizes for COVID-related volatility, comp scripts, excluding immunizations, increased 7.7%.

We administered 3.4 million COVID-19 tests in the quarter compared to 5.2 million last year. Additionally, with payers now reimbursing OTC tests, we sold 7.8 million OTC tests through the pharmacy. As a reminder, our comp script numbers exclude testing.

Finally, pharmacy adjusted gross profit declined driven by a much lower level of COVID-19 vaccinations and ongoing margin pressure.

Turning next to our U.S. Retail business. Overall, we saw good retail performance as we continue to benefit from our omnichannel and mass personalization initiatives. Comp retail sales decreased 1.9%, and this was largely due to lapping a very strong prior year quarter when sales advanced 6.2%.

Overall, our retail business has good underlying momentum with 13% growth on a 3-year stack basis. On a full year basis, comp retail sales were up a strong 6%, the highest in nearly 2 decades with positive contributions from personal care, beauty and cough, cold, flu as well as COVID-19 OTC tests, which contributed about 3 percentage points of growth.

Retail gross margin expanded throughout the year. reflecting the effective margin management, including strategic pricing and promotion optimization and stabilizing shrink levels.

Turning next to the International segment. And as always, I will talk to constant currency numbers. International delivered a strong set of results. Sales increased 6.7%, reflecting growth across all international markets, with Boots U.K. up 6% and Germany wholesale advancing 6.8%. Adjusted operating income was $163 million in the quarter, up 31% versus prior year. The strong finish to the year led to full year sales and adjusted operating income growth of 13% and 65%, respectively.

Let's now look in more detail at Boots U.K. Strong retail sales performance more than offset a decline in comp pharmacy sales of 7% as we lapped strong demand for COVID-19 services. Comp retail sales advanced 15%, reflecting a 20% rebound in footfall with flagship and travel locations showing robust improvement.

Market share increased with personal care and health and wellness driving notable gains. Compared to pre-COVID levels, store footfall remains around 15% lower. However, this was more than offset by a 14% increase in store basket size and Boots.com sales that more than doubled. Over 11% of our total U.K. retail sales came from digital in the quarter, up from around 6% pre COVID.

Turning next to U.S. Healthcare. Segment sales were over $600 million in the quarter with pro forma combined sales growth of 34%. VillageMD grew in line with plan and revenue growth is on track as we launch new clinics, scale existing clinics and increased value-based arrangements.

Shields delivered another excellent quarter with pro forma sales growth of 48%, driven by annualizing recent contract wins and by expanding their value proposition with existing health system partners. Segment adjusted operating income was a loss of $151 million in the quarter. Organic investments accounted for $45 million. Investments at VillageMD more than offset the profit contribution from Shields and led to a $106 million AOI loss across our majority investments.

The clinic rollout at VillageMD continues on pace. VillageMD had 334 clinics at the end of the year, an increase of 82 clinics compared to prior year. VillageMD had 433,000 value-based patients as of the end of fiscal '22, up from 326,000 at the end of fiscal '21.

Fiscal '22 was a peak investment year and the fourth quarter loss is not a good indicator for fiscal '23 and beyond. VillageMD, Shields and CareCentrix will drive increasingly high contributions as the businesses mature. Additionally, investments in the Walgreens Health organic business will be partially offset by positive contributions from clinical trials expansion and integration synergies.

Turning next to cash flow. Operating cash flow was $3.9 billion, and free cash flow was $2.2 billion as we cycled through some exceptional headwinds. First, the sales decline of AllianceRx led to the unwinding of a favorable working capital position with a year-over-year impact of $400 million. Secondly, we benefited from COVID-19 government-related support in fiscal '21, whereas this partially reversed as the deferred FICA payments became due in fiscal '22. In total, the year-over-year impact was around $400 million.

Additionally, we executed an inventory prebuy ahead of an expected strong cough, cold, flu and holiday season. And finally, there were some onetime items, including legal settlements in the U.S. of $200 million.

Free cash flow was also impacted by a $355 million increase in capital expenditures to support our growth initiatives, including the VillageMD clinic expansion, rollout of microfulfillment centers and continued omnichannel and digital investments.

Before moving on, I want to reiterate that our full year EPS grew 3%, ahead of our original guidance of flat, and we made substantial progress against our goals as we build out our U.S. healthcare business. I'll now turn to our fiscal '23 guidance and long-term growth outlook.

We are guiding to fiscal '23 adjusted EPS of between $4.45 and $4.65 compared to the $5.04 achieved in fiscal '22. While we expect solid core business growth, looking forward into '23, we are facing 2 key challenges. First, we project a much lower level of COVID-19 vaccination and testing activity, and this leads to an earnings headwind of 15% to 17%.

Second, the dollar has strengthened significantly and is a 2% headwind to EPS in reported currencies. Excluding these 2 headwinds, we expect core EPS growth of 8% to 10% on a constant currency basis, with positive contributions from all segments. This healthy core growth reinforces our confidence in achieving our long-term growth algorithm. And today, we are providing more clarity and raising our U.S. healthcare targets.

Based on execution to date and improved visibility, we are increasing our 2025 sales target for U.S. healthcare by over 20%, and we are now projecting sales of $11 billion to $12 billion by 2025. Furthermore, we expect the U.S. Healthcare segment to generate positive adjusted EBITDA by fiscal '24. Later, I will provide greater detail on the key drivers.

Let me now walk you through our 2023 guidance in greater detail, starting with WBA. Overall, we expect low single-digit sales growth on a constant currency basis. Excluding the COVID-19 headwind, we do expect sales growth of 2% to 4%. This sales growth is also impacted by a 2-percentage point headwind from AllianceRx, which largely cycles out in the second quarter. So if you strip out the AllianceRx and COVID-19 impacts, we expect constant currency sales to be up mid-single digit.

Adjusted EPS is projected at $4.45 to $4.65, a constant currency decline of 6% to 10%. Excluding the COVID-19 and ForEx headwinds, adjusted EPS growth is around 8% to 10%.

Let me now walk you through the assumptions and guidance for each of our reporting segments, starting with U.S. Retail Pharmacy. Sales are projected to decline low single digit. Our lower sales contribution from vaccinations and testing will reduce the growth by 2-percentage points, whereas the low-margin AllianceRx business also has an adverse impact of 2-percentage points.

In summary, if you strip out these factors, we expect low single-digit sales growth. We are projecting 16 million vaccinations in 2023 compared to 35 million in both of the previous years. The 16 million estimate assumes only 1 booster this year and that around 40% of the population chooses to get one. AOI is projected at $4.5 billion to $4.6 billion, including an 18-percentage point headwind from the lower COVID-19 contribution. Excluding this impact, core AOI growth is 10% to 11%.

Let's walk through some of the key growth drivers. First, we anticipate script volume recovery as we move through the year. Focused labor investments are already leading to positive net staffing trends, and over the coming months, we'll allow more stores to return to normal operating hours. We expect the ongoing rollout of microfulfillment centers to continue to drive efficiencies in the pharmacy, easing staffing challenges.

Additionally, pharmacy will be boosted by increased contributions from pharmacy services and patient acquisition initiatives. We also have good visibility to reimbursement net of procurement savings. Second, we expect continued momentum from the retail business, driven by our digital and omnichannel offerings, the enhancements we have made to our myWalgreens loyalty program and through innovation and growth in own brands. We are also seeing increasing contribution from alternative profit streams, including financial services and media. Finally, actions to mitigate shrink are well underway, and we are already seeing improved shrink rates.

Overall, we expect gross profit to be broadly flat but up around 5% to 6%, excluding the COVID headwind. SG&A is expected to increase by around 1% to 2%, reflecting increased investments in team members and technology, offset by continued strong results from the transformational cost management program.

Turning next to the International segment. International had a very strong year in fiscal '22, and we expect continued robust growth in 2023. However, the strong dollar will negatively impact reported results and represent a headwind to sales and adjusted operating income of around 11% to 12%. Sales are projected to grow 5% to 7% on a constant currency basis with all markets growing. Specifically, we expect the U.K. to grow 6% and Germany will grow 4%.

We expect adjusted operating income of $830 million to $870 million with strong constant currency growth of 26% to 32%. This follows on from 65% growth in 2022. Sales growth, strong cost management discipline and integration-related benefits in Germany are the key drivers.

Now let's turn to U.S. Healthcare. We are very encouraged by our progress as we build out our next growth engine. We expect sales of around $5 billion, including a full year of contribution from prior acquisitions and pro forma sales growth of 45% to 55%.

We are introducing an adjusted EBITDA metric for the U.S. Healthcare segment. And for fiscal '23, we expect an adjusted EBITDA loss of $220 million to $240 million. This is an improvement of $70 million to $90 million versus fiscal '22. We have moved past the fiscal '22 peak investment period, and the team is operating with agility and efficiency. And we have clear line of sight to positive adjusted EBITDA in fiscal '24.

Let's now take a deeper look at the U.S. healthcare projections. The U.S. healthcare segment is scaling to $5 billion in sales, and pro forma sales growth of 45% to 55% reflects strong growth across all of our healthcare businesses. VillageMD sales are projected at $2.8 billion to $3 billion, growing 50% to 60% with the performance driven by growth in value-based patients at existing clinics and continued expansion of their clinic footprint.

We anticipate pro forma growth of 20% to 30% at CareCentrix, reaching sales of over $1.4 billion in fiscal '23. This performance reflects growth across existing and new payer and provider customers and upsell of innovative new home services. Shields is expected to drive pro forma sales growth of 30% to 40% through new health system partners and an expanding value proposition at existing customers. Given the relatively early stage of development, we expect the Walgreens Health organic business to deliver a modest sales contribution of $120 million to $150 million.

Let me now walk you through some of the key corporate assumptions. Our tax rate is expected to be around 16% in fiscal '23, roughly 50 basis points higher than prior year. However, we do anticipate an increase to around 20% in fiscal '24 largely consistent with our previous expectations. This step-up will be driven by higher tax rates in the U.K. and Switzerland and a greater percentage of income from U.S.-based businesses.

Interest expense is expected to increase by $100 million due largely to higher interest rates. Our fiscal '23 guidance assumes only anti-dilutive share repurchase activity as our near-term capital allocation priorities will be primarily focused on growth investments and debt paydown. However, beyond '23, we do expect to have flexibility for a sizable new program. Please note that our fiscal '23 guidance does not assume any acquisitions or divestitures. And finally, corporate costs will decline slightly as we tightly manage central costs.

While we are not providing quarterly EPS guidance, we see a more balanced cadence between the first and second half compared to current consensus, which appears more first half weighted. In the first half, we will be lapping strong COVID-19 execution and record retail comps. The second half of the year will reflect the pace and timing of script volume recovery and reduced U.S. healthcare losses as the segment scales up.

Let me now turn to our long-term outlook. Looking beyond '23, we are reconfirming our long-term growth algorithm with mid- to high single-digit adjusted EPS growth in '24, building to low teens growth in 2025. Additionally, I would highlight that 2024 includes a more modest headwind from COVID-19 and the impact of a higher tax rate. Our transformation to a healthcare company will drive accelerated earnings growth as the faster growth and higher-margin U.S. healthcare business reaches scale.

We expect U.S. healthcare to contribute over half of the annual adjusted EPS growth over the long term while we continue to assume moderate growth from the core business and increased returns from capital deployment as we exit '23 with improved credit metrics.

Looking now at our capital allocation priorities. First, we will continue to prioritize organic investment in our resilient core business, and this will drive consistent returns and fast payback. Second, we will prioritize M&A that advances our healthcare ambitions, evaluating all opportunities through a rigorous strategic and financial lens. We intend to further simplify our portfolio to unlock value, and this provides significant flexibility as we execute on our transformation. Third, balance sheet strength is a key focus area for us. We remain committed to maintaining our investment-grade rating. Finally, we will return excess capital to shareholders, including a growing dividend. Beyond fiscal '23, we have potential capacity to resume sizable share repurchases.

Given the rising importance of U.S. healthcare, I would like to provide increased clarity on the segment goals over the next 3 years. With our solid execution to date and greater visibility ahead, we are increasing our fiscal '25 sales goal from $9 billion to $10 billion previously to $11 billion to $12 billion and representing a compound annual growth rate of approximately 50% on a pro forma basis.

VillageMD is the largest contributor with growth achieved as existing clinics mature and realize more attractive economics and through ongoing expansion of VillageMD's clinic footprint. We expect continued strong sales growth at Shields, benefiting from rapid growth in the broader specialty pharmacy market and their unique focus on health system enablement.

CareCentrix sales will be driven by increased demand to better manage the needs of patients with complex or chronic conditions as they transition out of the hospital and into other post-acute settings including the home. Finally, we expect the Walgreens Health organic business to scale rapidly as we add new payer and provider partners and increasingly move to value-based and delegated risk arrangements. We expect the Walgreens Health organic business to contribute over $1 billion in sales by 2025.

Moving now to our EBITDA projections for U.S. Healthcare. We have a clear path to profitability by fiscal year 2024, building to a target of mid-teens adjusted EBITDA margin. We are projecting adjusted EBITDA of $125 million to $225 million in '24 rising to $500 million to $700 million in 2025. We are confident in this trajectory with several factors expected to drive significant profit growth. Achieving scale across the portfolio is critical as it enhances our ability to cover central overheads and platform investments, including technology. As you have seen earlier, sales will scale from $5 billion in fiscal '23 to $7 billion to $8 billion in '24 and $11 billion to $12 billion by 2025.

Our maturing VillageMD clinic profile is a significant tailwind as a greater percentage of clinics reach positive contribution margin. As a reminder, this typically occurs in year 3 on a 7-year glide path to very attractive at scale economics. Within the Walgreens Health organic business, we continue to have productive discussions with existing and prospective payer partners around a shift to risk arrangements. And our margin-accretive Shields business is projected to continue to grow strongly. On top of all this, the U.S. healthcare team has identified sizable synergy opportunities across our various healthcare assets. And they are operating with speed and agility and driving operating efficiencies on a clear path to profitability.

Let me now wrap up the guidance section. I would like to leave you with 3 key takeaways as to why we are excited about the near-term and long-term outlook for WBA. First, we expect to drive positive core business momentum in fiscal '23 as we lap strong COVID-19 execution in 2022.

The U.S. healthcare segment is rapidly approaching positive adjusted EBITDA. The business continues to scale, and we have raised our 2025 sales outlook to $11 billion to $12 billion, representing a compound annual growth rate of roughly 50%. Finally, we remain confident in our long-term growth algorithm, and we are reconfirming our goal of low teens EPS growth. We are committed to our vision and strategy, and we have and will take action to simplify the business and unlock shareholder value. With that, let me now pass it back to Roz.

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

Thank you, James. Now we're going to turn the page and offer more insights into our U.S. Healthcare segment. As I mentioned earlier, we're very happy to have John Driscoll, joining us as our President of U.S. Healthcare. John is an outstanding entrepreneur, who has partnered closely with us for some time now in his role as CEO of CareCentrix. He's an incredibly knowledgeable thought leader in healthcare and has become a confidante and a friend as we work side-by-side during our 3-year planning process. I am certain he will be able to hit the ground running overseeing this vitally important part of our business and building on our strong momentum. John, welcome once again, and now I'll turn it over to you.

John Driscoll - *Walgreens Boots Alliance, Inc. - Executive VP & President of U.S. Healthcare*

Thank you, Roz. I have spent my career leading initiatives to reimagine and reinvent healthcare solutions that improve outcomes, lower costs and meet patients where they are. I'm delighted to join you today as the President of U.S. Healthcare. I believe that Walgreens is uniquely positioned with its pharmacy backbone as well as the quality of the assets and teams that we have invested in to start the journey at scale to help health plans and patients lower costs and improve outcomes.

Building on our strong foundation in retail and specialty pharmacy, our U.S. Healthcare business expands WBA into significantly larger and faster growing profit pools. We're gaining access to $135 billion in addressable EBITDA profit pools versus $41 billion today. We focus on market segments that are natural extensions of the pharmacy that create value for our payer and provider partners and again meet consumers where they are. I'm thrilled that WBA has invested in foundational, best-in-class assets with VillageMD, Shields and CareCentrix that, together, create a platform for us to drive growth in some of the most attractive healthcare markets.

Primary care physicians are at the center of managing health and wellness of patients. And we have a market-leading business in VillageMD. As more care moves into the home and the community, we have a natural platform to meet that demand from plans and patients with CareCentrix.

Specialty pharmacy is one of the fastest-growing segments in healthcare, and most specialty spend originates in health systems. We also have an industry-leading provider in health system specialty pharma services in Shields. Simple convenient access to low-acuity healthcare services is also key to managing the health of our consumers. We're starting to deliver population health services through our health corners to close care gaps and help our payer and provider partners expand their reach.

In the end, scale is critical, but healthcare is local. We're creating a nationally scaled healthcare business, which will leverage our entire portfolio to deliver better care at lower costs. And by focusing our portfolio on these higher-growth markets, we will accelerate the return on our investment and our path to profitability in U.S. healthcare.

Today, most patients and their caregivers are overwhelmed as they try to manage across different health conditions, providers, appointments, bills and medications. They struggle with getting basic access to care and experience a lack of coordination across their health needs. Our consumer-centric tech-enabled model will provide care across the full continuum, bringing together products and services across our portfolio.

We see significant opportunities for synergies, allowing us to pursue value-based care and risk arrangements, which will demonstrate the value of an integrated approach. Our focus is on expanding our risk business, supporting integrated care, expanding our pharmacy value proposition and driving operational efficiency.

Over the past year, we've made strategic investments to rapidly expand the breadth and depth of our portfolio. Bringing together our current individual assets, which are increasingly working together, our U.S. Healthcare segment now covers over 26 million lives cared for through a network of over 12,000 providers in communities across all 50 states.

While the Retail Pharmacy is not part of our U.S. Healthcare segment, it serves as the bedrock of our healthcare portfolio. We have deep community ties, and demand for healthcare services in our stores has never been higher. And it's not just consumers looking to Walgreens for help with healthcare. Federal, state and local jurisdictions are increasingly looking to partner with us because we are close to patients, and they know they can count on us to deliver high-quality services that are absolutely critical.

Our pharmacy serves 96 million patients through a team of 90,000 care providers. We administered 48 million total vaccines in fiscal year '22. And importantly, almost half of our pharmacies are in high need underserved areas, where we can drive health and vaccine equity.

Our front-end business is increasingly relevant to health and wellness as we've seen with the sale of COVID OTC tests as well as our trusted selection of OTC medications. Both the retail and pharmacy businesses are serving the consumer across channels. We drove 117 million visits to the Walgreens app last year.

Lastly, our stores are anchor access points to serve consumers through our Walgreens Health business, which now covers more than 2.3 million lives through 3 health plan partners. Health advisers in our stores conducted over 200,000 interactions with consumers to tend to their healthcare needs. Being lost in the wilderness of healthcare is a big challenge for patients and families.

Walgreens Health is perfectly positioned to help consumers navigate what can be a bewildering experience in U.S. healthcare.

Now let's turn to VillageMD. Village is a leading asset in the field of risk-taking primary care. Village is uniquely positioned as one of the largest primary care providers in the U.S. We can now leverage the combined power of the Walgreens stores and our trusted brand with primary care. VillageMD providers touched the lives of over 1.6 million patients, covering over 430,000 value-based patients through over 340 clinics in 22 markets. 152 clinics are co-located with Walgreens stores, half of which are in underserved areas.

VillageMD has achieved a Medicare Stars rating of 4.0 to 5.0 in their mature markets. It generates material Medicare Advantage cost savings of $2,400 per patient per year. We are also very proud to say that we serve patients across all socioeconomic statuses and are truly payer-agnostic. VillageMD is one of the leaders in the move to value-based care. The move to value is increasing and inevitable, and we expect very attractive growth ahead.

There are a number of companies directly or indirectly competing in the value-based primary care marketplace. But VillageMD is differentiated by a faster path to favorable economics driven by our acceptance of all patient populations and all payer types. We have a unique ability to address all of the ecosystem's pain points at scale.

VillageMD's payer-agnostic model has enabled us to secure value-based contracts with every major national health plan as well as many of the local and regional health plans in the markets we serve.

Our integrated primary care and pharmacy model has driven strong results, especially in combating chronic disease in the Medicare population. 23% of VillageMD's Medicare patients are on at least 10 medications, making pharmacists critical members of the care teams. And moving forward, we see opportunity for commercial and care delivery synergies with CareCentrix.

Now let me talk about Shields Health Solutions. Shields is not a traditional specialty pharmacy but instead represents an evolution to the model. Shields participates in the specialty pharmacy space by building and accelerating hospital-owned specialty pharmacy programs that are integrated with care providers at the point of care. The idea is simple. 75% of specialty prescriptions in the U.S. originate in a health system, yet those hospitals retain only 10% of those prescriptions. Shields' mission is to help the health system close that gap by driving a 5 to 7x higher capture rate of specialty prescriptions for our partners.

Today, our network of more than 75 health system partners represents more than 1,000 hospitals nationwide. Our partners include well-known health systems such as UMass Memorial, New York Presbyterian, Ohio State University and UC Health.

Our health system enablement model has 3 core components: first, an integrated clinical model between the pharmacy team and the patient care team; second, centralized infrastructure to remove administrative burdens; and third, proprietary software for end-to-end workflow and operations.

Shields benefits the health system, the patient and Walgreens. We expect this business will continue to yield strong top line growth at accretive margins, while also providing a balanced approach to the traditional contract pharmacy model. The Shields' high-touch model is highly effective, resulting in nearly a 40% reduction in readmission rates. Shields creates strong value for every participant in the ecosystem and is well ahead of key market averages. For patients, the need to get on therapy as soon as possible is critical. We get them on therapy in 2 days versus a market average of 21.

Affordability is also critical for patients. The Shields team can help achieve an average co-pay of $8 versus an industry average of more than $100.

As I mentioned before, Shields drives a superior specialty capture rate at up to 70% versus the market average of under 10%. Shields ultimately reduces the total cost of care by about 13% compared to market averages.

Finally, let me turn to CareCentrix as the only nonpayer owned post-acute and home services platform, CareCentrix will help us extend Walgreens' pharmacy network and services to the home. CareCentrix provides national scale, care coordination and actuarial capabilities along with a deep focus on the customer experience. We cover 19 million lives across the network of 7,500 home supplier locations. In 2022, we will coordinate nearly 6 million home-based services. CareCentrix has externally validated results showing the total cost of care reductions of up to 20% delivered with member satisfaction results routinely exceeding 90%, and we are already working to integrate CareCentrix across our business, including VillageMD and Shields.

For example, together with VillageMD, after a hospital discharge, CareCentrix will be able to immediately refer a member to a primary care physician when needed and even schedule an appointment for follow-up care. Analysis has shown that this rapid action can reduce hospital readmission rates by 20%. Collaboration with Walgreens pharmacists can increase the number of successful medication reconciliations after a hospital discharge by 15% to 20%. When done right, these not only lower care costs but also improve a health plan's stars rating to drive sales growth, creating a very attractive value proposition.

Relative to the competition, CareCentrix is highly differentiated. Not only are we a payer agnostic provider of home and post-acute services, but our network-based model provides national reach today with an ability to easily scale. We have the most experience with over 25 years in managing home-based care as well as the broadest portfolio of home and post-acute services, including home health, durable medical equipment, home infusion, home-based palliative and hospice care and post-acute and readmissions management. This home-focused platform simplifies the coordination of home services for the members, health plans and hospitals.

Over time, the platform can also easily expand to include other types of home services. Not only does CareCentrix manage the broadest set of home services, but we also manage all lines of business, Medicare Advantage, Medicaid, commercial and marketplace Exchange.

Let me close today by emphasizing my excitement to be joining WBA at this key moment of transformation for our company and for the U.S. healthcare system. WBA has the right assets, the right team and the right strategy. We are already providing care delivery across the healthcare continuum and driving consumer engagement through our platform. Thank you, and let me hand it back to Roz for closing remarks.

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

Thank you, John, and thanks to everyone for joining us for today's extended call. Before we kick off Q&A, let me sum up what you've heard. Fiscal '22 was a year of broad-based outperformance against our expectations. We are well positioned to drive continued execution through our resilient core business and by scaling our winning assets. We see a clear path for U.S. healthcare to achieve profitability starting in fiscal year '24, and we're already raising long-term sales targets. At the same time, we are investing in talent and capabilities and rapidly simplifying the portfolio as part of our transformation to a healthcare company.

We have good visibility to tremendous growth with best-in-class assets that we have in place today. This builds my confidence that our strategic priorities are working to drive our long-term growth algorithm.

In closing, we are pleased with this year's performance. We are tackling the challenges that next year poses, and we have conviction in the development of our new U.S. Healthcare business and our future growth potential. Now I'd like to open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Lisa Gill from JPMorgan.

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

Thank you for all the details. And John, I have to personally say I'm very excited that you're back on the public side of the market. So let me start there. When we think about all the comments that you made around Walgreens Health, I just really want to understand a couple of things. One, when we think about the more than 2 million lives that you're talking about today, when I try to look back and I look at some of the other comments you made around at-risk lives at VillageMD, can you maybe just talk about how we think about those 2.3 million lives, how do you monetize those lives? Is this shifting towards value-based arrangements? And then secondly, I know James talked about 2025 and the increase in getting the profitability in that segment. How do we think about the longer-term profitability of Walgreens Health?

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

Lisa, this is Roz. I'll start that off, and James and I and John might fill in a few little pieces here. You asked a question about value-based arrangements. So the assets that we have right now, I will talk about a little bit on the Village side, Village has a large amount of their current business that is in a value-based arrangement. And you'll see that even more of that will grow over time. That is our objective.

And then to think about how we tie our assets together, I want to just talk a little bit about the grounding of what we have in that relationship between the pharmacists and the primary care physician because that's the real key for us in terms of what we do inside our stores and taking that relationship that we have between our current customer and the patient that comes into a VillageMD and bring those 2 relationships together between the pharmacists and the primary care physician. When you think about value-based care, John, do you want to say a few words about that?

John Driscoll - *Walgreens Boots Alliance, Inc. - Executive VP & President of U.S. Healthcare*

I think -- and Lisa, thank you for those kind words. It's great to be on this side again. I'm really going to underscore the fact that I think this is an amazing platform. With regard to the contracted lives, we're starting with contracting with health plans that are really enthusiastic about partnering with Walgreens around closing care gaps and working on screenings and really integrating more into the healthcare system. Over time, you will see us work more closely with those plans on shifting to risk. It's a natural baseline, and we've obviously got some great assets with VillageMD and CareCentrix to accelerate that transformation over time. But right now for those 2 million lives, it's really initial contracting around leveraging the pharmacies to close care gaps and screenings.

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

Yes. And Lisa, we -- you asked about the long-term margins. We've given a long-term target of mid-teens, and that's probably even a little bit on the conservative side. And as you've seen, we've started flipping the metric to EBITDA to emphasize that we've already passed the peak of heavy investments. And I think as you look out over the coming years, I think we will we have Shields which is immediately profitable, and we're not breaking out by unit, but it's at least $100 million profit in the fiscal '22. And that is growing like gangbusters. We've given you the revenue growth. And you can probably assume that the profit growth in that business will outpace the revenue growth as it scales.

And CareCentrix is a new acquisition. I think you can make your own estimates. I think we've said in the past it's like mid- to high single-digit margins. And we've given you a revenue number. We've given you a growth number, so that's pretty easy. I think the one we -- we're probably struggling with a bit is VillageMD. We've been quite clear on this one, that's in an investment phase, and we actually accelerated the investments in 2022. So instead of 160 clinics in calendar '22, we've gone to 200. So we're actually doing the smart thing. We're doubling down. This is a scale business. The unique part of -- as John said about the model is, this is not an [Oak] Street. This is a model that breaks even in year 3. So opening clinics for us, yes, it will be painful in the first 2 years, but then the returns are outsized because we get a very rapid payback.

So -- but realistically, if you plot out the number of clinics, it will be fiscal '25 before we're EBITDA breakeven. And the same goes for the organic business. And just to add on to what John said is there is a lot of excitement amongst the partners we have been discussing with. We do expect to take delegated risk in -- probably in the near term, so 6 to 12 months kind of time frame. So we're very excited by it. And we've called up the revenue guidance as -- and that is basically just coming from better visibility as we went through all the business reviews in the 3-year plan. And we're very excited by the signal that's sending and for strong operational plans behind each one of those.

Operator

Your next question comes from the line of Elizabeth Anderson from Evercore ISI.

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

I had a couple of questions about sort of just like cash flow. In terms of the debt paydown, can you talk about like how much are you sort of thinking about sort of mandatory versus voluntary paydown over the next couple of years? And then on M&A, I think it was very helpful to hear, obviously, the Walgreens Health outlook. I just wanted to see if there were any other additional assets you felt like you needed. I think at sometimes you've talked about maybe a healthcare IT asset there, so I just wanted to understand how that fits in your current mix of thinking? And then any other one-off sort of cash flow items like opioids or anything that might change going forward.

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

Thanks, Elizabeth, for that question. Let me start off by first saying that, first of all, we've moved past our most significant M&A period in FY '22. We're past our peak investment period at this point. So we're pleased with the assets that we have, but we remain committed to our prior conversation that probably our next asset will look something like a tech asset. But I will also mention, though, too, outside of that, we would seek something that is currently achieving EBITDA as we look forward in terms of where we would invest. But in terms of what we would do next is looking to really carefully tether these assets together, and it lends us to look in the technology space. James, do you want to go through the cash flow and debt paydown?

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

Yes. I think on the debt paydown. I think we've got exiting the year of $12 billion of debt. Well, we also have a lease liability of $24 billion. So I think you can do the calculation yourself. Our target is [3.75] debt to EBITDA for Moody's and 4x for S&P, and we're currently running above those levels, and we have taken commitments with the agencies to get them below these levels. So I'm not giving an absolute number.

What I would point out, though, is the tremendous flexibility we have in our portfolio, we have a lot of assets, and a fair portion of them are liquid. So it gets back to your M&A question. Should we need to do M&A more likely to be EBITDA accretive. And then secondly is we have a lot of firepower to do EBITDA because we have a lot of assets that are not necessarily very close to the core. So we feel like we're in a fairly good position. But your question is the right one. We will, in the short term, focus on internal and actually potentially some M&A but not very large. We will focus on investment in the business and debt paydown.

And then as we look forward beyond '23, we've put it in the materials, our cash flow generation improved substantially when we get into '23 and '24 as healthcare investments taper off and it turns profitable. At that stage, we probably have fairly significant capacity to return capital to shareholders. But a lot can happen between now and 2024.

Operator

Your next question comes from the line of Steven Valiquette from Barclays.

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

Great. So in the U.S., you mentioned that the comp script growth ex immunizations was flat year-over-year in the fiscal fourth quarter. You mentioned they should start to recover in fiscal '23, and you talked about the labor investment starting to pay off. But I guess with that, I wasn't quite clear whether the labor investments are the key variable in your U.S. growth recovery in fiscal '23 or if other factors are more important. So I guess I was hoping to just get more color on the expected U.S. script growth recovery in fiscal '23.

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

Yes. We think we have -- I think I have almost take it up a level up on to the pharmacy business. We actually see pharmacy growing next year. So you take out the impact of COVID, and we're expecting a very strong performance across pharmacy.

And there's a couple of factors. So number one is scripts. So you asked the #1 question, and we expect script growth of about 5%, which is well above what we're currently doing. We expect an acceleration as we go through the year. And that directly answer your question. We expect 50% to come from either the labor investments, our fairly sizable marketing investments we're making on customer retention and regaining lost customers because, frankly, we lost customers during our overfocus on COVID, and now we've got to win them back. So the short answer is we're investing in people, and we're investing in marketing and we're investing in attracting and winning back the patients that we lost.

But if you look at the bigger picture, so a 5% script growth that generates significant profit growth. And obviously, it is ahead of us. The other factor is reimbursement. This is quite an unusual year because we have 95% of the contracts closed. So we have extremely high visibility to the actually reimbursement number, so 95% closed. And this is -- some of our contracts are in the second year. So this is a step down year. So the reimbursement in 2024 is around 80% to 85% of the reimbursement -- sorry, in '23 is 80% to 85% of the reimbursement level in '22. So we're getting a favorable, call it, net margin compared to what a typical year would look like.

The third one is we have pharmacy services. So obviously, as we've gone through COVID, we've developed new capabilities. There's lots of states opening up the ability of pharmacists to do more activity. So our pharmacy services business is growing quite strongly. So there's 3 things: script growth, which is big investments to drive script. And two is it's an easier than norm reimbursement net of procurement here. And then the third one is a fast-growing pharmacy services business. So we have a fairly strong plan for the pharmacy business for next year.

Operator

Your next question comes from the line of Charles Rhyee from Cowen.

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

Just wanted to follow up. As we think about the macro environment and we are potentially moving into sort of recessionary environment, can you talk about sort of what you guys are planning in your assumptions in the guidance, particularly for this next fiscal year and maybe beyond to kind of things to get ahead of a potential slowdown in the economy?

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

Yes. Maybe I'll just give you some of the impacts that are already assumed in the P&L. And we've essentially planned for a moderate recession, but there are significant impacts in the income statement. We've got about $0.08 or $0.10 of higher interest cost. We've got lower pension returns in the U.K. That's like $0.04. And the labor investments we've thought about are not necessarily directly a recession impact, but we have a very high level of inflation planned in the income statement. So I think the total inflation impact in the U.S. income statement is probably, I guess, $700 million, and we have a significant cost program in the U.S., the TCM program offsetting that, right? And then the other thing is that we do have -- still have some assumptions on supply chain and inflation.

I see that a little bit as of an opportunity. We see China becoming less difficult right now and shipments are coming out way faster. And I think there's a bit of a release in the system. The latest inflation numbers are not particularly encouraging, but we've planned the inflation side of the envelope quite in a detailed way. I think your real question is about how do you offset it. And maybe I'll flip to the retail side of the business, right?

So I think you have to look at track record as you look forward into our plans and the track record of the U.S. front of store business in '22 was we grew overall volume at -- sorry, comp revenue at 6%, of which about 3 points came from OTC test but still a strong 3% across the business for the year, and we increased margins at the same time. So we could walk and chew gum, right? So the margins went up. Despite all of the inflation, supply chain, the confusion around COVID and the stress on the stores, we still delivered this kind of performance.

So looking forward, we have planned for inflation. But our offsets are coming from a lot of the levers we pulled in the current year. One is we are assuming next year a comp growth of about 2% to 3%. So we're not expecting an acceleration versus the previous year. We're expecting repeat what we did in the base year.

Two is we have a lot of marketing levers. It's not just the omnichannel and digital investments that we've been making over the last 2 years. There's a customer value transformation program that has delivered significant margin enhancement in the -- in 2022. And that will continue into 2023. And the big one is own brands. We didn't get entirely to the targets we expected in '22. So actually, we see own brands being an even bigger lever going into '23 and '24. So own brands assortment, and that will drive tremendous mix. We have strong own brand positions in some of the health and wellness categories. But have we covered them all? No. Should we be covering them? Yes. And are they very profitable? Yes. So we've got a lot of plans more of the same and more on top again while we're very excited by front of store.

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

Can I just follow up and ask on the own brand? Is that tied also to shipments coming from China being -- coming in quicker? Is that part of what will help accelerate own brands in the front end?

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

No, we actually did pretty good in fiscal '22 on availability in the stores. It wasn't in line with prior levels. But I think if the prior years were at 96 or 98, I think we were at 92 or 90, right? So not dramatically different. So I think the supply chain guys here did a really good job on getting stock in. Seasonal was not great in the current year. We missed some of the seasonal. But the core health and wellness products, we generally had stock across the stores. And that's one of the opportunities we have in the current fiscal year is supply has released freed up from China. So seasonal -- all the seasonal holidays will be better than they were in '22.

Operator

Your next question comes from the line of Ann Hynes from Mizuho Securities.

Ann Kathleen Hynes - *Mizuho Securities USA LLC, Research Division - MD of Americas Research*

So my question really has to do with the previous question because what really stuck out to me when I saw the guidance for retail, especially the adjusted operating income is for 10% to 11% growth ex COVID, which is, in my sector, one of the probably highest operating growth for next year. So -- and I know you have a lot of confidence in gaining the market share back. Maybe can we look at it in a different way? Like when you look at your guidance, what do you worry about most? What would be the risk for the downside? Are you not achieving it? And can we also talk about international. You're assuming international growth. And sitting here in the U.S., we see a lot of headlines that you're going into a recession. So maybe if you can give a little bit more details on what would be the drivers of growth over there.

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

Maybe I'd take it a different way, though. I'll take it what's the core EPS growth? And it's -- I'll take a midpoint of around $0.55 and just break it out by business. And we have $0.03 coming from Healthcare, so not a lot. We have very strong plans behind it. All the acquisitions have been closed. And I would say, if I take the Healthcare business, I would say it's slightly skewed to opportunity. The team there has been shifting to more of a private equity cost-optimized rollout of all of the businesses. And we probably have opportunity on the amount of costs we're putting in upfront. So I would say Healthcare at $0.03 is done with probably some opportunity.

International, we expect the contribution. And this is a midpoint of estimates about $0.14. And I don't think it's a crazy number given that we've put out there of 5% to 7% growth in sales. And you just got to look at the most recent performance. We're doing a 6% growth in both the U.K. and in the current environment in the U.K., and we're doing a 6% in Germany. And the plan for next year is to do a 6% and a 4%. So we're not counting on improved circumstances. And I would argue the U.K. is already in the depths of a pretty challenging environment.

What's happening in the U.K. is -- and this has happened over the last 12 to 18 months, a lot of high street retailers went past, and we won all the market share. And these are very profitable categories. So in front, basically, the retail business, we're in a very, very and much stronger position than pre COVID. And then 2 is we've completely shifted the business model in the U.K. on to online. So we have doubled the penetration that we had pre COVID. So it's a completely different business with a different set of strengths. So we believe International should be able to grow revenue at 5% to 7%. That's what we're doing in the most recent quarters. So there's no reason to say it would get materially worse.

The other differentiating factor is the cost management across International has been very, very aggressive. We have really downsized the stores. It includes the opticians business, the mainstream business. And Germany, we had an integration of 2 businesses last year and the synergies are way ahead of plan, and it turned out to be a very smart combination. And we own 100% of the business now, so we're getting all the benefits of the synergies. So I think that $0.14 is pretty safe. So you basically come down to talking about the U.S. business, which is $0.38.

And just for transparency, we will give you the numbers by business; $0.45 comes from pharmacy, $0.48 from retail and a negative $0.55 from SG&A. So this is the precision, which we're prepared to give the guidance. And we walked through a little bit the -- and I do want to emphasize, don't worry about the International and the Healthcare. This is a discussion around just dimensions in the U.S. The Rx, we discussed the $0.45; retail, 48%; the SG&A, $0.55. We have a very -- we have an investment focused plan. We have $0.40 of labor investments, either minimum wage or in the pharmacy. The pharmacy investments at $0.24 generate a return on investment through scripts. We have incremental marketing on pharmacy. It's probably $0.04, I think it is. That's generating a return on investment.

We have other investments of roughly $0.55. That's over $0.5 billion in systems capabilities, omnichannel, digital. So we're continuing to invest, and that's what's driving the top line. We have -- we mentioned the inflation number. But TCM in the U.S., that's the transformational cost management, that's $650 million of savings in 1 year plus the business is saving another, I think, $300 million.

So we're taking out to fund all these investments. We're taking out almost $1 billion of cost, which is -- it's a massive number. And we're being deliberately transparent on this. To make you understand, we know what we're doing when we're giving these guidance.

And I think your question is on risk. I think the #1 risk is we have the plans and they're very detailed, and the money is in the income statement. The question is how quickly will we get back the scripts in the pharmacy business. We're not concerned about reimbursement. We're not concerned about procurement savings. The only risk we see is on Rx scripts in the U.S. And it's orders of magnitude. You can figure out for yourself how much 1% of growth is worth. It's not the end of the world. That just brings you to the bottom end of your guidance or it brings you to the midpoint. It depends on where the Street comes out.

On the flip side, there could be a deeper recession. Well, we think our business is differentiated against mainstream retailers. I'm talking front of store for a minute -- that we're not in the same high ticket categories where we have smaller baskets. When gas prices are high, people don't travel as much to a Walmart, they go to a Walgreens, right? So we have -- and we have an intense focus on building a much, much bigger owned label business. And we intend to -- we don't say we're insulated but we're far more insulated than some of the other peers out there.

If you don't flip to the opposite side on opportunities, I think -- I personally think, and I'm not sure I can convince all my compatriots all the time, I think we have more opportunity on the cost side. And I think that's the job we have to do. We will develop contingency plans on the cost side such that we will offset any risk in the income statement. Roz mentioned it earlier. The deployment of capital, could we do smaller acquisitions that are immediately EBITDA accretive? Yes, probably. So that becomes an opportunity. So I'm thinking cost plus capital deployment offset Rx volume. That's a simple to sum up. I don't know, Roz, how you would characterize it?

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

I think you said it well. The one thing I would add is I don't want to overlook the investments that we're making in our fulfillment centers. That's a capital investment. And the intention with those 8 centers that we have currently that's supporting 1,800 of our stores, our goal is to take about 50% of the scripts out of the store, put them in a central fill location and feed those back to the store. So when you see these investments, it's not only investment in the labor piece. It's also an investment for better jobs for our pharmacists, so they can lift up and consult, and then also we get better throughput in the stores. And so that's part of this equation, to return the script count is that you have better service at the same time, and we're reducing costs by bringing in the fulfillment centers. And it's one of those things that's in the backdrop of our business but really strengthens our operating model inside the stores.

Operator

Your next question comes from the line of George Hill from Deutsche Bank.

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

I guess I have a couple of questions related to the portfolio and then a housekeeping question. So I guess as you guys talk about continuing to streamline the portfolio. Is it safe to assume that we should continue to see moves like you guys have made with the minority investments in other public companies? And I don't know if you're willing to talk about timing on that. The flip side of that is, given that strategy, does it make sense to fully consolidate and buy out the remaining interest in VillageMD given the growth profile there? And I wanted to ask the housekeeping question of do you guys have a prearranged purchase price for the balance there. And then I have a quick housekeeping follow-up, if you don't mind.

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

Sure. George, thanks for that question. So let me talk a little bit about our M&A position. I think one of the things to think about, too, is the work that we did around our Boots strategic position this year as well. So when we look at our portfolio, it's broad. And what James mentioned earlier is that we have a repository of cash that we could access. And you've seen us do that with the work that we did with ABC. We did that work also with our arrangement with Option Care. So our whole objective here is to simplify our portfolio. That's most important for us is to simplify.

And then when you see us strategically invest, it's about our healthcare growth. And so we'll be very deliberate about that and send that through a strategic funnel as we think about what we do next. To talk a little bit about our work with Boots, we went through a confidential process. We achieved a high level of interest, about 8 to 10 interested parties. And we were really encouraged. There were productive discussions with a wide range of individuals. And the markets turned on us and we went in another direction and decided to hold on to that asset. And you can see their performance, as we finished, fiscal year '22, was strong. And so we're going to continue to work there in Boots and keep it strong until we make a decision there. So that's one piece to think about.

And then, again, just going back to look at the work that we've already done, we'll engage Village, our CareCentrix team and Shields. And with Village, we don't have a number out there that we've settled on in terms of a preconceived number, and then we've not made any plans with Village to go any further at this point. But the work we're doing with them right now is very strong. It's probably the center of our healthcare work for us. And so we're excited about it, and it's going well.

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

Yes. So I think just -- maybe add in a little bit on the portfolio. We can't say anything about any of our future actions. But I think you should listen to what Roz said that we are -- we're very, very focused on simplifying the company because it's too complex for investors. And then the second piece is, we are focused on our debt and returning value to shareholders. So we will be in cleanup mode for the foreseeable future.

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

That's great. And maybe just a point of clarification. I wanted to follow up on Steve's question. When you talked about reimbursement being 80% to 85% of 2023, is that what we should assume kind of a like-for-like reimbursement reduction looks like to basically call it down 15%?

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

Yes. What all I mean is if you look at absolute in the income statement in 2022, the '23 number is about 80% to 85% lower just because certain of the contracts are on a year or 2 of the contract. And then -- but the most important factor is we have 95% of the contracts closed. So the volatility in the guidance is reduced, right? So -- because that's what it all is. It's all about volatility. And we got the question on ops and risk. The only thing we theoretically can control, we can influence very heavily as already scripts. But the reimbursement rate is not a large concern going into the year.

Operator

Your next question comes from the line of Michael Cherny from Bank of America.

Michael Aaron Cherny - *BofA Securities, Research Division - Director*

Maybe James, to pick up on that last comment and some of the commentaries you made around the control of regaining some of that script capture. As you think about the push and pull you have on trying to get some of the scripts that were lost due to the staffing dynamics, can you go a little more granular into some of the specific dynamics that you're pulling forward to? How much of it is consumer-oriented versus payer-oriented in terms of that outreach? And in the past, especially when there's been times of script loss, I know it was before a lot of management's time, but thinking back to the Express Scripts dispute from a decade or so ago, what were some of the activities that worked in order to make sure that you recapture the script growth that you were targeting?

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

Yes, I think it's actually quite scientific. If you take the labor investments, we have each of the stores track and it's startling what the result is. The stores that don't have a labor hour restriction or growing scripts 3%, and the stores that have the labor restrictions are down 3%. That's actually a delta of 6%. So store by store, you put in the labor that you don't just switch it on straight away. You've got a playbook. They got to start calling patients. So there's a big physical element to this, and there's a training and playbook element.

The other part is the marketing team has defined programs on outreach to all of the patients. We've got to first figure out which ones we lost by store because it makes no sense to contact the patient if that store hasn't been solved, right? So you first got to put the labor back, then you got to do the outreach. And as I said, we've built in, I think, $45 million of marketing -- incremental marketing dollars in pharmacy on this consumer engagement. So it's very data-driven. It's very, very focused. But ultimately, it's quite complex because you got to reach the consumer and they've lapsed and you've got to convince them to come back and that the -- and our service level in the overall store has gone up. I don't know, Rick, do you want to maybe add some light to that?

Rick Gates - *Walgreens Boots Alliance, Inc. - Senior VP of Pharmacy and Healthcare*

I think it's the right question. I think as you look at the -- our ability in the marketing space, it's very much advanced from where it was back in the days of Express Scripts and all the stuff you referenced. And if you look at our ability on the mass personalization side and really understanding the dynamics of where consumers are, how do we actually meet them, where they are and understanding how to win them back. It's not just a win back. It's also trying to engage them in a different way to really get them to leverage our stores for more than just scripts or services and other types of things that we're doing as well. So I think what you'll see is a very focused approach on how we leverage our marketing dollars to really have a bigger impact than we would have in the mass personalization or rather the broad-based marketing campaigns we may have had in the past.

Michael Aaron Cherny - *BofA Securities, Research Division - Director*

So if I may ask a quick follow-up along those lines relative to those marketing campaigns. What precisely are you doing? I know there's been a dynamic in place when someone leaves, it's really hard to pull them back out. And if there are scenarios where because they're disappointed that the hours didn't work, whatever it means. How do you convince them really specifically to get back in the door?

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

So there's a couple of access points that we have. It really lies in the space of the digital work that we've done over the past couple of years, and it's mounting. We opened the conversation today and talked about that we had 102 million members right now coming through our Walgreens -- myWalgreens app. Those are customers that come into our stores in various ways. And then we also are aware of what they purchase. So a lot of this has to do with the data and analytics that we're pulling together around the customer and speaking to them on a one-to-one basis, and then we can reach back out to them and then engage -- reengage them back into the process. So we can track script loss, we can track their activity in the store, and we put that information together and then tie them back into that actual physical location that they had their script at in the past. So that's the work that we're doing and the marketing dollars that come behind this are not the traditional marketing dollars from years past. This is primarily a digital plan.

Operator

Your next question comes from the line of Kevin Caliendo from UBS.

Kevin Caliendo - *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare IT and Distribution*

James, the dividend payout ratio is really, really high this year. I think we calculated at something like 75%. You've talked about growing the dividend. That's certainly the goal, remaining investment grade and having the cash flow improve dramatically next year. And I guess I want to sort of understand is the cash flow improvement going to come from lower CapEx? Is it better cash flow conversion? Like I noticed your ratio to net income was really low in fiscal '22. And at what point -- like what's the right payout ratio for Walgreens? Given now it's an accelerated growth story, how should we think about that in the context of all the moving parts around investment spend and potential M&A and everything else?

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

Yes. No, our cash flow this year, we were honestly a little disappointed how we finished the year. We probably came in a couple of hundred million lighter than we expected. We kind of mentioned it in the prepared comments, but it's this thing. We have placed all the advanced orders to make sure on-shelf availability was even higher, and China opened up quicker than we expected. And we ended up with some excesses. But that will completely work itself out of the system over the next few months.

We have specifically, I think -- hopefully I don't get this wrong, I think we've got $700 roughly million of working capital initiatives next year. We had some delays on [microfulfillment] (corrected by the company after the call) this year, and they're going to just be pushed into next year. So we are counting on around $700 million of working capital initiatives next year. But I think the cash flow will improve next year, but we are actually going to be increasing our capital investment. So don't expect next year to get back to the run rate because we will be probably -- our typical CapEx spend over a multiyear period was $1.4 billion this year is $1.7 billion or something.

Next year will be higher. It will be -- we have many [microfulfillment] (corrected by the company after the call) centers. We're scaling up on VillageMD -- and we have compelling programs that will deliver long-term returns. I think you get into '24 and '25 and the CapEx will be -- sorry, the free cash flow will be substantially higher than current levels. And we'll work ourselves comfortably into any kind of receptible payout ratio. You're right. We're a little uncomfortable where the ratio is, but we have great visibility for the long-term ratio. So we're much less concerned than maybe some market participants about the absolute level of the dividend.

You saw in the materials we just presented this morning, it remains growing the dividend is still one of our priorities. And in fact, we did highlight that when we look to 2024 and 2025, we didn't just mention the dividend. We said and there is the potential for a large share repurchase program, but no decision has been taken on any share repurchase program. So we -- this is -- I think what we said last October, we're facing into a period of 24 months of investment to build out the U.S. healthcare business, and the returns will be outsized and the working capital will -- sorry, the free cash flow will come back up to -- in the $3 billion to $4 billion type range in '24, '25, that kind of range. And we'll comfortably work ourselves into an appropriate ratio for dividend. I don't know, did that answer your question?

Kevin Caliendo - *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare IT and Distribution*

It does. it's really helpful to understand sort of how you're thinking about this and how we should think about it.

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

Yes. I think we have a large -- and I'd leave it on that. I think if you look at '24 and '25, we have a large opportunity on capital deployment. So it is -- it's either share repurchase, it's M&A, and it just becomes a discussion on which one is more accretive and which one drives more shareholder value longer term.

Operator

Your next question comes from the line of A.J. Rice from Credit Suisse.

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

Just maybe ask about the retail a little bit more. You mentioned the forward buying you're doing ahead of the cough, cold and flu season. Does that suggest you have any particular view as to what this cough, cold and flu season is going to look like? I know also you got the scripts coming back in the U.S. Are you assuming any benefit on the front of store from that pickup in incremental scripts? And then I would finally ask around this that you highlighted that you're still running below pre-pandemic levels and foot traffic in the U.K. Do you think that's the new normal? Or do you think that will, at some point, come back? And any comment about where the U.S. sits relative to pre-pandemic levels and whether you've pretty much normalized. I know you had an uptick in COVID, but just where are we at? Do you think we're in a normalized front of store today at this point and going forward?

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

So let me start this off. A lot of questions here on our predictions on COVID levels. It's hard to predict right now. We saw some recent comments this week about availability of vaccines at different age levels and taking that down. And then that's something that we hadn't forecasted in our thinking and also, too, in terms of what we see in cold, cough and flu, we know that people been -- there's been a flu spin out there. And we know that last year, people were wearing masks and so after a while, your immunity can get hit pretty severely. So I've got Rick Gates here in the room. I'm going to let him talk a little bit about what he's seeing out in the industry there and what we're doing in terms of on-the-shelf products and those kinds of things. Rick?

Rick Gates - *Walgreens Boots Alliance, Inc. - Senior VP of Pharmacy and Healthcare*

Again, I think you're right, Roz. And just to add. I think as you look at fiscal year '23, we're anticipating a back to normal seasonal flu, back to more of a pre-COVID pandemic. And so I think what you're seeing in the Southern Hemisphere is going to really impact us here in the Northern Hemisphere. And so I think whether it's going to be seasonal scripts or it's going to be OTC sales. I think that's all built into the plan based off of the expectations that we have. I think the COVID side of it is still the unknown, right, if you look at thoughts of annual boosters, how that ties together. But we are seeing a pretty strong uptick already in flu shots and those types of things early in the year, which is indicative, I think, of consumers really trying to protect themselves for what could be a pretty heavy flu season this year.

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

Yes. And then you had a question on the foot traffic. So it's a great question in the U.K. Foot traffic is below pre pandemic, but the center of city plus travel locations continue to improve sequentially every quarter. So there will be improvement over -- but I would say the recovery will not necessarily be absolute, and it will be over a multiyear period. The key question is how many people go back to the office. Central London is very, very driven. Many people in train stations and many people are actually doing this office trip. And until -- and I don't think it's realistic to assume that you're going to get 100% return to pre-COVID office behavior.

So the flip side of this is that we believe that we'll continue to capture the larger basket size because that's a behavioral shift that has changed and it hasn't been deteriorating and plus the shift to omnichannel. So I would say that the store will never get back to exactly where it was before in the U.K. but we've more than compensated by the omnichannel and the size of the online business. So as I said before, we're much, much stronger overall in the U.K. and our shares -- our share -- the proof is in the share of market. Our share of market is already higher than COVID on a value basis. So in one way or another, we've captured back the value that's in the U.K. market and more. And I think that's the ultimate test. I don't have 3-year stacks in the U.S. on foot traffic.

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

I don't think we have...

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

Yes. But I think it wasn't as dramatic in the U.K. The drop was not as dramatic because our stores stayed open and the U.K. -- sorry, in the U.S. The U.K., there were actually shutdowns of some of our stores in select locations. So the trough wasn't as deep in the U.S., and the recovery was much, much quicker in the U.S., but I don't think it's entirely recovered to pre COVID .

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

The only thing I'd add to that is the uniqueness in the U.K. The airport locations, if you look at just segmenting where our retail exists, airport locations had significant growth and continue to see that. We're seeing recovery in our convenience locations. And then as James just mentioned, where we need to see some improved performances around our flagship stores and those stores that are on High Street and some of the destination and health and beauty area. So we'll continue to see the nice work that the U.K. team is doing in that business and watch things like they're facing energy cost, and we just wonder if that's going to slow down traffic over a period of time. So we'll keep -- we're optimistic on the U.K. business.

Operator

Your next question comes from the line of Brian Tanquilut from Jefferies.

Taji Milan Phillips - *Jefferies LLC, Research Division - Equity Associate*

You've got Taji Philips on for Brian. So I just want to circle back to the issue around pharmacist labor and that driving softer scripts this quarter. Can you just talk about how the labor environment has trended throughout the year and the levers that you can pull to bring that SG&A impact down? And then as a follow-up to that general topic, can you discuss the labor headwinds you're seeing across Walgreens Health? And is that baked into the guidance? And if you can provide some color, what's the magnitude of that?

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

Okay. So labor trends in Walgreens Health side, we -- there's really no impact there. That's our primary care physician position through VillageMD. We're continuing to grow the number of primary care physicians. So we're really not seeing a labor issue on our Walgreens Health side. It's primarily in our retail sector and foot traffic in our stores impacted by what we have to do. I'll give you some examples. We still have emergency callout as people are diagnosed with COVID. And so that requires us to take a look almost daily at who's running the pharmacy and the pharmacy technicians.

And then the second part of that is to make sure that some of this is geographically based, too. We're seeing in the upper Northeast areas like Vermont in those areas that we're seeing that really the workplace and people reengaging in work is not happening as quickly. So we're working a little bit harder to reengage people to get them back to work, and that's why you see some of the incentives that we've had in getting people to sign up for bonus pay and starting with our pharmacists. So really, what we're seeing in terms of labor, we made investments over the time frame we announced last year that we would go to $15 an hour on our hourly labor. That has helped us tremendously because we're competitive in the stores. And that's rolling out and will be finished in the next -- I think we've got another 12 months to roll that across the country.

So the combination of our investments in labor and improving our working conditions in stores, all of those things are driving our employees back to the store. And also, you're probably seeing some issues with labor in different sectors. But I would have to say that we're doing our best work in terms of best jobs and best pay for our labor model that we deploy in our stores.

Operator

Your next question comes from the line of Eric Percher from Nephron Research.

Eric R. Percher - *Nephron Research LLC - Research Analyst*

I wanted to connect some of the commentary on both labor and COVID to the guidance for the year. You mentioned a little lower first half relative to where consensus is. Is it fair to assume that the COVID benefit, the 16 million shots will be first half weighted? And at 16 million, is that still larger than your expectation for flu shots in the average year? And then aside from that, is it fair also to assume the labor benefits will not be in place by the flu season? Those are kind of back half of the year for what we should expect relative to retail.

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

I'm just looking at the forecast, I think the majority of the vaccines will be earlier in the year -- of the 16 million we said. So because it's all a booster, right? And all of the emphasis is on it now. So I would have said out of 16 million probably I don't know if there's a couple of million that would be in the second half. The rest would be in the first half would probably a skew to the first quarter. But when we made the comment on the phasing, I think the consensus is up 54%, something like that. 54% of the EPS is in the first half. It's probably closer to 52% or 51%. It's not down in 50%. But we just wanted to guide that it was a little bit on the heavy side, and it just required a slight adjustment. That's the way I would emphasize it.

And then you asked about labor. The labor is basically in place, right? So it's going to be -- if you take from now onwards, all the temporary measures are already in place, and changes were in place. I think [merit] has been announced. So if you take the 265 of pharmacy, I think it's pretty much all year. I might get this slightly wrong. And then the minimum wage is pretty similar we're going up in stages. It's -- there's also the minimum wage, which is -- I think it's 240 in 2023. And that's roughly coming in the same phasing all year.

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

Sorry, Eric, did I get all your questions?

Eric R. Percher - *Nephron Research LLC - Research Analyst*

Yes. I guess is the implication that's really ramp of (inaudible) and maybe the U.S. healthcare contributions that...

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

Yes. Look at U.S. Healthcare, you're right. Yes, you're right. U.S. healthcare as an EPS will still be a headwind in the first quarter, will be neutral in the second quarter. And actually, healthcare turns to be a generator of favorable EPS growth in the second half of next year, if there is a large phase-in impact on healthcare.

Operator

Your next question comes from the line of Ricky Goldwasser from Morgan Stanley.

Erin Elizabeth Wilson Wright - *Morgan Stanley, Research Division - Equity Analyst*

This is Erin Wright on for Ricky today. A follow-up on capital deployment and the questions there. I know that you're limited on what you can say on the investment, as you mentioned. But broadly speaking, does your debt paydown assumptions in 2023 assume or is contingent on further monetization of those assets in your portfolio? And then just a quick clarification. I just wanted to make sure or clarify, are you anticipating any recession risk in your international target at this point? Or is it really just a continuation of what you're seeing now?

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

Yes. Sorry...

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

Go ahead with the international recession.

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

Yes. On the recession risk and international, we've already built in a fairly -- I wouldn't say conservative, but a realistic plan. And the -- I would argue the recession has hit, if there is one, has hit the U.K. already. So they came in with their budgets, and we had a robust discussion on what the outlook looked like. And they've probably built a scenario that is a recession, whereas in the U.S., it's moderate recession stance. So that covers that piece. And then on monetization, we can't speak that much about it.

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

Yes.

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

It's just not -- it's impacting other people's share prices. But I think you need to go back to the prepared comments, we want to simplify the company over a fairly short period of time. But that's not saying what we're going to do specifically next year.

Operator

Your next question comes from the line of Justin Lake from Wolfe Research.

Austin Jason Gerlach - *Wolfe Research, LLC - Research Analyst*

This is Austin on for Justin. James, I wanted to kind of return quick to the -- you guys laid out that 8% to 10% core growth. And I know you've kind of laid out a lot of moving parts through the Q&A here, but hoping to kind of just consolidate and kind of bridge that in one place. What are the building blocks there around shrink, the pharmacist bonuses, kind of working our way through that? And then as a quick follow-up there. Just hoping for any kind of updated color on 340B, if there's kind of a magnitude of headwind or tailwind that you guys are sort of thinking about there?

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

Yes. The -- I'll kind of simplify and just summarize the U.S. business. We said that the pharmacy business is $0.45 favorable. Retail was negative $0.48-- sorry, positive $0.48, and SG&A negative $0.55. So we had a robust discussion that labor and significant investments to drive top line are mostly offset by transformational cost management program and cost programs. They're all very well defined there's people and names beside each initiative in the SG&A. We had the discussion on retail. Shrink specifically, I think, is an $0.08 favorability in 2023, if you want the specific number.

But the retail story of $0.48 is all about the comps are growing at 2% to 3% ex COVID impacts, mix will be significantly positive because of a large drive on new own label and assortment. And then finally, the strategic planning and customer -- sorry, strategic pricing and customer value transformation. And you get into Rx, and we said the scripts were up 5%. And we have very large visibility to reimbursement, which is slightly lower than the previous year. And we have high visibility to cost evolution on generics, which continues at a similar pace in 2023 as we did in '22.

So -- and then pharmacy services was the last piece. So I think we have significant programs and drivers behind each of the numbers we gave you. And I hope you appreciate we're giving a lot more guidance on the individual components of the business and what's driving them.

Operator

And your final question comes from the line of John Ransom from Raymond James.

John Wilson Ransom - *Raymond James & Associates, Inc., Research Division - MD of Equity Research & Director of Healthcare Research*

If I look at the new guidance for '23 and I compare it to what you guys implied a year ago, I mean we're running $0.70 or so behind. So I was just wondering if you could help bridge us to where we are now versus where we thought we'd be and kind of what the specifics were of the change?

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

Sure. So it's actually $0.60. And the 2 biggest drivers -- well, I'll give you one is ABC, for example, we sold some of our shareholding. That cost $0.14. So it's not a small number. And then the financial climate, we have lower pension returns in the U.K., that's about $0.05. And then ForEx is $0.12. So there's a lot of corporate type items that have nothing to do with the core business. And then if you take the core of the business, the pharmacy business is the largest variation. That's about $0.30 and it's coming from 2 things. 340B, it's not a particular headwind year-on-year, but versus our original guidance, it's a very large number. It's almost all of the $0.30.

Script volume. Script volume is worse than the prior guidance, but so are the procurement savings is -- are way, way better and they offset that. So I would have called it a 340B issue on pharmacy. And then if we flip to SG&A, it's about $0.30 worse, and that's all from labor costs. So it's all the pharmacy labor that we've put in place. So if you wanted to kind of simplify it, there's a bunch of corporate stuff, call it $0.20 or $0.30, and then there's a 340B issue.

Operator

And this concludes our Q&A session. I will now turn the call back over to Ms. Roz Brewer for some closing remarks.

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

So thanks again to all of you all for joining us today. I personally appreciate the engagement and the relevancy of the questions. We were very intentional about making sure that you know we were committed to providing you with as much detail and transparency as possible. And we shared even more information about how WBA is executing well on the 4 strategic priorities and then how we're transforming rapidly into a healthcare company. Those are the real takeaways there. But to just recap, as we close this down, I know it's been a couple of hours is I want to remind everybody that we'll be focused on accelerating our growth and profitability in our U.S. Healthcare segment.

We'll focus on optimizing our best-in-class assets and our partners. We'll focus on driving positive momentum in our resilient core business and making significant progress on talent and capabilities and moving quickly to simplify our portfolio. And we'll do this at a pace to deliver our long-term growth algorithm. So we look forward to continue to keeping you fully updated as we build on our success in the months ahead. We hope you have a great rest of your day. And as always, we deeply appreciate all of your support and commitment to the bright future we've planned. Thank you so much.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect.

REFINITIV