REFINITIV STREETEVENTS

EDITED TRANSCRIPT

WBA.OQ - Q3 2021 Walgreens Boots Alliance Inc Earnings Call

EVENT DATE/TIME: JULY 01, 2021 / 12:30PM GMT

OVERVIEW:

Co. reported 3Q21 YoverY sales growth, constant currency basis, of 10.4% and GAAP EPS from continuing operations of $1.27. Also reported YTD YoverY sales growth, constant currency basis, of 10.4% and adjusted EPS from continuing operations of $3.74.

CORPORATE PARTICIPANTS

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

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

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

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

CONFERENCE CALL PARTICIPANTS

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

Brian Gil Tanquilut *Jefferies LLC, Research Division - Senior Equity/Stock 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*

Eric White Coldwell *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

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

Glen Joseph Santangelo *Guggenheim Securities, LLC, Research Division - Analyst*

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

Rivka Regina Goldwasser *Morgan Stanley, Research Division - MD*

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

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Walgreens Boots Alliance, Inc. Third Quarter 2021 Earnings Conference Call.

(Operator Instructions) Please note that today's conference is being recorded. (Operator Instructions) I would now like to hand the conference over to Gerald Gradwell.

Thank you. You may begin, sir.

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

Good morning, ladies and gentlemen, and welcome to our earnings call for the third quarter of fiscal year 2021. On the call with me today are Roz Brewer, the Chief Executive Officer of Walgreens Boots Alliance, James Kehoe, Global Chief Financial Officer, and John Standley, President of Walgreens, is also here for any relevant questions.

Before I hand you over to Roz to make some opening comments, I will, as usual, take you through the legal safe harbor and cautionary declarations. Certain statements and projections of future results made in this presentation constitute forward-looking statements that are based on our current market, competitive and regulatory expectations and are subject to risks and uncertainties that could cause actual results to vary materially. We undertake no obligation to update publicly any forward-looking statement after this presentation, whether as a result of new information, future events, changes in assumptions or otherwise. Please see our latest Form 10-K and 10-Q for a discussion of risk factors as they relate to forward-looking statements and note, in particular, that these forward-looking statements may be affected by risks relating to the spread and impact of the COVID pandemic. In today's presentation, we will use certain non-GAAP financial measures. We refer you to the appendix in the presentation materials available on our Investor Relations website for reconciliations to the most directly comparable GAAP financial measures and related information. You'll find a link to the webcast on our Investor Relations website at investor.walgreensbootsalliance.com.

After this call, the presentation and webcast will be archived on the website for 12 months. I will now hand you over to Roz.

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

Thank you, Gerald, and good morning everyone. Welcome to our earnings call.

Let me start by saying that we're pleased with our third quarter financial performance, which we announced earlier this morning. Our total adjusted earnings per share of $1.51 were above our expectations, driven by the strong execution of our vaccine administration, increased mobility as restrictions were lifted in various geographies, and recent increases in digitally driven sales in both the Walgreens and Boots businesses. Many categories performed well, including beauty and photo

and our investments in marketing technology are driving further revenues by more precisely targeting our customers.

In recent months, the leadership team and I have been emphasizing across the company that we must deliver operational excellence. And our teams have answered this call in many ways, with our COVID-19 vaccinations being a particular highlight. This initiative is really quite remarkable and demonstrates our ability to move at pace and deliver at scale. We have now administered over 25 million vaccinations by quickly creating an extensive technology and logistics infrastructure and utilizing close partnerships with public officials, community and faith groups, and others. I continue to be deeply proud of our team members and their commitment to keep our communities healthy and safe, especially those communities that are the most medically underserved. Strategically, we remain committed to our previously stated priorities, to create neighborhood health destinations around a more modern pharmacy, to accelerate digital, to transform and restructure our retail offering, and to drive our transformational cost improvement. All of which you will hear more about today as James provides more insights on our results. It's also great to observe firsthand these priorities being carried out by our teams as I continue to spend time at our stores and vaccination sites. During these visits, I see

over and over again the incredible strengths that our company has. We have deep brand trust and loyalty, an extensive understanding of our millions of customers, and an expansive store footprint in the heart of 9,000 communities across the U.S. And as I mentioned to you last quarter, I am also conducting a detailed review of our long-range business plans across the company, including where we should make further investments, allocate capital, and deliver the best possible financial returns. There are tremendous opportunities in healthcare right now, and we are uniquely positioned to capitalize on them. One example of our next phase of growth is our previously communicated, tech-enabled healthcare initiative. As we build this out further, our choices will be guided by what our customers want as we continue to deliver solutions that meet their evolving needs, while leveraging our unique assets and capabilities in order to win. But first and foremost, we have to ensure that we continue to operate our core pharmacy and retail businesses with excellence. Said simply, in order to build the pharmacy of the future and new healthcare solutions, we must build upon the core assets of the pharmacy of today. Next, we need to determine where we are best positioned to offer even more to our customers. What we're hearing from them is that they are often overwhelmed trying to manage different health conditions, providers, appointments, bills and medications, all of which are on different platforms and channels. And we know we can help them address these problems in a way that builds on our strengths and establishes even deeper relationships with them. But the overall healthcare space is sprawling and incredibly complicated, so we must be laser-focused on the products and services that have the most potential and value, that can be enabled with the most innovative technology and that will be delivered at a level and quality that our customers expect.

Lastly, we must be mindful that speed is a priority in this rapidly changing landscape. We will assess appropriately and accelerate into new categories, spending just enough time getting it right. And then we'll deploy quickly and at scale. I'm looking forward to sharing more with you soon about our further plans. But again, there's fantastic potential here, and we're very excited about the prospects for the future.

And with that, I'll turn it over to James to take us into more depth on our results and operations. James.

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

Thank you Roz and good morning. In summary, we had an excellent quarter. Total adjusted EPS was $1.51, well ahead of expectations and up 81.4% versus prior year on a constant currency basis. On a continuing basis, adjusted EPS was $1.38, 93.6%

(technical difficulty)

above prior year, impacted by 2 key COVID-related factors. Firstly, we were lapping a weak year ago quarter which was depressed by the severe restrictions associated with the COVID-19 pandemic. Secondly, we executed strongly in the current quarter and accelerated the pace of COVID vaccinations, thanks also to the significant investments we have made to provide vaccinations across approximately 8,500 locations.

Cash generation was also strong, with year-to-date free cash flow of $3.3 billion, 35.8% higher than prior year. The strong third quarter performance allows us to increase our full year adjusted EPS guidance from mid- to high single-digit growth to around 10% growth.

Let's now look in more detail at the results. Third quarter sales advanced 10.4% on a constant currency basis, reflecting strong double-digit growth in international and 5% growth in the U.S. The result included a 4.6 percentage point benefit from the formation of the German joint venture last November.

Adjusted operating income increased 82.4% on a constant currency basis, driven by strong gross profit performance in the U.S. and a rebound in international sales and profitability due to less severe COVID-19 restrictions. Total adjusted EPS was $1.51 in the quarter, a constant currency increase of 81.4%.

On a continuing basis, adjusted EPS was $1.38, a constant currency increase of 93.6%, driven entirely by strong growth in adjusted operating income in both operating segments. The higher tax rate in the quarter was mostly due to a catch-up adjustment in the prior year period as initial COVID-19 impacts favorably impacted that quarter's tax rate.

Finally, on a continuing basis, GAAP EPS increased by $3.32 to $1.27, reflecting prior year impairment charges of $2 billion and investment gains in the current quarter related to Option Care Health.

Now let's move to the year-to-date highlights. Year-to-date sales rose 6.1% on a constant currency basis. Adjusted operating income increased 3.9% on a constant currency basis, with the U.S. segment up 2.3% and international almost doubling operating income as it rebounded from a very weak prior year due to COVID-19. On a continuing basis, adjusted EPS was $3.74, a constant currency increase of 9.9%, reflecting adjusted operating income growth, lower interest expense and a favorable impact from prior year share repurchases.

Now let's move to the U.S. segment. Sales increased 5.1% in the quarter with 6.3% growth in pharmacy and 1.4% growth in retail. Both retail and pharmacy saw sequential improvement over the second quarter as we executed strongly against vaccinations and foot traffic improved.

We saw notable improvement in consumer trends, especially in urban areas and across discretionary categories such as beauty and photo. Adjusted gross profit increased 14.5%, driven by strong sales growth and improved margins in both pharmacy and retail.

Adjusted SG&A spend increased 6.5% in the quarter to 16.8% of sales, 0.2 percentage points higher than last year. The year-on-year increase was primarily driven by an approximately 500 basis point impact from COVID-19-related costs, mainly the cost of rolling out vaccinations. Adjusted operating income increased 50.3% as the strong gross profit growth more than compensated for the fast-growing investments behind both COVID-19 vaccinations and growth initiatives.

Now let's look in more detail at U.S. pharmacy. Comparable pharmacy sales were up 8.4%, while comp scripts increased 9.8%. We completed 17 million COVID-19 vaccinations in the quarter and this boosted comparable script growth by around 600 basis points. Solid underlying results were also bolstered by improved market trends as more patients return to doctors' offices and seasonal script headwinds softened.

Adjusted gross profit grew nicely, reflecting strong sales growth and improved gross margin as a result of favorable mix from vaccinations.

Turning next to our U.S. retail business. Total retail sales increased 1.4% in the quarter, including a 50 basis points adverse impact from our store optimization programs. Comp retail sales increased 1.7%, and excluding tobacco and e-cigarettes, comps were up 2.6%. Performance improved sequentially as the negative impacts from cough, cold, flu subsided and mass personalization boosted results by around 100 basis points.

Store traffic improved, especially in urban areas, and discretionary categories came back nicely with beauty sales growing 14.9% and photo advancing 54%. Gross margin increased 100 basis points year-on-year, largely due to favorable mix as a result of stronger growth across discretionary categories.

Turning next to the International segment and I'll talk to constant currency numbers. Our International segment continued to be negatively impacted by COVID-19, with continued weak footfall on the U.K. High Street. That said, as we lap the start of the pandemic, we are encouraged by the rebound in sales and profitability due to focused execution across Boots U.K., Boots Ireland and opticians. Sales increased 58.7% in the quarter, including a 46.6 percentage point contribution from the formation of our wholesale joint venture in Germany.

Excluding this benefit, sales were up 12.1%, reflecting ongoing recovery across most international markets. Adjusted operating income was $94 million in the quarter, up $222 million versus prior year as sales rebounded from prior year lows and costs were tightly controlled.

Let's now look in more detail at Boots U.K. Comparable pharmacy sales increased 3.7%. Stronger demand for services and favorable phasing of NHS funding more than offset lower script volume.

Comparable retail sales increased 38.7% as footfall continued to recover and we lapped the start of the prior year COVID-19 restrictions. However, footfall in the quarter was around 45% below pre-COVID levels, compared to the 70% to 75% declines that we saw at the peak of the pandemic in April/May last year.

Nevertheless, we are encouraged by continued strength in basket size, which was up over 20% in the third quarter compared to pre-COVID levels. We are rapidly regaining the market share lost to grocers at the height of the pandemic and discretionary categories are performing strongly. And Boots.com delivered strong sales growth of 42% and accounted for 20% of total retail sales in the quarter. Overall, while it was a strong quarter for the International segment, the recovery is more gradual than we originally anticipated.

Turning next to cash flow. Free cash flow was strong, with $3.3 billion delivered in the first 9 months of the year, up $873 million year-on-year, reflecting the strong profit results and successful working capital initiatives. Working capital initiatives are driving sizable cash flow benefits as we eliminate excess inventory and extend payment terms to more optimal levels. We have benefited from some one-time cash favorabilities, including timing benefits associated with destocking of COVID-19-related safety inventory, and benefits associated with passing of the CARES Act.

Looking forward, cash generation in the fourth quarter will be adversely impacted by the divestiture of the Alliance Healthcare business, as historically, the fourth quarter was the strongest cash flow quarter for the business.

Turning now to full year guidance. Our third quarter performance was clearly very strong. We were lapping the peak of the pandemic restrictions last year and less severe restrictions in the current year led to improved footfall in the U.S. and a rebound across most international markets. Additionally, this quarter was the peak quarter for vaccinations, and we successfully completed 17 million vaccines, a testament to our strong executional capabilities. We are expecting solid year-on-year EPS growth in the fourth quarter, although at a slower rate than the third quarter.

The prior year comps are a little tougher, we will administer less vaccinations in the fourth quarter compared to the third quarter, and we are ramping up our growth investments as we accelerate our digital and healthcare plans.

Turning now to EPS guidance. We are raising our continuing basis adjusted EPS from mid- to high single digit, to around 10% growth. The full year guidance is based on 3 potential swing factors: firstly, our full year forecast now assumes 28 million vaccinations, with around 7 million vaccinations in the fourth quarter compared to 17 million in the third quarter. Secondly, COVID-19 has resulted in many changes to our business and we should expect some continued volatility as markets reopen and foot traffic returns to more normal patterns. And finally, we are increasing investments to reposition the company for continued success. On an annualized basis, our transformation and growth investments are an earnings drag of approximately 3% to 4%, with a fourth quarter impact of around 7% to 9%.

In summary, we have raised our adjusted EPS guidance to around 10% growth to reflect strong operational performance and improved visibility around fourth quarter adjusted EPS growth drivers.

Let me now cover our key strategic initiatives. We continued to make progress in transforming our pharmacy business and the ways in which we deliver healthcare, both through our physical stores and through our digital channels. One of our core objectives is to simplify the pharmacists' role and free up more of their time to spend on adherence and healthcare services. This will be the foundation for improved health outcomes through a more integrated care model. One of the key steps is to modernize and automate our pharmacies. Our recent investment, iARx, plays an important role as it brings together automated pharmacy solutions and enhanced workflow capabilities. Two micro-fulfillment centers are now operational in Phoenix and Dallas and are supporting around 550 Walgreens pharmacies. Over time, these 2 locations will support around 1,000 pharmacies. We have also decided the next 9 markets for micro-fulfillment centers and we expect the deployment to be completed

by the end of calendar year 2022.

We are accelerating our rollout plans with VillageMD following continued positive patient response. We have already opened 46 sites, and we have identified a further 35 locations to be opened by the end of this calendar year. This will bring the number of co-located sites to approximately 80 by the end of this calendar year.

In addition to these physical co-locations, we've formed an integrated virtual healthcare collaboration with VillageMD in an additional 9 Walgreens locations. This will give Village Medical patients access to the same expanded pharmacy services that are available at the co-locations.

Finally, building on our success in COVID testing, we are developing our testing and diagnostics business to provide a wider range of solutions for our customers going forward.

Now turning to retail. We are evolving our U.S. retail model across consumer value, services and convenience. Our customer engagement platform is progressing nicely and building momentum. We are constantly refining our personalized offerings as we gain additional consumer insights. Membership of myWalgreens was up 42% (corrected by company after the call) over the prior quarter to 75 million members. And mass personalization boosted retail sales by around 100 basis points in the quarter. Secondly, the work we've undertaken throughout the pandemic to improve our omnichannel experience and offer convenience options is resonating with customers. We have now completed 6 million curbside, drive-thru and last-mile delivery orders. The alternative profit streams we've mentioned in the past are quickly taking shape. Our Walgreens Advertising Group is expanding its offerings and is now working with third-party brand providers across digital and video, helping them better connect with customers based on our uniquely scaled first-party data set.

Additionally, early in the fall, we plan to launch a series of exciting debit and credit card products. Finally, behind the scenes, we've completed the rollout of SAP S/4 HANA. This will unlock significant operational efficiencies and working capital improvements, and from a customer point of view, it will improve product availability and speed of delivery.

Turning next to our International initiatives. During the quarter, we made excellent progress in developing our digital healthcare offering. Boots Health Hub now offers an online marketplace for Boots and third-party providers, with almost 100 healthcare services now available. As part of the Health Hub, we recently launched Boots ONLINE DOCTOR, a new, innovative and market-leading service, which connects physicians and patients online. Patients can already seek advice from doctors on over 40 conditions with more to follow in the future.

On the retail side, we delivered strong market share gains in the quarter, particularly in discretionary categories. And as life gradually returns to normal, customers are increasing their spend on beauty products, with sales advancing 85% in the quarter. We now have over 500 beauty brands available in our stores and online, with 34 new brands introduced this year. And we recently launched a major marketing campaign designed to capitalize on the gradual lifting of U.K. restrictions. We continued to play a major role in COVID testing in the quarter and are well positioned to support vaccination booster programs.

Boots is one of the U.K.'s leading COVID test providers with over 3 million tests completed to date, mostly undertaken in partnership with the NHS. We also have a growing private test offering with several at home and in-store tests available in addition to testing partnerships with several major airlines.

And finally, a quick call out to China. We now have almost 8,300 stores, up 2,500 stores compared to the same period last year. I'll now hand it back to Roz for her closing comments.

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

Thank you, James. So as you've heard, we have delivered a good financial quarter and have the prospect of a very solid financial performance for the year as a whole. Therefore, we are raising our guidance for the full year accordingly. As we continue to focus on ensuring the success of our business of today, while at the same time investing in our future, I look forward to sharing in the fall more of my learnings and our path forward. Currently, I'm examining and challenging all parts of our enterprise strategy. And there will be some key principles guiding our work ahead and leveraging our right to win, including; applying a disciplined approach to capital allocation and performance metrics, driving innovation to be built into our core and our culture, performing as a best-in-class operator at all times, allocating our focus in the right amount by balancing our immediate needs with our mid- and long-term growth plans over the next 2 to 3 years, maximizing the value of our existing assets, particularly our pharmacy, as a centerpiece of what we do moving forward, and leaning into key tailwinds such as the localization and consumerization of healthcare.

Let me close by once again thanking our team members for the resilience, empathy and care that they have shown for both our customers and fellow team members as they administered more than 25 million vaccinations and many other accomplishments around the world. Our success over the last year shows the power of a unified focus, coupled with exceptional capabilities and highly trusted brands that represent the communities we serve. This focus and purpose will be the root of our success for years to come. Now I would like to open the line to questions. Operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of A.J. Rice with Crédit Suisse.

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

Ros, if you don't mind, I might just -- I know the details on your results of your strategic review or -- are still months away. But I would ask about 2 parts to your comments: one, it sounds like there's a lot of U.S.-focused effort around that strategic review. I wondered if your review of strategy also includes the U.K. and the international operations and any comment -- early comment about your thoughts there. And then the second aspect is I think Walgreens has, over the last year, done a lot of interesting things, almost a collaborator of choice type of approach with a lot of providers and vendors. Do you see the opportunity to take a few of those relationships? Obviously, things like the VIllageMD relationship and really exploit that. Is that one of the areas of great -- not necessarily that specific one, but that type of thing, the greatest opportunity? Or is most of the opportunity you're seeing retooling internal aspects of Walgreens going forward?

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

A.J., thank you for that question. Let me start with your first question about the look that we are across the entire business. So the evaluations we're doing right now, they are global. They may feel U.S.-based because of the size of that business in the total WBA construct, but this is a global look at the business. The one thing I would say about our business in the U.K. and other geographies is we're seeing a slower recovery in some of those areas. So we are looking at a full enterprise look as we evaluate what's next in the company. The second part of your question is around the collaborations. I believe you said in partnerships that we had and what portion of that will be in balance with just looking at our base business. And I will tell you that it's a bit of both. One thing that I will tell you is that as I analyze the company and see where they are, this team has done some tremendous work in building partnerships. Those partnerships will be key to us going forward. there's an opportunity to innovate with our partners and really grow some of these collaborations

(technical difficulty)

see that. And then as I mentioned, it's also about making sure that our base business is very strong. So it is both of those, A.J., and thank you for that question.

Operator

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

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

It was good to hear some of the updates in your prepared remarks around the tech-enabled healthcare start-up operation that's embedded within Walgreens. I'm curious if this digital asset is something that Walgreens could still separate and potentially monetize sometime in the next 18 months or so or does this just stay embedded within Walgreens for the very foreseeable future and just drive the overall enterprise results?

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

Steven,

(technical difficulty)

question. And in terms of how we're looking at tech-enabled health care, when we look at the long-term enterprise vision of the company, that is one of the things that we are looking at is that how do we address what's so important for the customer and what we embed within the company and what we partner with and what could be stand-alone. So that will be part of the work that we do. So we will share more about that in the fall.

Operator

Your next question comes from the line of Lisa Gill with JPMorgan.

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

Just on VIllageMD, I just had a couple of questions. One, I wanted to understand the prescription what's you're seeing in co-locations. And then, James, you made a comment about simplifying the role of the pharmacist, you or Ros, do you have any comments around changing reimbursement. So if you're freeing up the time of the pharmacists, are we actually seeing where you're getting paid for consultation versus just the fulfillment of the script? And do you have any relationship, for example, with VIllageMD or anyone else where you're getting paid for those kinds of consultation services?

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

Lisa, let me have both James and John respond to that question for you.

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

Yes. I guess I'll -- Lisa, I'll jump in. This is John. I'll jump in first. So yes, VillageMD is a great partnership for us in the pharmacy because we can do a collaborative care model for chronic patients with VillageMD and it kind of breaks down a bunch of the barriers that you might have in that kind of relationship. So I think there's a lot of learnings for us in the VMD experience. And there is definitely a script uplift in the store from the relationship that's going to develop over time as we have opportunities to continue to advance the model as we roll out additional VMDs across the chain here. So I think that piece of the question. As it relates to the various programs that we have today to drive adherence and provide other services with pharmacists, a lot of our focus has been around P4P programs and Medicare Part D and other opportunities like that to work with a lot of our partners, and that's where a lot of our effort has gone -- But I think it's really the future that we're talking about here. And so the investments that we're making in IAA to free up our pharmacists really create, I think, future avenues for growth of revenue as we kind of look down the line. That's how we're thinking about it. And we think there's a lot of opportunity there as we move forward.

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

If you could just add one thing, Lisa, because you're correct, the micro fulfillment centers will be rolled out over an approximate 24-month, 36-month period. The first 2 were up and running, and we've already released funding for the next 9, and they will be completed within the course of '22. I think it is -- the simple part of this is how do you free up time so that the pharmacists operate at the top of their profession. And the key question, and I guess that's why you're asking the question is how do you get paid for that? So the simplistic one is paid for performance. The stuff that's in development internally, I think we'll give more visibility on it in the fall. One is testing and diagnostics. We did mention that. It's clear now in the U.S. that pharmacists have played a huge role in the pandemic. And the question is, how do we expand our testing and diagnostics role so that we're providing value-added services. And then the key to all this is the payers hopefully are now recognizing the critical role that has been played during the pandemic. And the fact that less people end up in hospitals reduces overall medical bills in the U.S. system, which means our medical loss ratios are going down. So this has to become at some stage a win-win for everybody where we are freeing up resources, they're spending time improving health outcomes, and we work closely with the payers to share that improved health outcome environment. That's the simple version. But it's a 2- to 3-year journey here in getting these centers up.

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

Just going back to my initial question around the lift in prescription when you have a co-location with VillageMD. Is there anything that you can give us that we can kind of think about as you roll out incremental relationships and incremental co-locations is there...

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

I think we're getting towards 46 of these things up and running. So it's a little early for us to guide you on that, Lisa. We definitely see a benefit there, but I think it will continue to develop over time and so give us a little room here.

Operator

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

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

I guess, Jim, 1 and 1.5 for you. Could you be a little bit more explicit about the contribution from the COVID vaccine to the U.S. business during the quarter? And then you guys kind of noted in the press release that the improved pharmacy margin was due entirely to product mission COVID vaccine. Could you talk about what pharmacy margin looks like ex the vaccine?

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

Yes. Just want to take those. As we move forward, it's getting increasingly tough to try what's due to COVID and what's not due to COVID. But obviously, with a result that's up 95% -- EPS up 95% in the quarter. I think you can assume the impact of COVID was in the region of 80% to 85%. So we saw solid growth on the core in conjunction with a nice recovery from COVID.

When I used the word recovery, there's 2 aspects. One is we had a week last year, and we're recovering from that. And then we had 17 million vaccinations in the quarter. And the vaccination is the key driver of the margin in the quarter. You saw the spectacular gross margin growth in the U.S.

(technical difficulty)

up 14%. And it's not a one-shot wonder here. This is actually very much sales-driven. We have a great front of store performance. And then secondly, the scripts were at high single digit. So we were on all the cylinders on that. I will point out that retail margins were up 100 basis points. And again, it's coming from mix. It's coming from more photo. It was up 50%, Beauty was up 15%.

And then turning to the vaccination question. We actually had a pretty decent quarter on margins. And the base business was basically flattish versus prior year, and vaccinations drove all of the upside on margins. We expect something similar in Q4, but a lesser extent. We've been quite transparent on the amount of vaccinations

(technical difficulty)

28 million, 7 million in the quarter. But before you get too excited on the margin build is, we estimate just on a full year basis that we invested in SG&A just for the rollout of vaccinations, $0.5 billion of incremental SG&A. So I think you have to look at the vaccination on a net basis because they -- and you are seeing that we point to 6.5% increase in overheads -- 6.5% in the quarter. We actually estimate that will be higher in the fourth quarter. So we have a fair amount of pressure on overheads. Mostly it's all spending against the vaccination efforts. I hope that covers your question.

Operator

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

Brian Gil Tanquilut - *Jefferies LLC, Research Division - Senior Equity/Stock Analyst*

Congrats on the quarter. James, just to follow up on your last few comments there. As I think about the guidance that you gave, I mean, it implies something for Q4 under a $1, comp is about $0.91 from last year when you still had some pretty big COVID headwinds there. So I know you called out vaccination, fewer vaccinations in Q4 on a sequential basis, but how should we be thinking about this? If I'm thinking about it on a year-over-year basis? And is this just conservatism? Or is there anything else that we should be considering as we look at your guidance?

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

Yes, it's a good question. We spent a fair amount of time on this. So the full year of 10%, I would back into that number is 10% or 11% in the Q4 leads to 11% to 13% kind of range on the Q4 EPS growth. So there's 7 million vaccinations in there. The one comment I would add to is we've called it out in the prepared remarks, we expect SG&A to be up significantly in the fourth quarter, 7 -- and we'll have an EPS impact of 7 to 9 percentage points. So in the 11% to 12% kind of range of growth in EPS. It's absorbing 7 to 9 on projects. And then there are a couple of onetime items we're facing. We -- there's a shift on impairment between 2 quarters plus bonus payouts. That's probably another 9 points of growth. So as we dissected this as we work through it, we were looking at a core growth of somewhere in the region of 27 to 30. We're doing heavy in both for future innovation, but also for vaccination and absorbing this 7% to 9%. So it's fairly comfortable that the core was performing. If you go back to the original part of

-- the original guidance at the beginning of the year, and I do feel it's quite important. Bear in mind, we gave guidance at the beginning of the year of low single digit, and we're now at 10%. So I think we executed on all cylinders here. When we gave the guidance, we said the first half would decline 17% to 23%, and the actual decline was down 12%, so a good first half. In the second half, and I think people thought it was a crazy aggressive goal, at least internally. We said 30% to 40% growth. If you take our full year of 10%, that comes out at 47% growth in the second half. So we're actually quite happy with the projection. I think if we go back and compare to what we said in March, there's been a shift of about 3 million to 4 million vaccines from Q4 into Q3. So I would say, in general, Q3 came in stronger than we thought in March and Q4, it's essentially lighter just because we're shifting

(technical difficulty)

into Q3. And this was very much in line with the more recent request from the Biden administration to get people vaccinated as quickly as possible. We put a lot more expense in the system. We've hired more people than we originally anticipated, and we ramped up opening hours in 4,000 stores. So this is why the Q3 is proportionately stronger than Q4, but we're quite happy with the Q4 profile in terms of quality of earnings.

Operator

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

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

You're giving a lot of really helpful commentary about the pacing of the COVID vaccines. I was just wondering if you could comment about your assumptions for the core script growth in the fourth quarter and sort of any early comments you can talk to from June in terms of how

(technical difficulty)

the reopening script growth going?

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

John or I can handle it, but maybe you can...

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

Yes, I can at least talk about the trends a little bit. I think what we saw really kind of started in the third quarter and has continued into June is that some of the underlying headwinds that we were facing in the business have abated a little bit here. So we saw new-to-therapy improve, which has continued in June. We have some heavy early headwinds on seasonal and anti-infective prescriptions, but again, as we came through the quarter, those abates have now turned positive in June as well. So we've seen a decent amount of business and a decent amount of momentum in the underlying prescription business as we head into the fourth quarter. And so I think that's really positive. And some of that is also kind of happening in the front end as well.

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

Yes. So bear in mind that what we said in Q3 is the -- of the 9.8%, 600 basis points are coming from vaccines but that's on 17 million vaccines. So if you fast forward to Q4, you're going to have less than 600 basis points coming from vaccines. So the rate won't be high single digit. It's probably going to mid- kind of single-digit growth in scripts because I'd say it's quite influenced now by vaccinations in the short term. But as John said, we had a very strong start to the quarter.

Operator

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

Rivka Regina Goldwasser - *Morgan Stanley, Research Division - MD*

As we think about fiscal year 2022, and I know it's early and you're not guiding, but should we look at the new fiscal year '21, the $4.71, should we use that as a starting point to 2022? And if so, and understanding there's still COVID uncertainties, but at least all sort of the data points that you have to date sort of should we think about kind of like it's fair to assume similar EPS growth in 2022 if you're guiding to second half of the year? Or are there any key tailwinds and headwinds that we should factor in?

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

Ricky, I'm really sorry, you're not coming through very clearly. Can I ask you maybe just to repeat that?

Rivka Regina Goldwasser - *Morgan Stanley, Research Division - MD*

Can you hear me better now?

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

A little bit, maybe just -- maybe it's phone, I'm sorry, it's just a bad line.

Rivka Regina Goldwasser - *Morgan Stanley, Research Division - MD*

Yes. So when we think about the implied fiscal year '21 EPS of I think it's $4.71, should we use this as a starting point for 2022? And if that's the number, how should we think about, with all the data points that you have now, is it fair for us to think about similar growth in 2022 -- '21 to '22, similar growth as what you're seeing in the second half of this year? Just trying to understand sort of...

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

I think, first of all, we don't give guidance. So anything I'm saying is just a stream of comments, I guess. So you're right,

(technical difficulty)

that's sort of $4.71.] That's the starting base. I think the key thing money market participants will struggle with as they look into next year is what will be the continuation of vaccinations into next year because you've got 28 million vaccinations in your base here. And will there be booster vaccinations, when will pediatrics come on, there's as many questions as there are answers.

Obviously, everybody has a strong desire in the U.S. to get back to normal. The other thing is, I think, slight

[Audio Gap]

that is we still have some adverse COVID impacts in the base here, and some of those will improve over time.

What Ros did say earlier on, we are seeing somewhat of a more gradual recovery than we would have anticipated out of the U.K., so we're watching that quite closely. But I think that's the big question for next year. The other one is what's the pace of investments as we modernize and getting back to Ros' comments is we want this company to be more innovative and to drive long-term shareholder value and watch the pace of investments over time.

But that's exactly what the team is working through over the coming months, and there will be a comprehensive -- lay out the comprehensive strategy later in the fall. So -- but I think it's the COVID number we have to wrestle with going forward, mostly the vaccination number.

There's nothing else unusual in the base. I think if you look to the 2 halves of next year, you're going to have cough, cold, flu, which was a big headwind at the beginning, but Q3, Q4 of next year will be pretty tough because you're lapping 17 million vaccinations in Q3. So I think it's -- I wouldn't get lost in any weeds here. I would just think about what are the big items on vaccination and COVID.

Operator

Your next question comes from the line of Eric Coldwell.

Eric White Coldwell - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Appreciate it. So you've got a really strong cash flow and balance sheet profile building with the Alliance proceeds, as well as the working capital improvements and the strength from COVID as well. I'm just curious if you give us a little more color on your thought process around capital deployment priorities over the next 12 months, including share repurchase, is that something that you might get back involved with as we look forward? And then if I might ask a follow-up, just there's been a lot of ranker recently about staffing levels across most industries in the country, wage inflation, et cetera. I was hoping if you could give us an update on your thoughts around wage inflation, staffing, ability to attract and retain staff, that would be great.

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

Thank you, Eric. I'll take the first part of that question, and then I'll ask John to talk about wages. So first of all, with capital, you probably are aware that we spend roughly about $1.4 billion a year on capital expenditures, and we don't see that changing too much in the future. What I will say is that how and where we deploy that and being very disciplined about that. I will tell you that there is energy on my part and this leadership team's part to really accelerate a lot of the work that's already underway in this company. And I will tell you that there's innovation that we will put a lot of focus on, we'll continue to invest, so you'll see capital going in those areas. In the past, you've seen us we build out stores, but in addition, the work that we're doing in investing in digital. And so that will continue. Just to give you a little bit of insight of what we will do in terms of how we will deploy the capital, but we really say -- see us staying in line around that $1.4 billion to $1.5 billion range on capital expenditures. John, do you want to talk about wages?

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

Sure. I think -- and just more generally, I think about -- I think your question is about the employment market as well. And so yes, it's definitely heating up out there. But it's really -- I think what we've seen has probably been more kind of in regional instances, and we've been able to work through those with the various levers that we have available to us to operate the business. One example is we were able to meet all of our needs to really get through a very busy third quarter with our 17 million vaccinations and really didn't have a problem. So we continue to watch the situation and kind of deal with it on an area-by-area basis as issues arise.

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

Ricky, can I add one more part to your question on capital. I also want to mention around the work that we've already invested in. The Rx renewal is part of our investments that we've had, the work around our store level investments and our partnerships there. Also two, I don't want to overlook the work that we're doing around mass personalization, as I mentioned, digital, more specifically in that area. And then the work that we've been speaking about in terms of the micro fulfillment hub and the spoke rollout that we have planned. So you'll see us continue that kind of work around where we buy capital in the future.

Operator

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

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

Maybe a question for James or Ros here. I think starting in July, the existing child tax credit is being converted to direct payments and I think it's going to hit something like 39 million households, which will represent a pretty sizable increase in disposal income for those households. Can you talk about how much of your customer base indexes to households that will receive payments? And have you guys thought through what potential impact positively that could be for your front end?

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

Charles, actually, I'm going to have John respond to that. He's close to that one.

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

Yes, thanks for the question, yes. So this is a monthly credit, I guess, it starts here. And we have looked at it a bit. It doesn't look probably

(technical difficulty)

material as maybe some of the stimulus money that came out earlier

(technical difficulty)

pandemic in terms of impact on the business. So this one doesn't feel like it's going to be hugely material to us. But obviously, we'll get into it here a little bit and see how it plays.

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

Is that because from a prescription side, a lot of these houses will be half insurance coverage maybe through Medicaid. So a lot of the purchasing is just not as impacted? Or is it that the front-end items that you would expect this disposable income or the increase would not necessarily go to items in the front end?

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

No, I think it was more just the relative size of it as it kind of filtered into. If we kind of look at how we performed on other type of incentives, stimulus money that was just, I think, in terms of relative size, that's all.

Operator

Your next question comes from the line of Glen Santangelo with Guggenheim.

Glen Joseph Santangelo - *Guggenheim Securities, LLC, Research Division - Analyst*

I just wanted to follow up on some of your prepared comments you made with respect to the gross profit margins. If I heard you correctly, I think you seem to suggest that ex COVID vaccines, your gross profit margins might have been flat year-over-year. So one, I'm not sure if that's correct, if you could confirm that. And then secondly, last quarter on the call, you discussed maybe some favorable generic pricing trends that may be aided the margin and -- so I'm just kind of curious, could you maybe just unpack that gross profit margin ex COVID vaccines a little bit more to help us think about the current trends and how we should think about that going forward?

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

Yes. It's -- it's broadly correct what you said. So if you take out the benefit of favorable mix from vaccinations, for this quarter, the margin was broadly flat. So we had a decent month in terms of generic -- a decent quarter in terms of generic procurement. But the model is a scale model. The more volume you sell and the more generic procurement you get, the better the margins in the quarter. So it's significantly helped by the fact that the script growth was 9.8%. So it's not a sustainable position in general.

And as we've said in many occasions, we start the year with a significant amount of reimbursement pressure only -- which is all set through generic procurement and the rest has to come from volume. So the margin is highly variable with the volume delivered in the specific quarter.

And then the watch out is, I wouldn't take 1 quarter and extrapolate in the pharmacy business. The timing of accruals and payments is quite volatile and can shift significantly. So my advice to you is always look at the year-to-date as the best proxy for the forward projections. Don't pick a quarter an anchor on that because you're likely to get it wrong because of the volume leverage, plus a point in time is not a good way to look at the pharmacy business. So we do expect fairly continued pressure from reimbursement over a fairly long-term horizon. That's not going to change. The business model is not changing because of 1 quarter. But that being said, we had a fabulous quarter, it's driven by the role we've played in the community. We did 17 million vaccinations and we invested significant dollars to get that return on gross profit. We're quite happy with the base margins, especially front of store as well as very positive for -- and that's a number of quarters now that we've seen favorable margins. So we had a very good quarter overall.

Operator

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

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

You've spoken about

(technical difficulty)

in the performance of suburban versus the 4 large urban markets. And I'm interested to hear if there's been a real difference, this may be a gross margin question as well, in overall margin performance that you're seeing? And also, what have the patterns been at this point? Does the Las Vegas market look different maybe than New York or Chicago in the cities? Any perspective there?

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

Yes. It's -- we had a fabulous time with -- in urban markets because as you know, we have a distinct SKU both in the U.K., actually and in the U.S. So one interesting statistic is that in the previous quarter, and it shows actually the power of the U.S. economy as well. Once people went back on the street and started spending again, transactions prior to in the third quarter for urban stores were down 37%. And in Q3, transactions were up 10%. So footfall in the U.S. is very consumer driven, people are back, people are traveling again and cities are filling up again. So we saw a major skew. Every one of

(technical difficulty)

our formats. So if you look at rural transactions were up, suburban was up and less than urban was up, but the actual biggest transaction gain was in the urban area. And the same play true on sales were urban is still down year-on-year slightly, but we think we will see an ongoing recovery there.

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

Yes, I think that's the big opportunity, I think. So we've -- it's been

(technical difficulty)

we've seen like 2 of our stores really sort of take off here. I think as things have opened, as James said, in suburban and rural. But I think our urban stores are -- present a real upside opportunities...

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

Upside opportunities. Yes, particularly as you looked at March, April, May, it was

(technical difficulty)

transactions in March were down 21% in urban. By the time we got into April, they were up 42%. So there's a market difference between March, April, May, and we see that continuation into June as well. So we're very happy with the recovery that we're seeing, particularly in the U.S. However, I would counterbalance that with the U.K. where there's been a longer lockdown than we anticipated, and they're still not fully out of lockdown and where some lack of clarity as to when people will be encouraged to go back to work.

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

Okay. Thank you very much, indeed. That's all we have time for on the call today. As ever, the IR team are here for any of you that we didn't get a chance to get to. I know we did have some additional questions. And in the event that we don't get to speak to you before the holiday weekend, I hope you will have a fantastic holiday weekend then we are -- next week as well.

Thank you very much indeed. We will speak to you again next quarter on the next earnings call.

Operator

Thank you for participating in today's conference call. You may now disconnect your lines at this time.
