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Q1 2022 Walgreens Boots Alliance Inc Earnings Call

EVENT DATE/TIME: JANUARY 06, 2022 / 1:30PM GMT

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PRESENTATION

Operator

Good morning, and welcome to the Walgreens Boots Alliance, Inc. First Quarter 2022 Earnings Conference Call. (Operator Instructions)
Thank you.

Tiffany, you may begin your conference.

Tiffany Kanaga

Good morning. Thank you for joining us for the Walgreens Boots Alliance earnings call for the first 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; and James Kehoe, our Chief Financial Officer.

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. We are off to a very strong start to the fiscal year. First quarter sales increased 7.6% in constant currency, and adjusted EPS grew 53%, well ahead of our expectations. This strong performance was underpinned by enhanced execution across all of our business segments and supported by ongoing contributions from vaccinations and testing.

While testing and vaccinations are tailwinds for our business, I am very proud of the continued success of our core businesses, with strong growth in U.S. retail and robust recovery in our international markets.

We are raising our full year adjusted EPS guidance to low single-digit growth versus flat previously. We are capitalizing on our first quarter performance and overall business momentum to make incremental investments of roughly \$120 million in our people or 2

percentage points against EPS.

As a reminder, building a high-performance culture and winning team is 1 of our 4 key strategic priorities and is foundational to the other 3: first, transform and align the core; second, build our next growth engine with consumer-centric healthcare solutions; and third, focus the portfolio and optimize capital allocation.

Absent these incremental investments, our revised adjusted EPS guidance for fiscal '22 would have been 3% to 5% growth. You may recall that our original guidance already included a 4 percentage point headwind from investments to build out our healthcare growth engine, investments that we strongly believe will position the company for attractive low teens earnings growth over the long term.

As we will show you today, we are delivering well against our Investor Day commitments as laid out in October and making meaningful progress towards our strategic priorities. While it remains early days in implementing our vision, the bold steps we are taking are clear and we are committed to creating sustainable value for our shareholders.

I want to take a moment to discuss our role in the fight against the pandemic, which demonstrates Walgreens' leadership in promoting the health of the consumers who live in our communities.

In the U.S., we administered 15.6 million COVID-19 vaccinations within the quarter. This achievement was made possible through the extraordinary work of our pharmacy team members. We recognize their dedication to supporting our patients, our customers and our communities as we continue to help lead the nation's efforts in combating the pandemic.

Nearly 1 year after we began our vaccination program with 1 COVID shot at a long-term care facility in Columbus, Ohio, we reached an important milestone for Walgreens at the end of the first quarter, 50 million COVID vaccinations administered to members of our communities. As of Monday, we have administered over 56 million COVID vaccinations, and we are not slowing down in our efforts. Walgreens began offering COVID vaccine boosters in September. And to date, we have administered over 9 million doses.

As of November, we started administering COVID vaccinations to children ages 5 to 11 in thousands of stores across the U.S., just in time as many families prepared to travel and gather for the holidays and variants continue to emerge. We are particularly proud of being the largest pediatric vaccine provider in the pharmacy channel as a powerful testament to the trust that families are placing in our Walgreens pharmacy team members. Importantly, about 40% of Walgreens stores offering the Pfizer COVID vaccine to children ages 5 to 11 are located in areas with a high social vulnerability index score.

Our testing and diagnostics business has also accelerated, with over 22.9 million COVID tests completed to date. Not only will we continue to grow this vital service as part of our pandemic efforts, but we are building on this platform as we are developing a wider range of testing and diagnostic solutions for our customers.

Our execution in vaccines and testing, our outperformance in the first quarter and our healthcare investments are clear steps towards fulfilling our vision to be the leading partner in reimagining local healthcare and well-being for all. We are making significant progress towards the broader commitments we established in October, along our 4 strategic priorities.

Let me provide you with some details on several important initiatives. First, we are transforming and aligning the core business and building a pharmacy of the future that will enable and support our healthcare strategy. We had an especially strong first quarter online, including buy online pickup in store. Digital sales were up 88% in the U.S., driven by 3.6 million same-day pickup orders. Walgreens saw its biggest Cyber Monday ever. And importantly, average order value is about \$30 online versus \$20 in stores, expanding our overall basket size as the digital channel continues to mature.

We are in the early innings of possibilities for Walgreens' digital platform. We've enrolled over 92 million myWalgreens members, up 7.2 million since the fourth quarter. Additionally, our alternative profit businesses are growing nicely, including media advertising and financial services.

Second, we're building a platform of consumer-centric healthcare solutions, which we expect to fuel our next phase of growth. We closed on our Shields and VillageMD majority investments in October and November, respectively, and our CareCentrix investment is scheduled to close by the end of the third quarter. We have 81 VillageMD co-located centers now open as the rollout has accelerated to a pace of a new opening every 4 to 5 days for calendar year 2022.

Our consumer health app is live with our Blue Shield California and Clover partners for their qualifying members. We are operating 47 Health Corners, including 10 recent openings in California. We're looking at a rapid cadence of adding a new Health Corner every week on average in 2022.

Third, we are refocusing our portfolio and optimizing capital allocation. We are applying a rigorous strategic lens to our equity investments and exploring all options to unlock value. Most recently, we have agreed to acquire 100% ownership of both AllianceRx Walgreens Prime and our German wholesale JV, creating greater agility ahead.

Finally, we are building a diverse winning team that will underpin our strategic priorities. We're getting even closer to the consumer by adding Tracey Brown as our Chief Customer Officer on the back of her innovation at the American Diabetes Association and Sam's Club. Our Chief Transformation and Integration Officer, Anita Allemand, is applying her experience at Optum and CVS to drive alignment across our initiatives. We're forging ahead in healthcare with Dr. Sashi Moodley as our Chief Clinical Officer, and Ramita Tandon, as our Chief Clinical Trials Officer, drawing on their experiences in care delivery and clinical solutions while at Anthem, ICON and CareMore. And Holly May, as our Global Chief Human Resources Officer, is driving our high-performance culture. I'm excited to share even more news with you in the weeks to come as we continue to round out the team.

As our results and progress demonstrate, we have a deep and experienced bench in place to drive our strategic priorities today. And I'm pleased to say we are in the final stages of welcoming a leader for our Walgreens Health segment.

To bring a little more of what I was describing to life, let me share with you an anecdote from one of our new Health Corners in California. On just its first day of operation in November, we saw the value proposition in action. A Blue Shield California member introduced himself and told us he's diabetic and struggles to make his visits to his primary care physician for his A1C testing. He was thrilled to learn he can do that here, along with his family. This is just one example of how we can close care gaps through our convenient offering.

As the Health Corners roll out, I have increased confidence that when executed at scale, this innovative and consumer-centric strategy will drive significant growth and value creation ahead. We are connecting our physical Health Corners with our digital app and our other unique complementary assets to meaningfully reduce costs and improve health outcomes and equity.

And when you factor in the continued expansion of co-located clinics with VillageMD, nearly half of our footprint will be covered. We are building community engagement today as only Walgreens can do, through our trusted customer relationships, our local knowledge and our deep data insights.

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.

In summary, we had an excellent start to the year, with focused execution across all of our businesses. Adjusted EPS was \$1.68, well ahead of expectations and up 53% versus prior year on a constant currency basis. We executed strongly in COVID vaccinations and testing. U.S. retail comps were the highest in 20 years, and international markets continued to recover nicely.

Operating cash flow was \$1.1 billion in the quarter, with free cash flow of \$645 million. The strong first quarter performance allows us to increase our full year adjusted EPS guidance from flat to low single-digit growth.

Let's now look at the results in more detail. First quarter sales advanced 7.6% on a constant currency basis, reflecting strong comp

growth in Walgreens and the International segment. Adjusted operating income increased 48.5% on a constant currency basis, driven by strong gross profit performance in both pharmacy and retail in the U.S. and a continued rebound in international sales and profitability.

Adjusted EPS was \$1.68 in the quarter, a constant currency increase of 53% driven almost entirely by adjusted operating income. The result was aided by around \$0.10 or 9 percentage points of phasing benefits. GAAP EPS increased by \$4.58 to \$4.13, reflecting a \$2.5 billion after-tax gain in the current quarter related to the valuation of our prior investments in VillageMD and Shields as well as a \$1.2 billion charge net of tax from the company's equity earnings in AmerisourceBergen in the year ago quarter.

Now let's move to the U.S. segment. Sales increased 3.2% in the quarter, with a strong performance from Walgreens more than offsetting a 270 basis point headwind from a decline in the AllianceRx Walgreens Prime business. Adjusted gross profit increased 12.3%, with both pharmacy and retail growing nicely. Strong sales growth was partially offset by lower reimbursement and higher shrink costs.

Adjusted SG&A spend increased 4.2% in the quarter to 17.2% of sales, 20 basis points higher than last year. The year-on-year increase was primarily due to investments relating to vaccinations and labor, partly offset by savings from the Transformational Cost Management Program and some phasing benefits. Adjusted operating income increased 46.3% as the strong gross profit growth more than compensated for higher costs associated with the COVID-19 vaccination program.

Now let's look in more detail at U.S. pharmacy. Pharmacy sales grew 1.1%, including the negative impact from AllianceRx Walgreens Prime. Comparable pharmacy sales were up 6.8%, while comp scripts increased 6.2% with vaccinations accounting for 535 basis points of the script growth. We completed 15.6 million COVID-19 vaccinations in the quarter and administered 6.5 million COVID-19 tests. We are now administering COVID-19 tests at around 7,000 stores. Flu shots were down as we saw a return to more normalized levels compared to the record levels last year. Additionally, underlying scripts were challenged by staffing shortages and temporary operating hour reductions. Adjusted gross profit grew nicely as strong sales growth at Walgreens more than offset reimbursement pressure.

Turning next to our U.S. retail business. Comp retail sales increased 10.6%. And excluding tobacco, comps were up 11.7%. Compared to pre-COVID levels on a 2-year stack basis, comp sales were up low double digits.

We saw broad growth across all categories led by 24.7% growth in health and wellness, driven by at-home COVID-19 tests and cough, cold, flu. Transactions were up 9% and discretionary categories performed well, with beauty comp sales growing 16.6% and personal care, up 11.6%. Strong sales growth drove an increase in gross profit. However, gross margin declined slightly, constrained by higher shrink from organized crime theft and increased import freight costs.

Turning next to the International segment. And as always, I'll talk to constant currency numbers. Sales increased 34.2% in the quarter, including a 25.6 percentage point uplift from the formation of our wholesale joint venture in Germany. We are lapping the formation of the Germany JV on November 1, 2020 with the prior quarter, including only 1 month of sales. Excluding this impact, sales were up 8.6%, reflecting the ongoing recovery and strong execution across most international markets, particularly in the U.K., where sales advanced 13.4%. Adjusted operating income was \$164 million in the quarter, up 89% versus prior year, led by higher sales and tight cost control.

Let's now look in more detail at Boots U.K. Comparable pharmacy sales increased 8.8%. Stronger demand for services contributed to the increase, with sales up more than 200% year-on-year, benefiting from COVID-19 testing. Flu vaccinations were also up, and we recorded our largest ever season, with 2 million vaccinations during the first quarter, up 150% compared to last year. These positive developments were only partially offset by the non-repeat of favorable prior-year phasing of NHS funding.

Comparable retail sales increased 16.3%, reflecting a recovery in footfall and strong commercial execution. Market share strengthened across all categories, with beauty performing particularly well.

Despite these strong results, footfall in the quarter remains around 20% below pre-COVID levels, with particular challenges in travel locations. We do, however, see continued strength in basket size, which was up around 12% in the first quarter compared to pre-COVID levels.

Finally, boots.com continued to do very well. Digital sales almost doubled compared to the equivalent pre-COVID quarter and now account for more than 15% of total retail sales.

Looking ahead, we are monitoring the impact of Omicron. The U.K. government announced a move to slightly tighter restrictions, which started on December 13. We expect that footfall will remain sensitive to new COVID variants.

Turning next to Walgreens Health. This is our first quarter reporting results for our new Walgreens Health segment. Our majority investments in Shields and VillageMD closed on October 29 and November 24, respectively. Shields is immediately accretive, with sales of \$25 million and adjusted operating income of \$10 million in the quarter. Reflecting 6 days of ownership, VillageMD had sales of \$26 million and an adjusted operating loss of \$3 million. For this fiscal year, we anticipate VillageMD to be dilutive to EPS, consistent with our October statements.

Organic investments in Walgreens Health were slightly lower than expected due to the timing of expenditures. We expect to see rising investments over the course of the year.

Let's now look at some of the key metrics for Walgreens Health. In addition to Clover and Blue Shield, we continue to work with other interested partners and we are approaching our December 2022 goal of 2 million lives. As we scale our access to lives and partnerships, we will continue to build out our Walgreens Health Corners, with a goal of more than 100 by the end of 2022, with 47 already up and running.

We continue to expand the VillageMD footprint and will be in expansion mode for the foreseeable future. VillageMD currently has 257 locations across 18 markets, 81 of which are co-located with Walgreens stores, up from 55 at the end of fiscal '21. The goal is to have at least 160 co-located clinics in place by the end of '22.

Both VillageMD and Shields are on a high-growth trajectory. On a pro forma basis, they delivered strong sales growth in their most recent quarter, with VillageMD advancing 182% and Shields growing 62%. Overall, we are very excited about our growth potential.

Turning next to cash flow. We generated \$645 million of free cash flow in the first quarter, \$118 million below prior year. Strong growth in operating income was more than offset by the phasing of working capital, prior year one-time benefits associated with the passing of the CARES Act and the increased capital expenditures behind key growth initiatives.

Turning now to full year guidance. We are raising our adjusted EPS guidance from flat to low single-digit growth. We now expect higher growth from our base business, reflecting a strong first quarter and higher levels of vaccinations and testing. We expect 30 million vaccinations this year, 5 million higher than our previous guidance.

Our Walgreens Health segment is tracking well against its key milestones, with both the Shields and VillageMD transactions closing in the first quarter and the Walgreens Health organic business continuing to invest in future growth.

Within this guidance, we've reflected our decision to increase investments in our team members by an incremental \$120 million. As highlighted earlier by Roz, without this investment, our full year adjusted EPS growth would have been 3% to 5%.

Let me now provide some additional color on our guidance raise, including puts and takes versus prior guidance. As mentioned, we are planning for higher vaccinations in the fiscal year. Additionally, our U.S. retail comps were very strong in the first quarter, and we have seen this momentum continue into the second quarter. And we are also driving tight cost management across all of our segments. Balancing this, we made a decision to increase our labor investments. Recent labor challenges led to somewhat softer script volumes in the first quarter, and these investments should help improve the situation. Additionally, as with many of our peers, we are experiencing higher rates of shrink loss due to organized crime theft.

Inflation is also on the rise. And while we expect to pass through the majority of these higher costs, there may be some short-term impacts.

In summary, we are raising our adjusted EPS guidance to low single-digit growth driven largely by our U.S. segment.

And let me now update you on some of the guidance metrics we provided during our recent Investor Day. Sales in the U.S. are now expected to be around 2 percentage points higher than previous guidance, driven by strength in both pharmacy and front of store. As a result, adjusted operating income is anticipated to be flat to up slightly, better than our previous guidance.

Sales projections for international have also improved to 9% to 11% growth mainly due to improved market growth for our German wholesale business. We still expect International adjusted operating income growth of more than 50%.

Walgreens Health remains on track. Sales will be slightly lower due to the timing of regulatory approval related to CareCentrix. However, this has an immaterial impact on earnings. Finally, we expect an adjusted tax rate of around 16%, consistent with prior guidance.

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

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

Thank you, James. To summarize, we are executing with a very strong start to the year and an increased fiscal 2022 outlook. WBA's transformation is underway, and I am pleased with our rapid progress along our strategic priorities.

I'm looking forward to continuing this dialogue with you about our execution and progress next week at the JPMorgan Healthcare Conference. We are energized and focused on reimagining healthcare and well-being for everyone, with a clear path toward accelerated value creation across all our stakeholders.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from Eric Coldwell from Baird.

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

I'm first hoping you can provide a little more color on what's going on with AllianceRx Walgreens Prime. We saw the headlines earlier this week that Prime appeared to be dropping the contract and the fiduciary breach claims. But I guess, bigger picture, what's happening with that business, number one. Number two, is there any impact on guidance that we should note from taking the holding from 55% to 100%? And if you don't mind, I might have a follow-up.

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

Thank you, Eric. Let me start off first by asking James to give a little bit of color on your second question, and then we'll go into the AllianceRx after that. Thank you.

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

Yes. So Eric, so we've taken the stake from 55% to 100%. As you plot out your adjusted operating income, there will be no change because we already consolidate 100%. And then you have the below-the-line adjustment for the minority interest to 45%.

So you will recall that when we gave guidance at the beginning of the year, it was a material driver within the U.S. business. We called out that there would be a 7% decline in U.S. revenues as a result of roughly an \$8 billion decline in the AllianceRx Walgreens Prime business.

So this large decline -- and we kind of stared at this and looked at it and said, this business will need to be restructured. It's probably better under one owner to do this quicker.

And honestly, we see -- we're formulating a new specialty strategy in the business. We see now that we have the Shields asset combined with our specialty pharmacies, combined with the AllianceRx Walgreens Prime business, we do believe we can formulate an integrated specialty business. Hold on a little bit until we come out with more information on this.

You've raised some legal disputes between the 2 parties. They've now been resolved as a result of the acquisition. Looking at our guidance, it has a slight negative impact because if we were declining \$100 million in income year-on-year, we will now be declining 100% of that income on a net income basis as opposed to 55%. But honestly, this is a couple of cents on the full year. So I wouldn't even worry about it in the context of guidance.

But I do want to reiterate, I think you'll see us maybe in the next 6 months, come out with a more energized specialty strategy, which will be more integrated in how we surround potential partners with a series of integrated services. So we're pretty excited by this.

I do want to emphasize -- yes, sorry, I just do want to emphasize the relationship with Prime is very strong as a result of this. We're still significant partners of theirs in retail, and we will continue to offer specialty services to them on an ongoing basis as they require.

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

We actually have John Standley on the call. John, is there anything you want to add to that response to AllianceRx?

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

No. James did a great job summarizing it. Specialty is a huge part of our business. We do \$20 billion plus of specialty, and we're excited to bring these assets fully back into the portfolio, as James described. So big opportunity for us. We're really excited.

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

John, you actually answered my follow-up on just sizing the specialty business in total.

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

North of \$20 billion. So...

Operator

Your next question comes from 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

Roz, I look forward to seeing you and James virtually next week.

So let me just start with, first, a clarification. James, just I want to understand in the guidance when you talked about higher vaccinations, this quarter was higher than we had anticipated. Obviously, we now have boosters for even 12-plus in the U.S. Can you talk about your expectation for vaccinations as well as testing in the updated guidance?

And then secondly, I just had a broader question for you, Roz, as we think about the strategy and the Health Corners. And how do we think about -- I don't know if this is for you or for John Standley, but how do we think about the profitability there? Do you think that longer term, you can do some kind of whether it's shared savings programs or other types of programs? Because getting an incremental script is great, but where really the opportunity is, right, is to lower the overall cost and potentially share in those savings. So if you could help us understand that as well.

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

Okay. Great. I'll let James get started on testing. Thank you, Lisa.

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

Yes. So Lisa, thank you. I think you had 5 or 6 questions in there. The first one, vaccinations. So we've increased the estimate from 25 million to 30 million. And that's basically as a result of high levels of activity in the first quarter.

I do want to stress, though, the 30 million is just -- it's a number picked at a point in time. Depending on the evolution of the variants and guidance from the CDC and others, this number could vary quite a bit. So there could be some potential upside to this, actually. And two, but specifically on that, we increased 5 million. That's worth about \$0.09.

And then testing, we had a fairly large opportunity as well because actually, the biggest driver in the first quarter is actually probably testing as opposed to vaccines. And that's probably in the range of \$0.12 to \$0.15 just on the full year. So I'm giving you a full year number. So \$0.09 on vaccines and testing is, kind of call it, \$0.12 to \$0.15. So quite a sizable contribution to the full year.

As we look at the 30 million, you break it out and approximately 19 million are boosters. And you can figure out what the rest is. Pediatrics, I believe, is somewhere in the region of 2 million, 2.5 million. So the rest is people aged 12 plus. So I can't be much more specific than that from memory. That is kind of our base assumptions.

We're not giving profitability. You can work it out from the cents per share that we just gave you. And I'm trying to remember that I cover all your questions?

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

Yes, you covered all my questions on that side.

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

We'll see you next week.

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

So Lisa, let me talk a little bit about how we're thinking about our growth in Walgreens Health and how that really leverages our core business in Walgreens managed by John Standley.

So here's the way to think about this. We are creating an entity here that does much more than just dispensing of pharmaceuticals. And so -- and the way to think about this is the number of VillageMD units that we plan to bring together, when you think about this investment of \$5.2 billion, we'll be opening at least 600 of those Village Medical clinics within our entity and then adding the health corners. We're trying to put the consumer in the middle of this and also giving them the visibility of what it costs to manage their healthcare over their lifetime.

When we think about where does the profitability come from in this, it is much beyond the prescription usage. When I think about a customer coming into a VillageMD and actually understanding more about their healthcare needs, it will help them understand the spending and then also, too, what comes from operating a primary care physician practice within our entity.

And then I think about the work that can happen between optimizing for that patient between understanding what the pharmacist is applying to that customer or patient's healthcare needs and to get that repeatability. And also giving the customer or patient the opportunity to come into one of our units and utilize a Health Corner.

And so just managing their care over time, for instance, looking at their AIC levels and things like that over a period of time will hopefully bring their cost of care down and keep them out of the healthcare system and returning to emergency rooms in hospital settings. And so we've not really articulated a clear view on profitability going forward. But what I would tell you is that this does take us well beyond just the additional script, it's much larger than that.

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

Okay. Great.

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

I'll see you next week.

Operator

And your next question comes from A.J. Rice from Credit Suisse.

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

The front-end store in the U.S. sales were really strong. And I just wondered if we could delve into that a little bit? As you look at that, clearly, at-home testing probably had a component. Can you parse out how much that helped? And how -- as you look at the rest of the year, with the administration talking about sending out 500 million at-home tests, does that have implications for you in terms of your ability to get those tests yourself to sell them? Or -- and your expectations around that testing? And if there's something beyond testing that's really strong, can you comment on that as well on the U.S. front-end sales?

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

Yes. The -- I'll take a shot at that and then maybe John can add to it. If you take the growth on front of store, which was -- the 10.6% was the highest in 20 years.

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

Right.

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

The contribution coming from the COVID-19 screening test was about 320 basis points. So it was about 29%, 30% of the growth rate. So there is strong core performance in the front of store. It's not just at-home testing.

And so that's roughly in the quarter. I think it's a little over \$200 million of revenue in the quarter. And I think it's around \$0.06. I might get this wrong, roughly \$0.06 contribution. So it's not a massively profitable sector. It's below the average of the health and wellness sector on a gross profit basis. Is that what you were looking for, A.J.?

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

Okay. How about areas of strength?

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

Yes. I think I'd just comment, James. We saw really strong performance in OTC, beauty, personal care, all very strong categories. Good success with our mass personalization efforts and a little bit of halo from the vaccine and testing. So I think those were all good contributors to the strong performance in the quarter.

Operator

Your next question comes from George Hill from Deutsche Bank.

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

Yes. First, I'd like to welcome Tiffany aboard. So Tiffany, look forward to working with you.

And I guess, Jim and John, I kind of have 2 questions around -- one is around what I would call underlying Rx's. You talked about the comp on the front of the store. In 2019, I guess, can you talk about where you feel like the -- what I would call the acute care script or the regular script comp looks like versus 2019 because there seems to be some debate about how close back to baseline we've gotten?

And I guess if I could just sneak in a follow-up on the front of the store, James. A.J. asked a question about the in-home testing -- I'm sorry, yes, the in-home testing. Can you talk about the impact that, that's had on the average basket size and maybe the tier rate? What have you guys seen from people who've come in shopping for tests and people who've kind of bought stuff in addition to the tests?

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

You want to take a shot, John, on the Rx?

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

Sure. I mean I think the -- I would just say on Rx, I think we saw script count growth above and beyond what we saw in vaccinations, but we think there's more opportunity for us there, just looking broadly at the marketplace. We are, as James and Roz talked about, making significant investments in the business, both from a staffing perspective as well as with Project Nucleus and other capabilities we're putting in to really drive that pharmacy experience in store. So I think we still see a ton of upside and growth opportunity just in the base pharmacy business just to grow our market share and to push that forward.

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

Yes. So George, the -- sorry, that's wrong. The Q1 was -- excluding immunizations, was up 1.8%. And it was a little softer than where we would have liked to have been. One of the big drivers was Medicaid, where the market grew strongly in both Medicaid and discounted products. And we like the market in Medicaid because we have a lower percentage overall share in the category.

That being said, don't -- there is a fairly strong connectivity between the scripts and the amount of vaccinations and testing done in the quarter because the pharmacists are doing both jobs, and there's been a high level of stress in the system, hence, the investments.

So I think what has happened a little bit is because of staffing shortages, we've had to reduce operating hours in some locations. And then two is some of those phone calls that happen to say adherence follow-ups, are they taking the medication. Those phone calls were not priority #1 during the administration of the vaccination.

So we got to get a bit of a rebalancing in the year to go, and we are reasonably confident that the actions we're taking are definitely in the right direction. So we should see an uptick in scripts in the coming months.

Operator

Your next question comes from Elizabeth Anderson from Evercore.

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

I just wanted to follow up maybe on A.J.'s question. When you were talking about the at-home testing contribution in the quarter, that was super helpful. I just -- I guess, in terms of like how you're thinking about that on a go-forward basis with some of the administration changes, et cetera, how are you thinking about that in the broader context of the new guidance that you put out?

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

Well, maybe I'll tag team with John on this. There is a fair amount of talk about free testing. It's still to be determined when that will be in the market. We -- as far as I know, there isn't a website set up and there isn't a defined procedure of how it's all going to work. So I think it's a couple of months away.

I think the critical one right now is stock availability. And I'll give you an interesting statistic. Our health and wellness share in the market generally is around 17%, 18%. Our share of the at-home test is 40%, 45%. So I think what we've superbly executed against is supply chain fulfillment and partnerships with suppliers.

Right now, we're a little spotty in places on availability. We're at about 70%, but we clearly sold the majority of the at-home tests in the (inaudible) channel. So it's been a huge success. So the \$200 million didn't come just magically, it came because of stock availability and we're much more -- we had -- I think we had 7 different types of COVID at-home tests in our stores in various places. So we've out-executed on this one, and that's why we have such a big contribution in the first quarter.

We think we will continue to out-execute. We see our stock availability levels going up significantly by mid-month. So we're feeling in a pretty good place in the next 3 months. Beyond that, nobody can tell. It's all on what's the -- where are the variants at a particular point in time. I think testing is here to stay for a considerable amount of time, but our full year forecast is not riding on this. I can assure you of that.

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

That's really helpful. And if we think about -- I think you were really helpful in sort of giving your updated thoughts on the broader longer-term picture with VillageMD. I was wondering if you had any sort of data from the quarter sort of from co-located locations in terms of increase in sales in the Walgreens, either front end or pharmacy, or any other data you could point to us from that perspective?

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

No, not really. I think it's a little bit soon. I think we need another quarter behind us. We've got, I think, 81 clinics open. We still need -- and I was on the phone to some of the Village guys yesterday. We still need to get the same kind of stats. They already have stats that prove that a pharmacist working with a doctor produces tremendous benefits in terms of outcomes. We need to replicate those statistics in the co-located. We're convinced that will happen. It's just a timing difference.

I think as you look forward on Village and -- I'm sorry, if you look forward on our segment, one thing I'd ask you to have in mind is the revenue is pretty small in the quarter because we're just closing the acquisitions. A good way to think about these acquisitions is both -- if CareCentrix closes at the beginning of the third quarter, we essentially will be doing a little over \$1 billion a quarter in terms of revenue in the segment.

So if you think about Q4 and you do a simplistic run rate, by the time we finish Q4, we'll have a run rate of about \$4 billion, probably north of \$4 billion in terms of, call it, a 12-month run rate on the segment. That's the only kind of new insight we would give because a little bit -- analyst models are a little bit all over the place in terms of expectations.

So I don't think you're going to see stability on revenue until we get into Q3, and it all depends on closing time on CareCentrix. But once that's closed, you're looking at \$1 billion a quarter for the remainder of the year.

Operator

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

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

I apologize if I keep coming back to this, but I just want to make sure I understand a lot of the moving pieces on guidance in particular, how it factors into the multiyear growth that you outlined at the Investor Day back in October.

It seems to me, James, that if I'm looking at the pluses and minuses that you outlined, which are quite helpful, especially with some of the dynamics around the testing benefit that you're seeing, that the pluses more than offset the minuses relative to the magnitude of the EPS guidance. Maybe I would have expected a bit more.

And so I guess, relative to -- you quantified the labor investments relative to the shrink or the inflation or anything else. Is there anything we're missing in there in terms of the moving pieces? And especially given that a lot of the benefits are COVID-oriented. I know we can't predict what COVID is going to look like in fiscal '23. But does this change anything about the trajectory of jumping off point you expect for earnings growth relative to the previous outlook that you had mentioned?

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

Yes. I'm not sure we want to start getting into next year. But I would say that -- let's talk about shrink for a minute because you could actually argue that shrink is somewhat correlated with COVID in terms of it is something that has started to tick up post-COVID.

So whether -- I'm not trying to get a direct correlation with it, but I'll give you a number. The shrink issue for us this year is in excess of

\$0.15 a share. So we don't anticipate that, that will continue longer term. So as you said, there's many puts and takes in both direction. So testing is a big number, but so is shrink. And we're going to have to redouble our efforts on shrink to get this number in a different direction.

And honestly, I think Congress needs to step up a little bit here because the magnitude of the problem is -- it's enormous. We've had, I don't know, 10 years where shrink is at -- And I'm not going to -- it sounds precise, it's not the exact number. It's a little over 2% of shrink, 2.25%. It's currently running at 3.25%. That's a 40 -- we estimate the shrink is about 40% to 50% higher on a percentage basis than it was prior to -- sorry, back prior to '19 -- sorry, prior to '20. So this is over the last 2 years. We're absorbing a 52% increase in shrink.

And it's organized crime. This is not petty theft. It's not somebody who can't afford to eat tomorrow. These are gangs that actually go in and empty our stores of beauty products. And it's a real issue for the -- as with all of our peers, it's a real issue.

The other one is inflation. Honestly, I think we're doing a very good job of managing that. We have some -- we'll have minor ups and downs quarter-to-quarter. But generally, we're offsetting inflation. It might be \$0.03 negative on the full year. So we're not talking about big numbers.

But I think we have to wait and see how the year evolves. There's too many moving pieces honestly in terms of what is the final vaccination number in here, what's the final testing? And maybe I'll ask John just to comment a bit because we have an intention to build a diagnostics business longer term. And that will provide partial offset as we get into next year.

John or Roz, want to add on anything and maybe labor costs? Yes.

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

Yes, absolutely. I mean I think where we've gone with diagnostic testing now, just with COVID testing, in over 7,000 stores, we've got some good green shoots in A1C testing that are underway right now, just at the very early stages, but I think that's a big opportunity for us.

And in our COVID testing, we do CLIA-waived rapid testing in our stores in over 4,000 locations. So as James said, I think that's one example of some of the changes to our business that will come out of COVID as we move forward that are big opportunities for us.

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

Mike, this is Roz. Can I just add a couple of things here, just for clarity. So you also noticed that we made a significant investment in labor. And as we are all involved in this uncertain labor market, we're not quite sure how much more investment we'll need to apply there. But what we've done so far, applying it very directly against regaining our script business, which could turn the numbers around in that area. And also as the potential for a forth dose to come online, we're managing through that. So the uncertainty here is the other part that we need to think about.

And then I just wanted to mention the piece on shrink, is that we're managing this on a couple of different levels. We -- it's happening at store level, but myself personally and our government relations team has been in the Washington, D.C. area, having conversations with our national leaders on how do we get around this shrink issue. And what we're seeing is goods leaving from our store and ending up online applications.

So we're working with our partners that are in the online business pretty heavy to make sure that we can monitor this situation. So it's that level of uncertainty and the enormity of some of these issues that you may look at this and say, is there more to be had here. But it's the uncertainty piece that we're managing, Mike, if that's helpful.

Michael Aaron Cherny BofA Securities, Research Division - Director

All of that's very helpful in terms of understanding the moving pieces.

Operator

Your next question comes from Steven Valiquette from Barclays.

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

So just a quick question on the quarterly cadence of earnings in the remainder of fiscal '22. The adjusted operating profit for the company has always been up sequentially in fiscal 2Q versus fiscal 1Q in each fiscal year historically. So is there any reason why that would not be up sequentially in fiscal 2Q versus fiscal 1Q this year, just on the sequential adjusted operating profit? Also, what are your latest thoughts around the flu benefit for the company in fiscal 2Q as well?

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

I'm not sure on the sequential side. Honestly, I don't have it in front of me. I think we do see that Q2 will be a positive quarter on EPS growth year-on-year because there was low levels of vaccination in the prior quarter. So will we have a good second quarter? The answer is yes.

Obviously, there's a lot up in the air in terms of how much of the vaccinations were shifted from Q2 into Q1. And that's what we're struggling with on a daily basis is what is the estimate on the full year? How many people will get boosted? What is the pediatric number? And it's quite a lot of detailed work. So -- but we will have a good second quarter.

And the second part of your question was?

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

Yes. Just as far as the updates on the flu.

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

Yes. Flu, we had a very strong -- strangely, we had a very strong flu season in the U.K., which was up 150%. Then we had a fairly weak one in the U.S. Flu incidences generally were down compared to a record season last year. So did it go brilliantly? The answer is no.

I would -- I think the exact number is while we were -- I think it was an 80 basis point headwind on vaccinations, something like that. When you look at the script numbers, the first quarter was 80 basis points negative due to a weaker flu season.

Operator

Your next question comes from John Ransom from Raymond James.

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

You guys have called out 340B as a risk. And we've noticed that the manufacturers have won a couple of rounds in the courts and that there's reduced support for this program for the contract pharmacies. Is that -- what kind of headwind is that this year versus last year? And how should we think about this long term?

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

John, thank you for that question. I'm going to ask our John Standley to talk a little bit about the impact of 340B. And if there's any other numbers, James will close out the question. John?

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

I don't think it's a hugely material issue for us at the moment. We're obviously watching the situation. We feel the administration is actually very supportive. And the idea here is obviously to get access to the medications to as many folks who should have them as possible, and that's really our objective as well.

And obviously, Shields gives us a whole another approach here as well as we look at the 340B space. But it's also an important part of our specialty business and again, just making sure that we can get patients access to the medications that they should have. So I think as far as what we can see in exposure so far, that's reflected in the guidance that we've given.

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

Yes. I would just summarize. It's not material year-on-year. I think it's tracking slightly behind budget, but it's not even material enough to talk about. And then year-on-year, I'd call it kind of neutral.

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

Okay. And then just as a more of a big picture question. I guess we're all trained that 20 years of thinking that the PBMs have just locked up the specialty market. They can use their benefit structure. UnitedHealthcare just took Diplomat to 0. People use their mail order. So just at a high level, and I know you -- this is yet to be rolled out fully, but how do you break that PBM benefit structure cartel with specialty given that you don't own a PBM directly?

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

John, I'll...

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

John.

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

Yes. I was going to jump in, if that's okay. So I think what's important about us is access. So between what we have in community pharmacy today, what we have in hospital pharmacies, what we dispense in our retail pharmacies and what we have today through our central fill, we bring, I think, a great network of access to the marketplace with really strong clinical capabilities.

And just as an important part of that is our relationships with pharma. And just over the last few months, we brought in 10 new limited distribution drugs to our portfolio now of probably just over 200 limited distribution drugs. So we actually do business with all of those large PBMs that you mentioned and support them in their efforts. They're important partners to us as well as direct contracting.

So I think there's space for us in this market, and you'll hear us talk about that as we bring our strategy forward here for the integration of all the capabilities that we have.

Operator

And the last question for today comes from Eric Percher from Nephron Research.

Eric R. Percher Nephron Research LLC - Research Analyst

I'll stay on the pharma macro front. I know that the Biden administration is considering taking administrative action on DIR fees. And these fees, we understand, to be significant for independent retail and spec pharmacies. I'm interested to what extent they've been meaningful as a reimbursement pressure for Walgreens? And would it be material if we see limitations to DIR fees put forth?

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

Thanks, Eric, for the question. John Standley, you want to take that one?

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

You bet. So yes, we're working with industry groups in various states to really try and make sure that any kind of performance-related fees are fair and equitable, which many DIR fees today just aren't, the way they're designed. And so that's really, I think, the key component of it from a regulatory perspective.

So we support efforts to just try and have a fee structure that makes sense where a community pharmacy or a retail pharmacy is fairly compensated for the services that it provides. That's really kind of where we're headed here.

I think the impact of it, we would just have to see, one, specifically what the regulation is. And then secondly, do the PBMs or others -- or not really PBMs, plan sponsors somehow shift the playing field in some other way. You'd have to take into consideration in terms of trying to determine the quantitative impact of what those changes might be. But clearly, some of these fees just don't make any sense.

Eric R. Percher Nephron Research LLC - Research Analyst

And is it fair to assume that as you've had to deal with fees that maybe don't make sense, they're penalizing you and that has fallen to the bottom line fairly directly?

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

Yes.

Eric R. Percher Nephron Research LLC - Research Analyst

Or have they been offsets?

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

No, fairly directly. Yes. It's been impactful over the last several years for the business.

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

All right. Thank you. I just want to mention to everyone, thank you for joining the call this morning. I hope your takeaway from this call is that you see that we're making meaningful progress towards our strategic priorities. We've been delivering against our Investor Day commitments that we laid out just as early as October.

It's still early days, but it's clear that we're creating sustainable value for our shareholders. And we're off to a strong start for the fiscal year. Raising our full year adjusted EPS guidance is important for us as you continue to track us and see the road that we're on to really try and achieve these attractive low-teens earnings growth over the long term.

So I appreciate your time today, and we look forward to those who will join us at the conference next week. Thank you.

Operator

This concludes today's conference call. You may now disconnect.

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