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WBA - Q4 2017 Walgreens Boots Alliance Inc Earnings Call

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OVERVIEW:

Co. reported FY17 GAAP diluted net EPS of $3.78. 4Q17 sales were $30.1b, GAAP net earnings attributable to WBA were $802m, and GAAP diluted EPS was $0.76. Expects FY18 adjusted diluted net EPS to be $5.40-5.70.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Walgreens Boots Alliance Fourth Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the conference over to Gerald Gradwell, Senior Vice President, Investor Relations. Please begin.

Gerald Gradwell

Hello, and welcome to our earnings call. Stefano Pessina, our Executive Vice Chairman and Chief Executive Officer; and George Fairweather, Executive Vice President and Global Chief Financial Officer, will take you through our results as usual. Alex Gourlay, Co-Chief Operating Officer of Walgreens Boots Alliance, is also here and will join us for questions. You'll find a link to the webcast on our Investor Relations website at investor.walgreensbootsalliance.com. After the call, this presentation and webcast will be archived on the website for 12 months.

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. Except to the extent required by the law, 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.

As a reminder, today's presentation includes certain non-GAAP financial measures, and 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.

Before I hand you over to George to review our results, I would just like to draw your attention to the announcement made by CVS last night, in case anyone may not have seen it. CVS announced a new PBM, performance-based pharmacy, network focused on reducing costs and improving clinical outcomes. Formed through a partnership between CVS pharmacy and Walgreens and including a number of community-based independently owned pharmacies across the United States, this initiative creates a 30,000 store network to service CVS' Caremark PBM clients and their members.

As this new network has been announced since the year-end, we do not comment on it in the presentation of our results today. But we will be happy to take any questions you may have on it following our presentation.

Given how much we have to cover today, our presentation will run slightly longer than usual. I'm pleased to say only slightly. But we will still allow the full hour for questions at the end of the presentation.

I will now hand you over to George to take you through the numbers.

George Rollo Fairweather - *Walgreens Boots Alliance, Inc. - Global CFO & Executive VP*

Thank you, Gerald. We've delivered a strong business performance in the year, both in terms of adjusted profit and cash flow despite currency headwinds and some challenging market conditions.

In the fourth quarter, we recognize, of course, that our GAAP numbers have been significantly impacted by the Rite Aid-related costs, including the merger termination fees. However, overall, on an adjusted basis, the final quarter was better, mainly due to U.S. pharmacy volumes and market share continuing to grow in line with our strategy.

As you know, on 29th June, we announced a $5 billion share repurchase program. During the quarter, we purchased $3.8 billion of shares. And since the fiscal year-end have completed the repurchases.

In keeping with our commitment to operate as efficient a balance sheet as possible, we've decided to add an additional $1 billion to the program. This is in addition to our routine anti-dilutive share repurchases.

Of course, our other recent news was Rite Aid regulatory clearance in September, which I'll come on to shortly.

First, I will take you through our fourth quarter results. As we indicated throughout the year, we expected the fourth quarter to be particularly strong. As you can see, this is the case. Currency had a negative impact, the U.S. dollar being around 4.4% stronger versus sterling than in the comparable quarter last year. This impact was less significant than in the first 3 quarters.

Sales for the quarter were $30.1 billion, up 5.3% versus the comparable quarter.

On a constant currency basis, sales were up 6.4%. GAAP operating income was $1.1 billion, a decrease of 2.3%. GAAP net earnings attributable to Walgreens Boots Alliance were $802 million, down 22.1% and diluted EPS was $0.76. This was 20% lower than the comparable quarter last year due to Rite Aid-related costs, mainly merger termination fees.

Adjusted operating income was $1.9 billion, up 21.2%, and in constant currency, up 22.3%. Adjusted net earnings attributable to Walgreens Boots Alliance were $1.4 billion, up 18.8%, and in constant currency, up 19.1%. Adjusted diluted net earnings per share was $1.31, up 22.4%.

The adjusted effective tax rate, which we calculate excluding the equity income from AmerisourceBergen, was 24.6%. This was 6.3 percentage points higher than in the same quarter last year, when you'll recall, we particularly benefited from positive discrete items.

Our core tax rate, which excludes discrete tax impacts, was in line with our rate in the third quarter.

So turning now to the performance of our segments, starting with Retail Pharmacy USA. Retail Pharmacy USA sales were $22.3 billion, up 7.5% over the year-ago quarter, comparable store sales increasing by 3.1%.

Adjusted gross profit was $5.6 billion, up 4.3% over the year-ago quarter, reflecting an increase in both pharmacy and retail. Adjusted SG&A was 18.9% of sales, an improvement of 1.8 percentage points compared to the year-ago quarter. Adjusted SG&A as a percentage of sales has improved versus comparable quarters for 17 consecutive quarters. Adjusted operating margin was 6.3%, up one percentage point, resulting in adjusted operating income of $1.4 billion, up 27.5%.

So next, let's look in more detail at pharmacy. U.S. pharmacy total sales were up 12.6%. We filled 250.2 million prescriptions on a 30-day adjusted basis including immunizations, an increase of 9%.

On a comparable basis for stores, which excludes central specialty, our pharmacy sales increased by 5.6% with scripts filled, up 8.7%. This is primarily due to strong volume growth from Medicare Part D and the positive impact of our strategic pharmacy partnerships.

Within sales, volume growth and brand inflation were partially offset by reimbursement pressure and the impact of generics. Our reported market share of retail prescriptions in the quarter on the usual 30-day adjusted basis was 20.5%, up approximately 120 basis points over the year-ago quarter. Total retail sales were down 3.9% on the same quarter last year, this includes the impact of the previously announced closure of certain e-commerce operations.

Comparable retail sales were down 2.1% in quarter with declines in consumables and general merchandise and the personal care categories, partially offset by growth in the beauty and health and wellness categories.

Compared to prior quarters, comparable sales were lower, partially through changes to our promotional plans as we focused on delivering improved margins.

Gross profit and margin were higher than in the same quarter last year mainly due to actions we took in the fourth quarter last year to put in place foundations for long-term growth.

In addition, margin was higher due to the changes to promotions, as I just mentioned, and improved mix, as we increasingly focused on higher-margin categories.

On the last call, I told you that we were implementing a program in approximately 1,500 stores to simplify our offering and improve our retail operational performance. This program has now been completed, and we are starting to see the early benefits including ongoing efficiencies and reduced working capital.

Our beauty differentiation program has driven profit and margin improvement as our own brands continued to perform well.

Beauty category sales in beauty differentiation stores continue to be markedly better than in other stores, supported by strong sales growth of No7 and Soap & Glory.

In line with our strategy of introducing new owned brands to our U.S. stores, we launched 2 terrific cosmetic brands during the quarter. CYO is our new and exciting makeup collection developed by Boots in Nottingham, which is designed to encourage our younger customers to be colorful and creative.

We have in addition launched Sleek MakeUP in Walgreens stores and online after a successful launch in Boots 2 years ago. Sleek is one of our fastest-growing brands in the U.K. with a young ethnically diverse customer base.

Since the year-end, we have launched a brand-new skincare range, Your Good Skin, which is exclusive to Walgreens and Boots. Developed by our scientists, the product is designed to promote visibly healthier skin.

As well as developing our offer of owned brands, as I said on the last earnings call, we are introducing our enhanced beauty offering to over 1,000 additional stores. This program is expected to be completed in the next few weeks, bringing the total number of stores with the enhanced beauty offering to around 2,900.

So now let's look at the results of the Retail Pharmacy International division. Sales for the division were $2.9 billion, down 0.4% in constant currency. Comparable store sales decreased 0.2% in constant currency. Comparable pharmacy sales were up 0.5% on a constant currency basis due to higher prescription volumes in the U.K., with Boots U.K. comparable pharmacy sales up 1.2%.

Comparable retail sales for the division decreased 0.5%, with Boots U.K.'s comparable retail sales decreasing 1.3%. This was due to a decline across a number of product categories with beauty being impacted by the timing of new product launches.

We've continued our work on cost control in the quarter while putting in place the foundations for future growth.

Adjusted gross profit for the division was down 0.8% in constant currency to $1.2 billion, mainly due to lower retail gross profit. This was more than compensated by lower adjusted SG&A, which was down versus the year-ago quarter on a constant currency basis.

As a percentage of sales, adjusted SG&A on a constant currency basis was 0.9 percentage points lower at 32.8%, reflecting work we have done to reduce costs, particularly in the U.K.

Adjusted operating margin was 8.9%, up 0.8 percentage points in constant currency. This resulted in adjusted operating income of $261 million, an increase of 8.9%, again, in constant currency. This was a much better performance than in the first 3 quarters due to the measures we've taken to reduce costs.

So now let's look at our Pharmaceutical Wholesale division. Sales for the division were $5.4 billion, up 5.4% versus the same quarter last year on a constant currency basis. This was ahead of the company's estimate of market growth weighted on the basis of country wholesale sales, with growth in emerging markets and the U.K. being partially offset by challenging market conditions in Continental Europe.

Adjusted operating margin, which excludes ABC, was 2.5%, down 0.3 percentage points on a constant currency basis. This was mainly due to lower gross margin, including some generic procurement pressures in the quarter.

The division benefited from $84 million in adjusted earnings from ABC, up $34 million versus the same quarter last year, mainly due to our increased level of ownership.

Adjusted operating income was $221 million, up 11.5% in constant currency.

So now let me turn to the full year numbers for fiscal 2017. As I've said, this has been a strong financial year with results coming in just above the top end of our guidance.

In summary, GAAP diluted net earnings per share of $3.78 was down 1%. This decrease primarily reflects a number of special items, including, as I said previously, the Rite Aid merger termination fees.

Importantly, our adjusted diluted earnings per share increased by 11.1% to $5.10, up 12.9% in constant currency.

The adjusted effective tax rate was 23.2%.

During the year, we particularly benefited from favorable discrete items. As ever, the tax rate also reflects the geographic mix of our pretax earnings and the U.S. taxation of our non-U. S. entities.

Operating cash flow was $2 billion in the quarter and $7.3 billion in the full fiscal year. Over the course of the year, our working capital inflow was $1.5 billion, reflecting improved payables and lower days inventory.

As a result of our focus on driving working capital efficiency, over the last 2 years, we've generated $2.9 billion of positive cash flow.

Cash capital expenditure in the quarter was $439 million. For the fiscal year, expenditure totaled $1.4 billion, which was broadly in line with last year.

We continued to invest in key areas to develop our core customer proposition, including our stores and U.S. beauty program as well as the upgrades to our IT systems, which we have previously talked about.

Overall, this resulted in free cash flow for the quarter of $1.6 billion and an impressive $5.9 billion in the full fiscal year.

In addition to the share repurchase program, which I mentioned earlier, in the fourth quarter, we made early repayments of $2.6 billion of debt to further optimize our balance sheet.

So turning next to Rite Aid. As you know, in September, we secured regulatory clearance for the purchase of 1,932 Rite Aid stores and related assets. We're delighted to be completing this transaction, which will extend our network, particularly, in the Northeast and Southern states.

In the past week, we've acquired the first stores to confirm the operational readiness of the key Rite Aid transitional IT systems. We will then begin acquiring stores in phases with completion anticipated in spring 2018.

To deliver the full benefit of the acquisition, we must, of course, fully integrate and rebrand the retained stores into the Walgreens network. This is a relatively complex, time-consuming and costly process.

Initially, Rite Aid is providing transitional services for all acquired stores. Over time, we will transfer these stores onto Walgreens' existing IT systems prior to rebranding as Walgreens with our full retail offer. We expect to complete the integration of the acquired stores and related assets within the next 3 years. The acquisition-related costs of this are estimated to be approximately $750 million.

In addition, we plan to invest around $500 million in incremental capital expenditure on store conversions and related activities.

As previously announced, we expect to realize synergies of over $300 million per annum, which we anticipate realizing within the next 4 years.

Following regulatory clearance, we have been able to complete a comprehensive review of the combined store portfolio to determine the scope for optimizing locations. This has resulted in our decision to close approximately, 600 stores and related assets over an 18-month period beginning in spring 2018.

We estimate the cost of this program to be approximately $450 million, substantially all cash spend. The resulting cost savings are expected to be approximately $300 million per annum by the end of the fiscal year 2020. We will, of course, when reporting our adjusted operating results, adjust out both the acquisition-related and optimization program costs.

So turning now to guidance for fiscal 2018. We're expecting adjusted diluted net earnings per share to be in the range of $5.40 to $5.70. As usual, this guidance is based on current exchange rates remaining constant for the rest of the fiscal year.

As we've said before, we do not expect the Rite Aid transaction to significantly impact adjusted diluted net earnings per share in this period. As I'm sure you'll appreciate, the recent hurricanes have been very challenging and continue to be so in Puerto Rico, where Walgreens is the largest pharmacy chain. We are very proud of all our people who have worked tirelessly to give our customers access to the medicines they need.

Based on our work to date, our initial estimates indicate that the cost of the stone damage and store closures could be around $90 million. The majority of this is in Puerto Rico. We plan to adjust for this when reporting our first quarter results. The damage to Puerto Rico's infrastructure continues to impact everyday life, including trading in our stores. We estimate that in the first quarter this could adversely impact adjusted earnings per share by a few cents.

Moving on to Med Part D. Although it's not our usual practice to comment on future sales expectations, given recent market speculation, I feel that it's worthwhile to point out that in 2018 we're expecting Walgreens to grow its Med Part D business year-over-year.

While not material, you should also note that our partnership agreement with Fareva, which includes the sale of our contract manufacturing business, will commence at the end of October. As a result, in the future, we won't have these low margin sales within Retail Pharmacy International. Thinking about phasing, we expect this year to be more balanced between the two halves.

I will now hand over to Stefano for his concluding comments.

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

Thank you, George. So as you have heard, another strong quarter and for us, a busy quarter to round off a very busy financial year.

It has been another year of good financial growth delivered in a variety of ways, but all coming back to the hard work, determination and commitment of our team.

It's amazing to think how much we have achieved in such a comparatively short period of time, when you bear in mind that it is less than 3 years since we completed the transaction to create the Walgreens Boots Alliance.

Over the past 3 years, we have delivered growth of over 50% in adjusted diluted net earnings per share, averaging over 15% compound annual growth year-on-year during the period.

I appreciate that looking from the outside, it may be easy to underestimate how much progress have been made. The economic progress is clear, and however people may choose to be view it, the earnings growth that we have delivered has been impressive.

Since we started this project to create Walgreens Boots Alliance, we have delivered on our promises and more. It has been a real deliverable value to our shareholders.

We have always been clear that we deliver growth in many different ways. Part of the benefit of a large and complex organization like Walgreens Boots Alliance is that its size and scope gives us many different opportunities in many different areas, both commercially and geographically. And so our task as managers becomes more about deciding where best to use our resources in order to create the most value.

Naturally, in part, these decisions are influenced by where we know we have proven strengths and experience. I would characterize those strengths as being primarily around operational expertise, financial expertise and strategic expertise.

Alex and Ornella are continuing their work to deliver the transformation we need in our businesses to keep them relevant and deliver a healthy mixture of operational and financial growth from our core operations.

The work and skills needed differs business by business and country by country, which is why during this stage in our company's development, the structure we have with co-COOs is appropriate given the huge amount of hands-on work that is needed. For all of our businesses, we are constantly balancing the benefits of investing for growth, developing new services and products and controlling costs.

We are still some way from where we need to be overall across the company, but we are making good progress and I measure the work we need to do to continue this progress as pure opportunity.

From time to time, I hear some concern raised about the amount of growth we will be able to deliver from financial or economic restructuring of our business. I do not really see this as an issue at all. I see it as essential for any good company to be as focused on its economic health every bit as much as it is on its operational health.

Also, as I have said, I believe our focus on the financial efficiency of our organization is a key strength. The work that we are doing to structure a robust and efficient company, and transform the various businesses within it, is at the same time providing us with an extraordinary range of opportunities to enhance the economic efficiency of our business.

Make no mistake, these are true cash benefits. It is real and tangible value creation.

Then there is a need to use the benefits of all these operational and financial work to invest in the continued growth of the business and further value enhancement for our shareholders.

In September, we saw in the U.S. our acquisition of assets from Rite Aid move from review to execution, a process that, I will not deny, took us far longer and was far more complicated than I had expected. We were always optimistic that the deal could be structured in a way that would be acceptable to all parties. While the deal we have ended up doing was very different from what we originally announced, it was not so very different from what I had originally envisaged. And now, I am pleased we are finally able to get on with the process of bringing these stores into our group and undertaking the next phase of review and transformation work within our U.S. network.

This is the latest and perhaps most public transaction in a range of deals and partnership we have announced over the year, including our innovative strategic partnerships with Prime, FedEx and Fareva and our minority investment in the pending acquisition of PharMerica.

These range of deals is aimed both developing our core businesses today and putting in place the foundation for developing new products and services for the future.

Of course, all of these is very much a work in progress.

We are an organization in transformation and that will always been the case. We are an organization that works in markets that are constantly changing and we must change and adapt to them and with them. Change is good. Change is a sign of life. Change brings opportunities.

Our challenge is to make sure our businesses are ready for change, embrace change, at times even drive change both, within our organization and in our markets overall.

We achieve that by continuing our work to help ensure that we are delivering the right products and services at the right price and in the right way to differentiate us to our customers, whoever and wherever they may be. To do that we must continue our work to ensure that our structure, system and skills are right.

We must continue to study our markets and ourselves, truly understand our strengths and play to them, truly understand our weaknesses and address them. Sometimes internally through hard work and effort, sometimes with partners, sometimes by bringing new skills and experience into the organization.

You may not recognize it, but I see us doing these across our businesses every day. The changes are often individually small, but they all add up to deliver a far more dynamic organization with a far more dynamic approach and mindset.

Our markets contain a compelling mixture of personal well-being, huge economic scale and political attention. These factors attract a lot of comment and commentary, which in turn leads to a lot of speculation and noise, all with an agenda reflecting their point of view.

As a management team, we must see through this noise to recognize the true underlying trends and dynamic of our markets, and manage our businesses in a way that addresses the market, not the commentary.

So as I hope you can see, I remain very optimistic about our company.

We have achieved a great deal, delivered a great deal in the past year, indeed, in the past few years, and I still see truly massive opportunities ahead for us. We have come a long way in creating an organization that is well placed to embrace these opportunities, and in many ways lead the market in approach and vision.

In a company with many businesses in many areas, we have many moving parts, which gives us great flexibility in how we respond to our markets and fully embrace the opportunities I have spoken about. We have many levers in our organization to deliver growth and value. We have set our guidance at a level that we know can bring all this together. And as you have heard, we are, again, giving adjusted earnings per share guidance that reflects the double-digit growth we seek to achieve.

In coming to this guidance we have, as ever, taken into account our assessment of the many headwinds our businesses face, as well as the drivers inherent in our markets, to offer what we believe is a realistic view of our prospect for the year ahead.

We never give guidance lightly, and I am proud of our past record of delivering against targets that we set for ourselves.

In the years ahead, you can be assured that I and my entire team will be continuing our work operationally, economically and strategically to make sure we have the right structure, people, skills and strategy to continue to deliver real growth and value, not just for the year-end, but well beyond that. Thank you.

Now I will hand you back to Gerald.

Gerald Gradwell

Thank you, Stefano. We'll now open the lines for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from George Hill of RBC.

George Robert Hill - *RBC Capital Markets, LLC, Research Division - Analyst*

And I guess, Alex, I have 2 questions for you. In the U.S. business, I guess, can you break out the difference between pricing pressure and client mix as it relates to gross margin, and then I guess, where do we think this stabilizes? And then on the retail side of the business, how do you separate the impact of promotional changes from what might be other channels or players taking share?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

George, thanks very much. I think on the first question, I think it would be really clear that reimbursement pressure is part of our life, and we have very clear levers that we use to address this. On the pricing side, we have a fantastic organization, and we abide in a real partnership philosophy. You saw recently that we've also now joined that up there with Express Scripts to help us to deal with our pricing pressure on our side. And also in terms of the mix of the businesses, you can see that we are very open to different networks for different types of business, government and commercial. And also, we are partnering with everyone in market, including, as Gerald said this morning, a partnership with of course CVS. And of course, within our partnership, this year, the pricing has been driven a lot by our alliance, our ex-partnership, we saw fundamentally changed our position in specialty. We don't see any of that changing going forward. The one bigger opportunity we have, of course, on that side of it is, of course, the optimization, it gives us another lever in which to manage the cost of the reimbursement and pricing on the pharmacy side. So we see that -- that's how we see it today. On the retail side, we made a deliberate change. We've been doing this consistently, but maybe more aggressively in Q4 in the promotional side. And that was the additional impact that you primarily saw in terms of the trend change in our front-end sales. And as George said in his prepared remarks, we improved both the margin and the gross margin in the front-end. And again, we are seeing good growth in beauty. In fact, if you look over the last 2 years against front-end sales, we've seen a 60 bps improvement in the beauty category in that period of time. So we see our strategies working in both the retail side and the pharmacy side, and we continue to work hard, as Stefano said in his prepared remarks, to drive these opportunities as they come with different partners in different ways.

George Robert Hill - *RBC Capital Markets, LLC, Research Division - Analyst*

Okay. Maybe as quick follow-up then. I don't know if George would update us as the businesses evolved, the profit contribution from a store versus back at the store. Any direction or color?

George Rollo Fairweather - *Walgreens Boots Alliance, Inc. - Global CFO & Executive VP*

Really, nothing to -- I really don't have much to add to what we said in the prepared statements and just what Alex has said, just I think the one thing I would add to, Alex, if you remember in the third quarter when we were looking at gross profit percentage and RPI, I drew attention to the fact that we, obviously, post the establishment of the AllianceRx Walgreens Prime joint venture, which we consolidate. If you recall, I said that impacted the mix by about 100 basis points and, of course, we didn't have a full 3 months in that time. So it's just worth bearing that in mind. But I mean, we're very pleased, as you can see, with the progress that we're making in both the retail and the pharmacy part of our business in the States.

Operator

The next question is from Lisa Gill of JPMorgan.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

First, I just wanted to start with Stefano's comment around new products and services for the future and trying to bring that change to healthcare. You talked about the relationship with Caremark on the network side. What we consistently hear about this idea around member engagement, what are the things that are changing in the pharmacy? And is it changing the way you're being reimbursed? Are you seeing new elements of risk that you've got see a certain amount of outcome in order to be able to drive the reimbursement that you're getting? I just want to understand how do we think about some of these new relationships as well as some of the new products and services that you'll bring in this new world of engagement.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Lisa, it's Alex here. I think as you can clearly see from the CVS announcement yesterday and previous ones that we've also been involved in, health outcomes are becoming more important in all of the networks and for all of the payers. And I think that you can see that in the Med D networks, and you can also see that in some commercial networks as well. Again, we can't be explicit in terms of what we get and don't get paid for in home and how that affects, how that affects the overall payment to pharmacies, but more of a payment slowly but surely over time we see as being driven by role of the pharmacists and the service they provide to the patient in the pharmacy that drives different behaviors and different outcomes. I think that's very clear and that's slow but it's certainly happening. And we saw something very similar in Europe, particularly, in the U.K. So we have a lot of experience in our group as the model changes to more payer services for outcomes rather than just dispensing tablets into a bottle. That is for sure. I think the networks are also changing, as you can clearly see, they are becoming more [model], not just on the Med D and the Medicaid side but also in the commercial sides. That's very much driven by the strategies of the PBMs and the insurance companies. And we are very open and very happy to speak to anyone about our network. The deal with Rite Aid, as we said on many occasions, was to improve our network. And then through that improvement in reach was to improve the quality of that network for the payers and the customers that we serve.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

Great. And then just my -- my second question would just be for George around the key assumption as we think about fiscal '18. We know -- we see the EPS, we see your assumptions around FX, but anything else that you can help us understand? I know there are comments that your Medicare Part D business will actually grow when I think some people in the market thought, perhaps, it wouldn't going into '18. You've shown that you can have the leverage that you talked about bring in these new scripts. But is there any other key metrics that we should think about as we go into '18? And should we be thinking that you can grow U.S. operating profit growth as we go into '18?

George Rollo Fairweather - *Walgreens Boots Alliance, Inc. - Global CFO & Executive VP*

I've -- we've -- I've very much tried in my prepared remarks to really point you in the direction of our thinking. Obviously, we don't give specific guidance on adjusted operating growth in total or in our divisions. But I think from what you've said, you'll gather that we're very confident that we can continue to grow our business through that combination of driving the top line, managing the margins and, obviously, keeping a very, very tight control of the costs because saving costs is very much a way of life. The one thing I would sort of just I think remind everyone is, of course, that in this new fiscal year, we'll have a full year of contribution from the Prime acquisition, which resulted in the forming of our AllianceRx business.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

Okay, great. I'm sorry, did you have something else, George?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Yes, so I just had one thing. Remember that our strategy in the front-end is a very important lever as well here. So there's cost, as George just mentioned, where we're actively preparing and managing cost ahead of the game. And I think we have a very strong track record. I think it was 17 consecutive quarters where we've reduced our cost at the set of sales. We're making strong progress in key elements of our front-end strategy and, again, that will play through the year. And of course, as George just said, our partnerships with Prime and also with UnitedHealth and Med D is an important partnership. So again, I would just point to the many different ways that we have developed our front-end -- sorry, our overall U.S.A. business as evidence that we can continue to grow operating profit going forward.

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

Stefano. But if you look with this every time -- but if you look at the adjusted operating income and, particularly, at the overall group at adjusting operating income, the overall group, you will see that we are very constant -- this number is very constant, it's very flat over the years. So you have to expect in future that this will probably be a little weaker because, as you have understood, we will have the full integration of AllianceRx. And of course, as you know, the specialty margin -- the specialty products have a very lower margin. So they will have an effect to the full year. But you can see that even this year, we have been able to compensate for the partial effect that we have -- just part of the year and there we are coming with an overall margin, which is quite constant. So we have shown that we are able to took action, many, many different levers.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

Right. So just so I have this straight, when we think about specialty, it's going to be higher dollar amount, obviously, but a lower margin percentage. So your EBIT dollars will grow, but only think about the margin of the business, could have a headwind just like you talked about in this quarter as we think about '18. Am I correct in that?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Yes, I think as George said in the previous answer, absolutely, the specialty business, as you know well, we will grow much faster than in past -- the margin is much smaller. But it still is a very good business and a very important business as half the market will be specialty by 2020.

Operator

The next question is from Robert Jones of Goldman Sachs.

Robert Patrick Jones - *Goldman Sachs Group Inc., Research Division - VP*

Just wanted to go back to the aggressive shift we've seen to prefer the narrow networks over the last few years. And it seems like it's certainly posed some challenges for retail pharmacies to grow gross profit dollars during this transition. Just curious, how we should be thinking about the shift and the impact to the business as we look out into '18 on the gross profit dollar growth expectations within the U.S. pharmacy business.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Robert, again, it's going to be a similar answer, I'm sorry, but it's really a similar answer. We -- as Stef has said in his prepared remarks, we look carefully on what we are achieving, and we look carefully to what we can achieve and we use all the levers available to us, as you would expect. So we are confident that we can grow our share, as George said in the prepared remarks, in Med D and in the other books of business, so volume will continue to grow. We continue to work hard with partners to gain access in the networks that are available to us, both commercial and government. And again, the announcements last night was another example of that. And of course, we continue to really work hard to make sure that we give real incentives effectively to our payers as they want to be paid, not just in the cost to fill the product but to develop services with them that will change the model over time. So we're in the market, we work with the market, we adapt to the market. And I think your evidence is very good. So we remain really positive that the 120 basis points growth that we have achieved in the dispensing market will continue to be held. And we remain very positive that over time, particularly, with the acquisition of the assets of Rite Aid, that we'll continue to grow market share in pharmacy volume and retaining gross profit dollars.

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

At the end of the day -- Stefano here. At the end of the day, we give guidance, look at what we have done in the past, how we have given our guidance, the results that we have delivered at the end. Everything is in our guidance. And though you have to look at it -- and our guidance, it's really the center of all the elements of our businesses. We couldn't be clearer than that.

Robert Patrick Jones - *Goldman Sachs Group Inc., Research Division - VP*

No, I appreciate that. I think it's just the building blocks to get to the EPS that I think we're just looking for a little bit more on. But I've just one follow up for George on cash flow. As I look at the costs associated with the cost transformation initiative, continues to trend a little bit above where we were looking for. Can you just give us a sense as you think about the cash cost expenses associated with the cost savings programs as we look out into '18. Just trying to get a better handle on modeling cash flow for the coming year.

George Rollo Fairweather - *Walgreens Boots Alliance, Inc. - Global CFO & Executive VP*

Well the main cost transformation program, obviously, we completed that last year, and we were delighted with the results and the costs as you've seen came -- have come in exactly where we anticipated them to be. In terms of the store optimization program that we've announced today, clearly, the majority of that is cash and then we're going to have the investment in the capital, in the Rite Aid stores and the conversion rebranding. And so we've tried to give that factor into guidance. But I'm very confident about our ability to continue to deliver a really strong cash flow. I think as I explained in my remarks, we had another very strong year for cash flow in the year just ended, the same in the prior year. We were really able to really continue, in particular, to improve our working capital efficiency. We talk a lot about driving cost efficiency, which is a way of life, but similarly, continuing to improve working capital is a way of life as well. And so I'm very confident that we're going to continue to really be a very strong cash generative business going forward. And obviously, when it comes to the returns and all the projects that we do similarly, as I think we've said on many times, we're very disciplined in the way we evaluate all our capital expenditure and the investment programs. And I'm very confident that we'll get the returns on those.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

So one example over summer, you know we -- we decided to the simplified stores in Walgreens, and we did 1,500 stores in a matter of weeks. And that was really designed to not just face into some cost challenges in these lower stores in terms of lower-volume stores in the front end, but also get working capital out. And I can tell you successfully achieve both of these in a very short period of time, and give us lessons for the rest of the state as well.

Operator

The next question is from Brian Tanquilut of Jefferies.

Bryan William Ross - *Jefferies LLC, Research Division - Equity Associate*

This is Bryan Ross on for Brian Tanquilut. I had a question on the store rationalization program. I guess, how are you -- you've talked about 600 stores, and how are you thinking about the optimal set of these Rite Aid stores that you ultimately retain? I mean, is it more focused on retaining the stores within markets where you already have a sizable presence? Is it bolstering outside of that? And how are you thinking about it in terms of -- you talked about before with preferred networks and that Rite Aid would be a nice asset to add to your assets for those networks. I guess, how are you thinking about the trade-off between the access and maybe some of the more productive Rite Aid stores?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Hi, Bryan. Thanks for the question. It really looks quite simple. Post the transaction, the teams really looked at it in location by location. And really, the vast majority of these closures will be Rite Aid and the vast majority are actually being closer within 1 mile of another drugstore that we own going forward. So really is a micro level and real detail and also we have a very strong record of file transfers. We understand how to do it, we understand the economics of it very clearly. And I think as the numbers that George described in terms of the value of $300 million by spending approximately $450 million, you can see this is economically a very good thing to do. But also because mainly within 1 mile of each other, it means that the network, the ones remaining, really is buying on our strategy. It really is about improving access to Walgreens in the future in the Northeast and across the country.

Bryan William Ross - *Jefferies LLC, Research Division - Equity Associate*

Okay, great. And then just a follow-up on -- I guess, from our math about half the stores that you're getting from Rite Aid, have they guessed already gone through a remodeling type of phase. And what are your thoughts on -- I know you talked about the additional investment, some CapEx. Are you -- and then even related to the stores that you'd be closing are -- the majority of the stores that you're keeping, have those, I guess, what's the view on that in terms of how many have been remodeled or kind of going forward, what you'll be doing to improve those stores?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Yes. Thanks, Bryan. Again, as you know, the sizable amount of these stores, not the majority in this occasion have been remodeled. So therefore, they are in good shape. However, there are some which are very important to us from a network point of view that will require some additional capital. And also as we develop the front end proposition in Walgreens further, we'll have the opportunity to move some of that investment with a good return also into these stores. So again George has mentioned a figure for -- not just for integration, but a figure also over $0.5 billion, I think, it was more or less for capital improvement into the stores that we're buying and remaining open going forward.

Operator

The next question is from Eric Coldwell of Walgreens (sic) [Robert W. Baird & Co.]

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

So honestly, so much of this investment story is about the gross margin right now, especially in U.S. retail. You guys came historically the last few years, a management team that come from Europe where your gross margin was very good in retail pharmacy. U.S. is in the mid-20s, you're 40%-plus ex-U. S. My question is, when you look at the stores where you've done beauty, you've done mix enhancement, you've done simplification, could you give us some proxy for how much gross margin improvement you've actually seen in those stores? And that's it.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

We don't give that level of details, and I'm really sorry we can't give that. But we keep on reassuring you that we understand the model really well. We are working diligently to apply that model appropriately in the U.S.A., and we believe we're making strong progress, and you can see that coming through at an economic value that Stefano described. So again, we're into -- almost 3,000, 2,900 stores with few differentiation. We have further to go much more opportunity there. You can see that we have also materially improved the cost of goods, both in the retail side and also on the generic side, again, experiencing we're coming that constant working with suppliers and long term ways to make that happen. And you can see how we are carefully investing our cash as well as our operating costs to drive improvements in volume and also improvements in customer experience. Our internal Net Promoter Score's and many of our brand measures are improving going forward towards more off a pharmacy-led health wellness and beauty retailer. So we continue to work diligently on this model. We continue to believe strongly that we absolutely know more of about the American market, how to achieve it. We understand the customer is changing, we understand the markets are changing, and we will adapt it appropriately. So again, I don't know what more we can say. We can't give you any more detail. But I promise you that we are satisfied with the progress we are making.

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

And you see you said that coming from U.K., we are used to better margin and higher margins. But if you look at the pharmacy, the pharmacy in U.K. is quite under pressure, and it has been under pressure for decades, I would say. And the way that we have -- the reason why we have developed the Boots as it is increasing margin on the front of the shows -- the shop creating a completely new model, is just because of this time, we had to cope with a margin in the pharmacy, which initially being very, very good, has shrunk over time, and we had to compensate. So we go out to adapt in the U.S., the margin of the pharmacy is still decent. It's under pressure, yes, but we have so many levers to compensate for it that we are not particularly worried. But in the meantime, we are trying to create a new model that will help us to keep. Overall, the profit of the company at the level which we believe is satisfactory.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

And also, Eric, I mean, I would encourage you to get a trip to the U.K., see how we continue to improve the model in the U.K. For example, our whole this season started really strong in the U.K. because the gifting in that marketplace is really strong this year. So again, you'll -- I think we often have a conversation in this call about the U.S.A. only. We have a model in Europe, which we continue to improve, we continue to drive. And I think, it's what sometimes understanding that model even more in terms of looking at our whole group and what we can bring to know-how to the American market.

Operator

The next question is from Ricky Goldwasser of Morgan Stanley.

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

So obviously, you talk about the fact that the market is changing, and the customers are changing and partnerships are key to your strategy, but with this -- as the landscape continues to evolve, and CVS is tracking their partners, they have been -- some are very similar to yours and we hear about Amazon evaluating potential entry. How are these changes impacting your strategic thinking of partnerships versus M&A going forward?

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

No, I have to tell you that the market is changing but is not changing in the direction which was expected from us. So our strategy substantially doesn't have to change. Our idea of partnerships, our idea of trying to adapt our stores to a future different reality is practically still the same. Of course, we are adapting, of course, we are learning, and we make some changes from the failures that we have, due to the experience that we have, but the basic strategy is still the same. And we are just, as we have said many, many times, we are just building the strategy piece by piece. And we have to create, I have said this many, many times, the right platform to build the future company. And we have work on that, and you can see that now, things are changing. You can see that we're constantly delivering. You'll see that we are not only constantly controlling our cost, but also now expanding our sales. And of course, all the different trials and tests that we have done in these years are coming to fruition. I'd think of something we have already spoken about, our collaboration with FedEx and the fact that now FedEx is practically it's everywhere in our stores, except Puerto Rico, I believe, that FedEx is everywhere in our stores. Whilst we have really tested the case after the execution, it's been quite fast in 7, 8 months. We have hold over the FedEx pickup and delivery point in all of our stores. And this is just the first phase as we said because now, we will use this to create a fantastic network to deliver to the customers directly from our pharmacies. And so you'll see that we are consistent with what we were saying in the past.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Eric. Again, just on the FedEx point, I just want to say what a fantastic partnership we have here. And also if you think about this idea of the last mile and having an ability to really deliver in the last mile. We believe the FedEx partnership, which had rolled out in a matter of months to every single drugstore apart from those affected by the hurricane as Stefano said, is now available to our customers and to FedEx's business partners as well. So I think that's just one example of how we are rapidly changing with the market as it rapidly changes. And I think that this idea of the last mile, which many people are struggling with many -- particularly of the online business are struggling with. I think the stat in the marketplace is that 30% of e-commerce gets returned, for example. Partials get returned (inaudible) in the supply chains are big customer problem, ports piracy is a big customer problem. We believe that with the best last mile working with people at FedEx and many others, we can solve some of these problems for businesses and for customers, and that's what we intend to do.

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

So just a follow-up on the FedEx partnership. So do we think about it both as addressing the omni-channel, but also competing more effectively with mail?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

So Rivka, I didn't quite catch your question. Could you repeat your question? I apologize. I couldn't quite hear the end of the question.

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

Just on the FedEx partnerships, should we think about the opportunity not just as response to kind of like an omni-channel, but also as more effectively competing with mail?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

In pharmacy? Yes. I mean, obviously, that's an opportunity going forwards. And we look at -- we work hard on cost and still reducing that cost in the pharmacy. We are very keen getting close to many, many customers, both patients and people who buy retail products, as I said before. So that's a good opportunity for sure that we are looking at, and I'm going to let you know if we do anything about it, but that's certainly one of the opportunities with this partnership.

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

And then one just last question regarding guidance. Honestly, the SG&A improvement has been the most substantial we've seen in the last 8 quarters. So should we think about that as the new run rate given the savings you've talked about? And then can you just share with us what are you assuming for tax rate for 2018?

George Rollo Fairweather - *Walgreens Boots Alliance, Inc. - Global CFO & Executive VP*

I'll take up on that. But on the guidance, obviously, on our prepared comments, you've seen we just gave guidance at the adjusted EPS level, so we haven't given the composition. But notwithstanding that, I would really stress that we're continuing to look to drive SG&A efficiencies. It's very much a way of life. Clearly, we'll have additional costs coming in as we go through the Rite Aid transition. So we won't be quite comparing apples with apples as we go through that period. But the focus on improving SG&A will continue to be absolutely relentless. It's just the way of life. We will, of course, also then have the mix effect from the prime because we'll have prime acquisition because we'll have a full year in the coming year, and I think as Alex has already explained, there's a mix effect in terms of it's a lower percentage gross margin, it is by nature. In terms of the tax rate, we've that given specific guidance for tax, but as I said in my prepared comments, our effective tax rate excluding ABC equity income was 23.2%. Within that, there was a couple of percent of discrete items. So excluding discretes, we were at 25.2%. And of course the level of discretes can tend to vary year by year. The final point really would be post in terms of you thinking about tax, post Rite Aid, and of course, we will have a higher proportion of income as we start to see the accretion come through from Rite Aid over time, and we'll start to have a higher proportion of the things being equal in the U.S., which, of course, continues to be one of the highest tax rates really in the world at the moment.

Operator

The next question is from Alvin Concepcion of Citi.

Alvin C Concepcion - *Citigroup Inc, Research Division - VP and Senior Analyst*

I know you mentioned that Rite Aid shouldn't be materially accretive in 2018, but I'm wondering if you could talk about accretion level in the first full year. I guess, the run rate for fiscal '19. And then I have a follow-up after that.

George Rollo Fairweather - *Walgreens Boots Alliance, Inc. - Global CFO & Executive VP*

We're not giving the specific guidance beyond what we've said in numerical terms, but to help you with your thinking. In terms of the Rite Aid stores, we'll be acquiring them on a phase basis. And as we've said, we just acquired the first few in the last week or so to start testing the IT system. So we'll be acquiring those on a phase basis over the next 6, 7 months until the spring of next year. We then have the store optimization program, which I talked about, which Alex has elaborated on a little more detail, which is when we acquire the stores over time, we then have to really treat them like internal file buys and do the conversion. And that is going to take roughly -- we've got an 18-month program from the spring of '18 through to the end of '19. And then we have got to convert as we convert the existing stores, we've got to do the remerchandising, the rebranding, putting in IT systems, getting everyone trained up, particularly our -- the pharmacists on our pharmacy management program, which is very important part, and obviously, move the logistics over. So really, as we've said originally, it takes -- it will take a number of years to complete that till we absolutely see the full benefit from the Rite Aid transaction, which we're very confident about.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Alvin, it's Alex here. Again from an operational point of view, we feel really good about this execution. You know the team have been working really closely on this for 2 -- for almost 2 years, and we got going really quickly on the first stores that was mentioned in the prepared remarks by George, have transferred really well. So I think that -- so I think we're feeling good. We're well prepared, and we'll get this job done and execute it really well and get this network inside of Walgreens network.

Alvin C Concepcion - *Citigroup Inc, Research Division - VP and Senior Analyst*

And in the U.S., do you need the front end comps to turn positive in order to hit your 2018 guidance? I know you're undergoing a transition, so I'm wondering at what point it becomes positive and if it's necessary in 2018?

George Rollo Fairweather - *Walgreens Boots Alliance, Inc. - Global CFO & Executive VP*

As I said before, we only give guidance on one number. A lot of our focus is on improving our offer as Alex has said and then driving overall shareholder value creation of profit. And mix, it's not just all about driving the top line, what's important is growing in a profitable way. And we're very disciplined in the way we evaluate our promotions so that we don't unnecessarily promote where it doesn't make economic sense to do so. And we're very focused on improving the mix. I mean, As Alex has said, again, a few minutes ago, the lessons that we learned from Boots in particularly developing our own differentiated offering, particularly in the beauty area is a key component of being able to do that. And of course, it offers our customers fantastic products at fantastic value.

Alvin C Concepcion - *Citigroup Inc, Research Division - VP and Senior Analyst*

Great. If I could squeeze in one more. I just wanted to ask about your mail order business. What kind of trends are you seeing there? How sizable is it in terms of your sales? How the margin profile has been looking? Just curious if you could provide any color on mail order.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Yes. Mail order is part of AllianceRx, so it's part of our Prime business. So really, we're at the very early stages of this. I think there's a previous question came in, we don't think of mail order separately from the network. We think about it as making the most convenient way for customers to receive their prescriptions in a way they want to. So we're confident that we can grow our pharmacy business including mail order overtime by having a really customer-focused approach working closely with Prime in this case, but also closely with other partners on the network.

Operator

The next question is from Kevin Caliendo of Needham & Company.

Kevin Caliendo - *Needham & Company, LLC, Research Division - MD & Senior Analyst*

Question on Anthem and Genio and (inaudible) . Can you take us through the opportunity for Walgreens in that network? Obviously, they're going to restructure a lot of their preferred networks. And just wondering how Walgreens might fit into that, come 2020?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Yes. It's Alex here. Yes, I think, obviously it's evolving situations from the point of view of the networks, but I go back to this point that we want a partner with absolutely everyone. This was PBM contract, not a pharmacy contract. And we have a relatively low share of the network within the Anthem book of business today. So we believe as we -- as things evolve with our performance-based networks, our higher quality pharmacies, our better customer offer, we can play a big part in the evolving Anthem-PBM.

Kevin Caliendo - *Needham & Company, LLC, Research Division - MD & Senior Analyst*

Can you talk a little bit -- you've mentioned some comments about cadence for the international business earlier, but just as we think about fiscal '18 and the cadence for earnings over the course of the year, should it look or be similar to what we saw in '17? Or will it be a little, like you said, a little more level or even as the year goes on?

George Rollo Fairweather - *Walgreens Boots Alliance, Inc. - Global CFO & Executive VP*

Currency is obviously a key factor in this, and it's obviously, from your overall guidance, we assume constant -- we assume a constant rate. So in the international division, the number of different markets we've, obviously, in the U.K., we're very confident about continuing to grow our Boots business, which has got a very strong position with its differentiated products and product ranges. In some of the international markets in Latin America, these are by nature, more challenging, a challenging market. But again, we believe that we've got the right strategy to continue to develop those businesses. So we're very confident overall about our prospects and really, in all 3 of our divisions, not just Retail Pharmacy International.

George Robert Hill - *RBC Capital Markets, LLC, Research Division - Analyst*

In terms of cadence, I was talking about Walgreens corporate earnings cadence for fiscal 2018 and how we should think about it in terms of modeling. Should the cadence look a lot like it was in '17? There were some certain things that happened in '17 that might change that. I'm just wondering how we should think about big full year in terms of a quarterly progression.

George Rollo Fairweather - *Walgreens Boots Alliance, Inc. - Global CFO & Executive VP*

Really, I would just re-emphasize what I said in guidance. As I said, I think that in the phasing, as I said in my prepared remarks, we expect this to be more balanced, but between the 2 halves. I think when we give guidance a year ago, we always explain that fiscal '17 would be more weighted towards the final quarter. And obviously, the results that we've announced today demonstrate that. So I would think more balanced would be really the best way of thinking about it.

Operator

The next question is from Charles Rhyee of Cowen and Company.

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

Alex, when you talk about the evolving business model and trying to meet all the kind of competitive threats out there, can you kind of talk about other things that you're doing? I mean, are you considering in your outlooks new technologies like pharmacy automation? Or maybe can you go in more details on how the pilot with LabCorp is going?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Sure. Sure Charles. As Stefano said, we have a lot of pilots in tests in the marketplace. And again, we are very pleased with the progress on all of them. They're really testing, at this stage, consumer behavior. We currently get consumers and patients to see us differently and use these services that we're now providing. So just some examples LabCorp, as you said, that's a recent one, it's early, but the early indications are positive. And of course, we learned something from the previous experience we had in terms of customer experience with the team we had before. Secondly, we are moving to increased number of pilots in optical. We have a big business in the U.K., a very successful business in the U.K. and global partnerships with the most important partners in this industry in the U.K. and are bringing all of that knowhow to the American market. And again, we're pleased with the progress so far. Hearingcare. Hearingcare again, we have a successful business in the U.K. We understand the model very well and again, we're bringing that here to the U.S. in a testing trial here in the U.S. as well. And again, it's -- that's happening just after Christmas. And last but not least, with sort of Urgent Care where again, with MedExpress, we're integrating in Urgent Care. And again, that is going well so far. So again, using our physical convenient locations, using our healthcare brand, working in partnership to give them access to our Walgreens customers and of course, working together to make sure that we target people through data in the most appropriate ways are all part of what we're doing right now in terms of developing new business models in that health care space. All work in progress, all being properly managed, all with the best partners in the U.S.A. market, and so far, so good.

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

And I want to stress the idea of partnership, because to have a partner in areas which are close to what we do as a basic business, but not exactly the same, is important. Because of course, these partners will continue to evolve and adapt to the technology, so we are sure that we will be always at the forefront of what is required of the needs of the customers. And having also a strong partners, we'll help us once we will have really tested carefully the formats of our offer to the customers. A strong partner will help us to develop the business very rapidly to roll over the business very rapidly. And this partnership for sure an important element for us, and we have had very, very good experience in the past in U.K. and in other countries when we have been able to select the right partner.

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

And just a follow-up on the Urgent Care, the MedExpress partnership. Can you comment on how you're looking at that market? Obviously, it's a fast-growing market, very large as well and very fragmented. Can you just think -- give us some thoughts on how you're looking at that in the sense that doesn't it make sense at some point to really have those as your own, maybe through acquisition or growing -- building it out organically?

George Rollo Fairweather - *Walgreens Boots Alliance, Inc. - Global CFO & Executive VP*

It's really early. I mean, at the moment, we're really -- I go back to where we're looking at customer behavior and how that's changing inside of the Walgreens brand and inside of the Walgreens box, the properties. And it's very encouraging. So of course we'll analyze what we bring. We bring great locations, we can bring a great brand to which customer associated health care. But we also, as Stefano said, believe in partnerships. We believe in not having to build things already successfully built. So we'll assess all of that in Urgent Care. But you're right, more and more health care is going to be delivered in communities and many people see the drug stores today as an ideal place to deliver these health care services. And of course, we're doing lots of work to understand what that could look like in the future, as I said with the very best partners and Urgent Care, for sure, is a good example of that.

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

Great. If I could just add one more. Opioids, obviously, a big issue right now. Can you give us some -- your comments on what you're doing in terms of trying to prevent over prescriptions and diversions and maybe a sense on how long you have had these measures in place?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Sure. Yes. We wrote something called take-back codes, I believe it was about 18 months ago, was our first take back . And we've now got that in 800 pharmacies evenly spread across the U.S.A. I would note expanding that by another, I think, it's 800 in partnership with our key partners to provide our service even closer to communities in America. So people can bring back their unwanted drugs, out of their bathroom cabinets to make sure they're not available for misuse. That program is going very well. I think the ones we have at the moment, we've got about I think it's 80 million tons of drugs back. So that program is going very well and we're delighted that others are also doing that now as well. Secondly, pharmacist education is really important and we're making sure that our pharmacists really understand how to deal with this issue in a positive way to good phase dispensing. That's a program that's been in place for many years, and we continue to drive that and improve that. And thirdly, we are working with the industry to make sure that any evident -- any other opportunities there are to play an active part in preventing this situation we play a role in as well.

Operator

The next question is from David Larson of Leerink.

David M. Larsen - *Leerink Partners LLC, Research Division - MD, Healthcare Information Technology and Distribution*

Can you just talk briefly about the agreement that you reached with CVS last night? It seems to me like you and CVS have been very competitive in pricing on the retail side. Is this may be an indicator of perhaps a bit more of a friendly relationship and some easing potentially of price pressure that we're seeing in the market?

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

Let me say one thing that, that was not a war. This is a -- there is a competition on certain contracts, which can go either way. And our relationship with CVS have always been good. So this idea of the war it's -- is not precise. Having said so, I will ask Alex to comment more -- in more details.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Yes, I mean, obviously, CVS-PBM is a very, very important partner. And we said this in previous calls, and has always been so and always will be so in the marketplace. They discussed with us this performance network where they wanted to have around about 3,000 pharmacies where they could manage and measure the performance of the individual pharmacy in certain ways that draw better health outcomes for patients and for payers. And we work with them and agreed as part of the normal agreements to go into this network. So we're very pleased. We think this is an important move for us and an important move for CVS. And we look forward to making this network successful.

David M. Larsen - *Leerink Partners LLC, Research Division - MD, Healthcare Information Technology and Distribution*

Okay. And then just one more. Did I hear you correctly? Are you considering getting into the mail business, where Walgreens members could go on online and order a script through the Walgreens website and then you would ship it to them through your own mail facility? And is that in response to Amazon by any chance, did I hear that correctly?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

No. I think we've always had a mail business. We combined it with Prime's mail business as part of the AllianceRx deal that we announced last summer. So we're always looking for ways to reduce cost to fill. We believe that the position of our network, which is closer to customers than any other network in the U.S.A. allows us to have a lower cost last mile and get customers their flexibility of being able to receive the prescriptions in their pharmacy and potentially, at home. So of course we're looking at that option. But really, I think that's not a response to Amazon, it's a response to the customer opportunity we have.

Operator

The next question is from Scott Mushkin of Wolfe Research.

Michael Devins Otway - *Wolfe Research, LLC - Research Analyst*

This is Mike Otway in for Scott. I guess, first, on the synergies and store optimization savings over the next 3 to 4 years. Can you frame the ramp up of those savings, the bulk of the savings to come in any year like fiscal '19 or should we -- how should we expect you guys to benefit from those savings over the next 3 to 4 years kind of the ramp?

George Rollo Fairweather - *Walgreens Boots Alliance, Inc. - Global CFO & Executive VP*

They will take time to come through because as we go through the store optimization, the store optimization program, and we've set out the timescales for the programs, the important thing is, I think Alex emphasized, is that we do that in a structured and disciplined way so that we -- like we do with file buys, we maximize the transfer of the business that we're acquiring into the combined store. And not a lot of experience in doing, but we will do that over a period of time on a store-by-store basis. And we've got a -- there's a very well experienced team being set up to lead this within the Walgreens business. So you should expect things to come over time. We're very clear both in terms of the benefit. The benefit will be $300 million by the end of 2020, but it will ramp up over time is how I would best describe it. The same thing then with the overall $300 million that we also talked about in the synergies. Again that takes time as we move over the business over our -- more and more over our control as we move on to our systems and our ways of working.

Michael Devins Otway - *Wolfe Research, LLC - Research Analyst*

And I guess, and just my second question here. We talked about it a little bit on the call, but the front-end comp sales, you guys made a decision from a promotional standpoint. But do you ultimately think that all the things that you're doing on beauty can overwhelm, kind of from a positive standpoint, some of the drag from these other categories? And actually get the front-end comp back to positive? And then much longer term over the next couple of years, how do you see customers shopping Walgreens from a front-end perspective? And what's your role on consumables and general merchandising and that role that those categories play in the store? Is your expectation that store trips for some of these items and purchasers for some of these items decreases over time as maybe consumers want them delivered to the homes? Is it a bigger picture view of customer's interaction with Walgreens from a front-end perspective.

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Yes. Mike, it's Alex here. Yes, Walgreens' strategy is always to be very convenient. It's a convenience-driven strategy and that does not change. So the model that we're developing really is to really understand more and more customers will shop today and in the future from a convenience location. So job number one to simplify the offer so they can find the product really quickly they want, at good value, a combination of convenience, quality of products, uniqueness of products and also at price. We believe we can do that really well in health care, and do well in health care OTC and also going forward, we're doing it better and better and better in beauty. And we think that's one we can accomplish. In terms of other (inaudible) because they are very important to that offer. So we are working hard. For example, we just relaunched the nice product that own brand product. The packaging is fantastic, it's doing really well early. And that's a roll in rollout. So again, we will continue to improve the quality of our products and the quality of our value and improve the convenience as part of that model. I think that the second thing I would say is that what's really important to the customer in the future, particularly the evolving customer is the app and how we can join both the convenience store with our mega app under Walgreens. And we've got a really good platform, a mature platform there and more and more, we're connecting into a store and allowing other people also to connect into store in the same way. So again, since we combined all of our assets in e-commerce under Walgreens.com, we have seen good positive growth in Walgreens.com, in particularly health and beauty again. And again, we continue to invest in that particular capability and we'll do so moving forward. So again, nothing changes. We just go to adapt to the evolving customer. Of course, we want to see improvements in front-end sales, but more importantly of all, we want to see a value proposition, a customer proposition, which really makes us more unique and more focused on the emerging customer than the old drugstore model. And that just takes time, as we said before.

Operator

And the last question will come from John Heinbockel of Guggenheim Securities.

John Edward Heinbockel - *Guggenheim Securities, LLC, Research Division - Analyst*

So Alex, I wanted to touch a little bit on Rite Aid. I know it's early yet, but you've been looking at it for a long time. What are the 1 or 2 things you learned from them that you think could be applied to the Walgreens business but maybe you're not doing as well as they are?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Yes, thank you. And I think, the most obvious thing for us is how they have adapted to run a lower cost -- genuine lower cost, low volume front-end model. So I think as we said before, we have -- we started our journey with the 1,500 lower-volume stores in the summer, and for sure, I'm looking forward to re-understanding how they apply they -- how we can apply their look -- their thinking to our model going forward. That's one area that is very obvious to me. I think the second area is we're getting a lot of great people. We're getting the operational teams who have run that business to understand the drug store channel. And I'm sure within that, we will find talent that will really help improve the great time we already have in Walgreens. Of the 2 obvious areas, looking at it going forward, and I'm sure we'll discover more. You always learn lots from acquisitions, and we're very open to learning more going forward.

John Edward Heinbockel - *Guggenheim Securities, LLC, Research Division - Analyst*

And then secondly, if you look at the underperformance right of those stores versus you or versus the core Rite Aid base, so how much of that is real estate versus operational issues? I guess, structural versus not?

Alexander W. Gourlay - *Walgreens Boots Alliance, Inc. - Co-COO*

Well, again, we believe that over time, by transforming everything into the Walgreens brand and improving by aligning lessons from Rite Aid and also applying what we are doing from the know how we have in our Group WBA to the Walgreens model, that we will be able to generate similar returns today from Rite Aid as we get from Walgreens. So for sure, there are some locational -- some profit disadvantages in the Rite Aid portfolio. We understand that. But having said all of that, think we can improve Walgreens further, and we can improve Rite Aid further and put them both together. So I know it's not a clear answer to the question, but we are confident in the synergies of being $300 million plus over the 4-year period. And of course, we're looking to improve that further. And as Stefano said in his prepared remarks, we're always looking to improve our core business anyway, and we put both these together going forward.

Stefano Pessina - *Walgreens Boots Alliance, Inc. - Executive Vice Chairman & CEO*

And also, remember that we are closing certain stores and transferring the files to other Walgreens stores. This will have a double effect. To eliminate the stores, which generally is not particularly profitable and to increase efficiency of the stores where we transfer the file. This, of course, it's in the synergies that we are expecting, but at the end, the stores that we will keep will not be bad stores, will already be good stores. And improving the offer, improving the service, integrating them into the Walgreens organization, these stores will for sure be absolutely comparable to the rest of the stores that we have.

Operator

There are no further questions. I'll turn the call back over to Gerald for closing remarks.

Gerald Gradwell

Thank you very much, indeed. Thank you, everyone, for your questions, and thanks to the team here for the presentation today.

Over the next hours, days, weeks, anyone that has further questions, please feel free to contact any of the IR team here with Ashish, and the whole team available to answer questions. We look forward to speaking to you again after what's been a comparatively long quiet period for us. And so we will look forward to speaking to you going forward.
