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WBA.OQ - Q1 2025 Walgreens Boots Alliance Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to Walgreens Boots Alliance first-quarter results conference call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Eric Wasserstrom, Senior Vice President of Investor Relations. Please go ahead.

Eric Wasserstrom - *Walgreens Boots Alliance Inc - Senior Vice President, Investor Relations*

Good morning and thank you for joining us for the Walgreens Boots Alliance earnings call for the first quarter of fiscal year 2025. I'm Eric Wasserstrom, Senior Vice President of Investor Relations. Joining me on today's call are Tim Wentworth, our Chief Executive Officer; and Manmohan Mahajan, Global Chief Financial Officer.

In addition, Mary Langowski, Executive Vice President and President of Walgreens Health; Rick Gates, Senior Vice President and Walgreen's Chief Pharmacy Officer; and Tracey Brown, President of Walgreens Retail and Chief Customer Officer, will participate in Q&A.

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 are outlined in our latest form 10-K filed with the Securities and Exchange Commission.

We undertake no obligation to publicly update any forward-looking statement after this presentation, whether a result of new information, future events, changes in assumptions or otherwise. You can find our press release and slides referenced in this call in the investor relations section of the Walgreens Boots Alliance website.

During this call, we will discuss certain non-GAAP financial measures. These measures are reconciled to the most directly comparable GAAP financial measures and the reconciliations are set forth in the press release. You may also refer to the slides posted in the investors section of our website for reconciliations of non-GAAP measures to the most comparable GAAP measures discussed during this earnings call. We encourage you to review the comparable GAAP measures and reconciliation to non-GAAP values in the other earnings materials we provided. I will now turn the call over to Tim.

Timothy Wentworth - *Walgreens Boots Alliance Inc - Chief Executive Officer, Director*

Thanks, Eric, and good morning, everyone. We've started the fiscal year by making progress against our financial and strategic priorities despite the challenging backdrop for our consumer. Our operating earnings in the period were driven by cost management initiatives and relative strength in our US pharmacy services businesses, offsetting weakness in our front-end retail business as we work to respond to changing consumer behavior.

Among the outcomes we achieved this quarter in US pharmacy, we maintained script market share. Our international business continued to show strong returns, and our US healthcare segment contributed somewhat above expectations on a combination of revenue growth and cost control. Importantly, we started to progress on the opportunities that we consider essential to our longer-term turnaround.

At the end of fiscal 2024, we identified four areas of long-term focus. And one quarter into the current financial year, we are executing against these targets. Let me spend a few minutes walking through each.

The cornerstone of our turnaround is stabilizing the US retail pharmacy business, and we showed progress across several key planks of this plan. We've begun our Footprint Optimization Program and are pleased with the early results.

We're currently exceeding historical script retention rates and have retained the majority of store and pharmacy team members. We expect to significantly ramp the pace of our store closures from the first quarter level. As a reminder, we have a lot of experience with store closures having closed about 2,000 locations over the past decade.

That said, to handle the stepped-up pace for the next three years, we've assembled a dedicated team to focus exclusively on the end-to-end process to improve upon our historical results. This team has already sequenced the next approximately 450 store closures. And at this point, we have a high degree of confidence in the execution of this process through the end of 2025.

Naturally, we expect our future footprint to support stronger performance. Currently, we see comparable front-end sales in our retained store fleet outperforming those stores slated to close this year by approximately 250 basis points and comparable pharmacy scripts by approximately 390 basis points.

To be clear, even within our future footprint, we have to execute on our longer-term merchandising and consumer engagement initiatives in order to grow. However, this data supports our view that the smaller footprint will be a healthier one for our company.

Also, critical to our retail turnaround is our employee experience. Across the enterprise, we are refining the way we forecast, allocate, and schedule labor in our stores. Beginning with about 200 stores this month, we're launching new scheduling optimization logic to better deliver on the in-store experience for our customers, patients, and team members.

The solution deploys labor based on store-specific demand patterns, while also accounting for team member availability and preferences. We've received positive feedback from our initial pilot and are excited to roll this logic out to the chain later this year.

Winning in pharmacy requires superb operating leverage, so we are also taking steps to improve our pharmacy operations. You may remember at the start of last year, we talked about a pause in rollout of our micro fulfillment centers to optimize productivity and better engineer our patient and team member experience. This work has yielded successful results.

Our MFCs currently serve about 4,800 stores. And shipped volumes from these centers are up 23% year-on-year, while [cost of fill] was down by 13%. These improvements allow our pharmacists to spend more time on patient care and clinical services, expanding the critical role they provide.

For example, stores supported by MFCs were able to administer more vaccines and complete more medication therapy management for our patients, payers, and B2B customers. Looking forward, there's still more work to do to expand this across our national footprint and further lower our operating costs on a per script basis.

In addition to improving our pharmacy operating model, a key priority has been to reframe the reimbursement discussion with our partners to focus on fair value for our services. As an update to last quarter, we have now completed all of the contract negotiations for calendar 2025, and the nature of these conversations has evolved.

We've had success in adjusting contract dynamics in our negotiations with our commercial, Medicare, and Medicaid plans, such as rebalancing brands and generics and carving out new categories for high-cost drugs, all in response to the evolving needs of customers and to better align reimbursement with our cost of goods.

We are also expanding discussions about being compensated for additional services beyond dispensing and promoting alternative payment models. Notwithstanding our progress, there's still much more that needs to be done over the next several years. Our goal is to serve as many patients and communities as possible, but this is dependent on being reimbursed fairly so that we can maintain our presence as a healthcare provider across the country.

It is also our goal to become a market leader in drug procurement. We are working to ensure that we're procuring drugs at the most competitive price and continue to engage with our partners at Cencora. We are making incremental progress in these discussions as we work towards a more acceptable long-term solution.

Turning now to our third priority, the turnaround of our consumer retail business. This has been made more challenging by the persistent deterioration in consumer discretionary spending. Our consumer remains under pressure from accumulated inflation and higher interest rates, and we are seeing continued value-seeking and channel-shifting behavior.

Additionally, the warmer season impacted our first-quarter results with reduced respiratory incidences and the associated baskets with those trips, contributing to about half of our retail decline versus last year. As we look to effectuate a broader repositioning of our retail business, we're responding to these conditions in real time.

Some of our actions like recent changes in our targeted approach to managing store inventory have been successful, and our in-stock rate is the highest it's been in over four years. We are also modernizing the tools we use for assortment optimization to have the right item in the right store to create a customer-centric assortment.

We began to introduce new products as a part of our health and well-being focused growth strategy, specifically in categories such as women's wellness, super foods, and sports nutrition. We also continue to pursue own brand penetration, which is up 75 basis points in the first quarter to 17.8%.

Coming into this year, we targeted introducing about 300 new own brand products and have introduced approximately 60 in the first quarter. As it relates to the evolution of our consumer experience, we are further leveraging our omnichannel capabilities such as home delivery and virtual care to meet evolving consumer preferences.

Walgreens has offered same-day prescription delivery nationwide for more than three years and delivery within two hours from approximately 800 stores. We also offer virtual care in 30 states available to nearly 90% of the US population. While we expect home delivery to continue to grow across retail and healthcare, we view it as one component of many touch points with our customers, including in-store, drive-thru, and online.

In summary, we are progressing a number of elements of our retail strategy. While we are seeing early green shoots, we still have substantial work to do here.

Turning to our non-core assets. We are underway with the sale process for village medical while continuing to evaluate the best options for Summit/CityMD. We are encouraged by the leadership of new CEO, healthcare veteran, Jim Murray.

To be clear, our ultimate intent to exit is unchanged. And we remain committed to redeploying any proceeds to reduce our net debt and improve the health of our balance sheet. Importantly, we improved free cash flow this quarter with decreased capital expenditures and higher adjusted operating income, excluding the noncash impact of sale-leasebacks.

Longer-term generation of positive cash flow remains a key priority for us in the context of litigation, opioid payments, debt, and our current dividend. Continued progress on cash flow will require meaningful action and focus.

In conclusion, we've shown progress on our priorities over the past quarter. And while we have a lot of work ahead of us, this progress underpins our belief in delivering a successful turnaround. I will now turn it over to Manmohan to review our financial results.

Manmohan Mahajan - *Walgreens Boots Alliance Inc - Global Chief Financial Officer, Executive Vice President*

Thank you, Tim, and good morning, everyone. Overall, first-quarter results were better than our expectations. Sales increased 6.9% on a constant currency basis with growth across all segments.

Adjusted EPS of $0.51 declined 23% year over year and on a constant currency basis. This decline was entirely driven by prior year sale-leaseback gains and lower Cencora equity income. Absent these two factors, continued cost discipline in US retail pharmacy and growth across US healthcare and international businesses were partly offset by challenging US retail market trends.

GAAP net earnings for the first quarter included after-tax charges of $252 million related to Footprint Optimization Program and $152 million non-cash charge related to fair value adjustments on variable prepaid forward derivatives related to monetization of Cencora shares.

Now, let me cover US retail pharmacy segment. Comparable sales grew 8.5%, driven by pharmacy and partly offset by a decline in retail sales. The Footprint Optimization Program negatively impacted total sales during the quarter.

AOI decreased 36% versus the prior year quarter, including $184 million headwind related to prior year sale-leaseback gains and lower Cencora equity income. Absent these impacts, AOI declined due to lower retail sales, partly offset by continued cost discipline.

Despite the $160 million headwind from prior year sale-leaseback gains, adjusted SG&A was flat to last year. This cost improvement was largely driven by our initiatives to modernize our store-level demand forecasting and labor deployment tools.

Let me now cover US pharmacy. Pharmacy comp sales increased 12.7%, driven by brand inflation and script volume, partly offset by lower vaccine volume. Comp scripts, excluding immunizations, grew 3.5% in the quarter, and we held script market share. Pharmacy services performed better than our expectations during the quarter as higher margin for COVID-19 vaccines was offset by the lower overall vaccine market volume due to the weaker cough, cold, and flu season.

Pharmacy adjusted gross margin declined versus the prior year quarter, negatively impacted by brand inflation and mix impacts and net reimbursement pressure. NADAC changes in November did not have any material impact to the gross profit in the quarter.

Turning next to our US retail business. Comparable retail sales declined 4.6% in the quarter, which was lower than our expectations. There are two key drivers. Third-party data shows flu, cold, and respiratory activity over 40% lower compared to the prior year, which paired with the warm weather through November led to a much softer cough, cold, and flu season. This dynamic negatively impacted comparable retail sales by approximately 270 bps in the quarter, including the impact from the attached basket, which was about half of the comp sales decline.

Second, the consumer backdrop also remains difficult with the promotional environment and continued channel shift, impacting our discretionary categories. Retail adjusted gross margin declined year over year, negatively impacted by pricing and promotions as well as lower sales related to cough, cold, and flu.

Turning next to international segment, and as always, I will talk in constant currency numbers. Total sales grew 6.5% with Germany wholesale increasing 11.3% and Boots UK up 4.5%. Segment adjusted gross profit increased 3% with growth across all businesses. Adjusted operating income was up 16%, led by a strong retail performance in Boots UK and growth in Germany, partly offset by cost inflation and technology investments.

Let's now cover Boots UK in detail. Boots UK continues to perform well. Comp retail sales increased 8.1% with gains across all categories. Boots.com sales increased 23% year on year, aided by a strong Black Friday performance and represented 22% of our UK retail sales.

Turning next to US healthcare. Sales of $2.2 billion increased 12% compared to the prior year quarter. VillageMD sales of $1.6 billion grew 9% year on year despite the impact of clinic closures. The increase was driven by growth in full risk lives and fee-for-service revenue.

Shields sales were up 30% driven by growth within existing partnerships. Adjusted EBITDA for the first quarter was $70 million, up sequentially and an improvement of $109 million compared to last year, reflecting the growth at VillageMD and Shields.

Turning next to cash flow. Operating cash flow in the quarter was negatively impacted by the seasonal inventory build in the US, UK and Germany and legal payments of $137 million. Year over year, free cash flow improvement benefited from decreased capital expenditures and higher adjusted operating income, excluding sale-leaseback, which does not impact free cash flow.

We remain on track to achieve $500 million in working capital initiatives and are currently ahead of our target for a $150 million reduction in capital expenditures. While we do see opportunity for further reduction in CapEx, we have plans for investment later this year in our stores and technology to support them.

During the first quarter, we reduced our lease obligations by $652 million. We remain committed to improving our cash flow generation and net debt position through a combination of operational actions and asset monetization activities. As Tim alluded to, we also continue to evaluate the appropriateness and size of our dividend as part of our capital allocation policy.

Our priority for fiscal 2025 is to stabilize our core performance, while we make progress on the longer-term strategic and operational turnaround. Our progress to date is reflected in our reaffirmed adjusted EPS guidance of $1.40 to $1.80.

We continue to execute on cost savings inclusive of our Footprint Optimization Program. We continue to expect $100 million in AOI benefit from Footprint Optimization Program with working capital benefits and sale proceeds from own locations significantly higher than cash closure costs.

We are also encouraged by pharmacy services results to date. We believe the impact of lower than originally expected vaccines volume to be offset by higher margin on COVID vaccines.

The recently announced NADAC changes are expected to be less than a $50 million negative impact on pharmacy margin for the remainder of the year versus our original expectations. However, as we think about rest of the year, there remains certain risks to our outlook as well. The weaker cough, cold, flu season and continued challenging consumer discretionary spending are impacting our retail sales in the US.

We now expect retail comp sales for fiscal '25 to decline approximately 4% to 5% compared to our prior outlook of down 2% to 3%. While the first quarter results are encouraging, we are maintaining our guidance range considering the challenging US retail environment. With that, let me pass it back to Tim.

Timothy Wentworth - *Walgreens Boots Alliance Inc - Chief Executive Officer, Director*

Thanks, Manmohan. Before I open the call up for Q&A, let me leave you with a few closing thoughts. Our first-quarter results demonstrate that we are executing against our long-term strategic priorities. Importantly, we believe our approach to 2025 payer contracting supports our expectation for future stabilization in our pharmacy business, and we're still in early stages of getting to a better outcome on our drug procurement costs.

We're also executing on items that are in our control. Our initial wave of store closures has performed better than expected on multiple facets, including script retention and employee engagement. This gives us increased confidence in our centralized, deliberate approach to this process.

Also fundamental to our turnaround is financial discipline. While we are pleased with our first-quarter results, there is more work to be done as we aim to strengthen our balance sheet and to ensure longer-term positive cash flow generation.

We remain committed to achieving a retail pharmacy led turnaround underpinned by a sustainable economic model. Our turnaround will take time, but as the quarter's results demonstrate, we are executing with urgency and believe the actions we're taking will be the basis for sustained value creation over the long term. With that, let's take questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Lisa Gill, JPMorgan.

Lisa Gill - *JPMorgan Chase & Co - Analyst*

Thanks for taking the question. Tim, I'm encouraged by the comments that you made around the levers to lessen reimbursement risk and the fact that contracts for 2025 are done. But can you maybe just give us a little bit more color on, one, what does that new reimbursement look like?

And two, when I think about contracts are generally three years in length. So should I be thinking that for calendar '25, it's roughly one-third of your book of business that has some type of new reimbursement metrics that are tied to reimbursement? That would be the first thing.

And then secondly, just really want to understand the script retention. You talked about script retention being better than expected. Can you maybe just give us a number around that?

Timothy Wentworth - *Walgreens Boots Alliance Inc - Chief Executive Officer, Director*

Sure. Thanks, Lisa. So the new reimbursement -- actually, let me answer the other part of your question first, which is you're correct that the arrangements that we have with PBMs typically are multiyear. It doesn't mean that we don't, by the way, come back to the table and open them up in response to opportunities or changes in the market.

But generally so, we haven't said exactly what percentage it is, but it was a meaningful percentage. So your number, broadly speaking, is probably about right.

And in terms of what the actual arrangements themselves, how they've evolved, and what they look like, I think what you've seen is a couple of things. One is we've been successful in aligning with PBMs to create a category for higher cost drugs, for example, where in the past, those drugs would fall into the basic reimbursements, and they were massively insufficient in certain cases.

We've highlighted GLP-1s as an example. And so that's one of the things that we've done in many of the contracts. In other contracts, what we've seen is rebalancing of brands and generics to more appropriately sort of reflect the environment today, both in terms of the absolute environment and how it's going to be evolving.

Because if you really take a look back, and I know I've spoken about this before, what you had was essentially us performing well on generics, but it being insufficient to offset the less than our acquisition cost, brand drug reimbursements or/and are less than cost to deliver services. And so we've been able to, in many of the contracts, again, rebalance.

And so what I'd say is each contract we've come to the table to be creative, and we have found good receptivity. We still have a ton to do, let's be very clear because what you just said indirectly is we have two-third of our contracts left. The good news is many of those are with some of the same payers that we've had success with this year, aligning on going forward.

In terms of the script retention, we haven't given a number on that, but we do track it internally. And again, it has been much better than our underlying assumption in those stores that we've been closing.

I would point out, we closed about 70 stores in the quarter. We have a lot left to do this year. But we have a very different process. It has been definitely pushed through our receiving stores so that the patient experience when their store is closing is meaningfully different as they come into a new store. And all of this really drives to longer-term pivoting to profitability in the back of our stores.

Obviously, other services such as vaccines, adherence programs, other things we may do for pharma or for payers will be incremental to that. But in the current short term, the things that we've done have put us in the position we wanted to be in at this point.

Operator

Eric Percher, Nephron Research.

Eric Percher - *Nephron Research LLC - Analyst*

I'd like to stay on the same subject, Tim. And I guess what I'd ask is when you look at the type of pressure that you're facing in reimbursement in 2025, are you finding that the actions you've taken are leading to an absolute improvement -- reduction in the pressure in '25 versus what you saw the last couple of years? Or has your focus been on changing terms and contracting in a way that leads to stability today and really positions you for better visibility and the improvement comes in future years?

Timothy Wentworth - *Walgreens Boots Alliance Inc - Chief Executive Officer, Director*

The answer is both. So there's no question that restructuring our contracts to be, I'll call it future proofed or at least more resistant to the inordinate shifting of risk to us that was simply we had no levers to manage, to be frank, was really, really important.

And again, I think the good news is that our PBM and payer partners also saw that. And in many cases, their markets are sort of looking for these same sort of changed terms in terms of unraveling the cross subsidization that has just gotten so distorted.

And so from that standpoint, the construct is important. Also though, in 2025, and of course, we're in the very early days of calendar 2025, setting aside our fiscal calendar, we are now fully in those contracts that were redone. And our projections are -- continue to be that we see a reduced pressure than we have seen in the past. That is a continuation of several years. And the number that we achieved in these negotiations was pretty darn close to what we had set out as our goal to experience.

And again, I would remind you that in the context of what we have said is over the next three years, this being the first of three that we expect to reach a place where what we are taking out of the market in terms of increased value, whether that's new generics or other things, that we would not be giving more than that. And ideally then we would be subjected to being able to collect on other services and other things that we do to improve profitability in the back of the store.

So we have continued to set the stage for that. 2024 was a very important year for it, and we are very pleased with that start on the three-year process.

Operator

Charles Rhyee, TD Cowen.

Charles Rhyee - *TD Cowen - Analyst*

Yeah. Thanks for taking the questions. Tim, I hear everything that you're saying. And it sounds like you are definitely making progress here, particularly in the contracting side. But typically, I would assume that a lot of these are for one-one starts for the calendar '25 year.

Given sort of the strength in the fiscal first quarter, any reason not to think that we would see the incremental sort of positive step changes as we move through the rest of this year along with the fact that we're still at the early part of the store closure cycle and yet you still maintain guidance.

Can you help us square that a little bit? I understand trying to -- there's still some uncertainty here, but the sort of the outperformance in the first quarter that suggest, particularly on the pharmacy side, that things are at least moving in the right direction relative to at least where the initial guidance was set. Thanks.

Timothy Wentworth - *Walgreens Boots Alliance Inc - Chief Executive Officer, Director*

Sure. Thanks, Charles. So what I'd point out is that the first quarter, which, as you correctly say, did not -- was not impacted by any of the 2025 contracts that we were able to negotiate, it was strong for two fundamental reasons. One is we had good pharmacy volumes; and two is we had good -- in terms of pharmacy services, particularly vaccines, we have good reimbursement.

And so those two things were strong in the quarter. And we -- what you've seen is part of those volumes is closing stores, we were successful in beating our own targets in moving patients into the receiving stores. So that was good. We closed stores, and we didn't just give up share.

And again, while the vaccine volumes haven't been quite as strong as we might have expected, the fundamental fact of the matter is that we were reimbursed pretty fairly for those vaccines, and we were very successful in getting patients who came into our store to nearly, I think, 40% of the time or thereabouts actually co-administer multiple vaccines to keep themselves safe across several disease platforms.

So that all was what carried the quarter. Therefore, as I look at our full year '25, what we see based on the contracts results that we've had so far, and again, there will be some perturbation because of mix of -- or did you get as many patients as you thought with some new business that may have been won, but those are generally small impacts; we would expect to continue to see what we wanted to see in 2025 and nothing incremental to that in terms of things. So we see it being better than it was in '24, but we ended '24 strong because of some things that didn't have to do with PBM reimbursement.

Operator

Michael Cherny, Leerink Partners.

Michael Cherny - *Leerink Partners LLC - Analyst*

Good morning and thanks for taking the question. Maybe if I can build a little bit on Charles' question there relative to the changing dynamics of the business. Tim, you spent a lot of time on the reimbursement side.

Maybe if we can go back to the procurement side and the work you're doing with Cencora. What does that look like qualitatively in terms of making sure that you're maximizing your procurement, especially for a partner that you've had for more than a decade? And specifically within the guidance, are there any changes to procurement that are built into your current fiscal '25 expectations?

Timothy Wentworth - *Walgreens Boots Alliance Inc - Chief Executive Officer, Director*

Yeah. So we haven't -- let me start with the second question, which is that we haven't broken down in our guidance what would be contributed by any improvements that we make in our process or our underlying contract with Cencora.

That said, you asked about qualitative sorts of things. What I would tell you is qualitatively, there's a question of having a partner who sits down with us, and we have made very clear what our long-term aspiration is, which is to be world-class at buying drugs. And today, we're not.

And so from that -- and they are in a position to help us and to benefit from that when our volumes increase because we're able to be more competitive in our underlying business model. And so from that standpoint, what I would tell you is we have relationships with their team.

We have spent a lot of time together. We continue to spend time together to navigate a way forward that not only helps us in the short term incrementally but more importantly, transformationally, in the long term, modernizes the way that we buy drugs in a way that keeps us very competitive and growing, which is good for both parties. And I'm pleased that we've had the discussions we've had. We have a lot more work to do.

Operator

Kevin Caliendo, UBS.

Kevin Caliendo - *UBS Investment Bank - Analyst*

Thanks for taking my question. First, just on the footprint optimization. Is that number going to grow over time? Like how do we think about that as the store closings increase?

Is it a forward look as to where we are? Is that like your projection is this $331 million projection? Or is that like point in time and as the stores keep going, that optimization add-back grows?

And then I guess my second question is, your peer announced that they had put in their sort of cost-plus model successfully across their 2025. As you see that happening, is there opportunity for you guys? Is that a pivot for the market that maybe can be advantageous to you?

I know you're renegotiating all your contracts; you did that already. I'm just wondering if this changes the market in any way, shape, or form positively or negatively for you. Thanks.

Timothy Wentworth - *Walgreens Boots Alliance Inc - Chief Executive Officer, Director*

Yeah. Thanks. Let me take the second half of your question first, which is, obviously, we're always pleased when we can see the market moving in direction that is rational for us in the role that we play. And so CVS' announcement -- well, I'm not going to comment specifically on details with that.

Really, if you think about what they announced, it's very similar -- it's a different way of, I guess, thinking about what we've been doing in our contracts, which is realigning brand and generic because if you think about a cost-plus model, cost-plus model, therefore, doesn't have a cross subsidization. It has a service fee on top of an acquisition cost.

And from our perspective, that's very much what we have been coming to the table with, willing to both work with the various payers and how they want that constructed and how they want to go to market because not all cases will the payers necessarily go to market with that exact model. They may use it and then alter it to meet what the benefits consultants drive at the self-insured employer level, let's say.

And so I don't want to get into sort of the real arcane detail on how all that works. But suffice it to say that their announcement didn't surprise us. We haven't announced or put a brand name on our process for unwinding these things in the contracts, but we are doing exactly the same thing.

And we, again, come to the table as a very willing partner to help the payers win in whatever configuration of value works for them, but also more importantly, puts us back on track to have a sustainable pharmacy model.

As it relates to the stores -- store closures, which, of course, we mentioned 70 or thereabouts in the quarter for the full year on track and prepared for another almost 450, I'll let Manmohan speak to the underlying financial impacts of that.

Manmohan Mahajan - *Walgreens Boots Alliance Inc - Global Chief Financial Officer, Executive Vice President*

So Kevin, as you think about the impact of store closure in the year, we've talked about expecting $100 million of AOI benefit in the year. We're still on track to close 500 locations during our fiscal year '25.

And from a cash flow benefit perspective, we believe the benefit from working capital as well as sales proceeds from some of the own locations that we're closing, and we will sell is going to outpace the closure cost in the year. Now as you think about this, these are in-year benefits. And so as we continue down the path over a three-year plan, these benefits will scale over time.

Operator

Elizabeth Anderson, Evercore ISI.

Elizabeth Anderson - *Evercore ISI - Analyst*

Hi guys. Good morning. Thanks so much for the question. Two questions. You obviously had a very nice improvement in the free cash flow on a year-over-year basis. And I know, Manmohan, you talked about the improvement in both working capital and CapEx. Can you talk about your sort of confidence for positive free cash flow on a full-year basis?

And as a follow-up, can we also talk about sort of the rollout of the micro fulfillment centers? I know you talked about sort of a broad level that you expect to roll them out to an increased number of stores. But how do we think about the pacing of that as we think about the rest of 2025? Thank you.

Timothy Wentworth - *Walgreens Boots Alliance Inc - Chief Executive Officer, Director*

Sure. So I'll let Manmohan take the free cash flow question first since it's such a central question to what we focus on every day.

Manmohan Mahajan - *Walgreens Boots Alliance Inc - Global Chief Financial Officer, Executive Vice President*

Yeah. So Elizabeth, on the free cash flow, yes, the year-over-year cash flows were better in the quarter. A couple of elements driving it. First, the underlying performance, the adjusted EBITDA was higher year over year as you exclude the sale-leaseback gains, which does not impact free cash flow.

And second is we did see higher-than-expected reduction in the capital expenditures. Actually, we talked about at the beginning of the year, targeting $150 million. We achieved more than that in the quarter.

And in my prepared remarks, I talked about while we do see opportunities on CapEx reduction rest of the year, we also have plans to invest in stores and technology that supports them. So there is that phasing part to think about.

In terms of overall free cash flow for the year, we're not sharing guidance on the free cash flows today. But I would say we're broadly in line with the commentary I provided at the beginning of the year, which had really four factors in there, which is the sale-leaseback gains and Cencora earnings reduction does not impact CapEx reduction, which we have achieved in the quarter. And working capital, we feel good about. And so those elements, we're broadly in line with.

Timothy Wentworth - *Walgreens Boots Alliance Inc - Chief Executive Officer, Director*

And as it relates to the multisite -- multi fulfillment centers, we're super pleased with where we are in the progress we've made this year on a number of levels. First is in the absolute operating -- operations of them and the cost to operate them.

And we brought in a very talented leader, a gentleman named John Joplin, who has just done a phenomenal job working with our team to take that to the next level in terms of operating efficiency, but also longer term, in terms of the experience for our stores as receivers for this.

As you may recall, a year ago, we have slowed this way down in part because the experience at the last mile was not what we wanted it to be. It also was not as cost effective as we had hoped.

We have made massive improvements in both to the point where, again, today, we have over 4,500 of our stores that are being serviced by the MFCs. And we believe over the next 12 months, we will get that number closer to 6,000 as we continue to again ratchet down the cost so that it is not cost disadvantageous for us to use automation.

And importantly, what we've seen in the stores that we have moved on to the platform has been a material increase in our ability to counsel patients, do adherence programs, and use our clinicians in, frankly, more higher order activities that also bring reimbursements that help sustain our model.

And so we are very focused on it. As I said, we're not going to give you guidance exactly as to how many or when. We have several more that we are going to be bringing up. And I can tell you that now when I'm in the stores, it's very exciting.

A year ago, they didn't want to talk about it. The bags were too big. The bottles were too big. Now we go into the stores, and they're saying, when are we going to get on the platform because they've heard from their colleagues that we have meaningfully improved the experience. So it's a great example of our broad theme of hopefully you're hearing today, which is execution for the customer and for the shareholder.

Operator

Ann Hynes, Mizuho.

Ann Hynes - *Mizuho Securities USA Inc. - Anlayst*

Good morning. Thanks. I just want to focus on long term just given the new speculation of a potential private equity. I really feel it's important from a stock perspective that investors have some visibility on the timing of when management thinks they can stabilize free cash flow and adjusted operating.

Tim, now that you've been over the -- here for over a year, do you think you can provide more clarity in the long term? And if not today, when do you think you'll be in a position to provide more clarity or more certainty to investors? That's my first question.

And my second question is healthcare obviously did better this quarter, both on the revenue and cost side. Can you talk about what subsegments did better than your expectations? That would be great. Thanks.

Timothy Wentworth - *Walgreens Boots Alliance Inc - Chief Executive Officer, Director*

Sure. So we aren't going to give multiyear cash flow guidance per se. I'm going to let Manmohan speak briefly to cash flow though because, again, I appreciate the spirit of your question.

And the fact is that, as I think we've said, our focus on our balance sheet and on a sustained positive operating cash flow and doing the things we have to do in order to achieve that are front and center for us. And it is a multiyear process to position ourselves to be able to consistently and reliably deliver that. So I'll come back and let Manmohan add any color to that he wants.

As it relates to what drove our healthcare -- our US healthcare assets, it was a great quarter in a number of ways. We saw VillageMD, as we said in our prepared remarks, grow. So even though we are running a sales process for VillageMD, we have new leadership there in Jim.

We have a team that's really functioning very effectively and executing well on the smaller platform because we closed a lot of facilities. And we're growing off of that smaller platform. And economically, we're also seeing the benefits of that focused business. So that was a piece of the puzzle is VillageMD.

The second piece of the puzzle is Shields had a terrific quarter and continues to -- what you would see if you were sitting in our chair is strong revenue growth that comes with strong profit growth. Also interestingly, we don't talk a lot about it, very strong renewals. So their clients are renewing at rates that are not putting us in a position where we're essentially dropping backwards in terms of the growth platform.

In fact, if anything, they are some of the most strong supporters I have ever worked with for a company. When I speak to the CEO of one of the largest health systems in the country or I speak to a head of strategy, they tell me how important Shields is to them. So that business is terrific, and that shows through in its growth profile.

CareCentrix had a good quarter. They're selling through some new relationships that they have. It wasn't material to the overperformance, but we're super pleased.

Our -- and again, from our perspective, longer term, we see that the opportunity to serve the B2B payers as well as pharma companies is super interesting longer term, but it's nice to see that result this quarter, obviously. And in terms of -- Manmohan, anything you want to add additionally to the longer-term cash flow outlook and how we would want to communicate that?

Manmohan Mahajan - *Walgreens Boots Alliance Inc - Global Chief Financial Officer, Executive Vice President*

Yeah, sure. So a couple of thoughts as you think about the long term from a cash flow perspective. Again, we're not providing guidance on this call, but few elements to consider. First, obviously, operating performance as we think about the free cash flow generation as we improve operating performance over time, that's going to have an impact.

I think from a CapEx perspective, we've made a great progress over the last 1.5 years. And so I think we're getting to a good place there. I believe working capital continues to be an area for us to streamline and take the benefit on the cash flow. So we'll continue to do that, including the rest of this year.

The one part that is impacting our cash flow this year as well as in fiscal '24 was significantly higher run rate on the legal payments. And so as we're looking at this point, fiscal '26 onwards, we believe that we're going to come down from the run rate we have seen.

And then the last thing I'd say from a cash flow perspective outside of free cash flow is we continue to look at asset monetization. We have made progress with our Cencora shareholding as well as BrightSpring in the quarter. And so those activities will continue to provide us flexibility from a cash perspective.

Operator

George Hill, Deutsche Bank.

George Hill - *Deutsche Bank AG - Analyst*

Hey good morning, Tim and Manmohan and thanks for taking my question. Manmohan, maybe one for you more from an employer perspective, and this goes back to the idea of the recontracting around pharmacy rates. As a large employer, I'd be interested if you could comment on how you guys have modeled out how this will impact your pharmacy costs.

We've done some calls around how the cost-plus models are impacting payers. And it seems like some of them are seeing a significant cost increase as part of a model transition regardless of who the pharmacy partner is. Now, I'm wondering if there's anything you can tell us about like what you guys are seeing as it relates to pharmacy costs for Walgreens.

And just general -- Tim, maybe generally speaking, how your payer partners are telling you this will impact pharmacy costs downstream?

Timothy Wentworth - *Walgreens Boots Alliance Inc - Chief Executive Officer, Director*

Sure. Actually, I'll take that. What I want to point out is changing how we're reimbursed and how the industry is reimbursed is not in and of itself a cost increase or decrease. That depends on the negotiations that's underneath of that.

Every payer we negotiate with starts with essentially a matrix to understand what the cost of goods is going to be to them that they take to the market. And so again, changing how the risk is being assigned and managed and future-proofing things is different than -- I would not position us as the -- or our industry is that the reconfiguration is necessarily a price increase. It is instead a realignment that sets us a place for us to get paid over the longer term for what we do.

What I would say is what we've seen -- I haven't looked at it directly, but in talking with Elizabeth, our Head of HR, we have not seen a cost increase as a result of how pharmacy is showing through to our patients, except I think the thing I would point to and it's something we don't talk a lot about and it's a really strong attribute of our longer-term growth is you certainly see in specialty costs going up as new indications, new products and so forth come to market. And obviously, the levers around that are very different than the levers on the small molecule pills and capsules sort of business.

And so from that standpoint, we and frankly, probably every payer in America continues to be very focused on managing specialty pharmacy to ensure that the right patient is getting the right drug that they're staying on it because the downstream benefits you get from those particularly intense patients come not from cutting drug costs as much as from making sure that you're getting what you're paying for in terms of outcomes.

And so we continue to see very strong interest in our specialty pharmacy in some carve-out bids as payers begin to want the transparency that we can bring to the table as an independent specialty pharmacy and also the tools that we bring to keep patients safe and healthy and help them manage the costs.

Operator

Brian Tanquilut, Jefferies.

Brian Tanquilut - *Jefferies - Analyst*

Good morning, Tim. So maybe in your prepared remarks, you talked a little bit about execution on the merchandising strategy as a way to arrest some of the pressures on the retail front end side. So maybe if you can just walk us through what those are and kind of like the success checkpoints that you need to see for that to be viewed as the right strategy going forward.

Timothy Wentworth - *Walgreens Boots Alliance Inc - Chief Executive Officer, Director*

Sure, appreciate it. So we've got a lot of things underway inside of our front-of-store envelope of initiatives beyond getting to the right number of stores so that we can invest in them properly for the customer experience that needs to be, frankly, for -- too many of our stores improved.

And so there are shrink elements, for example, and continuing to be -- I just met with our head of asset protection to look at some of the creative things that we are looking at, both as a company and as an industry, as it relates to the customer experience on shrink. I don't have anything magnificent to share with you today.

It is a hand-to-hand combat battle still, unfortunately, but it does impact how sales work through the store because when you lock things up, for example, you don't sell as many of them. We've kind of proven that pretty conclusively. But we're excited about the fact that we have revamped our team.

I want to point that out. Under Tracey Brown's leadership, we have revamped our team in terms of our analytics, our omnichannel, and our digital experience as well as our merchandising team. And we've got significant underway work around customer loyalty program that ties much closer to our go-forward strategy as a health and wellness provider in the marketplace.

We just this quarter are in the process of launching super foods, sports nutrition, and women's wellness, three new categories for us in our stores. And I saw some photographs of some end caps that look phenomenal. And it's too early for me to tell you how those are doing. But that's aligned with what we're trying to do longer term, which really meet the customer where they are with the things they want from us.

Unfortunately, some of the things that we've historically done a great job of selling through aren't the things that people today are spending money on given the changed mindset of our consumer. And so some of the seasonal things that have typically been strength for us are not quite as strong.

And we saw during the Christmas piece that we were able to get consumers to meaningfully respond to a promotional sort of approach that acknowledged that rather than try to fight it. And so our Christmas, we're not going to talk in detail about it today, but what we saw about our Christmas sales, it was better than our several holidays prior to that by virtue of a more targeted promotional strategy that meets our customers where they are.

Longer term, we've got to get our pricing strategy aligned to that and our merchandising strategy, which is all things that we're doing. We also are in the back of our store because it is relevant. We are now launching in 100 stores. We had a couple. We thoroughly tested it. We are doing digital or virtual check-in for pharmacy patients.

What does that enable? That enables you to actually know where you are, when your product is going to be available, do that without having to stand in a line and you can shop the store while you're actually waiting.

And you don't get angry at our employees because you stood online. And so these things, which by the way, the NPS for employees in those stores that we have, the digital check-in and so forth is higher. And of course, for the customers, it's higher as well.

And what we've learned in there is we put in some of our store's concierges at the front to help our patients who come in, particularly some of the older patients to access that approach for us. So again, digital and virtual loyalty program, merchandising in some new areas.

Own brand is the last piece I'd point to because, again, a key part of our value strategy is a trusted provider of high-quality own brand merchandise. And this quarter, we said we launched 60 things.

I have a daughter who's got -- I've got three daughters who have new babies. My youngest daughter has a brand-new baby. She is so excited about the fact that we have launched own brand diapers because she actually trusts that they're going to work and that there are not going to be blowouts at her house. And at the same time that the price will be right and that it will be something that she and her husband can afford.

So from that standpoint, again, long answer for you because we didn't spend any time on the front of the store, it is a longer putt for us. It requires a lot of work. It is a multiyear piece that just shrinking a footprint and improving our digital experience is not going to be sufficient. We've got to have the right stuff at the right price.

And the good news is -- and I think Manmohan spoke about it in his prepared remarks. When you look at our stores, the stores that were not on the closure list, we see those stores being materially stronger, still not where they need to be, but materially stronger than the stores that we're closing. And that gives us a lot of hope that as we reconfigure our consumer experience across all channels, that the consumer who -- millions of whom trust us every day will trust us to buy more every day.

Operator

Thank you. At this time, I would now like to turn the conference back over to Tim for closing remarks.

Timothy Wentworth - *Walgreens Boots Alliance Inc - Chief Executive Officer, Director*

Great. Well, I appreciate everybody dialing in. Hopefully, what you take away is that we are executing against both short- and long-term priorities, that this turnaround, we've said it, it is going to take time. But the level of urgency, discipline and focus that our team has throughout our team.

And I want to thank all of our 300,000-plus employees. We didn't talk about International at all today, for example. The team at Boots had a good Christmas and continues to perform well.

So again, across our entire platform, we are acting with discipline and focus. And we are committed to our vision of a retail pharmacy led organization that has a sustainable economic model and drives long-term value not only for shareholders, but it positively impacts the health and lives of millions of Americans who trust us every day. And so we look forward to updating you on our progress next quarter. Thanks very much.

Operator

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