THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

WBA - Q3 2015 Walgreens Boots Alliance Inc Earnings Call

EVENT DATE/TIME: JULY 09, 2015 / 12:30PM GMT

OVERVIEW:

WBA reported 3Q15 net sales of $28.8b and GAAP net earnings attributable to Co. of $1.3b or $1.18 per diluted share. Expects FY16 adjusted EPS to be $4.25-4.60 and FY15 adjusted EPS to be $3.70-3.80.

THOMSON REUTERS

CORPORATE PARTICIPANTS

Gerald Gradwell *Walgreens Boots Alliance, Inc. - SVP, IR & Special Projects*

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

George Fairweather *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

Alex Gourlay *Walgreens Boots Alliance, Inc. - EVP, also President of Walgreens*

CONFERENCE CALL PARTICIPANTS

Meredith Adler *Barclays Capital - Analyst*

John Heinbockel *Guggenheim Securities - Analyst*

Lisa Gill *JPMorgan - Analyst*

George Hill *Deutsche Bank Research - Analyst*

Ricky Goldwasser *Morgan Stanley - Analyst*

Robert Jones *Goldman Sachs & Co. - Analyst*

Alvin Concepcion *Citigroup - Analyst*

Mark Wiltamuth *Jefferies & Co. - Analyst*

Ross Muken *Evercore ISI - Analyst*

PRESENTATION

Editor

(PLEASE STAND BY FOR STREAMING TEXT)

Operator

Good day, ladies and gentlemen, and welcome to the Walgreens Boots Alliance third-quarter 2015 earnings conference call. (Operator Instructions). As a reminder, this conference is being recorded. I will now turn the call over to your host, Gerald Gradwell. Please go ahead.

Gerald Gradwell - *Walgreens Boots Alliance, Inc. - SVP, IR & Special Projects*

Thank you, Stephanie, and good morning, everyone. Welcome to our fiscal 2015 third-quarter earnings conference call. Today, Stefano Pessina, our Executive Vice Chairman and Chief Executive Officer; George Fairweather, our Executive Vice President and Global Chief Financial Officer, will take you through our third-quarter results. Also joining us on the call and available for questions is Alex Gourlay, Executive Vice President and President of Walgreens.

You can find a link to our webcast on our Investor Relations website at investor. WalgreensBootsAlliance.com. After the call, this presentation and a webcast will be archived on our 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 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, Form 10-Q and other filings 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 to the presentation materials available on our Investor Relations website for reconciliations to the most directly comparable GAAP financial measures and related information. With that I'll turn the call over to Stefano for some opening comments.

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

Thank you, Gerald good morning, everyone, and welcome to our fiscal third-quarter earnings call. The past six months have been significant progress in delivering on the benefit of the merger, structuring the business for the future, but there is a lot more to do.

As you have seen today, I have been appointed by the Board as Chief Executive Officer replacing the interim appointment that I was previously fulfilling. The Board decided that, bearing in mind the pace of change and the amount we have still to do, there is a benefit to stability at the senior level in the organization. And to focus on the operational and strategic tasks before us rather than appointing, orientating and educating someone new to the business during the period.

The role presents me with certain personal and logistical challenges, but with the support of the Board, and particularly of James Skinner as our Executive Chairman, I (inaudible) accept the appointment in the best interest of the Company, my colleagues and, of course, my fellow shareholders.

Today, I am pleased to be announcing another strong financial performance in this, the first quarter, to reflect a full three months of the combined Company. Although it may not always appear so from outside the business, it has been a very busy period for us since I last talked to you. As I have mentioned, our focus has naturally been on putting in place the changes in the restructuring we need in order to deliver the full benefits of the enlarged Company and position the Company for growth in the immediate and long-term.

Given that the deal was consummated only six months ago, we are still in the early stages of this process. But we have been working hard and fast to deliver on our plan, in fact, better than our plan. And I am pleased to say that the benefits of this work are already beginning to be seen in our results with reasonable growth in revenues and margins and continued strong cash generation.

[Really] the first areas in which you can see the impact are freight cost control and disciplined financial management. But I want to assure you that we give our operations the investment that they need to grow and prosper.

We have accelerated our cost reduction process and have reaped certain benefits earlier than expected in this quarter. Of course, we cannot extract these benefits more than once. However, the process of identifying benefits is ongoing, not [final], so when we have completed this first wave of restructuring, we will revisit and review all areas of our business to identify further potential cost savings.

I must commend my colleagues throughout the Company for their willingness and openness to accept change, even when it is the most uncomfortable, in the interest of improving and growing our Company. And I would assure them that change is a sign of life and, if embraced in this manner, becomes more of an ally than an enemy.

It's a reminder that while we must prioritize our work if we are to achieve everything we want to and promise to, we cannot ignore any element of the business when it comes to our drive for efficiency and best practice. I will hand over to George now for him to take you through the results for the quarter and give you some color on what I have just said. George?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

Thank you, Stefano. Good morning, everyone and good afternoon to those listening in Europe. Today, I will begin my remarks by taking you through key highlights of our fiscal 2015 third-quarter results. I will then give you some insight into the performance of each of our three divisions before updating you on progress we have made in implementing our cost savings and continuing to execute cost synergy programs. I will conclude by taking you through our updated guidance for fiscal year 2015 and comment on our fiscal year 2016 goals.

As Stefano said, the benefits of the work carried out since Walgreens Boots Alliance was formed at the end of December are already beginning to be seen in our financial results, enabling us to deliver another strong quarter.

Looking at the highlights -- net sales for the quarter were $28.8 billion, an increase of 48.4% versus the comparable quarter in the prior year. Operating income on a GAAP basis was $1.4 billion and on an adjusted basis was $1.7 billion. The increase in adjusted operating income was driven by the consolidation of Alliance Boots as well as growth in our Retail Pharmacy USA segment.

GAAP net earnings attributable to Walgreens Boots Alliance were $1.3 billion or $1.18 per diluted share, while adjusted net earnings were $1.1 billion or $1.02 per diluted share. This represents an increase of 59.5% in GAAP net earnings per diluted share and an increase of 22.9% in adjusted earnings per diluted share over the comparable quarter in the prior year.

Net interest expense in the quarter was $151 million and our adjusted tax rate was 30%. Finally, the average number of diluted shares outstanding for the quarter was 1.1 billion. This includes, of course, the 144 million shares issued on December 31 as part of the second step consideration for Alliance Boots. It should also be noted that the third quarter results last year included three months equity earnings as a result of Walgreens 45% interest in Alliance Boots, compared to fully consolidated results and this year's third quarter.

Now I will take you through the walk from GAAP diluted EPS to adjusted diluted EPS. GAAP earnings of $1.18 per diluted share for the quarter reconcile to adjusted earnings of $1.02 per diluted share. The net adjustment of $0.16 per share reflects additions of $0.05 of LIFO provision costs in Retail Pharmacy USA, $0.06 of amortization of acquisition-related intangibles and an additional $0.11 of restructuring-related costs from our cost optimization and store closure program.

These additions were more than offset by removal of a $0.29 gain on our warrants to acquire AmerisourceBergen shares and a net 9% gain from special items which include the release of a capital loss valuation allowance totaling $0.12, combined with a $0.01 loss on the sale of Walgreens infusion services and $0.02 for an adjusted tax rate throughout.

So now I will take you through the performance of each of our divisions in the quarter. To remind you, our results are reported in three segments: Retail Pharmacy USA, Retail Pharmacy International and Pharmaceutical Wholesale. Segmental reporting includes the allocation of synergy benefits including WBAD as well as an allocation of corporate-related overhead costs.

Responding to feedback received at our Analyst Day in April, you will see that we are providing additional detail on segmental performance both in the press release and in this presentation. This quarter, we have provided gross profit, SG&A and operating profit on a GAAP and adjusted basis for each of our segments. We plan to continue this practice going forward.

So now, let's start with the Retail Pharmacy USA segment. Retail Pharmacy USA total sales for the quarter were $20.4 billion, an increase of 5.3% over the third quarter in the prior year. Please remember, of course, that we sold a majority stake in Walgreens infusion services on April 7. With our minority position, our share of earnings in the Company now flow through the post-tax earnings from equity method investments in the income statement.

Sales in the division on a comparable-store basis increased by 6.3%. SG&A on a GAAP basis was $4.5 billion and on an adjusted basis was $4.3 billion. We continued to see strong progress in controlling SG&A expenses this quarter, including benefits associated with our cost savings program. This was a significant driver of quarterly year-on-year performance. As a result, GAAP operating income for Retail Pharmacy USA was $1 billion while adjusted operating income was $1.3 billion.

So looking now at the pharmacy part of Retail Pharmacy USA in more detail. Comparable-store sales for pharmacy were up 9.1% for the quarter. We filled 226 million prescriptions including immunizations on a 30-day adjusted basis. That was an increase of 3. 8% over last year's quarter with prescriptions filled in comparable stores up 4.1%.

We continue to see a positive impact and further growth in Medicare part D scripts along with positive underlying share trends. Our retail prescription market share on a 30-day adjusted basis increased to 19.3% in the quarter, up 20 basis points. The benefit of positive sales growth was, however, substantially offset by pharmacy gross margin pressure, consistent with our expectations.

Retail product sales increased by 2% in total; comparable store sales increasing by 1.6%. The growth in retail sales was driven by performance in key destination categories including health and wellness. We are pleased with our progress in driving profitable sales growth and margin expansion while at the same time focusing on operating efficiencies and focusing on working capital efficiencies.

Additionally, we continue to enhance the successful Balance Rewards* program by recently releasing Balance Rewards with everyday points. We now provide our active customers with a more consistent platform to receive loyalty points on most pharmacy and retail product transactions. We also encourage healthy lifestyle choices by rewarding points for positive health and well-being decisions.

So turning now to the results of our Retail Pharmacy International division. The Retail Pharmacy International division has pharmacy led health and beauty retail businesses in eight countries. At the end of the quarter, we operated 4,565 retail stores, a net increase of six stores during the quarter. As a reminder, our biggest operations are Boots in the UK followed by Mexico. We also have retail pharmacies in Chile, Thailand, Norway, the Republic of Ireland, the Netherlands and Lithuania.

Total sales in the division for the quarter were $3.3 billion. GAAP operating income was $205 million while adjusted operating income was $249 million. Adjusted operating margin of 7.6% for the quarter was 1.5 percentage points higher than in the second quarter which, remember, included only January and February performance. The margin is typically lower in these early months of the year reflecting the seasonality of sales.

So now let's look more closely at the performance for the division. On a pro forma constant currency basis, comparable-store sales growth for the quarter was 3.1%. This reflects Boots UK growth of 2.4% complemented by higher growth in emerging markets, most notably in Mexico and Chile where we are making good progress in integrating these businesses acquired by Alliance Boots in August 2014.

In the UK, Boots retail sales were driven by good performance in both the beauty and retail healthcare categories. Orders on our UK website -- that's Boots.com -- orders during the quarter were up approximately 50% over the same period last year with approximately two-thirds of all website orders collected in store.

At our Analyst Day back in April, we talked about the importance of our product brands. We are very pleased with the growth in sales during the quarter No7, our award-winning beauty brand. This was in part due to the may launch of a new marketing program in the UK, the No7 Protect & Perfect Advance Serum. We were able to state for the first time in the UK that this innovative product was the first serum clinically proven to deliver groundbreaking anti-wrinkle results that get even better over time.

As well as developing our existing product brands, we continue to add brands to our portfolio which resonate with our customers. Following on from the acquisition of Soap & Glory last year, we are delighted to announce today that we've acquired Liz Earle from Avon. Liz Earle is an award-winning premium skincare range that uses naturally active ingredients and is recognized as one of the leading botanical brands in the UK.

So turning now to our Pharmaceutical Wholesale division. Pharmaceutical Wholesale division total sales for the quarter were $5.7 billion. On a pro forma basis, which assumes constant currency and excludes acquisitions and disposals, sales increased 0.2% compared with the same quarter in the prior year.

As we discussed in the last earnings call, wholesale performance in any quarter is impacted by performance in larger geographies including the UK, Germany, France and Turkey as well as by the unique business model. GAAP operating income for the division was $162 million while adjusted operating income was $171 million. Adjusted operating income margin was 3%, broadly flat versus the second quarter and consistent with our expectations. Key driver of profit growth continues to be our synergy program.

Net synergies in the third quarter totaled $194 million, making a total of $504 million for the fiscal year to date. As we've said before, synergies this year continue to come primarily from our drug procurement activities. As you can see from the numbers, we are on track to reach our target of at least $650 million net synergies in fiscal year 2015. For fiscal year 2016, we continue to expect at least $1 billion of combined quantifiable net synergies.

As we work increasingly close together as a combined management team, there are, of course, an increasing number of other synergies being identified in action, many of which are simply not practicable to quantify. Consistent with our prior reporting, these synergies are allocated across each segment and do not include any benefit from our relationship with AmerisourceBergen.

At the same time as driving our synergy program, as you know, we are very focused on costs. As previously announced, we have a target of $1.5 billion of cost savings to be delivered by the end of fiscal 2017. Expected pretax charges associated with this program, as previously stated, are between $1.6 billion and $1.8 billion of which the cash component is expected to be approximately 60%.

Good progress was made during the quarter in reorganizing our Retail Pharmacy USA field operations with work continuing on the optimization of the division's corporate office. Of the approximately 200 planned US store closures in the program, nine stores were closed in the quarter with approximately 70 to 80 additional stores planned to be closed by the end of the fiscal year.

We've also reduced the IT cost structure in the USA to help enable significant store system investments over the coming years. In addition, during June, we announced the reduction of approximately 700 non-store based draws in Retail Pharmacy International.

During the quarter, we incurred pretax charges of $160 million on the program. These comprise $102 million of asset impairments, $34 million of severance costs and real estate costs of $24 million.

So moving on now to cash flow and the deployment of capital. GAAP operating cash flow was $1.8 billion in the quarter and $4.2 billion in the first nine months of the year. Free cash flow was $1.6 billion in the quarter and $3.3 billion in the first nine months of the year. Net debt at the end of the quarter was $11.8 billion.

Investing to drive future growth is our first priority for capital deployment both in terms of capital expenditure and selective M&A. During the quarter, we invested $247 million in capital expenditure making a total of $890 million for the first nine months of the year. Here as the capital investments continue to be store investments as well as IT and digital capabilities, which are vital to building and maintaining a sustainable, competitive advantage and are increasingly on the channel world.

To some degree, this quarter disproportionately benefited from the imposition of stricter capital investment controls. And while we expect to maintain a rigid control on capital expenditure, to assure appropriate returns on every dollar we spend, we will clearly not deprive the business of the investment it needs to thrive. You should therefore expect to see future quarters return to a slightly higher level of capital expenditure than we are reporting today.

We remain focused on generating cash through working capital efficiencies particularly in Retail Pharmacy USA. A primary area of focus is inventory management, both in pharmacy and retail products. For the quarter, we improved our inventory days of supply in the US by approximately six days versus the prior year quarter. We continue to see further opportunity for working capital improvements over time.

At the same time, we're working hard to optimize our real estate assets including carrying out sale and lease back transactions. In the third quarter, we executed approximately $300 million of such transactions.

As we have said previously, our philosophy is to run an efficient balance sheet. As such, we completed approximately $237 million share repurchase is in the quarter against our $3 billion authorization, bringing the total purchases under this program to $331 million. The program is ongoing and we remain committed to completing the plan by the end of fiscal 2016.

In addition, we announced today that in order for us to manage our balance sheet, we are intending to redeem legacy Walgreens bonds with relatively short periods until they expire with a total principal amount of approximately $1.75 billion. This redemption will be funded from existing cash resources. You'll see that cash and cash equivalents totaled $4.4 billion at quarter end, so we have the capacity to do this and continue to exercise on our share repurchase program.

So turning to the dividend, we announced today a 6.7% increase in our quarterly dividend to [36] (technical difficulty) share. This raises the annual rate from $1.35 per share to $1.44 per share. We remain committed to our long-term dividend payout ratio target of 30% to 35%.

So now let me talk about the full-year outlook for fiscal 2015. In our second-quarter earnings release, we had issued an adjusted EPS guidance range of $3.45 to $3.65 for fiscal year 2015. Given our solid third-quarter results, and increased visibility as we look to the year end, we are pleased to both increase and narrow our adjusted EPS fiscal year guidance to a range of $3.70 to $3.80.

This range seems adjusted interest expense of approximately $150 million in the fourth quarter, a full-year adjusted tax rate of approximately 29%, fiscal year diluted share count of approximately 1.05 billion shares and estimates for foreign exchange rates that reflect current market rates over the balance of the fiscal year.

I'll remind you that when we issued our fiscal year 2015 guidance in April we viewed the second half of the fiscal year differently than the first half. Specifically, we indicated that adjusted earnings per diluted share would be lower in the second half with the third quarter being higher than the fourth quarter. As we update our guidance, this still holds true.

We expect quarter four adjusted earnings per diluted share to be sequentially lower for the following reasons. The primary component is seasonality which impacts sales and product mix. The summer months tend to be our weakest, particularly in our Retail Pharmacy USA segment. Within the US, we tend to see sequential declines in the growth of both pharmacy volume and retail product sales. Also, as we continue to work through our cost plan in the US, the phasing and timing of certain expenses will impact the fourth quarter relative to the third quarter.

So moving on to fiscal year 2016 -- we are reaffirming our previously stated adjusted EPS goal for fiscal year 2016, $4.25 to $4.60. This range assumes an annual adjusted tax rate in the high 20s, a full-year weighted average diluted share count of approximately 1.1 billion and no significant changes to current currency exchange rates. Please remember, of course, that since we established the goal a year ago, we've seen material appreciation of the dollar.

As you know, we have currency translation exposure based primarily on movements in the pound sterling versus the dollar. And as a reminder, we estimate that a 1% move in pound sterling versus the dollar at current levels would impact our adjusted EPS by approximately $0.01 per share. Given the current situation in Greece, where we fortunately have no business interests, we anticipate a certain level of volatility in the currency markets in the forthcoming months. So with that, I will turn the call back to Stefano.

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

Thank you, George. So, I hope that you will agree that these are a very solid set of results. It's (inaudible) we are far from being complacent about the challenges we face and the hard work it will take to deliver everything we want and that promise, but we are making good progress and targeting in the right direction.

I, and I believe all of my colleagues, recognize that the challenges and the work will be needed to overcome them. But are as convinced as ever about the immense potential of our Company as a global pharmacy led health and well-being enterprise.

We are in markets that are changing. Here in the US you are seeing this quite (inaudible). But as I have said many times, we are at the beginning of a new chapter for our Company and are actively reviewing every opportunity that the changing environment offers us as we work to deliver the true potential of our Company. I strongly believe that we have a significant role to play in shaping the future of our (inaudible).

I thank you for your continued support, but also acknowledge that the best way to thank you is to deliver on our promise. And I can assure you that we fully intend to continue to do so. With that, I think we will now open it up for questions. Gerald?

Gerald Gradwell - *Walgreens Boots Alliance, Inc. - SVP, IR & Special Projects*

Thank you. Stephanie, do you want to take over?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Meredith Adler, Barclays.

Meredith Adler - *Barclays Capital - Analyst*

Thank you very much and I'm asking questions for myself and Eric Percher who is not available today. I think our main question would be talking about the big difference, the spread between the growth in pharmacy scripts and the growth in dollars. Maybe you could talk a little bit about what the drivers are; some of it is hep C, but maybe you could talk a little bit about inflation in both branded and generic drugs. And then I will have one other question.

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, also President of Walgreens*

Hi, good morning, Meredith. It's Alex here. Thanks for the question. Yes, the inflation, we're managing the effect of that inflation pretty well in the business. We have good plans and the team has done a good job to get that done. So one of the differences in the spread you are seeing is (inaudible) inflation, but we're managing that effect really pretty satisfactorily and that of course is built into our future guidance as well.

Meredith Adler - *Barclays Capital - Analyst*

Would you describe inflation and branded pharmaceuticals as a positive for the margin?

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, also President of Walgreens*

I think it's marginal at the moment in terms of that. But again (inaudible), for example, slight improvements because of our generics coming to market both this year and next year. But again, the key thing here is that we forecasted this; we are planning it, and it's really consistent with our expectations.

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

If I can add something, you have also to take into account that we have a different business within our Company and some of these businesses, like the Wholesale business, or like WBAD are really taking advantage of certain inflation.

Meredith Adler - *Barclays Capital - Analyst*

Okay. That's very helpful. Thank you. And then I just have a follow-up question to talk about. The front end margin improved and I think you talked about not just the operating margin, but the gross margin. Maybe you could talk a little bit about changes that you might have made in terms of promotional strategies or the way you're marketing that might have driven a better gross margin in the front end?

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, also President of Walgreens*

Yes, Meredith; it's Alex again. We've made -- we've been [moving] on this strategy now for five quarters, so we're pleased with the progress we're making. And the key things that we have done is we stopped really promotions that were driving sales, particularly in some consumable categories, but not really helping the profit at all. And we are focused much more on the mix and making sure that we're much more focused on really the health and wellness and beauty care categories and that's really proven beneficial.

And as George has said in the scrip today we've launched a new platform called Everyday Points. And that released to make sure again that people who are coming to us more regularly and are picking up on the destination categories are getting a better platform and more reason to come back to Walgreens.

Now it still is early days. We have a lot of work to do and a lot of opportunity ahead of us and it will be step-by-step process. But the basic things we are doing is reducing unprofitable promotions and making sure that we focus more investment in our best customers and more investment in our destination categories.

Meredith Adler - *Barclays Capital - Analyst*

Great. Thank you very much.

Operator

John Heinbockel, Guggenheim.

John Heinbockel - *Guggenheim Securities - Analyst*

Hey, two questions. One on Walgreen USA costs. What would you guys peg the normal increase -- annual increase in SG&A at? Would it be 2% to 3% absent cost-cutting? And then of the 1.5 billion that you've identified, did you see any of that in the third quarter and how much and what do you think you see in the fourth? And then just lastly, it did look like pharmacy margin improved a decent amount sequentially, which was a little surprising. What were the couple of things that may have driven that?

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

Alex, maybe you can talk --

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, also President of Walgreens*

Yes, there are a number of questions there, John. So good morning again. So starting off with the cost question, I think it has George said really clearly, we've made solid progress against our $1.5 billion cost program and, of course, we started a bit earlier in the US in terms of what we announced. And I would say that we are seeing our SG&A in the US business down slightly year on year on a comparative basis, which is pleasing but also really what we had planned to do.

And I think as George also said, there's a bit of phasing here between quarter three and quarter four. And importantly from a continuation of business point of view, we are -- in quarter four this year we are making sure that we will continue to invest in things that customers value the most from it to make sure we keep the growth going forward and investing more in our customers and more in the things that customers see.

Again, finally on the cost side, again as George has said, we started some restructuring; we've closed, I think, George said nine stores in the previous quarter and we are on track to close another 80 to 90 in the period ahead. Again, that is very much on plan and benefits still to come over the period of time.

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

And, John, I think you also asked a question on the pharmacy margin and really just reinforcing what I said earlier, is that we did see in the US the positive sales growth. But that was substantially offset by the pharmacy gross margin pressure. But that was absolutely consistent with our expectation, so there is no change from what we were expecting when we last talked to you.

John Heinbockel - *Guggenheim Securities - Analyst*

But did it get better? It looked like it got better sequentially -- or no? Right?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

[Did it go up sequentially]? We're talking about -- obviously, we're reporting, John, on year-on-year quarter-on-quarter, but it really was as we expected. When the renewals come through and what we're seeing is what we were expecting.

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

You know the market -- it's Stefano here. Of course, the market is evolving. What is important is to be able to anticipate what happens and to take this into account when you budget. And I believe that this year we are doing exactly this. We are absolutely in line with what we were expecting.

John Heinbockel - *Guggenheim Securities - Analyst*

Okay, thank you.

Operator

Lisa Gill, JPMorgan.

Lisa Gill - *JPMorgan - Analyst*

Hi, thanks very much, and good morning. Stefano, you talked about the challenges that the US market and other markets are facing. We hear CMS talking about 50% of payments moving towards what they are calling fee for value. Can you talk about strategically where do you think Walgreens needs to be positioned? We are seeing lots of consolidation, whether it's managed care or other players.

Is it that we need to be the biggest retail provider in the US and therefore best position to partner with those that are taking on risk? Do you view yourself as more of a risk bearing entity over time? How do you think about your relationship, whether it's with managed care or PBMs and strengthening those going forward?

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

I have said many times that I believe that the American market will go through a substantial wave of consolidation, horizontally and vertically. I have said very clearly that we want to be part of this at the right time with the right partner. We are open to any kind of combination which could improve the value of our Company and we are looking actively around [assets] to understand which is the best option for us. But please don't forget that we are looking actively, not just in the US, but even in other countries because we consider ourselves a global Company.

Lisa Gill - *JPMorgan - Analyst*

And would you say that the priorities are more US driven or globally driven or does it depend on the specific opportunity that comes across your desk?

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

Well, the priority is the deal that you can do, and it depends where you can fit.

Lisa Gill - *JPMorgan - Analyst*

Okay, great. And then just my follow-up question would just be around of the synergies and you talked a lot about them coming from the procurement side of things. Can you maybe talk about where you think you are, George or Alex or Stefano, as far as what inning are we in as far as obtaining the synergies that you expected from WBAD? Are we close to getting the full benefit from them or is there still a good portion of the future synergies that will still come from the procurement side?

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

We are absolutely aligned with what we were forecasting and maybe, George, you can give more details about -- we will do what we were expecting and what we announced.

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

What I would just answer to that is what I said is that we are very much on track to achieve the target this year and our -- the goal of $1 billion. From what I would describe as hard, quantifiable synergies that we can measure. But what we're really seeing is now that we are a merged organization we are seeing lots of other areas of best practice and ideas that we are sharing, that we're implementing.

But clearly as we become more and more integrated, these are simply the [sites] that you cannot quantify to the standard that you can put in a number. And we are very much moving through this -- into this phase. And those types of synergies, as we know from previous transactions -- I remember from the merger of Alliance UniChem and Boots, these are very important synergies and we can see them time and time again. We're moving people around more and these are really what will help us to become a much, much stronger organization.

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

I would add, George, that, as you said, we are thinking of the buying synergies, [there are] certain synergies which are quite evident and we can easily forecast. But there will be for sure, as you are saying, George, many synergies that will appear evident -- become evident in the future, because when you put two companies together, you find a way (inaudible) four years, I would say, for three or four years, you find new ways to deliver synergies.

Lisa Gill - *JPMorgan - Analyst*

Okay, great, and congratulations, Stefano, on becoming CEO. I'm glad that they named you so.

Operator

George Hill, Deutsche Bank.

George Hill - *Deutsche Bank Research - Analyst*

Good morning or good afternoon, guys, based upon where you are and thanks for taking the question. The first one is for Alex. People have jumped in a bid on what margins have looked like. I guess we're getting further along in the year. Can you talk about what [payer] negotiations are looking like for 1/1/16 contract restarts? And I guess if things are proceeding according to expectations and how that squares with the fiscal 2016 guidance that you guys have provided?

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, also President of Walgreens*

Hi, George. Yes, absolutely. We're really as we expected and square on the gains we've given as well and I think the team has done a good job again anticipating and making sure that we've projected well and managed relationships in a very good way.

George Hill - *Deutsche Bank Research - Analyst*

Okay, and then a follow-up I guess for George and for Stefano, which is -- we're not too far away now from March of 2016 when the first launch of the ABC warrants become exercisable. I guess should we think about whether or not there is any contribution from ABC equity earnings built into the fiscal 2016 guidance? And does Walgreens want to be a larger stock owner of AmerisourceBergen or should we think of the warrants as a value creation vehicle for Walgreens? Thank you.

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

When we did the deal, we did the deal of course to improve our profit but also for strategical reasons because, as you know, we have always believed that better coordination between wholesalers and retailers again create quite substantial synergies. So the reasons for the deal are still there, so we will -- we have announced what we intend to do and at the right time, you will see the effect of these agreements. George?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

I've really not a lot to add to that. I mean we will look at the right time and take the decision at the time. In terms of the accounting, again, we will have to look at that at the appropriate time. But from where we are today, were we to exercise the warrants, then we would anticipate being able to account for that as an equity method investment. But clearly that will be -- it would have to be confirmed and looked at were we to exercise.

George Hill - *Deutsche Bank Research - Analyst*

Okay, thank you.

Operator

Ricky Goldwasser, Morgan Stanley.

Ricky Goldwasser - *Morgan Stanley - Analyst*

Yes, hi. Good morning, and congratulations on the quarter. Just a couple of questions here. First of all, just, George, you've highlighted some of the differences between this quarter and upcoming quarter. Can you just share with us more details on the headwinds versus the tailwinds that we should be thinking of between the fourth and third quarter?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

Well, I think really the first real point to come through, as I sort of touched on in the prepared comments, was that the primary component we've got to think about is the seasonality between the quarters, which impacts the sales and product mix. And thinking about the summer months very much tend to be our weakest months, particularly in Alex's business, the Retail Pharmacy USA segment, where we would see typically the sequential declines in the growth of both pharmacy volume and retail product sales.

The other factor is around the phasing and timing of certain expenses from -- in terms of the fourth quarter relative to the third quarter. And clearly when you go through the sort of programs that we are, we [already are trying] and push as fast as you can. But equally, you need to keep everyone very focused on the business and driving through all the programs that Alex is working on.

So there is always an element of timing on those where they -- eventually as to how quickly we can deliver some of those. We are clearly going as fast as we feel we can in a straight line. If -- there's other areas I talked about, clearly currency is a factor as I touched on. But I think increasingly, we have -- in terms of the internal factors, we've got pretty good visibility to our forecasting process and, hence, we are confident to both narrow and increase the guidance range for this year.

Ricky Goldwasser - *Morgan Stanley - Analyst*

And when we -- [generally] you talked about I think shutting -- closing down another 70 to 80 stores in the upcoming quarter, so should we see that through the gross margin line or the SG&A line?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

Yes, you see that particularly through the SG&A line. Obviously, we lose a few sales, but mostly sales we've successfully transferred into adjacent stores. I think, as you know, we also closed a number of stores there last year and we've got a pretty predictive model now which we're very confident about. So the SG&A will come down and overall we will have an [EBIT] benefit and we will lose a few sales and a few bps of margin.

Ricky Goldwasser - *Morgan Stanley - Analyst*

Okay, great. And then just one market-related question. We're seeing a lot of kind of like your competitors making strategic moves around specialty. When you think about kind of like the specialty opportunity for you, do you think that this is something that you can build internally by leveraging your retail infrastructure in the US? Or is this something that you think you need to go outside to add these capabilities? And also, how do you think about the specialty opportunity US versus ex-US and Europe?

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

We don't exclude any opportunities. We are looking around, as we have said many times, so we are analyzing all the opportunities for growth that we have, and at the right time and if the right opportunities come we will be able to face them.

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, also President of Walgreens*

Yes, and if I can also at as well, Ricky, that we are very focused on organic growth as well. We have got a very good model in the USA in community pharmacy and we're building that out through our relationships with doctors and with also any access we get to the [pharma] manufacturers. Also so in areas like HIV and cystic fibrosis, we have opportunities that we can grow organically. So again, we are not stopping; this is an important business for us and we've grown organically, particularly in the USA.

Ricky Goldwasser - *Morgan Stanley - Analyst*

Okay, thank you.

Operator

Robert Jones, Goldman Sachs.

Robert Jones - *Goldman Sachs & Co. - Analyst*

Thanks for the questions and, Stefano, congratulations on the appointment. Obviously, a number of moving pieces, but just really trying to get a better gauge of the underlying core US business. You guys talked about making good progress on the restructuring program, but is there any more details you can share with us on the savings that you've been able to generate to date? And then any breakdown of those savings, obviously, across the segments would be really helpful in us being able to track the underlying business a little bit better.

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

We have made an effort to be as clear as possible. George?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

I really do appreciate how sticky it is with the merger coming through, and obviously, (inaudible) we said the last time, we were -- it was not practical for us to work through and try and restate everything on a comparable basis at the cost side and the margin side. So that's why we've tried to give the adjusted figures. Clearly, in terms of the cost-saving program, that is the big -- it is primarily in Retail Pharmacy USA, as we said the last time. But we are progressing in the International but that is a much, much smaller part of it -- part of the program.

But we are very much on track with where we expect to be, as I said earlier, what's important is always go in a straight line in a disciplined, structured way. That's why we've tried to give you a little bit of a feel where you're actually looking at comparability. I tried to touch on the Retail Pharmacy International margin, which I know some of you felt looped [across] a little bit lower than you were expecting in the second quarter, but it only had the two months in and that is a seasonal business.

And the last quarter was at a time when seasonally we talked lower sales clearly as we come up to the important Christmas time and we got the leverage of the fixed cost base and therefore the net margins will reflect that when you look at seasonality. But I do appreciate how tricky it is to model which is why we gave the guidance going forward.

Robert Jones - *Goldman Sachs & Co. - Analyst*

No, I respect that, too, and I understand that comparability year-over-year is tough. I guess I was talking more specifically about just identifying what the cost cutting was in the actual quarter, this quarter itself. And maybe I'm missing something, but I wouldn't think that would be that difficult to identify -- store closings, headcount reduction, but --.

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, also President of Walgreens*

Bob, if I can maybe help a little bit. We've done a good review of all of our projects that we are focused on the future. And I think we've been really clear within the business that we're focusing back on our core business of our retail pharmacy front end products, specialty. And therefore all of the other areas where we were building out maybe potential future products, we will look [further in the stack] to reduce the spend in some of these areas to be more focused back on the core business. So that really has been reducing a lot of projects and we really very confident, as we said before, on the $1.5 billion in savings that can be achieved.

Robert Jones - *Goldman Sachs & Co. - Analyst*

Alex, fair enough.

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

To really reinforce what Alex has said, we've been putting a lot of internal work into the whole process of how we evaluate new initiatives, how we track initiatives that perhaps are not working. And then you stop them; you don't let them drag on. If something really isn't working you give it a good go then you stop it.

New initiatives, we've got a lot of what I would describe as financial rigor that has been increasingly put in place really over the last 12 months. Alex, you put a lot in place when you took overall responsibility for the Walgreens business and we're continuing to do that. And I think it's that rigor that we're seeing then in terms of some of the SG&A coming through.

Robert Jones - *Goldman Sachs & Co. - Analyst*

That makes sense. And I guess just one quick follow-up on Part D network specifically, there is a big initiative from your predecessors to get deeper into some of these preferred networks. I'm curious how the economics of those networks have compared to your expectations? I know it's only about six months in. And then based on that feedback, any thoughts on your continued participation in these preferred networks going forward? Thanks.

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, also President of Walgreens*

Yes, hi. It's Alex again. This is a really important customer, a really important market segment. It's a segment that's growing rapidly, so we remain very committed to this. And in terms -- as I said before, we are in terms of next year's plans, have almost completed all the contracts and they're to the expectations in terms of margins that we've planned for. So very committed to this business and we are -- we've done a good job. We're pleased with where we are and committed to next year.

Importantly for us, of course, we're only at the end of the first stage. The second stage which is how (inaudible) to access, how do you make sure that you really look after the patients and the customers who come to your pharmacy and make sure you get the appropriate level of draw-through and volume through your assets and that's a bit what we're turning our attention to.

Operator

Alvin Concepcion, Citi.

Alvin Concepcion - *Citigroup - Analyst*

Hi, thank you. Congratulations on another great quarter and congratulations, Stefano. My question is just really around beauty. Just curious how the tests are going in New York and Phoenix? Are there any findings you could share from that? I'm particularly interested if you think you are getting a sales lift in the island and if you are seeing much traction from No7?

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

Of course, you know the importance that we give to our brands. And No7 is having a fantastic trend in the UK and internationally. And it's one of our -- really hope for the future in the US. But maybe, Alex, you can say what you are doing now for No7 and what you are expecting, of course.

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, also President of Walgreens*

Yes, we've rolled No7 into about -- just over 400 Walgreens and Duane Reade stores in Phoenix and then in New York City. And the Phoenix market is just over 12 months old, and we've been able to measure the impact both on No7 sales, on Boots brand product sales and also on the beauty categories and we are pleased with what we're seeing. So we're now starting to plan for the next stage of evolution of No7 and the Boots brand in Walgreens and Duane Reade in the USA and we'll come out with these plans when they are ready. But we are pleased with the results.

Personally, I'm also pleased that we've been able to acquire Soap & Glory. I think that happened in the previous quarter, and obviously, this morning in (inaudible). But going forward, the more unique products that we're able to get into the Walgreens beauty and healthcare offer then the more unique it will make our offer going forward in what is a very competitive marketplace.

So again, very pleased with the brand's performance, very pleased with the progress that Ken Murphy and the team have made in the Global Brands organization. It's still very young and looking forward to getting these unique products in front of our customers in Walgreens in the future.

Alvin Concepcion - *Citigroup - Analyst*

And as a follow-up, what were you thinking for the timing of the full rollout?

Alex Gourlay - *Walgreens Boots Alliance, Inc. - EVP, also President of Walgreens*

Yes, we will come back with that. We're really -- I said before -- where just doing the walk now. We've got to get it right. This is a big estate; it's a fantastic brand, as Stefano said, in Europe and is growing really well in Europe. So we'll come back there when we're ready, but it's -- we're in a good position.

Alvin Concepcion - *Citigroup - Analyst*

Great. Thank you very much.

Operator

Mark Wiltamuth, Jefferies.

Mark Wiltamuth - *Jefferies & Co. - Analyst*

Hi. I just wanted to inquire how comparable the US SG&A number is on a year-over-year basis because it looked like there were some overhead allocations that changed versus year ago?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

Yes, so I mean they're not directly comparable because clearly the corporate expense, for example, as I said in my presentation, has to get allocated across the three divisions. Clearly, we're also allocating synergies which we talked about in terms of where the economic benefit is. So the results unfortunately are not directly comparable, and so they come with that very big health warning. But I think what we have said is we are very pleased with the progress that we're making in reducing SG&A and we are very much on target to deliver the program that we announced in the last quarter.

Mark Wiltamuth - *Jefferies & Co. - Analyst*

So -- and the numbers that presented were down, but I guess on an apples-to-apples (technical difficulty) was the SG&A percentage down?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

On an apples -- there isn't an apples-and-apples basis; that's the -- I guess that's the challenge that we've got and simply -- I think we said at the time we did the deal our priority was to get the deal done quickly. But one of the things that didn't enable us to do was to go back and rework everything on an apples-and-apples basis. But we're making good progress, that's the key message I can see. But I know how difficult it is not getting everything apples-and-apples.

Mark Wiltamuth - *Jefferies & Co. - Analyst*

Okay, and I understand you're not announcing the International segment's year ago performance as well. But is there anything you can give us in terms of health indicators for margin and profitability on those International segments, even though you don't have a GAAP presentation for us?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

I think we can say that we are pleased with the performance. When we look at Retail Pharmacy International, obviously Boots is the largest component there. We're delivering solid performance in a market where there are quite a lot of challenges in that market. And you see what's happening in some of the supermarket sector, for example. But I think this demonstrates the strength of the offer, it's very important of a differentiated retail offer, particularly in beauty where Boots is renowned. We've got a very strong loyalty card program.

Alex talked, obviously, about the great work that's being done here and taking Balance Rewards forward. The advantage card program equally important in the UK. And then the piece that I touched on in my presentation is really omni-channel where ordering online through Boots.com and picking up in-store to purchase is important.

And of course with the geography that we've got in the UK and the 2,500 points we can do that and we can actually leverage our Wholesale organization for delivery. We're able to do that in a profitable way that really meets the expectations of our customers. So that's the key component in there.

In Wholesale, in any year has been in a number of markets, you get markets that perform better, markets that are more challenging, it's just the way it always is. But the divisions delivered a solid performance and as it has continued to do for many years.

Mark Wiltamuth - *Jefferies & Co. - Analyst*

I guess on the international retail pharmacy there was some commentary in the analyst meeting that the margin focus for growth was really shifting away to more of a sales growth story. Was there gross margin declines as you go through that transition to driving sales?

George Fairweather - *Walgreens Boots Alliance, Inc. - EVP, Global CFO & Principal Accounting Officer*

We've not -- we've obviously not given the specifics on the comparability because we don't have the numbers on the same US GAAP basis. But I continue to say that the business has performed solidly. We're pleased with the performance in what's been a tough retail environment in the UK, and that's fundamentally (inaudible).

On the [NHS] side, on the pharmacy side, clearly the government continues to contain growth in healthcare expenditure. And so, we haven't seen the details of the settlement yet, that's probably going to be towards the autumn. We will just have to wait and see on the timing of that, but we continue to see pressure in that area as we've seen for a number of years, but no real change but that pressure continues.

Mark Wiltamuth - *Jefferies & Co. - Analyst*

Okay, well thank you for the color.

Gerald Gradwell - *Walgreens Boots Alliance, Inc. - SVP, IR & Special Projects*

Stephanie, I think we have time for just one more caller, please, if we could.

Operator

Ross Muken, Evercore.

Ross Muken - *Evercore ISI - Analyst*

Hi, good morning, guys and congrats. So as you think about the M&A landscape happening around you, so obviously, Stefano, you talked about lots of consolidation happening in managed care. We've seen it in generics. We've seen it in the PBM space. Where do you think, in terms of what is happening around you, it's most relevant to kind of your business? Or what are you watching most? And how do you think particularly on the managed-care side, any of the changes there? How does that make you think about your longer-term positioning from a healthcare perspective in this market?

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

As I have said, we can clearly see the need or the opportunity for horizontal and vertical consolidation in our industry and this is happening. In reality, I believe that this is a good move for us because the consolidation there is [under] consolidation will create a clear market and will give us more opportunities in future. What we will be able to do specifically it's a little too early to say. But I repeat, we want to be one of the players in this space and we see a lot of opportunities and the opportunities are really open along the chain, along the face of the healthcare industry.

Ross Muken - *Evercore ISI - Analyst*

And I guess just quickly, just staying on the M&A theme and I'll keep this to my last question. But you and your team have been remarkably savvy dealmakers over the course of your long career and have created massive amounts of value. How much of a challenge of it -- is it today with where global equity markets are from a valuation standpoint?

Obviously understanding the financing markets are wide open, but valuations are pretty elevated. And so, how do you think about that in the context of your capital allocation goals, particularly on the deal side? Does it argue to smaller transactions or certain geography? I'm just try to get a sense for how that plays into your thinking and your -- the timing aspects of it.

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

As you know, we have been always (inaudible) with potential acquisitions, so we will be -- if we will have an opportunity, we will analyze this opportunity very rationally and we will do it just if it creates additional value. It's true that the market is now quite bullish, but it's also true that the cost of the money is still quite low. And there are other ways to create value, not just in the acquisitions. So we are analyzing all the opportunities. If we will see an opportunity which fits our strategy and which can create value, we will take action.

Ross Muken - *Evercore ISI - Analyst*

Great. Thank you so much.

Gerald Gradwell - *Walgreens Boots Alliance, Inc. - SVP, IR & Special Projects*

Okay, ladies and gentlemen, that was our final question. Thank you all for joining us today. Feel free to contact myself or Ashish if you have any further questions. I know some of you do. And with that, thank you very much indeed. We will conclude our call. Thank you.

Operator

Thank you, ladies and gentlemen. That does conclude today's conference. You may all disconnect and everyone have a great day.