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WBA.OQ - Q1 2021 Walgreens Boots Alliance Inc Earnings Call

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OVERVIEW:

Co. reported 1Q21 YoverY sales growth (including 0.5% currency tailwind) of 5.7% and GAAP EPS loss of $0.36.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Walgreens Boots Alliance, Inc. First Quarter 2021 Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would like to now hand the conference over to your speaker today, Gerald Gradwell, Senior Vice President of Special Projects and Investor Relations. Please go ahead.

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

Good morning, ladies and gentlemen, and welcome to our earnings call for the first quarter earnings of fiscal year 2021. On the call with me today are Stefano Pessina, our Executive Vice Chairman and Chief Executive Officer of Walgreens Boots Alliance; James Kehoe, our Global Chief Financial Officer; and Alex Gourlay, Co-Chief Operating Officer of Walgreens Boots Alliance.

Before I hand you over to Stefano to make some opening comments, I will, as usual, take you through the legal safe harbor and cautionary declarations. Certain statements and projections of future results made in this presentation constitute forward-looking statements that are based on our current market, competitive and regulatory expectations and are subject to risks and uncertainties that could cause actual results to vary materially. We undertake no obligation to update publicly any forward-looking statement after this presentation, whether as a result of new information, future events, changes in assumptions or otherwise. Please see our latest Form 10-K and 10-Q for a discussion of risk factors as they relate to forward-looking statements. And note, in particular, that these forward-looking statements may be affected by risks relating to the spread and impact of the COVID pandemic.

In today's presentation, we will use certain non-GAAP financial measures. We refer you to the appendix in the presentation materials available on our Investor Relations website for reconciliations to the most directly comparable GAAP financial measures and related information. You'll find a link to the webcast on our Investor Relations website at investor.walgreensbootsalliance.com. After the call, this presentation and webcast will be archived on the website for 12 months.

Before I pass you on to Stefano, there is one change in definition we use in today's earnings that I would like to draw your attention to. Moving forward, comparable retail sales are now inclusive of our digitally initiated sales, as we believe this more adequately reflects our global omnichannel retail strategy. The full definition and historical restatements can be found in the appendix tables of this presentation or in our 10-Q to be filed later today.

I will now hand you over to Stefano.

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

Thank you, Gerald. Welcome, everyone. We are delighted to be announcing a start to the financial year that is better than we had initially expected. As you all are well aware, the retail markets have seen many ups and downs over the past months. With the current increase in COVID infections in recent weeks, things have, once again, proved more challenging. In these difficult conditions, I am pleased to say we have adapted well through the continued dedication of our people and as a result of work and investment we have undertaken in recent years.

The improvements we have made to the skills, infrastructure, processes and systems in our businesses is reflected in these results. The continued efforts to contain the spread of the virus have seen varying responses globally that have placed restrictions on populations and communities. People have had to adjust to life under these new conditions, both in terms of their health and retail behavior.

The availability of vaccinations, to provide the community with an element of protection from the virus, will result in a return to more normalized social activity. The consistent work we have done to build our capability to offer healthcare services via pharmacy is highlighted by the resources we are able to bring to bear, particularly in the U.S., to support the government initiatives for provision of both COVID testing and vaccination from customer identification and recruitment through to scheduling, providing the service and offering a comprehensive follow-up.

The pandemic has demonstrated very clearly the importance of one of our key strengths, in being a convenient healthcare provider in the heart of the community. Our capabilities in this area have been significantly enhanced by the investment we have made to date in the acceleration of our digital strategy and the expansion of our healthcare services.

We have transformed the data infrastructure of our businesses and combined it with enhancements in our fulfillment capabilities. As a result, we now provide a modern and flexible customer offering that is both multichannel and a truly personalized service. Through the pandemic, we have also materially improved the capacity of our systems. Today, a sizable amount of our business is transacted digitally and fulfilled via pickup, either in store at the drive-thru via curbside collection or home delivery. In the months to come, you will hear a lot more from us about our new digitally enabled products and services as we continue to invest in accelerating our program to update our customer offering, infrastructure and fulfillment capacity.

We have also continued to look at how we best focus our resources and assets to the greatest effect. You have seen this clearly in some of our recent announcements. We have just announced a significant transaction with our long-standing partners, AmerisourceBergen, to sell them our international healthcare distribution business, Alliance Healthcare. This is a great transaction for both businesses that will drive growth for each company without losing any of the benefits we have delivered already from our work together. It significantly enhances the range, scope and scale of ABC's network in what is increasingly a business driven by scale and reach. While Alliance Healthcare was always a very important part of our company, our focus must be on delivering against the significant opportunities we have in our Retail Pharmacy business. The transaction positions Alliance Healthcare as key part of ABC, a company dedicated to and focused on its area of business and its true expertise.

For WBA, it relieves both management time and resources, which can be focused on and invested in further accelerating the development of our core Retail Pharmacy businesses. Importantly, the transaction secured an attractive multiple for a high-quality business. We will employ the proceeds to reduce debt and accelerate the development of our healthcare services.

We have been able to begin this work almost immediately, using some of the funds to accelerate our investment in VillageMD. This will facilitate a significant acceleration of the growth of their own business, including a faster deployment of clinics within our stores.

Looking forward, we are still early in the financial year. However, we remain cautiously optimistic for the year as a whole. There is no doubt we have many opportunities ahead, but these opportunities may in part be tempered by the risk of further short-term disruption from continued and new restrictions and lockdowns, as communities continue to struggle to contain the spread of the virus while vaccination programs take place.

I would stress, however, that the issues are short term and may impact the next few months, while the opportunities we see stretch forward for years to come. Overall, this first quarter of the financial year has been a strong quarter for the group and an excellent start to what has the potential to be a better year than we expected.

With that, I will ask James now to take you through the results.

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

Thank you, Stefano, and good morning. Our first quarter performance was better than expected, as we delivered improved operational performance across a number of fronts. In particular, we exceeded expectations in Boots UK and Boots Opticians.

Adjusted EPS was $1.22, 11.6% lower than prior year on a constant currency basis. The year-on-year decline was entirely due to an adverse COVID-19 impact of $0.26 to $0.30. Overall, our markets encountered a widespread surge in COVID-19 incidences. And as a result, we saw increased restrictions or lockdowns across those markets. We estimate a COVID-19 AOI impact of approximately $290 million to $325 million, and this was worse than the guidance range of $250 million to $300 million we provided earlier. Nevertheless, the impact was much lower than the third and fourth quarters of last year.

In summary, we are actively managing the challenges and remain confident of delivering strong growth in the second half of the fiscal year. Cash generation was strong in the quarter with free cash flow of $763 million, 13% higher than prior year. And finally, we are maintaining our full year guidance of low single-digit growth in adjusted earnings per share on a constant currency basis.

Let's now look in more detail at the results. First quarter sales were up 5.7%, including a currency tailwind of 0.5%. On a constant currency basis, sales advanced 5.2%. Adjusted operating income declined 10.1% on a constant currency basis, reflecting higher-than-expected COVID-19 impacts of approximately $290 million to $325 million, offset in part by a stronger underlying business and good cost management.

Adjusted EPS was $1.22, a constant currency decline of 11.6%. A higher tax rate negatively impacted EPS by around 8 percentage points, and this was only partly offset by a 2.7 percentage point benefit coming from a lower number of shares outstanding. GAAP EPS went from $0.95 in 2020 to a loss of $0.36 in 2021, entirely due to a $1.73 charge within the company's equity earnings in AmerisourceBergen.

Now let's move to Retail Pharmacy USA. Sales increased 3.9% in the quarter, with 5.9% growth in pharmacy, partially offset by lower retail sales. Both retail and pharmacy continue to be adversely impacted by COVID-19, including lower foot traffic, significantly lower flu incidents and a reduction in new-to-therapy prescriptions due to fewer doctor visits and elective procedures. Despite a benefit from flu immunizations, the overall negative revenue impact was approximately 100 basis points in the quarter.

Adjusted gross profit declined 1.8%, with lower pharmacy reimbursement partly offset by procurement savings and a higher retail gross margin. Adjusted SG&A spend increased 1.4% in the quarter and was 17.2% of sales, an improvement of 0.4 percentage points versus prior year. The increase in SG&A was driven by higher growth investments and COVID-19-related costs of over $80 million. Adjusted operating income declined 14.4%, reflecting an adverse COVID impact of $200 million to $220 million or around 18%.

Now let's look in more detail at U.S. pharmacy. Total pharmacy sales increased 5.9% versus prior year, reflecting lower generic utilization, script growth and 13% growth in central specialty. Comparable pharmacy sales were up 5%, and comp scripts grew 2.7%. COVID-19 negatively impacted script growth by around 210 basis points.

Doctor visits remained significantly lower than pre-COVID-19 levels and a much weaker cough, cold, flu season led to a 25% decline in seasonal flu scripts. Market share for the quarter was 20.7%, down 15 basis points versus prior year, entirely due to our store optimization programs. Adjusted gross profit decreased low single digit, as the favorable impact of procurement savings and script growth was more than offset by reimbursement pressure.

Turning next to our U.S. retail business. Total retail sales declined 2.2% in the quarter, impacted by our store optimization programs. Comp retail sales increased 0.4% and excluding tobacco and e-cigarettes, comp sales were up 1.9%. In comp stores, health & wellness grew 4.1%. Excluding cough, cold, flu, which was a headwind of around 150 basis points on total retail store comps, our health & wellness business was up 11.6%. Beauty declined 13.1%, reflecting a category that is heavily impacted by COVID-19, noncomparable promotions and a high level of competitive intensity. Gross profit declined slightly, with lower sales partly offset by an increase in gross margin of 70 basis points, driven by supply chain efficiencies and reduced seasonal clearance costs.

Turning next to Retail Pharmacy International and as usual, I'll talk to constant currency numbers. Retail Pharmacy International continued to be negatively impacted by COVID-19, with higher incidence rates and additional lockdowns across a number of geographies. Encouragingly, despite renewed restrictions in November, the business outperformed expectations and continued to deliver sequential performance improvement.

Sales declined 8.2% in the quarter, a good improvement on the fourth quarter decline of 15%,it shows our ability to adapt and respond to the latest market conditions. Gross profit declined 11.5%, with a favorable NHS pharmacy timing benefit, partly offsetting lower retail revenue and higher fulfillment costs.

The gross profit decline was mitigated in full by decisive short-term cost mitigation and the benefits flowing from the transformational cost management program. This led to an adjusted operating profit of $84 million in the first quarter, up 0.6% versus prior year, with both Boots UK and Opticians performing well ahead of our expectations and offsetting an estimated COVID impact of $90 million to $110 million.

Let's now look in more detail at Boots UK. Footfall remains well below last year, particularly in the major high street and travel locations, where Boots has a prominent store presence. Despite a second national lockdown in the 4 weeks to December 2, retail store transactions improved slightly in the quarter, down 40% year-on-year compared to a 47% decline in the fourth quarter. Lower footfall is partly offset by bigger baskets, with basket size up over 20% in the first quarter.

Comparable pharmacy sales increased 2.5%. Lower demand for scripts and services reflecting reduced footfall, especially in city centers, was more than offset by favorable phasing of NHS funding. Comparable retail sales declined 9.1%, a sequential improvement from the 17.5% decline in the prior quarter, benefiting from targeted marketing activities, our strong reputation on the U.K. high street and an exceptional performance from Boots.com.

Gross margin remained under pressure, while we saw favorable phasing of NHS pharmacy funding, it was not enough to offset higher retail fulfillment costs due to the substantial growth of Boots.com, though, here again, we are pleased with the solid progress we have made this quarter.

The recovery in our U.K. opticians business has been faster than we originally expected, due to more flexible regulations and significant pent-up demand.

Turning now to our priority initiatives. As we said last quarter, one of our top priorities is to turnaround Boots UK and return it to profitable growth. The strength of the Boots brand is a central pillar supporting our recovery, and the Boots UK team continues to take swift and decisive actions on both sales growth and cost reduction.

Our store-based online fulfillment model, which we call hybrid stores, is now operating in 121 stores, and in November, supported over 30% of all online orders. This is an excellent example of leveraging our store estate to deliver a flexible, timely and scalable distribution solution.

November online [orders] (corrected by company after the call) almost doubled year-on-year, our largest ever seasonal sales period. And with sales growth of 106% in the first quarter, Boots.com accounted for 23% of our total U.K. retail sales. In-store investments continue at pace and are targeted at enhancing the customer experience.

During the quarter, we rolled out new No7 counters and fixtures in almost 650 stores and launched a new photo offering in more than 850 stores. We continue to play a key role in the community, with our largest ever flu vaccination season, and we have now completed over 2.1 million COVID tests for the NHS.

Turning now to the Pharmaceutical Wholesale division, which I'll also discuss in constant currency. Pharmaceutical Wholesale delivered another strong set of results, with sales up 16.3% versus prior year. The completion of our joint venture transaction in Germany on November 1 boosted sales growth by 8 percentage points, but excluding this, the sales growth was a healthy 8.3%, led by emerging markets and a one-time PPE contract in France. Adjusted operating income increased 7.4%, mainly reflecting the strong sales growth and a higher contribution from AmerisourceBergen.

Turning next to cash flow. Free cash flow was $763 million, up $90 million on prior year, or 13%. Our key working capital initiatives are on track. We continue to remove excess inventory and extend payment terms to more optimal levels.

Let's turn now to our Transformational Cost Management Program. We are well on track to deliver in excess of $2 billion in annual cost savings by fiscal 2022. We have now closed 232 of the 250 Walgreens stores targeted for closure, and we have completed 158 of the 200 Boots UK stores. We expect the store optimization programs to be mostly completed by the end of the current fiscal year. On smart organization, Boots UK is ahead of plan.

Following the third quarter announcement to reduce the Boots UK workforce by 7%, we are on track with the implementation and now expect a workforce reduction of nearly 11% or 6,500 positions. We are quickly advancing our BPO partnership with Genpact, actively transitioning finance activities across a number of markets. Our digital transformation initiatives are progressing well, and we recently announced a strategic partnership with Verizon in the U.S. Verizon will provide Network as a Service across all our 9,000-plus stores, enabling more seamless and personalized customer experiences.

On Smart Spend, we reselected WPP as our global marketing and communications partner. And the new agreement will unlock improved marketing capabilities and additional operational efficiencies. On divisional optimization, we continue to gain momentum in key programs, such as pharmacy cost to fill. We have created a new lower cost administrative role to remove routine administrative tasks from our pharmacists, and we also rolled out systems enhancements to further automate electronic prescriptions.

In summary, we are aggressively tackling our cost structure, and we continue to identify new opportunities to deliver savings across all areas of spend, and that will free up the funds needed to invest in future growth.

Let's now turn to guidance. When we provided fiscal '21 guidance back in October, we clearly highlighted that the opportunity from vaccinations could be required to counterbalance the risk of a second wave of lockdowns. You have seen the sharp increase in incidences across most markets. As such, given the fluidity of the situation, we are maintaining our prior guidance, but we do recognize that our profile is now tilted more to opportunity.

While we are very encouraged by the strong start to the year, we do expect a weaker second quarter due to higher COVID-19 impacts, including a significant decline in the cough, cold, flu season. Nevertheless, we do expect our first half EPS delivery to be broadly in line with the expectations we set back in October.

On a full year basis, the opportunity from the distribution of vaccinations is likely to be offset by COVID-19-related lockdowns and restrictions and by increased growth investments. Given the strong start to the year, we are selectively ramping up growth investments across both omnichannel and healthcare.

In summary, a good start to the year, and we are confident that we will deliver strong growth in the second half of the year and deliver or exceed our full year adjusted EPS growth target. As you have seen in our press release yesterday, we are selling our Pharmaceutical Wholesale business to AmerisourceBergen. This is a multifaceted transaction that unlocks significant value for both parties. The transaction includes an extension of our existing U.S. distribution agreement by 3 years, and we have agreed to explore operational synergies between our respective U.S. businesses.

Importantly, we have secured an attractive exit multiple of 12x adjusted EBITDA. We expect the deal to be accretive to adjusted EPS in the longer term, but mildly dilutive to fiscal 2021 by approximately $0.02. The cash proceeds will be deployed to boost healthcare investments and pay down debt.

Let me now bring you through the transaction highlights. Gross proceeds are approximately $6.5 billion, with the majority of the consideration in cash. We expect after-tax cash proceeds of over $6 billion and a one-time after-tax gain of approximately $1 billion. The business we are divesting has sales of around $19 billion and adjusted operating income of approximately $475 million.

The transaction perimeter excludes our newly formed German joint venture with McKesson as well as all of our equity method investments in China, but the deal perimeter does include small retail businesses in The Netherlands, Norway and Lithuania. We expect the transaction to close later in our fiscal third quarter, and the divested businesses will be reclassified as a business held for sale in our second quarter 10-Q.

Let me now hand you over to Alex.

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

Thank you, James. Before I highlight the progress on the strategic priorities and continued transformation, I must express my sincere gratitude to the hundreds of thousands of Walgreens associates across the country. They continue to provide essential pharmacy services and health and well-being products to their local communities during what has been an extraordinarily difficult time, facing challenges we've never experienced before, while putting the safety of our patients and customers first. Walgreens continues to provide clarity during uncertain times, and this quarter's results show the strength of the Walgreens brand, people and organization.

Today, I'll update you on some of the significant progress we've made in modernizing our pharmacy to create a more customer-focused and healthcare-driven offering, while transforming our retail business, all powered by our investment in digital capabilities.

I'll begin with pharmacy. We're accelerating our investments to modernize our pharmacy operating model, and we're starting to unlock the benefits. We are improving our processes, and we're increasing automation to free up our pharmacists' time, allowing them to provide more value-added healthcare services to our patients and customers. This model will also reduce working capital, while freeing up cash to further accelerate our transformation of Walgreens.

We have grown our pharmacy services rapidly since we last spoke to you, further validating the future role that the pharmacist can play. We have administered more than 2.8 million diagnostic COVID tests since testing began, and we are well on our way to being able to offer COVID testing in over 3,000 of our stores by the end of this month.

We are also very excited to be part of the COVID recovery and healing process as part of Operation Warp Speed. On December 18, we began administering vaccines to high-risk elderly individuals in long-term care facilities and medical care providers and we have plans in place to provide vaccines in over 35,000 long-term care facilities in 49 states as part of Phase 1A of the national COVID response. We are also well into the planning of Phase 1B, which is anticipated in most states to cover the over 75s, essential workers and people with certain chronic health conditions.

Today, we have over 30,000 qualified healthcare associates ready to deploy to the mass COVID vaccination program and we are in the process of growing that number to over 45,000 in the next 3 months. We have the storage and infrastructure in place to facilitate our role in the mass COVID vaccine program. We have the capacity, and we're ready to vaccinate tens of millions of Americans.

Our Find Care platform, which connects patients to telehealth providers, has grown exponentially, driven in part by the pandemic. In the quarter, traffic to the site increased 13x versus last year to over 18.9 million visits. We also continue to develop our physical healthcare locations alongside our digital offering to provide a broader range of healthcare services to our patients and customers.

In December, we announced plans for 40 new Village Medical at Walgreens clinics to open by the end of the summer in Texas, Arizona and Florida. And we have just announced that we are now accelerating our plans with VillageMD to open at least 600 Village Medical at Walgreens clinics in more than 30 markets. As you can see, there is a huge amount going on in our pharmacies and as Stefano mentioned in his opening comments, you will hear a lot more about this in the coming months.

Turning next to our retail transformation. As you know, we are executing an extensive program of modernization across the company, driven by a holistic omnichannel and customer experience strategy. We are unlocking the 100 million Walgreens loyalty members' data through implementing new digital tools and analytical capabilities via Microsoft and Adobe. We accelerated this process further during the quarter. We're harnessing our data to develop a new way of marketing through our mass personalization strategy, which has already boosted retail sales by 155 basis points in the quarter. And we are rolling out myWalgreens, our new loyalty program, redefining convenience and customer engagement.

We launched myWalgreens in November. It is the most visible customer-facing part of the strategy to date. It offers new loyalty benefits, a refreshed health and wellness-focused brand, with personalized products and services for all members. Approximately 40 million customers have already joined the program to date, and we are actively driving membership further in 2021. Over time, we anticipate that myWalgreens will become a vehicle for very targeted and personalized promotions and will play a key role in updating our customer proposition.

On the theme of convenience, we have acted swiftly throughout the pandemic to give our customers access to Walgreens' products online. Orders placed through Walgreens.com or via the app can now be picked up in store, at curbside or drive-thru, in as little as 30 minutes. We believe this makes Walgreens the fastest same-day retail pickup on a national basis. Over 1.7 million retail pickup orders were completed since launch in November. Total retail digitally initiated sales were up over 40% as a result of all the progress we are making, and we believe this will only continue to grow.

In summary, despite the tremendous challenges created by the pandemic, our team has worked tirelessly to adapt to the new market realities and ensure our patients and customers have access to healthcare, retail products and services where and when they need them.

I will now hand you back to Stefano for his closing comments.

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

Thank you, Alex and James. As you have heard, it has been a very busy time for the company. We have achieved a great deal already in the year, and the pace of work is not slowing. What we are doing is completely transforming our company to bring us greater focus and to concentrate our investment of time and resources where we can achieve most. We are doing this without losing any of the financial benefits we have delivered over the years, in terms of efficiencies or synergies.

In a time when there has been much uncertainty and noise, we have pursued a consistent and deliberate plan to modernize our company, our businesses and our customer offering. What you are seeing from us now, have seen in recent months and will see much more of in the coming months, is the output of a lot of hard work within the company.

But it was just the beginning in terms of our plans, in both the application of technology in our business and the delivery of health services through our network. I know there is understandable interest in who I will be handing over the role of CEO to, when and what direction that person will take the company in. Despite the added complexity that restrictions in travel and communication have created in the recent months, the Board have been very active in their search for the right candidate for this role, and I am hopeful we will have news to share with you about my successor soon. It has been a huge privilege to lead such great businesses and work with such a dedicated and talented team of people across so many countries and companies.

Of course, I very much look forward to working with the new CEO to ensure a smooth and effective handover and deliver long-term growth and a prosperous future for the company. I am pleased to be in a position to hand over the reins as the company is facing so many opportunities and has such positive momentum.

The progress we have reported today and the work we have done to modernize the company and build an infrastructure that is both flexible and robust reassures me. I will be handing the role over at a time when my successor will have all the tools they need as well as my full support and assistance to drive the business to deliver continued, reliable and consistent growth looking forward. Thank you.

We will now take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Ricky Goldwasser from Morgan Stanley.

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

My question is focusing on the divestiture of the wholesale segment. And it's a 3-part question. So one, is there any strategic rationale of keeping some of the market to Germany, Italy and China? And then as we think about the new portfolio, you have the relationship with VillageMD and with LabCorp, are there any other healthcare areas that you are looking to invest in? And how important do you think is an anchor payer relationship as you think about the strategy?

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

Well, Stefano here. I have to say that the strategy rationale -- we have had a very long relationship with AmerisourceBergen. I have met 3 of the Chief Executive, probably people you don't remember, like McNamara or David Yost or now, of course, Steve Collis. And we have always discussed doing something together.

In reality, the first tangible signal that we were able to achieve was during our merger, the merger of Alliance Boots with Walgreens, the -- an agreement that was allowing Walgreens to take a stake in ABC and was granting ABC a long-term contract, 10-year contract, for Walgreens. This has been really a physical and important relationship, which has gone through very well. And our relationship, which was already very good, have become better and better.

And in these years, we have spoken many times of putting together our wholesaling business and in the market, you have heard here and there something. And we have analyzed all the possible -- the possible combination, us buying them, them buying us, merging. And now we have come to a point where we have, even due to the acceleration of COVID, we have really decided that this was the right time to concentrate on our core business of the pharmacies and to sell our wholesaling business to them. And as the wholesaling business is a very good business, our wholesaling business, of course, it has commanded a good price.

And so I believe that now both of us have done a good deal. We have the money to repay some debt and above all to invest in our core business, particularly in the U.S., but also in U.K. And they have the possibility to get a global business.

This is -- the second question is VillageMD, if we have other targets? Yes, we have other targets. Of course, we cannot talk too much about it. But one of the reason why we are happy now to have additional cash is because we have a target. And of course, we will invest in our own business, as Alex was saying before, and maybe we'll reiterate after. But also we have a target to buy.

You had the third question, which one, sorry? Germany. Germany. Germany. It's an obvious question. Germany, we have a joint venture with McKesson. And so we have done this deal without talking to our people, of course. But the real reason is that Germany, the merger that we have done with McKesson in Germany will deliver a lot and lot of synergies. We are talking of many, many tens of million of synergies, we believe. And so the business will have a different value in 3 or 4 years when we will have been able to deliver all these synergies. And so of course, we have to keep develop the synergies. And after, we will see what to do.

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

And Ricky, it sounded like you -- on the anchor point, we're still a very open ecosystem, working closely with all of our commercial partners, payers and of course, PBMs. And that is still our strategy at this point in time.

Operator

Your next question comes from the line of Robert Jones from Goldman Sachs.

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

I guess maybe just on the VillageMD strategy. Clearly, this seems like the strategy to kind of transform the company more towards healthcare. I know you talked about taking some of these proceeds and now targeting 600 to 700 over 4 years. I believe the old target was 500 to 700 over 3 years. I know there's probably a lot of differences in cadence there. Can you maybe just talk about the time line of the rollout? And I guess, more importantly, how quickly can you get to enough stores where you think it really could start to matter to the economics of the business?

Obviously, you have a large store base beyond just hundreds of clinics. And so just really curious kind of what pace we should be thinking about? And how this could really impact the overall financials of the company? And anything just on a store-by-store basis to help us think about a Walgreens with a VillageMD? And what that could look like versus a Walgreens without a VillageMD?

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

Yes. I'll take a shot, it's James here, first. I just want to put some perspective on around the deployment of funds. I think, yes, they will principally be focused on healthcare. And VillageMD is just the first example, and we expect a number of moves over the coming weeks and months. And we won't be measuring this in years, we'd be measuring it in months.

VillageMD, if you take it as a specific, is, it's got 2 dimensions to it. It's not just the contribution to the business, where it is -- helps us to become relevant in as a location in reducing healthcare costs over time, that's got one financial return, and it's got an overall benefit of improving the ability of Walgreens to influence healthcare longer term.

The other one is, don't forget, it's a financial investment as well. And we are actually strongly encouraged by what we're seeing in the stores. We're hitting NPS scores of 90%. And as we stared at the performance, we decided this was the time to accelerate the investment. We believe VillageMD is, just even as a financial investment of 30%, is extremely attractive and it's getting more attractive by the day. So we're inclined to view this 2 ways. One is the financial investment; and two is, integral to the core premise, which is improving the cost of healthcare.

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

Robert, just one build on that point, is the cadence. We announced 40 the rest of this year. So we're increasing the cadence as we get going here. And so therefore, it's -- the length of time we're doing this over has stayed the same. So we'll clear up that point. It's going to be 600 in the same length of time as the 500.

And beyond that, also remember, we're integrating digitally as well, particularly around the pharmacy business and the way that all of the pharmacists works with the doctors. And extending the scope of practice of pharmacy is now a real possibility in many states, and we believe this model will be advantaged in that situation as well.

The last thing I would say is that remember that VillageMD also managed many risk-based contracts, almost 20%. I think that will be a bigger business. And therefore, you can imagine working with them closely on risk-based contracts as another opportunity in the future.

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

Don't forget also that VillageMD has also clinics outside our pharmacies, the clinics they're there or the clinics they buy because they are quite an aggressive buyer. And of course, this is another synergy for us because they are trying to organize, coordinate these clinics that they have with our pharmacies. Even if they are not physical in our pharmacies, there is a coordination. And part of the money that they have will be used for sure to buy additional clinics.

Over time, we will try to really relocate as many as possible of these clinics into our pharmacy. But even if they are not in our pharmacies, they are coordinated with our pharmacies.

Operator

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

Elizabeth Hammell Anderson - *Evercore ISI Institutional Equities, Research Division - Associate*

Congratulations on the deal that was announced yesterday. I have a question on the core business. I was wondering if you could provide a little bit more details on how you see the cadence of gross margin progressing as we go across the year, maybe particularly in the U.S. business, but then for WBA as a whole?

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

James here. First of all, we were actually pleasantly surprised in the first quarter in the U.S. Margins were pretty robust on the pharmacy business and, I would say, slightly better than we would have anticipated. And as usual, some of that is always timing, but we had a pretty good start to the year, it's promising.

And correctly so, you highlighted there will be a first half, second half to mention here. So you could look at the first quarter and second quarter as being the low points of the year in terms of margin. And the second half, the margins rising. But the strength in Q1, and you've obviously seen, is broad-based. And I do want to -- I'll take this opportunity to highlight that. We had overperformance in all of the divisions at a moment when actually the COVID impacts across the business were higher than we anticipated. And at the same time, we slightly increased the pace of the investments we're making, particularly in the U.S. business.

So we're actually -- we -- I would say in the U.S., retail was slightly weaker, but the retail margins were better than we expected. And then on pharmacy, the scripts were weaker because of COVID, but the margins were better. So I would say, in general, we were pleasantly surprised by the upside, particularly in the U.S. in Q1.

Operator

Your next question comes from the line of A.J. Rice from Crédit Suisse.

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

Thanks for the comments on the vaccine. I might pursue that a little more. I think you're saying that that's one -- the vaccine outlook is part of the reason why you're maintaining the low single-digit outlook in spite of the lockdowns. Is there -- do you have updated thoughts on the economics of the vaccine to you? Also maybe thinking about it in terms of right now, you're mainly helping in the long-term care facilities. But obviously, at some point, I assume there'll be some administration in the retail? Do you have any sense of the timing on that? And how's that -- the economics of that versus what you're doing in the long-term care facilities?

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

Listen, I'll take a shot at that. And you're right, your first comment was dead on. And I mentioned we've seen COVID impacts in Q1 about $15 million more negative than we expected. And we expect to see the same in Q2. And we're actually -- we can't predict this, but we expect COVID core impacts mostly coming through a tough cough, cold, flu to be about $200 million negative. And we do expect that to be offset by vaccinations and other opportunities. So the base business is also doing better.

Just on the economics, that's commercially sensitive, we don't want to provide it. But I'll give you one insight. So in the second quarter, when you would expect the contribution from vaccinations, and we have a contribution, we have no profit upside coming from vaccinations. So the administration of vaccinations to care homes is not a particularly profitable business. It's extremely labor-intensive, and the costs are incremental. But that's part and parcel of what we have to deliver as prominent member of the healthcare community.

That being said, the vaccines will be accretive to the profile in the second half of the year. And that's why we're relatively -- we did change the tone of our guidance, if you like. We confirmed low single digit. But please don't lose the sentiment of the last part of that phrase was, "and the profile has tilted to opportunity." So we don't have brilliant visibility to the availability of stock on vaccination. So there's a large amount of uncertainty. However, with the pieces of the puzzle we know, we believe we have opportunity in the second part of the year. So maybe, Alex, if you want?

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

Sure, yes. AJ, I think, as James had said, look, we've really invested upfront here appropriately, in my view, to make sure that we are ready to get these vaccinations out as fast as we possibly can. And you saw our press release yesterday morning, which states that we've got all of our long-term care facilities now actually ready to be administered with the first dose by January 25, I think it is. So we feel that we are -- we don't feel, we know we're on track with what we committed to do. And we're also on track with resourcing up the pharmacists and the pharmacy technicians and retraining a number of pharmacy technicians to be able to administer those. And our teams are really motivated to get this done. So we're really in really solid shape to administer the vaccines in the more complicated long-term care facilities.

Let me go back to being able to administer these vaccines inside of our facilities, which happens in Ib, and that really starts about now. We are very confident that we'll be able to speed and be able to keep up with demand and therefore move forward.

The whole program, I believe, will accelerate as we go through the spring. That's all that we're hearing from the new administration, in particular. And we're in close contact with both Operation Warp Speed and the incoming Biden administration to make sure that we are ready to do our job for America and also to make sure that we do it in the most efficient way for our shareholders as well.

Operator

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

Michael Aaron Cherny - *BofA Merrill Lynch, Research Division - Director*

I think following up, James, on that last line of commentary regarding the way you view opportunity. I'm hearing clearly the potential if the vaccination process accelerates at a faster clip than expected. But how else do you think about the puts and takes of that -- of the drivers of opportunity? And especially, how do you balance them against the trade-off you're making in the growth investments versus the potential for any cost ramp down or cost adjustments tied to the current spend you have around COVID that's impacting the overall profitability?

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

Yes. I think if you look at the full year and just simplistically say, you've got 2 big positives. One is vaccinations. And the second one is, we had a really strong start to the year. And it was largely driven by operational execution, really strong in the U.K., Ireland opticians and a positive start, especially to the pharmacy business in the U.S. And actually wholesale came in above plan as well.

So we actually have everybody on all the cylinders. The big negative and the big question mark, and it's the reason why we basically maintained guidance is, we actually have a lockdown in the U.K. right now that runs through the middle of February. Now we think we're much better at managing through a lockdown now, which is good. But still, it is a cloud in the future.

And then secondly, you see the large number of incidences in the U.S. That does pretty quickly drive through to lower medical visits. So in December month, the medical visits are worse than they were, on average, in the first quarter. So we're just being cautious in saying, "Hey, the big opportunity -- the opportunity on vaccination will offset the negative on COVID", with a really strong start to the year, and we are actually already reinvesting some of that.

So we're taking -- when you think about the whole deal that was announced yesterday, it's a catalyst for accelerating change if you think about it. So we're going to -- we've accelerated some of the omnichannel investments in the U.S. You've seen myWalgreens go out there. You've seen us get the curbside up in 9,000 stores. We're driving at a pace that is quite fast.

I think over the next 6 months, you'll see increasing investments in healthcare, with probably a skew to tack-on acquisitions focused on generating synergy with the pharmacy business and with a very technological bend to it. So there's going to be a lot of news on the way.

So I think you have to balance vaccinations versus COVID adverse impacts and then, simplistically, a very strong start to the year, which gives us additional confidence to increase investments in the coming months. And it's as simple as that. It's not any more complicated than that. That's the way we're thinking about it. But we did add in to the overall guidance that skew to opportunity, and I don't want that to be lost to the community on the phone.

Operator

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

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

Building on that commentary, can we speak to the E.U. pharmacy? And specifically, the return to profitability was encouraging. It sounds like much of this is cost mitigation or cost management, but clearly, some NHS timing and benefit? How should we think about the continued contribution from NHS? And I think that really comes down to, is what we've seen this quarter sustainable moving through the year?

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

Yes. The overall impact of the NHS funding, I think, was -- like it's in the region of $15 million. It's not a huge number, but it did give a favorable margin contribution in the quarter. And that's a little bit -- there's always a timing issue on when this stuff gets recognized in the P&L.

So it added about $15 million of positivity. I think the biggest trend in the U.K., I think, if you look at the overall segment, I'll give you 2 numbers. The gross profit was down 11% because footfall is still very weak in a lot of markets. But our e-commerce business, in general, across in international, is on fire. So the U.K. was up 106%, and we make nice margins on our e-commerce business in the U.K. and in Ireland.

So we're getting this -- and the second positive dimension is, overheads in the first quarter were down 12%. So as when -- you think about it this way, a high fixed cost structure, when COVID hit us at the end of last year, has a significant impact on the segment's profitability. But as we start to recover from COVID, the significant and quite decisive cost reductions taken will dramatically improve the leverage going forward. So there will be a fairly -- I think Q2 is a wait-and-see kind of moment in the U.K. There will be quite a lot of lockdowns.

And then when you get to the second half, there will be significant growth in the second half. But I think we told -- mentioned this before, we see the recovery in the U.K. over an 18- to 24-month period. And you could almost draw a straight line between the pre-COVID profitability and 2 years from now and estimate what the segment will look like at the end of this year.

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

And we are adding a lot of capabilities to deliver online.

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

Yes. So...

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

And also investing to create not a new warehouse, but to increase dramatically the size of the warehouse that we have dedicated to this. And so overall, we will be able to follow the trend of the online. And we see that the reduction that we have had overall in sales in this lockdown compared to the lockdown that we had a few months ago, now we are much better. Of course, we are suffering, but much less because the ability that we have to deliver online is definitely higher. And we have also found a way, as James was saying, to have a decent margin on these sales.

Operator

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

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

Actually, it's 2 quick questions, and they're basically housekeeping questions. Number one is, could you quantify what U.S. script growth would have been ex flu vaccines? And number two is, can you remind us of the split of pharmacy revenue versus non-pharmacy revenue in the Boots business? If I remember right, it tended to skew closer to 50-50 as opposed to the 75-25 split in the U.S.?

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

So I can -- from memory, particularly, I can take the second one. It's about 2/3 front-end, 1/3 pharmacy in the Boots business. And in terms of the first question, obviously, it's been a really strong flu season, around about 40% increase in flu. But it really is still the core business that drives the scripts. So the numbers that James gave in his prepared comments of underlying comp growth of 2.7% is primarily driven by the core business.

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

Yes. And bear in mind that the 2.7% is after what we estimate a negative COVID impact of 210 basis points. So I'd almost ask the question in a different way. If you didn't have COVID, what would your script growth would've been? And it would have been in the 4.5% to 5% range. And the vaccinations were stronger in Q1, but it didn't have a material impact on the result.

Operator

There are no further questions at this time. I will turn the call back over to the presenters.

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

Thank you. I'm aware that not everyone who wants to do got to ask a question. As ever, we are out of time. But if anybody didn't get to ask questions, the IR team are here still. So please come through to us by e-mail or phone, and we'll be happy to answer you. Thank you very much, indeed. We look forward to speaking to you next quarter.

Operator

Ladies and gentlemen, this concludes today's conference call. Thanks for participating. You may now disconnect.
