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WBA.OQ - Q2 2023 Walgreens Boots Alliance Inc Earnings Call

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OVERVIEW:

WBA reported 2Q23 YoverY constant-currency sales growth of 4.5%, GAAP net earnings of $703m and adjusted EPS of $1.16. Co. is maintaining FY23 adjusted EPS guidance of $4.45-4.65.

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PRESENTATION

Operator

Good morning. My name is Rob, and I will be your conference operator today. At this time, I would like to welcome everyone to the Walgreens Boots Alliance Second Quarter 2023 Earnings Conference Call. (Operator Instructions)

Tiffany Kanaga, Vice President of Global Investor Relations, you may begin your conference.

Tiffany Ann Kanaga - *Walgreens Boots Alliance, Inc. - VP of Global IR*

Good morning. Thank you for joining us for the Walgreens Boots Alliance Earnings Call for the Second Quarter of Fiscal Year 2023. I'm Tiffany Kanaga, Vice President of Global Investor Relations. Joining me on today's call are Roz Brewer, our Chief Executive Officer; and James Kehoe, our Chief Financial Officer; Rick Gates, Senior Vice President and Chief Pharmacy Officer at Walgreens; and John Driscoll, President of U.S. Healthcare, will participate in Q&A.

Today's call will be approximately 1 hour in length, including Q&A. Let me note that all references to the COVID-19 headwind include U.S. vaccines, drive-through tests and OTC tests. As always, during the conference call, we anticipate making projections and forward-looking statements based on our current expectations. Our actual results could differ materially due to a number of factors, including those listed on Slide 2 and those outlined in our latest forms 10-K and 10-Q filed with the Securities and Exchange Commission. We undertake no obligation to publicly update any forward-looking statement after this presentation, whether as a result of new information, future events, changes in assumptions or otherwise.

You can find our press release and the slides referenced on this call in the Investors section of the Walgreens Boots Alliance website. The slides in the press release also contain further information about the non-GAAP financial measures that we will discuss during this call.

I'll now turn the call over to Roz.

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

Thanks, Tiffany, and good morning, everyone. WBA has delivered a solid second quarter. Overall, results were in line with our expectations as a slow start earlier in the quarter was offset by a strong acceleration in February. The overall decline in adjusted EPS was against growth of 26.5% last year and again reflects the anticipated headwind from lower COVID demand and our investments in labor and the U.S. Healthcare segment. This is our final quarter of lapping last year's peak COVID contributions, and we are looking forward to accelerated growth ahead.

Second quarter sales grew 4.5% in constant currency. U.S. script volume growth exceeded guidance and our resilient retail business is successfully lapping record prior year performances. This was also a landmark quarter for our transformation to healthcare. We invested $3.5 billion to support VillageMD's acquisition of Summit Health, creating one of the leading independent provider groups in the country.

At the same time, we are taking decisive action to unlock value and strengthen the company by simplifying the portfolio. Our strategy is working. We are performing against our plans, and we will be relentless in driving continued progress ahead.

We are maintaining our full year guidance for adjusted EPS of $4.45 to $4.65 with good visibility into the key drivers of robust and accelerated growth in the second half. Importantly, the inflection is here. We are clearly pivoting to strong projected EPS growth in the mid-20s in the second half. I am very confident in our future, enabled by our execution and the bold investments we are making today.

We are making progress against each of our 4 strategic priorities. Let's start with the core business. U.S. Pharmacy comp scripts grew 3.5%, excluding immunizations exceeding our guidance of 3% growth and improving from 2.1% last quarter. Through our focused investments, we have returned an incremental 500 stores to normal pharmacy operating hours. Our market share trends are improving, and we saw 6% growth in stores with normal hours. While we have more work ahead of us to achieve our full year script recapture goals, I'm very encouraged by our momentum with strong acceleration into January and February. Our pharmacist team is supported by our 9 micro-fulfillment centers, which allow our pharmacists more time to focus on patient care and clinical services, expanding on the critical role they already provide in communities.

In Retail, U.S. comp sales, excluding tobacco, declined slightly. A very solid performance against the 15.7% growth we delivered last year. We achieved mid-single-digit growth after backing out the COVID OTC test headwind from last year's Omicron surge. The convenience and real value that Walgreens offers is resonating with consumers in a challenging environment. In fact, our comp accelerated to high single digits in February, while we also drove another quarter of margin expansion.

In our International segment, Boots had a stellar quarter with retail comp growth of 16% on top of 22% last year. The business achieved its eighth consecutive quarter of retail market share gains.

Now turning to our second strategic priority. We are accelerating the build-out of our healthcare growth engine. The addition of Summit Health is transformational. It creates one of the largest integrated provider platforms in the U.S., delivering quality affordable care for all patient populations regardless of insurance or payer type. This highly strategic transaction expands VillageMD's addressable market with primary care, multi-specialty and urgent care and reinforces our approach across the entire care continuum. Summit will accelerate the U.S. Healthcare segment to scale and profit. We see meaningful synergy potential over time with integration activities already begun.

We have also added our fourth payer partner for the organic business, Horizon Blue Cross Blue Shield of New Jersey and now have signed 5 clinical trials contracts. Shields Health Solutions and CareCentrix both continue to perform well, which led to the accelerated acquisition of both entities. Shields closed on December 28, and CareCentrix is scheduled to close this quarter. On a combined basis, our best-in-class assets drove pro forma sales growth of 30% in the quarter. Investments in this growth are funded through actions we continue to take to better align our portfolio and streamline the business. We've unlocked meaningful value fiscal year-to-date with over $3.6 billion in after-tax proceeds.

Our Retail Pharmacy business provides a solid foundation for our leading healthcare assets to deliver value across the full care continuum driving our long-term growth strategy. We are able to reach across both digital and physical channels to guide consumers through the complexities in healthcare. We are building the scale and resources to help health plans and patients improve outcomes and lower costs as only Walgreens can do. There are significant opportunities for synergies, allowing us to pursue value-based care and risk arrangements, which will demonstrate the importance of an integrated approach.

We are focused on expanding our risk business, supporting integrated care models, broadening our pharmacy value proposition and driving operational efficiencies. The combination of our best-in-class healthcare assets, a physical presence through our pharmacy footprint, our trusted brand and a scaled digital offering creates a platform that is unmatched in the industry.

Walgreens will increasingly be viewed as a partner of choice. We are uniquely positioned to engage consumers to manage their individual health and wellness whenever and wherever they need.

With that, I'll hand it over to James to provide more color on our results and our outlook.

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

Thank you, Roz, and good morning. In summary, we delivered a strong performance in the quarter. While we saw some favorable phasing, core operating performance was mostly in line with our internal expectations.

Second quarter adjusted EPS of $1.16 declined by 25.8% on a constant currency basis, and this was entirely due to a 26% headwind from COVID-19 vaccinations and testing. Strong retail performance in both the U.S. and International and sequential improvement in U.S. comp scripts more than offset 10 percentage points of headwinds from payroll investments in the U.S. and the expansion of our healthcare business.

Gains from a planned cash mobilization in Germany and sale and leaseback net gains in the U.S. contributed approximately $0.12 to adjusted EPS growth. However, this was entirely offset by reduced ownership of AmerisourceBergen of $0.05, prior year COVID-related onetime benefits in the U.K. of $0.03 and currency impacts and investment write-offs of $0.04.

Despite a slow start to the quarter, we delivered 4.5% sales growth on a constant currency basis with strong momentum exiting the quarter. February saw core sales growth up high single digits, more than offsetting weather-related challenges in December and a noticeable slowdown in respiratory virus cases in January.

Comparable sales in U.S. Retail Pharmacy were up 3.1%, despite lapping a very strong prior year comp of 9.5%. Comp script growth of 3.5% exceeded our guidance of 3%. International sales advanced 9% led by the U.K. Retail business, which delivered a 16% comp. And our U.S. Healthcare business continues to rapidly scale with sales exceeding $1.6 billion in the quarter and growing 30% on a pro forma basis.

So in summary, we had a solid quarter and based on the in-line performance, we are maintaining our full year adjusted EPS guidance of $4.45 to $4.65.

Let's now look at the results in more detail. Adjusted operating income declined 25% on a constant currency basis, and this was entirely due to a much lower contribution from COVID-19 vaccinations and testing, which led to a headwind of 28%. Labor investments in pharmacy and minimum wage were a 9 percentage point headwind, whereas the expansion of the U.S. Healthcare segment was an impact of 5 percentage points. The labor and healthcare headwinds were offset by strong performance across U.S. Retail and International. Excluding COVID-19 OTC test kits, U.S. Retail contributed 12 percentage points of growth and continued strength in international contributed 9 percentage points.

Adjusted EPS was $1.16, a constant currency decline of 25.8%, entirely due to a much lower contribution from COVID-19. GAAP net earnings were $703 million, a decline of 20% versus prior year. The current quarter included a $454 million after-tax gain from the sale of ABC shares and a $266 million after-tax charge for opioid-related claims and lawsuits.

Now let's move to the year-to-date highlights. Year-to-date sales increased 2.8% on a constant currency basis. Adjusted EPS was down 28% on a constant currency basis, mostly due to a much lower contribution from COVID-19 with an adverse impact of approximately 22%. GAAP earnings were a loss of $3 billion compared to net earnings of $4.5 billion in 2022. The year-to-date period included a $5.4 billion after-tax charge for opioid-related claims and lawsuits partly offset by a $1.4 billion after-tax gain on the sale of ABC shares. Additionally, we are comparing to a prior year period that included a $2.5 billion after-tax gain on the company's investments in VillageMD and Shields.

Now let's move to the U.S. Retail Pharmacy segment. Sales declined slightly in the quarter, reflecting a 3% drag from lower COVID-19 contributions and a 2.5% headwind from AllianceRx. The good news is that AllianceRx has now cycled through its contract losses and the COVID-19 headwind will lessen in subsequent quarters. Comp sales increased 3.1% and this comes on top of a very strong prior year comp of 9.5%. Adjusted operating income declined 32.8% year-on-year, broadly in line with our expectations. This was entirely due to a 29% decline from lower COVID-19 contribution and 10% from planned labor investments.

Ongoing reimbursement pressure was offset by retail gross profit growth and SG&A savings. We continue to expect AOI growth to accelerate in the second half, due to a lower COVID-19 headwind, less reimbursement pressure, favorable cost of goods sold timing and script recapture initiatives gaining traction.

Let me now turn to U.S. Pharmacy. Pharmacy sales increased 0.3% despite a 3 percentage point headwind from AllianceRx and 2 percentage points from lower COVID-19 contributions. Comp pharmacy sales were up 4.9%, lapping a 7.3% comp last year. Comp scripts were up 0.2%. We administered 2.4 million COVID-19 vaccinations in the second quarter, down a significant 80% versus prior year. And about 600,000 COVID-19 PCR tests down over 90%. Excluding immunizations, comp scripts grew 3.5%, exceeding our forecast of 3%. We are encouraged by the 140 basis point sequential improvement, driven in part by ongoing script recapture initiatives, including the return of an incremental 500 stores to normal operating hours.

As expected, adjusted gross profit and margin declined due to the lower contribution from COVID-19 vaccinations and testing and ongoing reimbursement pressure net of procurement savings. Pharmacy reimbursement was broadly in line with our expectations and represented a lower level of pressure compared to the prior year. Looking forward, we expect year-over-year growth in the second half as the COVID headwind lessens, script comps continue to build and second half reimbursement is less of a year-on-year headwind compared to the first half of the year.

Turning next to the U.S. Retail business. Overall, we were happy with the retail performance in the quarter, with good underlying sales trends and continued margin improvement. While Retail comp sales decreased 1% in the quarter, we were up against a record 14.7% comp in the prior year, which, as you will recall, included strong OTC testing volume related to the Omicron surge. Excluding tobacco, comp sales were down 0.5%, but on a 2-year stack basis, comp sales advanced by more than 15%. Looking at the quarter, lower sales of at-home COVID-19 tests led to a 500 basis point headwind, and this masked strong underlying trends, led by a 13% increase in cough, cold, flu, 9% growth in beauty and a 6% increase in consumables and general merchandise. We had a slower start than expected with December weather impacts leading to weak seasonal sales and some seasonal write-downs, and we saw lessening respiratory various cases in January.

However, February was very strong with high single-digit comp growth. Retail gross margin performance remained strong in the quarter, reflecting effective margin management including strategic pricing and promotional optimization and improved shrink.

Looking ahead, we expect a return to positive comp trends in the second half as we will be facing a smaller headwind from COVID-19 test kits, and we have meaningful opportunities to drive AOI growth from own brands, the myWalgreens loyalty program and strategic margin management.

Turning next to the International segment. And as always, I'll talk to constant currency numbers. The International segment continues to perform well. Sales increased 9% with growth across all International markets. Boots U.K. was up 11% and Germany wholesale grew 7.5%. Adjusted operating income was $352 million, up 66% versus prior year. Adjusted operating income benefited from $110 million in real estate gains from the planned cash mobilization program in Germany. These gains were included in our guidance at the beginning of the year, but were initially assumed to be more evenly split between the first and second quarters. Offsetting this, we are lapping COVID-19-related temporary benefits in the year ago quarter of approximately $40 million.

Excluding these 2 items, we estimate that core AOI grew by around 40%. This excellent performance was led by U.K. retail sales with a successful holiday trading season and strong operational execution in the Germany wholesale business. We are encouraged by our continued positive trends and looking ahead, we expect the International segment to deliver year-on-year AOI growth in the second half of 2023.

Let's now look in more detail at Boots U.K. Boots U.K. sales advanced 11%, led by continued strength in retail. Comparable pharmacy sales increased 2%, held back by lower demand for COVID-19 services. Comparable retail sales advanced 16%, which follows on from a 22% comp in the year ago quarter and benefiting from strong execution over the holiday season. Boots grew market share for the eighth consecutive quarter with gains across all categories, led by Beauty up 1.8 percentage points and consumables and general merchandise up 1.7 percentage points. Boots.com sales were up nearly 80% versus the equivalent pre-COVID period. Over 15% of our U.K. retail sales now come from Boots.com, up from approximately 9% in the pre-COVID quarter.

Turning next to U.S. Healthcare. The U.S. Healthcare business is rapidly scaling with VillageMD's acquisition of Summit Health and strong pro forma sales growth at VillageMD, Shields and CareCentrix. U.S. Healthcare sales exceeded $1.6 billion compared to $527 million in the year ago quarter. Pro forma sales growth was 30%. VillageMD delivered sales of over $1.1 billion, advancing 30% on a pro forma basis, driven by growth at existing clinics, expansion of the clinic footprint and Summit Health growth.

Excluding Summit, VillageMD grew 48% year-on-year. Shields continues to deliver with sales of $125 million and increasing 41% on a pro forma basis, driven by recent contract wins, including the addition of 3 new health system partners and further expansion of existing partnerships. CareCentrix sales were nearly $400 million with pro forma sales growth of 25%, driven primarily by new service offerings with existing partners.

Adjusted SG&A in the quarter increased by $177 million to $269 million, primarily due to the acquisitions of CareCentrix and Summit which were not included in the prior year quarter. Adjusted EBITDA was a loss of $109 million compared to a loss of $62 million in the prior year. This largely reflects the increased VillageMD clinic count and higher Walgreens Health organic investments, partly offset by positive contributions from Shields and CareCentrix.

Let's now look at some of the key metrics for the U.S. Healthcare business. At quarter end, the Walgreens Health organic business had 2.9 million contracted lives, up over 50% year-on-year as existing payer partners added new lines of business. As Roz mentioned, we've also added Horizon Blue Cross Blue Shield of New Jersey as our fourth payor partner. Under this agreement, we will provide preventative health and wellness services to a select group of Horizon's Medicare and commercial members. These services will be available at Walgreens Health corners and pharmacies across New Jersey, starting this summer.

VillageMD managed 806,000 value-based lives at quarter end, reflecting year-over-year growth of 38% in the legacy VillageMD business and the addition of 309,000 value-based lives from Summit. The total includes 177,000 full risk Medicare lives. VillageMD ended the quarter with 729 locations, including Summit Health and CityMD. The 403 clinics for the legacy VillageMD business compared to 270 at the end of the prior year period and included 210 clinics co-located with Walgreens, up from 94 co-located clinics a year ago. We are seeing benefits on the Walgreens side from our partnership with VillageMD. Roughly 50% of patients had co-located VillageMD clinics opt to get their prescriptions filled at Walgreens. VillageMD co-located sites that have been open for over 2 years are driving an incremental 40 scripts per site per day, and this is an increase of 35% versus prior year.

We will continue to build out our Walgreens Health corners as we add new lives and partners. We ended the quarter with 117 health corners, up from 47 a year ago.

In summary, we are moving swiftly to implement our vision, leveraging our integrated best-in-class assets and are excited with recent developments including signing another payer partner in the Walgreens Health organic business.

Turning next to cash flow. We generated over $1.2 billion of operating cash flow in the first half of '23, with free cash flow of $560 million. The year-over-year decline reflected lower earnings due to the COVID-19 headwind and increased capital expenditures related to growth initiatives. This was partially offset by ongoing working capital optimization.

Turning now to guidance. We are maintaining our full year adjusted EPS guidance. We delivered a solid first half, which was broadly in line with expectations. Our core retail pharmacy business has performed well in both the U.S. and International as we lapped very strong prior year comps. We also drove better-than-anticipated U.S. comp script growth in the second quarter. We continue to expect robust and accelerating EPS growth in the second half and have good visibility and strong execution plans against the key drivers.

COVID was a major headwind in the first half. And heading into the second half, we will see lower year-over-year impacts. In the U.S., we have clear line of sight to less reimbursement pressure relative to the first half of the year. Additionally, our script volume recovery is progressing and we are benefiting from some favorable cost of goods sold timing.

In the International segment, the business is well positioned to extend the second quarter's very good performance and we are moving past the peak investment period for U.S. healthcare. COVID vaccinations and testing do remain a wildcard as the FDA has not yet issued guidance on spring boosters.

In summary, at the midpoint of the guidance range, we expect second half adjusted EPS growth in the mid-20s.

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

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

Thank you, James. Before we kick off Q&A, let me sum up what you've heard. We continue to execute against our fiscal 2023 plan with solid first half results broadly in line with our expectations. Our retail pharmacy business is performing well, and we are progressing our healthcare business to scale and profitability. We exited the quarter with acceleration in February, adding to our confidence in achieving strong growth ahead. We have good visibility into the back half drivers.

As I said earlier, the inflection is here. Our bold strategic actions are working, and I'm very excited for our future.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from the line of Adrian Rice from Credit Suisse.

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

Actually, it's A.J. Rice. Obviously, it's still early days in the integration of VillageMD with CityMD and Summit. But any learnings that you've seen positive or challenges in the early days of that integration and maybe articulate a little bit whether there's any incremental cash needs that you see drawing on Walgreens capabilities, as they build out their growth strategy?

And then maybe the other question I'll just ask quickly would be on the front of store sales. It seems like that's still hanging in there very well. Are you seeing any impact either in the U.S. or U.K. from the sluggish economic backdrop? It's sort of hard to see it, but I wanted to just ask the question.

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

Sure. Thank you, A.J. This is Roz. Let me start with your second question about the front end of store and the recession that we're seeing, not only in the U.S. but in the U.K. So first of all, the U.S. retail comps at 4.5%, and that's excluding our test kits really show that we're running pretty strong right now. As you know, we've had a lot of work going on with our cost management, and that's played forward for us.

Secondly, the work that we've been doing with private label. So we've seen some trade down to private label over a period of time, probably about 100 basis points of improvement in our private label business. And then I would also tell you that we are pretty much a convenience place. So as gas prices go up, where that convenient neighborhood access point.

And then lastly, I would tell you, too, that in both our U.S. business and the U.K. business, we're seeing our online growth above 30% in many of those areas. So where -- people are switching over to online, particularly U.K., it is in a deep recession, but we're pretty proud of the work that is going on over there, achieving 16 comp. They're one of the top players over there selling pretty nicely in Personal Care and their over-the-counter business.

So we've been fairly resilient. We did take some time, A.J., to go back and look at '08 and '09, and during that time frame, we only saw maybe about a 0.5 percentage point dip and so we think we're pretty resilient at this point, but cost improvement has helped us the trend towards private label and our online business is helping us kind of weather the storm.

I'm going to turn it over to John to talk a little bit about the VillageMD business.

John P. Driscoll - *Walgreens Boots Alliance, Inc. - Executive VP & President of U.S. Healthcare*

Yes. A.J., thanks for the question. I think we're 90 days into the integration. And I think what it has reinforced is the value of combining Medicare, Medicaid, multi-specialty group, professional services and urgent care in our Village Summit offering. I don't think there's any interest -- and I don't think we're seeing excess cash needs. I think we'll continue to invest in sensible acquisitions. But actually, what we're seeing is the opportunity to, I think, drive more cost and growth synergies off of kind of a multi-threat set of assets that we think could be very impactful, particularly as we concentrate market power with more service offerings in specific markets.

Operator

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

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

Yes. I guess, Roz, I would come back to kind of the core pharmacy business. You talked about the acceleration you saw in February. But I guess for the full quarter, it looks like the company is still losing share in pharmacy. So I guess I'd ask kind of talk about trends intra-quarter and maybe even to the grade in which you can, what are you seeing in March?

And James, if I can tack on some housekeeping questions for you. Can you talk about the gains from the cash mobilization program in Germany and the impact of sale leasebacks in the quarter? Just a housekeeping question.

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

Yes. So I can't talk much about March, but I will tell you that we saw a good exit rate leaving the second quarter, February was a stronger month for us than December, January. So if that's any indication. I would also mention here around our script comp business, we've got 500 stores returned to normal operating hours. I'd also mention, too, that where we are seeing improvement in our normal operating stores like 6%, there's opportunity as we look at our execution in those stores to go even -- to improve those numbers even better. So operating behind the momentum we're getting in our stores that operate well.

And then I would tell you that -- we're doing a lot of work in terms of inventory in our stores and making sure that our operational efficiencies are happening every day in our stores. So we feel like we're moving in the right direction in that respect.

Rick, is there anything you want to add on scripts?

Rick Gates - *Walgreens Boots Alliance, Inc. - Senior VP of Pharmacy and Chief Pharmacy Officer*

Yes, George, I would just say, we bucket it in 3 different areas as we look at kind of acceleration in the second half. The first is staffing. We've talked about it quite a bit and the improvements we're making in staffing to get our stores reopened.

Roz talked about operations in stores and those stores that are opened or much stronger obviously than those that we're bringing back online, and we're continuing to work to obviously accelerate the performance of our stores that are at full hours. The third area, I think you're going to see us work really hard at is integration with U.S. Healthcare. So how do we work with our assets like VillageMD and Shields and others to really optimize scripts recapture and those types of opportunities.

So I would just say, in summary, the focus really is on execution of operations, optimizing our store hours by market, to really win back patients and improve our shares. So I think we have a lot going on in the second half that should help us continue the trend.

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

Yes. And George, let me just cover the sale and leaseback. But before I do, maybe just a bit of context. First of all, we believe we delivered a good in-line quarter with decent quality, and this gives us the confidence to confirm the full year guidance. And just to point out the key stat is the EPS was down 25.8%, and 26 points is due to COVID.

As we look at the sale and leaseback, the program in the U.S. has contributed an incremental year-on-year net benefit of $0.03. And on a full year basis, as we've said before, it will be flat. On a full year, there'll be no incremental benefit. So this is kind of timing within the quarters.

The one thing that stands out a little this quarter is a cash mobilization program in Germany, as we harmonize warehouses with an acquisition from more than 12 months ago, and that contributed $0.09.

But as I mentioned in the prepared comments, these combined $0.12 are completely offset by other onetime type items going in a different direction. I pointed out that ABC sale of the stock, which cost us $0.05 year-on-year. Some prior year benefits in the U.K. unit relating to COVID, which was $0.03 and obviously, then we mentioned ForEx and asset impairment. So the way we look at it, we have this sale and leaseback $0.12 and an offsetting $0.12. So we had decent quality in the quarter on onetime items.

So just in summary, this gave us the confidence because we're pretty much in line with good quality. It gives us the confidence to maintain full year guidance.

Operator

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

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

I was wondering if you could comment a little bit more on the payroll investments that you talked about in the U.S. Is that still sort of tracking towards the $525 million that you guys guided to initially? And is there any kind of reaction to some of the other retailers have moved up to $18 now. I just wanted to see if that was something that was helpful.

And then secondly, can you talk about what the main drivers are for Summit EBITDA as you think about the back half of the year?

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

I'll start off with your question on labor. So we've continued to make progress. A lot of our labor investments came in, in the form of 2 areas. And so as a reminder, we did go to $15 an hour, and that's spreading out over a period of time at our hourly rate. And then we also made the investment to regain the pharmacy talent in our stores. And it's working for us. Right now, we don't see any advanced needs in that area to move on labor any further.

A couple of things that we've learned in this process is we're closing the shortage by adjusting our pay practices and it's allowing us to return some of our operating hours in there. So what I would say to you is that we're steady in this position and don't have plans to take any further increases in that area.

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

And then you had a question then on Summit. I think we don't want to get into specific guidance on any of the individual units. But what I'd say is we're looking forward to strong performance out of Summit in the back half.

What -- a couple of items as you consider it is, one is we have 4 new businesses that were not fully in the base. So they've got coming on stream. They had 2 acquisitions back at the end of fiscal '21, NJU and Westmed. And these 2 -- they're basically in the process of squeezing out the revenue and the cost synergies on these 2 acquisitions. Very exciting as well. They opened a lab, a new lab at the end of '22, and this lab is the biggest private lab in the U.S. So this is going to be huge and a big driver of growth in the second half.

And then the final one, they just closed on an acquisition called Starling, which is quite sizable practice, multi-specialty, and will contribute heavily to both revenue and EBITDA growth in the second half.

The only item we saw with the acquisition has been -- and we saw it on our front of store business as well. As we look at the first quarter, the only real negative we saw was in January, where we saw a much lower incidence of virus cases. And this impacted our OTC business in front of store in the U.S. And we saw a slowdown in CityMD traffic. So that was the only item of any kind of note on the negative side on the Summit. And overall, the Summit multi-specialty business and the primary care physician business is doing really, really well. and we're very confident in the outlook for the second half.

John, I don't know if you have any?

John P. Driscoll - *Walgreens Boots Alliance, Inc. - Executive VP & President of U.S. Healthcare*

I think you took all the revenue and profit drivers -- in good shape.

Operator

Your next question comes from the line of Charles Rhyee from TD Cowen.

Charles Rhyee - *TD Cowen, Research Division - MD & Senior Research Analyst*

Yes. Maybe I know there's been a lot of recent discussions on the impact of changes in Medicare around the scoring, coding of CMS moves to ICD-10 from ICD-9. Have you guys done an analysis here the VillageMD and Summit in regards to this? Because I know that on a relative basis, the states like Florida have the most risk. And so maybe can you remind us what your geographic mix locations generally? And what percent of VillageMD suits mix is Medicare?

John P. Driscoll - *Walgreens Boots Alliance, Inc. - Executive VP & President of U.S. Healthcare*

Thanks for the question. I think just on the -- first on the geographic reach question, we have a relatively small, early-stage set of practices in Florida. So we've got a low exposure there. I think on the risk adjustment and rate changes, we're obviously looking at that carefully. It would be premature to talk about that given the fact that the final rule isn't out, and we don't know when the final rule happens, how that will -- how health plans on the MA side might adjust their benefit designs. But based on the way we are positioned and the variety of levers we have, we are cautiously optimistic that we're in really good shape to manage the changes that we expect may come down the pike. But I think we need to really look at what comes out on April 4. But with regard to Florida, it's a de minimis exposure.

Operator

Your next question comes from the line of Lisa Gill from JPMorgan.

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

James, I wanted to just start with how should I think about margins in the U.S. retail business on a go-forward basis? So if I look at the margin this quarter, I know there's like puts and takes, and you talked about growth rates and what's happening with COVID, et cetera. But how do we think about a sustainable margin one in that business? And two, do you have a longer-term goal of what you'd like the margin to look like?

And then just secondly, John, I wanted to follow up to your comments on VillageMD and as you think about capitated relationships, I think that James earlier talked about 177,000 fully at-risk MA lives. And I understand we'll wait for the fourth and see what the potential is there. But can you maybe just talk about vintages or what you're seeing right now around the profitability of some of those MA lives as we move into the back half of this year and going forward? Are there any key things that we should be looking at or thinking about for moving those members to profitability?

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

Okay. So let me take a shot at the first one on the margins. And I think some of this will come back to actually the JPMorgan conference, where we laid out, what are the drivers between the first half and the second half? I think you'll recall, Lisa, that we did call out pharmacy in the U.S. at the pharmacy reimbursement and cost of goods sold. Both of those were expected to be a much lower headwind in the second half of the year versus the first half. So I would not judge the first half representative of the full year. There will be a significant delta between first and second half.

You asked about longer term, how do we see the margins. I think on Retail, you've seen our performance, I would say, over the last 8 quarters. It's a business that has grown comp sales and margins at the same time, consistently over a long-term period. We actually think we're still at the bottom of this, if you like, because we still haven't unlocked the power of the Walgreens brand to an own-label offering and we have goals out there to be in the low 20s in terms of penetration, and we're currently sitting in 16. And that will continue to underpin margin growth longer term.

The second part of this is we've done some nice work on strategic margin management, both on promotional effectiveness and selectively adjusting price tiers within the stores and that is expected to continue to be a lever going forward. So we see positive gross margin gains longer term on the front of store business, which is already well improved over the last 8 quarters.

Pharmacy is a different animal in that we will continue to have reimbursement pressure. I do want to point out, I think we said at your conference actually that the reimbursement is approximately of 2023 is approximately 85% of the prior year and I'm going to pass it over to Gates in a minute. The atmosphere out there in the negotiation process is much more focused now on health outcomes and what value we can bring to a payer in terms of reducing overall cost. And it's less intensely focused on the absolute reimbursement number.

So we see some change in the dynamics on longer-term on pharmacy -- way too early to call any kind of victory, but I do want to emphasize that this year is a lower point than the prior year in terms of reimbursement pressure, and there are some positive signals going forward.

So Rick, I don't know if you want to provide an input?

Rick Gates - *Walgreens Boots Alliance, Inc. - Senior VP of Pharmacy and Chief Pharmacy Officer*

Yes. And I'll just give a couple of data points as well just to talk about the second half and then I can get back to your first point. But Lisa, we have about 98% of our contracts are accounted for -- or contracted for calendar year '23. And we have good line of sight into reimbursements that are, quite honestly, in line with our expectations. So we feel really good about what we're seeing there. We're always looking at improving procurement savings, increasing volume, doing things around pharmacy services, which are obviously offsets into our margin, which we're going to see continue in the second half.

And the other thing is pay-for-performance contracts. We're in these adherence based programs really trying to solve for what our end payers are looking for, which is improved outcomes, which is what James alluded to there. We're seeing great improvements in our store performance and how we're actually performing against these contracts, which should obviously come through in pay-for-performance benefits to us as well.

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

Yes, Lisa, Rick brings up a good point. I would characterize the second quarter as being especially weak in terms of generic procurement savings and there'll be more strength in the second half. And this we covered in this first half versus second half bridge back at your conference.

John P. Driscoll - *Walgreens Boots Alliance, Inc. - Executive VP & President of U.S. Healthcare*

Just, Lisa, on the Village question, the Village model works, and we've seen it work with -- with some of the legacy businesses in multiple geographies. I think what you'll see us do, the lesson learned, is perhaps concentrate our growth and our investments in specific markets where we can be hyper relevant in a concentrated geography. But we're confident, and we don't see any challenges to the actual model of what we're delivering for patients and with providers in those markets. So the trends are positive. The one thing that I think you'll see us do is really focus our investments so that we can get more of a return on that in specific markets where we can be particularly relevant.

Operator

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

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

A question on International. Just trying to sort through a couple of moving parts here and I think beyond real estate and NHS, I would love to hear your views on what the underlying business is running today? And a little bit more on where the NHS benefit or detriment fell in Q1, Q2 versus second half and expectations for second half normalized growth rates?

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

Eric, we think they had a very strong quarter in the second quarter. If you take out the real estate and these onetime, the prior year had some onetime benefits. It was a true-up from the government relating to COVID services that were done. And we had some rental contracts that we negotiated and didn't pay out last year, and we're lapping these this year.

You look at the U.K. and they're up 16% in terms of revenue and lapping at 22%. So I would say any business that can drive teens growth on revenue is an automatic money-making machine, and this is in a context of the U.K. market that is very, very depressed.

So where is this coming from? It's coming from -- if you look back pre-COVID, the U.K. business has actually gained 200 to 300 basis points of share depending on the category. So this is -- it's an execution story. If you look at the top retailers, the top 25 in the U.K., together with Aldi and Lidl, Boots is the highest performing retailer in the U.K. And that is something, if you're a premium retailer. So I think we have a strong franchise.

So looking forward, will we have as much of a boost in the forward periods? No, because we're lapping an Omicron period but we see strong revenue growth coming out of the retail business, continued market shares and margin stability. I don't think we will expand margins in the U.K. at this point.

Looking forward, the U.K. business is one with the fabulous brand franchise strength and a fairly -- probably the #1 player in beauty and personal care in the U.K. So -- and with an online presence that we've ended up with 15% penetration on online, and it was 9% pre-COVID. So it's a much stronger company than it was entering COVID and we're pretty happy with what the future holds.

Does that answer your question, Eric?

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

That's perfect. And any...

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

Just on the NHS. Sorry, I missed your NHS piece. We didn't see any NHS timing or margin shifts between first half and -- sorry, the first half of last year and we don't expect any negative going forward. However, it is fair to say the flagship business in the U.K. is our retail business. The pharmacy business is constrained by NHS which sets a limit on overall spending on pharmacy. So the profit pool is not going up. The way we would have to drive profit in the pharmacy business is it's not a script business that is driving healthcare services. So you try and capture a bigger part of the pool of money that's available by providing value-added services to the NHS. So that's the ongoing battle. It's tough, but our services business is growing far faster the base script business in the U.K.

Operator

And your next question comes from the line of Justin Lake from Wolfe Research.

Austin Jason Gerlach - *Wolfe Research, LLC - Research Analyst*

This is Austin on for Justin. James, just real quickly turning to kind of the store footprint and this return to normalized operating hours? You guys called out 1,900 kind of incremental stores that you're still targeting. Wondering kind of underpinned in the full year guide. Like is there an assumption that you guys clear through the rest of those or sort of a target number by year-end to sort of return? And do you feel like the level of investment at this point is adequate there or any need to revisit that?

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

Rick, why don't you take that?

Rick Gates - *Walgreens Boots Alliance, Inc. - Senior VP of Pharmacy and Chief Pharmacy Officer*

Yes. So -- The 1,900 is where we came out of Q2, obviously, we've continued to make progress as we've started into Q3 as well. I think as you look at the second half, we have to understand kind of the exiting rate for the year on short hours. We don't believe we're going to get through all of the stores by the end of year-end. And so I would say that the expectation should be that we will still have a subset of stores that are still shortened pharmacy hours.

We also have to take a look market by market to really understand dynamics of hours within those markets so that we could also take adjustments to hours as necessary based off of what's happening with competition in those locales as well. So -- the primary focus is still to get pharmacists hired to reopen our stores. But we do believe given the current trends and what's happened throughout the first half of the year that we will have a subset of our stores that are still on short hours exiting the year.

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

But I think we are feeling pretty good about the stores that have been reopened and stores currently without any restrictions are probably in the region of 6% growth. And we may actually see some opportunity to that because we are looking at operational improvements, not just restoring the store hours, but how you actually operate within the pharmacy and engage with patients and we probably will not -- we will roll those out across the entire portfolio as opposed to the stores that are unopened.

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

Also too, let me just add on VillageMD and what we're seeing with our scripts at Village. So in our co-located sites that have been open for more than 2 years, we're driving an incremental 40 scripts per site per day, and this is an increase of about 35% versus prior year. So when we begin to look at our script business, it's 3 areas. It's the return to store hours, the second piece is better execution in the stores and the third is to begin to drive our relationships from our acquisition partners, both the work that we can do with Shields, but most importantly with our Village co-located clinics.

Operator

And your next question comes from the line of Erin Wright from Morgan Stanley.

Erin Elizabeth Wilson Wright - *Morgan Stanley, Research Division - Equity Analyst*

On capital deployment here, how are you weighing the priorities now? And how are you thinking about further rationalization of certain investments or businesses, particularly Boots and what's your commitment to the Boots business now? And are you keeping your options open?

And then just second, more of a housekeeping question. But are there any changes from a segment level guidance perspective that we should be thinking about for the second half? And anything we should be thinking about in terms of third quarter versus fourth quarter? Anything above or below the line that may have changed relative to your initial thinking, for instance, tax rate?

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

Yes. Maybe I'll cover the last question first. I do want to emphasize that the way we looked at this is we delivered a good decent quality in line quarter and that gave us the confidence to confirm the full year guidance. There will always be puts and takes in a business like this, and we covered some of these. We have general outperformance across the retail business, and we have COVID, that's a bit of a watch out. So we kind of balance all of these. And so it's not the moment to go out and change specific guidance on any parts of the business. So we're pretty comfortable right now if we stare out at consensus, which I think is at $4.51. We're pretty comfortable with where that's sitting. And many of the vectors that are positive or negative for that case, we can play one off against the others. So that's our confidence on this.

You asked about the, call it, the sequence of the quarters if you were plotting out, we've been quite upfront and we expect mid-20s. I would say the growth rate is higher in the fourth quarter than this in the third as we cycle through some of the negative vectors, and then we implement the positive ones. But we're pretty comfortable with the overall profile.

Capital allocation, our priority right now is debt and probably tack-on acquisitions, they would be small in size and only focused on the healthcare business.

And then you had a question on Boots, which, I guess, Roz, do you want to take that one on Boots?

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

Sure. So on the Boots business, we've been pleased with their performance as James talked about in comparison to U.S. business, our healthcare business. What we feel like is we've got a balanced business here in terms of what we're seeing in Boots and they are continuing to take market share. And it's a business that is nice to have. It's been complementary. And until further notice, it's a good business for us to have.

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

Yes. And you would have seen, Erin, in the quarter that we did dispose, just after the quarter, we disposed of a fairly large portion of Option Care. And we've taken our stake below 10%. I think it's 6 something. So we're not -- we're still making progress against all of the portfolio simplification goals. We've taken action like on parts of ABC. Option Care is now down to 6% range. So we're carefully assessing when the right moment is on all of these vehicles on simplification of the company to ensure that we have the firepower to drive and create a successful healthcare services business. That's the goal, and that's the strategy Roz laid out and we're resolute in driving against this strategy.

Operator

And we have reached the end of our question-and-answer session. Ms. Roz Brewer, I turn the call back over to you for some final closing remarks.

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

Thanks. So thanks, everyone, for joining us. Let me sum up what you heard today, particularly in the Q&A portion.

So just in short, the U.S., we've really achieved a balanced performance. Our core retail sales are up mid-single digits, better-than-expected sequential improvement in our comp scripts. And then internationally, Boots has delivered 8 consecutive quarters with strong comp performance which accelerated to 16% this quarter. So we feel really good about leaving this quarter.

So when we talk about what are we thinking about recession inflation, our business is not only strong, but is showing resiliency. We've been able to absorb various industry-wide shocks such as rising labor costs and the inflationary pressures. So at the same time, though, we're moving beyond our peak investment period in healthcare, and we've turned the corner on comping last year's COVID demand. So that's what we're referencing in terms of an inflection point.

I'm really happy about this team. We're clearly executing against our plans and it's showing up in the results. We've achieved a really solid first half performance and broadly in line with our expectations. The investments that you all have been tracking very carefully, they're accelerating, and they're building out our healthcare growth engine as we designed and planned. And then the portfolio simplification is working, and it's unlocking the value that we need and funding our transformation.

So I would just reiterate that we're maintaining guidance and pivoting to a strong second half of the year. And I appreciate your time on the call.

Thank you. Have a great rest of the day.

Operator

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