

Walgreens Boots Alliance

Some questions answered, some questions remain

Reiterate Rating: UNDERPERFORM | PO: 23.00 USD | Price: 25.01 USD

More clarity on capital allocation; model still pressured

Walgreens provided answers to some key investor questions such as the future of the dividend and the company's thoughts around business strategy and capital allocation. We view the dividend cut and the decision to prioritize profitability over revenue growth in the US Healthcare segment as two positives. The dividend cut removes a longstanding overhang and the focus on profitability should help limit more intensive capital requirements for that business. While FY24 guidance and US Healthcare targets were reiterated, we remain cautious given limited visibility around US Healthcare segment growth and overall trajectory of core U.S. Retail pharmacy earnings. FY2Q headwinds including lower sale-lease back contributions and consumer pressure will be partially offset by a lower tax rate, but could create a more challenging ramp for 2H. Walgreens provided some comments that it would support a more transparent reimbursement model which would be thesis changing if adopted, but short-term headwinds in the core business outweigh this optionality today. We reiterate our Underperform rating but increase our PO to \$23 (from \$22) based on 7x CY24E P/E (from 6.6x) due to peer multiple expansion.

Reducing EPS/EBIT outlook on limited visibility

We are lowering our FY24 EPS estimate from \$3.25 to \$3.19 and our FY25 EPS from \$3.51 to \$3.47. We have also updated our FY24 EBIT estimate, reducing it to \$3.4Bn vs. \$3.5Bn previously, primarily due to our reduction in the US Retail Pharmacy segment EBIT. Our FY25-FY27 EPS estimates have also been revised down primarily driven by lower revenues from US Healthcare.

Upcoming events and catalysts

Near-term catalysts include the potential adoption of a new pharmacy reimbursement model, US Healthcare initiatives, US growth efforts – including script recapture, and the macro environment in the EU/UK for potential impacts to the International segment. The US Healthcare segment progress is important, both in terms of business expansion as well as the ramp in profitability. Finally, we continue to monitor capital allocation priorities including updates to the dividend, debt payoffdown, and cash flow dynamics.

Estimates (Aug) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	5.04	3.98	3.19	3.47	3.81
GAAP EPS	6.33	(3.57)	0.77	1.41	2.03
EPS Change (YoY)	2.6%	-21.0%	-19.8%	8.8%	9.8%
Consensus EPS (Bloomberg)			3.32	3.66	4.04
DPS	2.00	1.92	1.00	1.01	1.02
Valuation (Aug)					
P/E	5.0x	6.3x	7.8x	7.2x	6.6x
GAAP P/E	4.0x	NM	32.5x	17.7x	12.3x
Dividend Yield	8.0%	7.7%	4.0%	4.0%	4.1%
EV / EBITDA*	10.2x	12.8x	13.9x	13.1x	12.2x
Free Cash Flow Yield*	10.0%	0.7%	10.2%	11.9%	11.4%

* For full definitions of *IQmethod*SM measures, see page 9.

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Timestamp: 08 January 2024 05:09AM EST

08 January 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	22.00	23.00
2024E EPS	3.25	3.19
2025E EPS	3.51	3.47
2026E EPS	3.77	3.81
2024E EBITDA (m)	4641.0	4611.2
2025E EBITDA (m)	4915.2	4898.3
2026E EBITDA (m)	5199.2	5276.7
2024E DPS	1.94	1.00

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Stock Data

Price	25.01 USD
Price Objective	23.00 USD
Date Established	8-Jan-2024
Investment Opinion	B-3-7
52-Week Range	19.68 USD - 37.96 USD
Mrkt Val (mn) / Shares Out (mn)	21,568 USD / 862.4
Free Float	82.4%
Average Daily Value (mn)	372.35 USD
BofA Ticker / Exchange	WBA / NAS
Bloomberg / Reuters	WBA US / WBA.OQ
ROE (2024E)	9.8%
Net Dbt to Eqty (Aug-2023A)	29.2%
ESGMeter TM	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

PBM – pharmacy benefit manager

iQprofileSM Walgreens Boots Alliance

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	6.9%	4.9%	3.6%	3.8%	4.1%
Return on Equity	16.4%	11.9%	9.8%	10.6%	11.5%
Operating Margin	3.9%	2.8%	2.4%	2.4%	2.5%
Free Cash Flow	2,165	141	2,190	2,563	2,465

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	0.9x	0.7x	1.3x	1.6x	1.4x
Asset Replacement Ratio	0.9x	0.9x	0.7x	0.9x	0.9x
Tax Rate	13.3%	9.1%	23.9%	25.7%	25.1%
Net Debt-to-Equity Ratio	30.3%	29.2%	23.2%	19.0%	14.9%
Interest Cover	13.0x	6.7x	8.7x	7.5x	8.2x

Income Statement Data (Aug)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	132,703	139,080	143,514	154,009	162,185
% Change	0.1%	4.8%	3.2%	7.3%	5.3%
Gross Profit	28,451	27,427	27,118	27,842	29,187
% Change	1.3%	-3.6%	-1.1%	2.7%	4.8%
EBITDA	6,268	5,008	4,611	4,898	5,277
% Change	-4.6%	-20.1%	-7.9%	6.2%	7.7%
Net Interest & Other Income	(258)	(402)	(18)	(380)	(370)
Net Income (Adjusted)	4,360	3,439	2,759	2,989	3,287
% Change	2.4%	-21.1%	-19.8%	8.4%	10.0%

Free Cash Flow Data (Aug)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	4,065	(3,528)	663	1,219	1,748
Depreciation & Amortization	1,990	2,257	2,263	2,340	2,384
Change in Working Capital	495	1,602	50	400	183
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(2,651)	1,927	718	722	323
Capital Expenditure	(1,734)	(2,117)	(1,504)	(2,118)	(2,173)
Free Cash Flow	2,165	141	2,190	2,563	2,465
% Change	-40.8%	-93.5%	NM	17.0%	-3.8%
Share / Issue Repurchase	(160)	(150)	(150)	(150)	(150)
Cost of Dividends Paid	(1,732)	(1,659)	(864)	(873)	(881)
Change in Debt	3,587	(2,703)	(155)	146	87

Balance Sheet Data (Aug)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	2,472	739	2,327	3,664	4,834
Trade Receivables	5,017	5,381	5,592	6,043	6,408
Other Current Assets	9,412	9,383	9,802	10,646	11,258
Property, Plant & Equipment	11,729	11,587	11,809	12,707	13,638
Other Non-Current Assets	61,494	69,538	67,927	67,081	65,796
Total Assets	90,124	96,628	97,457	100,142	101,934
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	21,524	23,618	24,298	25,993	27,153
Long-Term Debt	11,674	9,062	8,907	9,053	9,140
Other Non-Current Liabilities	26,518	35,460	35,879	36,685	36,654
Total Liabilities	59,716	68,140	69,083	71,731	72,947
Total Equity	30,408	28,488	28,374	28,410	28,987
Total Equity & Liabilities	90,124	96,628	97,457	100,142	101,934

* For full definitions of iQmethodSM measures, see page 9.

Company Sector

Healthcare Technology & Distribution

Company Description

Walgreens, following the completion of the Rite Aid stores acquisition, is the largest global pharmacy, with nearly 10,000 stores in the US alone. The company also operates an international pharmacy business primarily composed of the Boots pharmacies in the United Kingdom. Walgreens is headquartered in Deerfield, Illinois.

Investment Rationale

Our Underperform rating is predicated on an uncertain intermediate profit growth stream given market headwinds, notably reimbursement pressures, ongoing profit headwinds within the international retail business, and competitive dynamics. With core profit dollar growth slowing and limited visibility into how Walgreens Health will offset that (not to mention investments in the venture), we think the limited visibility creates challenges for near-term stock performance.

Stock Data

Average Daily Volume 14,888,205

Quarterly Earnings Estimates

	2023	2024
Q1	1.16A	0.66A
Q2	1.16A	0.85E
Q3	1.00A	0.92E
Q4	0.67A	0.76E

FY1Q'24 call takeaways

- Opening remarks
 - Strong international performance
 - Maintaining FY24 EPS guidance despite difficult backdrop
 - Impacts from weaker respiratory and Medicare redetermination impact
 - Own brands up 90bps in quarter
- Savings:
 - On pace for \$1Bn in cost savings for FY24
 - On track for \$600MM reduction in Capex y/y and \$500MM in working capital reduction y/y
 - Reducing dividend by 48%
 - VillageMD exited 27 of 60 markets plans for exits
 - Buyout for Boots pension planned
- Pharmacy strategy:
 - Virtual pharmacy
 - Working with Deans of pharmacy schools to make WBA preferred employer in the space
 - Signed 25 contracts
 - Shields – sales up 27% in 1Q, meaningful existing client growth and new contract ads
 - More initiatives on specialty pharmacy to be laid out
 - Entering pay for performance contracts (adherence)
 - Willing to work with pharmacy benefit managers (PBMs) and payors on pharmacy reimbursement options to deliver transparency
- Results:
 - US healthcare pro-forma sales increased 12%. Adjusted EPS of \$0.66 declined 44% on a constant currency basis
 - Adjusted operating income declined 37.2% year-on-year, mainly driven by lower retail sales volume and margin
 - International growth in U.S Healthcare segment supported adj. EPS
- U.S Retail Pharmacy
 - Sales up 6.4% - brand inflation and contribution from pharmacy services
 - Retail business down 6.1%



- Retail sales volume/margin impacted adjusted operating income (AOI)
- U.S Pharmacy:
 - Up 13.1%
 - Ongoing Medicaid redetermination and weaker flu/COVID impacted sales – activity down ~13% q/q
 - Gross profit down – margin impacted by reimbursement pressure
- Retail
 - Weaker respiratory season (160bps impact)
 - Thanksgiving closure – 60bps headwind
 - Expect more headwinds in consumer/retail
- International
 - Total sales up 4.4%, Boots UK up 6.3%
 - Boots UK driving strong retail growth
 - Boots UK – Retail market share up for 11th consecutive quarter
- U.S Healthcare
 - Shields and CareCentrix EBITDA growth
- Cash Flow
 - FCF in-line with expectations. Operating cash flow impacted by inventory build up and redetermination timing
 - On track to reduce Capex by \$600MM y/y and working capital improvement of \$500MM y/y
- Guidance
 - Tailwinds –
 - Expect pharmacy services to delivery ahead of plans
 - Improved tax – 15-17% vs. 19-20% prior
 - Headwinds
 - Expect pull back in consumer retail – decline low single digit (LSD) vs. flat prior
 - Sale-leaseback impact to be \$125MM lower vs. prior outlook
 - Lower overall Rx volume growth
 - Segment adj. EBITDA in U.S Healthcare to be breakeven – driven by VillageMD cost improvements

- 2Q'24
 - Lapping adj. EPS of \$1.16 – y/y comp will be impacted by:
 - Lower contribution from sale-lease back
 - Higher shrink on retail
 - Expect headwinds to be offset by lower tax rate
- 2H'24:
 - Expect actions to lower cost base to ramp over year
 - U.S. Healthcare segment profitability to scale over the year-realignment of costs over the year
 - Tax rate elevated in 1Q, favorability through rest of the year

Q&A

- How can WBA support transparency and value?
 - Can play a significant role in contracts/relationships and
 - Retail pharmacy value is going to be driven by transparency, cost plus models etc.
 - Not giving guidance on margins for drugs – most of the innovation/reimbursement in pharmacy is likely to evolve where margin is based on services provide by pharmacy
- What is WBA core business vs. what is ancillary?
 - 60 days in, have a lot of work to do- still working on getting balance sheet together
 - Stores are important – central to strategy. Rightsizing footprint is on the table
 - Going to be a major community-based pharmacy footprint
 - View WBA as a fundamental health utility, not just a pharmacy
 - CareCentrix and Shield – great to drive value to payers. Have synergy with each other
 - Investments in VillageMD to be actively managed
 - Do they provide sustainable returns to payors, health systems, and other partners – that is the lens to look through
 - PBM basis is terrific for health services business, but pharmacy is fantastic
- VillageMD investments and primary care opportunity?
 - On a good path to drive profitability. Like it as an investment



- Future growth outside of VillageMD – not focused on primary care assets in portfolio of investments
- Color on specialty and opportunities in the space?
 - Shields is able to manage specialty pharmacy for health systems
 - Walgreens specialty assets inside that mix – central fix, gene/cell therapy (pharma has noted interested in working with WBA). Focused on payor market
 - Shields is a key enabler for pharmacy strategy
 - Not growing just with payors, growing beyond Blue's plans with other payors. Shield provides more adherence – paid for performance. Working with large/small health systems. Lot of runway to grow with underlying specialty drug market to grow
- Not looking to invest in care delivery assets – could you expect more partnerships though?
 - VillageMD provides a good sandbox to test new services
 - Can be a partner of choice for other providers where VillageMD has less depth
- Have we hit the floor on unit pricing?
 - Floor just kept getting lower. For PBMs – not much left for squeezing retailers.
 - More effective to win on providing value
 - 95% along the way of contracting with PBM's
 - Can drive a transition to a more value-based model
 - Two very large PBMs announcing programs for transparency is likely due to marketplace pull there
 - WBA can play effectively in that space
 - Have negotiated on core dispensing at one rate and negotiating services as additional reimbursements
- How long would it take to implement a transparency model?
 - PBM selling cycles are not short
 - Material potential change within a year or two
 - New sales for small groups – you could see a fairly quick uptake
 - But cautious – previous transparency models didn't pick up that fast
 - Plan designs that the market have largely evolved to are creating this underlying demand to give patients the pass-through or the cost plus experience so that they don't have an odd surprise when they go to the

- pharmacy counter of paying more for the drug than actually they would if they were a cash payer
 - Can convert to cost plus model over-night – so willing to do that
 - New brands coming out – don't work for pharmacy or High-Deductible Health Plan members
- On guidance – expect market growth in pharmacy to be lower? Any color on it? Given history – isn't it beneficial to own a PBM?
 - Prescription market growth – outlook in October was to grow in-line with market
 - Market is growing at a lower pace (weaker respiratory and impact of Medicaid redeterminations)
 - Expect market growth to slow down 50bps
 - Owning PBM is not the best path – been independent allows ability to work across chain
 - Buying a second tier PBM does not make sense vs. working with PBMs
- Lily announced Lily direct – impact to 3rd party fulfillment services and ability to work with WBA?
 - Can work with almost any reimbursement model to work with payors, pharma, and health systems
 - Transparency for consumers and lowers drug costs for consumers is good – so willing to deliver against those.
 - Definitely an opportunity
- Pay for performance contracts? Where are the contracts focused?
 - Had a conversation last week with the CEO of a very-very large payer who wanted to sit teams down to actually look at 2025 and how to work together particularly on Medicare Advantage
 - Most pay for performance contracts in Medicare part D space
 - Medicaid space- seeing contracts come through. Expect this to move to the commercial space
- Market share opportunities in cost plus models?
 - Competing on unit price is a straight-forward opportunity – hard to differentiate on this
 - Models discussed and pulled into market will allow differentiation on services

When using Walgreens brands – responses can be improved. Shows ability for WBA to differentiate vs. market in gaining access to patients

Price objective basis & risk

Walgreens Boots Alliance (WBA)

Our \$23 price objective is based on about 7x our CY24E EPS. This multiple is below its five-year average on an absolute basis of around 11x. The discount to the five-year average reflects our view that Walgreens' core retail pharmacy business is under long-term structural pressure and must diversify into stable business lines to improve the growth outlook.

Upside risks are better-than-expected generic savings from new partnerships in healthcare and other areas that support long-term growth, contributions from additional new partnerships and strategic investments for Walgreens Health (including Summit Health), and faster recovery in overall script trends.

Downside risks to our PO are ongoing pricing and reimbursement pressure, higher prescription attrition from Part D relationships, uncertainty on front end and pharmacy sales during the Covid outbreak, ongoing growth and profitability pressure within the Retail International business, incremental spending tied to building out the Walgreens Health platform (including investments in Summit Health), the risk of a disruptive force entering the supply-chain market, a slowdown in 340B, various opioid trials that could include financial penalties, and lack of available/appealing attractive capital deployment opportunities.

Analyst Certification

I, Allen Lutz, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Healthcare Technology & Distribution Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Accolade	ACCD	ACCD US	Allen Lutz, CFA
	American Well Corp	AMWL	AMWL US	Allen Lutz, CFA
	Cencora Inc	COR	COR US	Allen Lutz, CFA
	CVS Health	CVS	CVS US	Allen Lutz, CFA
	Definitive Healthcare Corp	DH	DH US	Allen Lutz, CFA
	dentalcorp	YDNTL	DNTL CN	Allen Lutz, CFA
	Envista	NVST	NVST US	Allen Lutz, CFA
	HealthEquity Inc	HQY	HQY US	Allen Lutz, CFA
	Hims & Hers	HIMS	HIMS US	Allen Lutz, CFA
	McKesson	MCK	MCK US	Allen Lutz, CFA
	Omniceil Inc.	OMCL	OMCL US	Allen Lutz, CFA
	Patterson Companies	PDCO	PDCO US	Allen Lutz, CFA
	Progyny	PGNY	PGNY US	Allen Lutz, CFA
	R1 RCM	RCM	RCM US	Allen Lutz, CFA
NEUTRAL				
	Cardinal Health	CAH	CAH US	Allen Lutz, CFA
	Dentsply Sirona, Inc.	XRAY	XRAY US	Allen Lutz, CFA
	Doximity Inc	DOCS	DOCS US	Allen Lutz, CFA
	Teladoc Health	TDOC	TDOC US	Allen Lutz, CFA
UNDERPERFORM				
	GoodRx	GDRX	GDRX US	Allen Lutz, CFA
	Henry Schein	HSIC	HSIC US	Allen Lutz, CFA
	Owens & Minor	OMI	OMI US	Allen Lutz, CFA
	Premier, Inc.	PINC	PINC US	Allen Lutz, CFA
	Walgreens Boots Alliance	WBA	WBA US	Allen Lutz, CFA

US - Healthcare Technology & Distribution Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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IQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

IQmethodSM is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of **IQmethod** are: A consistently structured, detailed, and transparent methodology; Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

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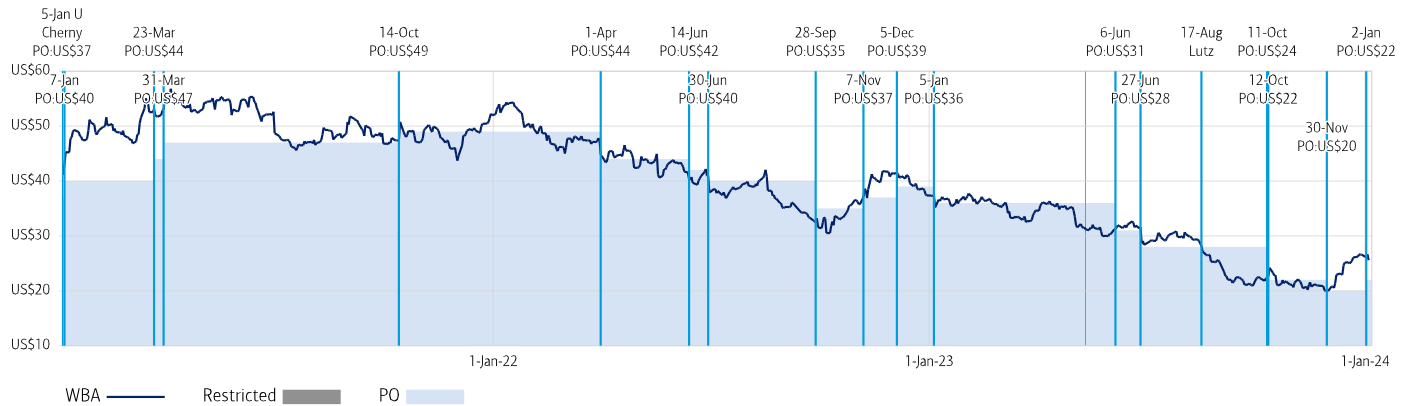
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Disclosures

Important Disclosures

Walgreens (WBA) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Health Care Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	234	60.94%	Buy	115	49.15%
Hold	80	20.83%	Hold	36	45.00%
Sell	70	18.23%	Sell	29	41.43%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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