OVERVIEW:
Co. reported 4Q19 GAAP EPS of $0.75.
CORPORATE PARTICIPANTS

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Gerald Gradwell  Walgreens Boots Alliance, Inc. - SVP of IR
James Kehoe  Walgreens Boots Alliance, Inc. - Executive VP & Global CFO
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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Walgreens Boots Alliance Fourth Quarter 2019 Earnings Conference Call. (Operator Instructions) Please be advised that today’s conference is being recorded. (Operator Instructions) I would now like to hand the conference over to your speaker today, Gerald Gradwell. Please go ahead.

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

Good morning, ladies and gentlemen, and welcome to our fourth quarter earnings call. I’m here today with 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 and President of Walgreens.

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. Except to the extent required by the law, we undertake no obligation to update any forward-looking statement after this presentation whether as a result of new information, future events, changes and 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.

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.
I will now hand you over to Stefano.

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

Thank you, Gerald, and hello, everyone.

Today, I am pleased to report that we delivered quarterly results broadly in line with our expectation. In doing so, we closed our financial year roughly flat year-on-year, which is, again, in line with the expectation we set in April.

That said, it has not been an easy task for us to recover from a very difficult second quarter, and there has been a lot of hard work done by our team to deliver these results over the past 2 quarters.

We have continued to make progress against our 4 strategic priorities.

Accelerating the digitalization of our company in terms of the way we use technology, to help us run our businesses more efficiently and effectively and, more importantly, to announce and transform the products and services that we offer our patients and customers and in the way we deliver those services.

Transforming and restructuring our retail offering, making sure we provide our customers what they want, in the way they want; and using the strength of our extraordinary local presence as an asset to support and enrich a modern multichannel, tailored and far more focused, responsive and interactive retail experience. And creating within our stores a network of health care destinations, backed by our digital investments, providing both services and support. This will enhance our role as a core provider of health care to the communities we serve and a highly effective and efficient resource for patients and payers alike.

And of course, to support all of these and to deliver the changes we need to structure our company in a market that constantly demands ever more responsiveness and efficiency, we are delivering on our Transformational Cost Management Program.

It is important to make that point. This is about transformation for us, both driving out costs and reinvesting in the business, to help fund investments we need to make to deliver our strategic priorities.

This program is truly about savings, to invest for growth.

Our teams have worked hard on the development of these strategies, and are working just as hard on their delivery.

We have identified an excellent group of partners that bring our skills, experience and resources to deliver our goal better, more effectively and more efficiently than we could do alone. We are transforming not just our businesses, but our business model to deliver future growth.

We have been very clear in our current expectations for the financial year ahead. James will cover them in detail as part of this financial review.

Looking forward to 2020, we expect adjusted earnings per share to be roughly flat on a constant-currency basis.

Excluding the impact of the 2019 bonus headwind, we would expect mid-single-digit adjusted earnings per share growth. And looking forward, we see a clear line to sustainable, profitable growth, driven by the work we are doing and the investments we are making.

I will now hand over to James and Alex to talk you through today’s earnings and update, and we’ll come back to take your questions at the end. James?
James Kehoe - Walgreens Boots Alliance, Inc. - Executive VP & Global CFO

Thank you, Stefano, and good morning, everyone.

Today’s results are broadly in line with our expectations. Adjusted EPS was $1.43 in the fourth quarter, 2.9% lower than the prior year on a constant-currency basis. Fiscal year adjusted EPS was $5.99, up 0.5% in constant currencies and in line with our guidance. We are encouraged by improved U.S. comparable sales and adjusted gross profit margin performance in the second half of the year.

Retail Pharmacy International continued to be impacted by a challenging U.K. market, whereas the Pharmaceutical Wholesale division delivered another strong performance. Our Transformational Cost Management Program is very much on track and with rising visibility on cost savings, we are raising our annual savings target to at least $1.8 billion by fiscal 2022.

Let’s now look in more detail at the full year results. Full year sales increased 4.1% versus prior year. On a constant-currency basis, sales growth was 5.8%, reflecting good performance from both Retail Pharmacy USA and Pharmaceutical Wholesale. Adjusted operating income declined 9.6% or 8.6% on a constant-currency basis, mainly due to Retail Pharmacy USA and Boots U.K., partially offset by Pharmaceutical Wholesale.

Adjusted EPS was $5.99, up 0.5% on a constant-currency basis. Share repurchases contributed 4.9 percentage points with tax adding 4.1 percentage points. These were partially offset by the 3.6 percentage points of adjusted EPS headwinds that are shown on the slide.

GAAP operating income declined 20.5%, including $477 million of expenses relating to the implementation of our Transformational Cost Management Program and, as we mentioned last quarter, $114 million relating to our share of AmerisourceBergen’s impairment of PharMEDium. In total, these 2 adjustments account for almost 50% of the year-on-year decline.

In the fourth quarter, sales were up 2.6% on a constant-currency basis, reflecting solid growth in our Retail Pharmacy USA division and a strong performance in Pharmaceutical Wholesale.

Adjusted operating income declined 11.9% or 11.1% on a constant-currency basis. Adjusted EPS was $1.43 and constant-currency decline of 2.9%. 5% of growth came from our share repurchase program and another 7% from tax. However, these were entirely offset by over 12 percentage points of headwinds as we increased investments and we lapped one-time benefits in the fourth quarter of 2018, including a post retirement curtailment gain and a previously disclosed adjustment to legal accruals and settlements.

GAAP EPS declined 51.4% to $0.75 per share. Just over half of this decline was due to 2 factors, a prior-year gain on the sale of Premise Health and the implementation of our Transformational Cost Management Program.

Now let’s move to Retail Pharmacy USA. Sales increased 2.1% in the fourth quarter reflecting 4.2% growth in pharmacy. Full year sales advanced 6.2%, reflecting the acquired Rite Aid stores and organic sales growth of 3%. Adjusted gross profit declined 1.1% in the quarter, with a decline in retail partially offset by higher pharmacy gross profit.

Adjusted SG&A spend increased 2.1% in the quarter, entirely due to higher investments and the prior year one-time adjustment associated with previously disclosed legal accruals and settlements. Adjusted operating income declined 12.2% in the quarter and 9.6% full year. The quarter was held back by 9.4 percentage points of headwinds from higher investments and a one-time benefit in the prior year. Excluding these factors, the decline was low single digit.

Now let’s look in more detail at pharmacy. Total pharmacy sales increased 4.2% in the quarter and 8.6% for the year. Growth in the quarter reflected higher brand inflation and prescription volume growth along with growth in central specialty, which grew 7.8% in the quarter and over 20% for the year. Comp pharmacy sales increased 5.4% in the quarter and 4% for the year. Comp prescriptions grew 3.3% in the quarter and 3% for the year. The trend is improving with comp scripts up 4% in the second half versus 1.9% in the first half.

As you will recall, we had some network headwinds in the first half, which we’ve now lapped.
Market share was 21% in the quarter, down 55 basis points versus prior year, mainly due to the store optimization program. For the full year, market share increased 35 basis points to 21.3%.

Pharmacy-adjusted gross profit increased in the quarter with script growth and procurement savings helping to mitigate reimbursement pressure.

For the full year, pharmacy-adjusted gross profit was down slightly. Fourth quarter adjusted gross margin was 65 basis points lower than last year, including a 40 basis point mix impact from specialty.

Turning next to our U.S. Retail business. Total retail sales declined 3.9% in the quarter impacted by store optimization. Comp retail sales declined 1.2% and, excluding tobacco, comp sales were up 0.5%. Full year comp sales declined 2.4% with 1.6 percentage points due to tobacco.

Looking at the second half versus the first half. Second half comp sales were down 1.1% compared with a decline of 3.5% in the first half. Retail-adjusted gross profit declined in the quarter, mostly due to lower reported sales, which were negatively impacted by our store optimization program.

We did say last quarter that we expected to see improved retail-adjusted gross margin in the fourth quarter, and I’m pleased to report that adjusted gross margin increased 35 basis points.

Full year adjusted gross margin was down 20 basis points as we adjusted promotional spend in the earlier part of the year.

Turning next to Retail Pharmacy International. And as usual, I’ll talk to constant-currency numbers.

Boots UK comp pharmacy sales declined 2% in the quarter and 1.6% in the year, reflecting lower script volume and a lower NHS funding level due to timing shifts between years.

Boots UK comp retail sales declined 3.1% in the quarter and 2.6% in the year as the U.K. market continued to be very challenging. However, we held share in a declining U.K. market with good share performance in Beauty.

Adjusted operating income was down 20.7% in the quarter and down 16.2% in the year, mainly due to weak retail sales and pressure on retail and pharmacy margins in the U.K.

Turning now to the Pharmaceutical Wholesale division, which I’ll also discuss in constant-currency. Our Pharmaceutical Wholesale division delivered another strong quarter with sales up 7.9%, led by emerging markets and the U.K. In part, our U.K. performance was aided by a customer contract change, which contributed 2.3% to revenue growth.

Fourth quarter adjusted operating income increased 6.9%, reflecting strong revenue performance and higher earnings from AmerisourceBergen. Full year sales increased 8%, and adjusted operating income increased 5.9% versus prior year.

Turning next the cash flow. Full year operating cash flow was $5.6 billion, and free cash flow was $3.9 billion. Our free cash flow was impacted by some fairly large exceptional items, and we have covered these on previous calls.

Excluding these exceptional items, our 2019 free cash flow was around $5.2 billion.

I’ll now hand over to Alex.

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

Thank you, James. I’m going to update you on our initiatives in the U.K. and the U.S., starting with Boots UK.
Last quarter, we talked about a number of initiatives to transform our retail offering, develop healthcare services and accelerate digitalization in the U.K. We’ve introduced new beauty hauls in 26 key locations, and we’ve opened up flagship stores in Covent Garden London and, more recently, in Meadowhall, Sheffield.

We’re also encouraged by our new brand introductions. 18 new beauty brands were introduced to key stores in the year and a further 17 in September. We’re developing new initiatives in digital health care with plans for expanding pharmacy services to improve the customer journey and broaden access to health care. We launched our online pharmacy in May 2019, which we’ve expanded to include repeat prescriptions.

We’ve digitalized the Boots Advantage Card with an app now integrated across our all our main customer platforms. And importantly, boots.com performed well with sales up 14.4% in the year and 18.4% in the fourth quarter.

As James mentioned, we continue to take actions to address our U.K. cost base. In February, we announced our intention to reduce Boots’ head office costs by 20%. This program has now been completed, and the savings will come through in fiscal year 2020.

In June, we announced a store optimization program that will impact around 200 Boots locations. We reduced the store count by 18 stores by the end of the fiscal year, and are on track to consolidate the remainder by the end of 2020.

We have also generated cost reductions through simplification of our care home operations and the supply chain.

Turning now to our strategic initiatives in the U.S. We have made significant progress on our 4 strategic priorities during the year. Let me start with our retail offering where we’re focused on delivering health, wellness, beauty and convenience, both in-store and online.

We remain very pleased about our strategic partnership with Kroger. In August, we announced the expansion of our store pilot to new test locations in Knoxville, Tennessee. The Kroger Express concept will be available in 50 Walgreens stores, and our own health and beauty brands will be available to customers in 17 Kroger stores.

We are extending our nationwide offering with FedEx. A new customer returns system is being introduced to Walgreens stores before the holiday season, giving customers an easier returning service for unwanted goods for Walgreens and other selected retailers. We continue to look for solutions for the last mile, building on our presence in the community.

We have recently announced our first-of-a-kind partnership with Wing to test on-demand drone delivery, joining up with our previously announced trial with FedEx for robot delivery.

We continue to make progress on health and beauty. We have seen strong progress in the U.S. with No7 skincare, and we’re expanding the distribution of No7 skin care in Walgreens in the months ahead. And last month, we launched a stand-alone No7 website, No7beauty.com, alongside a national U.S. TV campaign.

Turning next to health care. We’re strongly focused on creating neighborhood health destinations around a more modern pharmacy. We have made significant steps during the year to develop our primary care business. Our model is based on physicians and clinical pharmacists, and we’ll have primary care locations in 4 markets across the U.S., working in partnership with Partners in Primary Care, VillageMD and Southwest Medical, an Optum Company.

We also have plans to develop a new wellness partnership in our stores, and I’m delighted to say that we’ve recently signed a new agreement with Jenny Craig, a health and weight loss management company, to open centers in around 100 Walgreens locations by early 2020.

We have been reviewing our nurse practitioner clinic model and we’ve taken the decision to exit our wholly-owned loss-making clinics, but we will continue to work with our local health system partners, who are running successful clinics in 217 Walgreens locations. We now have a network of 15 partners, and we recently signed a new agreement with TriHealth to add further 7 clinics.
Our collaboration with LabCorp is well on track. We’re aiming to open at least 600 LabCorp patient centers across the U.S., providing diagnostic lab testing in the community. We opened 21 centers in the fourth quarter, taking the total to 58. We’ve also expanded our reach in specialty, making an equity investment in specialty provider, Shields Health Solutions.

We are an important partner for our payors, anchored by a national network of local community pharmacies. We continue to drive better clinical outcomes through patient medication adherence programs, such as Save a Trip Refills, which already has over 2.7 million patients signed up as we aim to lower the cost of care.

As you’ve seen, we’ve announced a strategic partnership with Centene, a leading Medicaid insurer, and, Rx Advance, a cloud-based pharmacy benefit manager.

And we recently signed a multiyear Medicare agreement with UnitedHealthCare, including a new co-branded Medicare Advantage plan, with Walgreens being the only preferred retail pharmacy.

Turning next to digitalization. Our partnership with Microsoft signed in January is central to driving our technology strategy, and the cloud migration program is on plan. We have expanded the Find Care platform available on walgreens.com to include new strategic partners and offerings. It now has 30 health care providers and over 40 services.

And we’re making good progress in our existing omnichannel business. Our Walgreens app has been downloaded 58.9 million times, up 11.8% since last year. Around 26% of Walgreens retail refill scripts were initiated through digital channels in the quarter, up 14% since last year. And we also have increased our active Balance Reward members to 89.7 million.

Finally, we’re also really pleased to report that Walgreens’ digitally-initiated sales reached over $15 billion in the year, up around 25% on last year.

Now back to James.

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

Thank you, Alex.

I’ll now update you on our Transformational Cost Management Program where we’re making strong progress. In April, we announced we were targeting annual cost savings in excess of $1.5 billion by fiscal 2022. We now have a clearer line of sight to multiple cost savings initiatives over a multiyear period, and this gives us the confidence to increase our target.

We’re now raising the annual cost savings target to in excess of $1.8 billion by fiscal 2022. Additionally, we are rolling working capital programs into the cost management program governance, and we see meaningful opportunity to reduce working capital investments over the coming years.

Regarding implementation costs, our estimates are unchanged versus the 8-K we filed on August 6. We continue to estimate that the program will result in cumulative GAAP pretax charges of approximately $1.9 billion to $2.4 billion. And we recently rebranded the cost management program internally. It’s now called Save to Invest to Grow.

This emphasizes that we must not only reduce costs to become the leanest operator, but we must also save more to generate the investment dollars needed to fuel long-term capabilities and growth.

Let me give you a quick update on some of the actions taken in the quarter.

On smart spend, we’ve started making policy changes. For example, we are changing how we manage the external consultants, mandating competitive bidding and making the contracts more outcome-based.
On smart organization, last week, we made select reductions in the U.S. support office, and additional restructuring is underway in our Retail Pharmacy International and Pharmaceutical Wholesale divisions. We are also working hard to define our new vision and road map for business services.

We have completed the review of our real estate footprint, and the actions are well underway in both the U.S. and the U.K. And dedicated teams are working hard against our biggest programs, particularly pharmacy costs to fill and shrink.

We've reorganized our global, digital and IT leadership under a new Chief Information Officer to improve execution and focus. We've also defined a new operating model for our day-to-day IT operations, and we've refocused our IT and digital spent to our growth priorities.

Now let's turn to 2020.

Let me start by providing some key assumptions for the upcoming year. We are projecting a full year adjusted effective tax rate of around 17%, and this may vary depending on the level of discrete items in the year. This will reduce adjusted EPS growth by approximately 2 percentage points as we lap an exceptionally low tax rate in fiscal 2019.

We anticipate full year share repurchases of $1.75 billion. While this is lower than the $3.8 billion of repurchases in fiscal 2019, it is entirely consistent with our prior indications. Share repurchases should contribute around 3.5% to adjusted EPS growth.

Within the guidance, we are investing heavily to transform WBA, including modernizing and upgrading our core foundational pharmacy systems and implementing SAP in the U.S.

We are also investing in new digital capabilities, and we have fully funded the multiple pilots that are ongoing across health care and retail.

In fiscal year ’20, we expect to invest $800 million to $850 million, an increase of $250 million to $300 million over the prior year.

In terms of operating expenses, we expect to invest $300 million to $350 million in 2020, a year-on-year increase of $100 million to $150 million.

Looking specifically at capital expenditures, we anticipate investing around $500 million in fiscal 2020, and this comes on top of $350 million in fiscal ’19.

In summary, we are investing strategically to modernize and transform our capabilities to drive future growth. Finally, while we don’t provide currency guidance, we have provided our internal currency rates in the appendix. As you will see, these assumptions are quite dated and, at the time, suggest that we could face a negative year-on-year currency impact of around $0.05.

The only thing we can be sure of is that we can expect the situation in the U.K. to remain fluid. The pound/dollar rate has moved quite a bit, and external estimates range from $1.14 to $1.35.

Turning now to adjusted EPS guidance for 2020. We are projecting constant-currency adjusted EPS growth to be flat and for a business of our size, you should expect a range of plus or minus 3%.

As you work through your models, please note that year-on-year adjusted EPS growth is negatively impacted by a lower bonus payout in 2019, and this is a headwind of 6.5%.

As we look at adjusted EPS phasing for fiscal year 2020, we expect a balanced performance between the first half and the second half with potentially a slightly stronger second half.

Let me now summarize the projected key drivers of adjusted EPS. The lower 2019 fiscal bonus payout leads to a headwind of 6.5%. Obviously, this year-on-year impact will negatively impact both SG&A expense and adjusted operating income.
The higher tax rate has an impact of approximately 2%. On the other hand, our share repurchase program should generate a favorable tailwind of around 3.5%. Excluding these headwinds and tailwinds, we would expect operational growth of around 5%.

Within this 5% number, we are funding the incremental investments I mentioned earlier of around 2% and an approximate 1 percentage point impact from removing e-cigarettes from our stores.

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

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

Thank you, James. Nobody should be surprised by what we have told you today. After our poor second quarter earnings, we told you what we would be doing and we have delivered for 2 quarters.

As you have heard, we anticipate a reasonable underlying operating performance for the coming year with solid underlying growth in most of our core businesses. This is very much in line with what we told you some months ago.

The action that we have taken to transform our businesses and the drive and focus with which our teams our pursuing our strategic priorities gives me confidence in our ability to deliver this growth. I strongly believe in an expanded role of a pharmacy and in our company’s ability to play a significant part in shaping how health care is delivered in the community going forward.

I remain convinced that we have, in our company, through our partnerships, an extraordinary foundation on which to build. The work currently underway on innovation and transformation across all our businesses, will mean we can and will continue to deliver real value for our customers and investors for many years to come.

Thank you. Now we will take your questions.

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**QUESTIONS AND ANSWERS**

**Operator**

(Operator Instructions) Your first question comes from George Hill with Deutsche Bank.

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

I guess, so, James, I think one of the things that investors are going to struggle with this morning is it looks like if you back out all the puts and takes, the company’s guiding to a 4% to 5% core OP growth in fiscal 2020. I guess, can you walk through some of the components of that about maybe a little bit on how the company’s thinking about volume growth. And I think particularly reimbursement is going to be a big question in 2020. So I guess, from a fundamental perspective, is, how are you seeing the business? Kind of what are the building blocks for growth for 2020?

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

Yes. So that’s a good question. So we did call out the operating performance once you take out the headwind coming from the prior year bonus of around 5%. And within that as well, we’re also covering 2 percentage points of growth investments, so you’re getting closer to a 7%. And then we’ve removed e-cigarettes, so you could -- actually, if you strip out, these are all the puts and takes we’ve laid out on Slide 19.

So the way I think you should think about this is we expect relative stability in the wholesale business. So you’ve seen the very strong performance in the current year. And I’d be calling on a mid-single-digit revenue growth. And then I think as you look at the RPI segment, you’d be looking at
probably flat to declining revenue until we see line of sight to improve market circumstances in the U.K. And that's the only question mark we have on the segment.

And then in the U.S., I think this year, the way you should rationalize the U.S. is this year, we had a contribution coming from Rite Aid. If you kind of remove the contribution, I think we're looking forward to pretty strong script growth is our outlook.

And then secondly, we see continued recovery in the retail business. So we had a very strong exit on retail compared with the first half. The same in pharmacy. We saw a strong recovery on scripts second half, first half. We expect to see a continuation of the improved trend. So that would lead to a low single digit revenue in the U.S. business. So I think if you look at the total company, I think we're looking at something in the low single digit revenue growth maybe 2%, maybe 3%.

So take out Rite Aid this year and you get pretty close to the same kind of number. The way we thought about reimbursement is we've planned reimbursement slightly higher than the last 3-year average, and we expect 2020 to be a continued tough year on reimbursement. And we've planned it relatively conservatively higher than the last 3-year average, and we're not giving any more information on that.

And then you've seen with the call up of the cost management program, that should give you the confidence that we will have significant leverage on the cost side too, so a combination of the solid revenue growth, plus generic procurement savings continuing at a similar level, plus a cost program that is really ramping up and gaining pace, gives us the comfort that we get to this mid-single-digit kind of range before the bonus impact.

And no I'm not giving you a lot of insights here into how we talk through this. So reimbursement, a little bit higher than in the past, but a much stronger cost program to give us the confidence to deliver this base case.

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

James, that's super helpful. And then, I guess, my quick follow-up would be, it sounds like this cost program, we should expect to see a lot of it flow through to the bottom line as opposed to reinvestment, I guess, that's the right way to think about that.

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

Yes. It's an interesting question, and that's why we won't be providing growth savings on the call because I have a philosophy on this, which is, the only thing that matters is what hits the bottom line. And you know the circumstances of the company. And if you think about it if you save on a gross basis, you're going to offset your inflation. And for a company this size, you can work it out. It's probably $250 million. And then if you're growing your scripts 3%, 4%, 5%, that's another $100 million of incremental costs because you have an incremental cost impact every time you fill in new scripts. So you can be quite easily -- before you start the year, you're facing a $400 million headwind. So that's the first part. How do you offset inflation? And how do you offset the impact of volume growth?

The second one, as you've seen, we've taken a very strong stance on the investments. And I don't want that message to be lost. We're hitting the previously indicated guidance range with substantially higher investments. And that's what the cost program is helping us deliver. So we, quite hopefully, put in the magnitude of the investments we're actually spending this year. And it somewhat gets back to the age of some of the systems we have in the company, where 40% of that investment we have year-on-year is going on new pharmacy systems in the U.S. and U.K. and implementation of SAP in the U.S. We will be able to take out an enormous amount of inventory over the next 3 years as we implement these systems. Enormous. So these systems will pay for themselves.

The second, the next, call it, third, is on new digital capabilities. And then the final piece is, every time we do a pilot -- and the pilots are starting to scale up. We have 50 plus, 70, 67 just on Kroger. It costs quite a bit of money to reorganize the stores and try these pilots. These are all fully funded.
So that's the long answer to your short question was the overhead is to pay for inflation. It's the dramatic step-change in the investment profile of the company to drive sustainable, long-term growth. That's the business we're in. We have to drive growth longer term, and then finally as part of the business model, where reimbursement is offset by general procurement savings volume and SG&A and cost discipline.

Operator

Next question comes from Lisa Gill with JPMorgan.

Lisa Christine Gill - JP Morgan Chase & Co, Research Division - Senior Publishing Analyst

James, I just want to go back to your comment around the strong Rx growth expectation going into 2020. You did talk about the relationship on the preferred side for Medicare with United, but is there anything else that's specifically driving that, would be my first question.

And then secondly, you talked a little bit about the incremental costs around some of these pilot programs, et cetera, but are you starting to see any benefit from some of these pilots and initiatives in the 2020 guidance that you're giving?

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

Yes. Let me give you -- I'll give you a quick answer and let Alex then take the more detailed one. Our point on the scripts is if you take the second half versus first half, the scripts are now running at second half, 4%. And we had, as you know, a very weak first half. We were up 1.9%. And that's because we were lapping these, call it, network changes, where we lost 2 points in the previous 12 months.

And then as you look at the investment profile, I guess, that's the upside scenario. We are quite conservative. We build in the cost of executing the initiatives. We do have working capital benefits built in our internal plans. They're quite sizable, so we do expect returns this current year on cash flow.

On the pilots themselves, we're not counting on significant flows of income in 2020. These will be building over the next 3 years, and it depends on the success. Any one of them can become significant upside. We just have to see how the pilots play out in the next 12 months.

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

Thanks, James. Hi, Lisa. Morning. Yes, I think regarding prescription growth, we see a return to normal market in Med D, driven by the fact that we got preferred relationships with some of the bigger plans. And we may have lost some of the small preferred access, but they are very small numbers otherwise. So overall, we feel pretty good about that. You saw an announcement with Centene, where we intend to be more proactive in the a Medicaid space going forward as well. There's still areas that we're working on. First of all, we are able to retain more customers. For example, I mentioned Save a Trip Refill in our prepared remarks. That's driving better retention adherence.

And last, not least, of course, we are able to consolidate pharmacies, not just already, but the marketplace is changing. We're seeing more pharmacies than normal on the marketplace. And we have a good pipeline of pharmacies that we'll be able to secure in the future and consolidate as the number of pharmacies in the U.S. for the first time, for a long time, seem to be in decline. So we're pretty confident that we'll be at the mark -- or maybe somewhat ahead of the market overall with all of these initiatives in terms of pharmacy growth.

Lisa Christine Gill - JP Morgan Chase & Co, Research Division - Senior Publishing Analyst

Okay, great. And just as a follow-up, I just want to make sure I understand this. So we think about its operational growth of roughly 5%, James, you talked about top line of 2% to 3%. So we're talking about cost-cutting and leverage of this business, including, I think, I just want to make I heard this correctly, that reimbursement is higher. And when you think about it, the reimbursement cuts are higher than what you saw in the last 3 years.
So you're conversative on reimbursement. It sounds like, Alex, that you have a line of sight to where the scripts are coming from, from that perspective, 2% to 3% on the top line. Cost-cutting is going to get you to that 5 percentage range. Do I have that all correct?

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

Yes. Just be careful. The revenue doesn't track the scripts. So for example, and I won't say much more than this, if you assume higher generic penetration, which typically improves and has been improving over a fairly long period of time and will still improve, not by major amounts, that will have a deflationary impact on your revenue. So we would believe that the scripts would be higher than 2% to 3%. So there'll be much more leverage in the income statement. So the 2%, call it 3% of revenue, that includes a deflation assumption for a higher utilization of generics.

Operator

Next question comes from A.J. Rice with Crédit Suisse.

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

First, I know there's a reference in your U.S. Retail Pharmacy comment to improve a higher brand inflation. I wonder if we can get you to comment on what you saw -- what you're referring to there and where did you end up for the year, and maybe any comment on what’s embedded in your outlook for 2020.

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

Yes. We are -- on brand AWP, we think the average on a mix constant basis that we saw over the entire year was about 5%, but it was trending up in the second half of the year. So the actual assumption on brand AWP doesn’t have a massive impact on the income statement. Honestly, the generic consumptions are much more important, but we're planning roughly the same kind of number. We're planning at the average level of the year. So more like a 5%. We're not planning on -- in the 8%, sort or 9%, where it has been touching in some recent months with a lot of...

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

Yes, that's right, A.J. I think -- and, obviously, you look at the innovation in the marketplace and see what we're getting as well, and in this particular year be more or less marked. So I agree with James. A general increase has been happening this year, but we're not banking on it continuing, and we see a trend a bit the same going to next year.

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

Yes.

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

Okay. And then maybe just following up -- or second one. On the pilots, I know it's a little unclear when they're going to swing positive, but I just want to make sure I understand. Is the main concept of the contribution from those, the LabCorp, the VillageMD, the stuff with Optum and Humana, is that foot traffic? Is it your percentage of the earnings of those entities themselves? How's the company going to benefit from those ventures?
James Kehoe - Walgreens Boots Alliance, Inc. - Executive VP & Global CFO

It is a mix. Yes, it’s a mix. Each one will be slightly different, but you could envisage that a fairly standard one would be -- there’ll be a rental contribution because we’re giving up space in the store. There’s probably some element of a share of the total business that the supplier does in that case, the partner does in that case. And then, arguably, the most important one is the foot traffic benefit, where we have quite sophisticated models in the case of existing types of businesses. So we know if there’s a primary care. That’s why we’re testing these pilots. We’re trying to see the uplifts on both retail and on scripts. So you’ve got 3 sources of income in most cases.

And when we say there isn’t a contribution, the FedEx agreement delivers favorable contribution already. And we’re already at full capacity, basically. Already, LabCorp, on an income basis, is positive. What’s negative is we’re investing capital every time we touch the store. So it’s more a cash flow negative. Some of these are neutral to positive already, but as we roll out the 600 LabCorp stores, there’s capital being expanded to reset each of the stores.

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

A.J., I think just one additional thing. The halo was quite important, particularly in pharmacy. So we are really looking to see -- convinced that having a general practitioner in a pharmacy alongside a pharmacist working together not only drives additional prescriptions and a, which is completely legal, but also provides better patient care. And that combination will lead to new platforms in the future we’ve spoken about as we look to not just provide a digital care, but also digital care in the community.

So again, it’s early days, but we are very excited about this idea of doctor-led and pharmacist-enabled and cleaning that partnership going forward in that model, yes.

Operator

Next question comes from Peter Costa with Wells Fargo Securities.

Peter Heinz Costa - Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst

Can you talk a little bit more about your AllianceRx Walgreens Prime specialty solutions business versus the Shields Health Solutions business? And what is your strategy going forward for bringing in the specialty revenues to the company?

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

Sure. Peter, it’s Alex here. Yes, I think that they are set at the moment. So let me deal with our investment in Shields to start with that. They really walk with health systems to enable the health system to take better care of the patients as they go back into community. We have a number of local assets, both in hospital systems and also specialty pharmacies, where we want to make sure that working with the local health system, we can help them to service and take care of that patient more directly. So it’s early days, but that’s the model there. Really, it’s a community model.

Our work With AllianceRX is really about the central model in the mean, and, of course, working very closely with the owners of Prime, which are the Blues, and particularly the financial contracts. Obviously, we’ve put together our business with their business just over 2 years ago. And the business is now performing, from an operational point of view, very well, but, clearly, the market is changing, and we’re looking forward to how we can, of course, accelerate growth and work even closer with the Blues in that model going forward.

So if you think of them as 2 separate areas at this stage, and, of course, we recognize the incredible importance of specialty and the new drugs in the marketplace in the years ahead, I think 50% of the value of medication will be in specialty within 3 years. So of course, we’re working very hard on both the individual piece I’ve mentioned, but also how we combine the Walgreens brand and all of our assets over time to create a more powerful specialty model with our -- partners.
Peter Heinz Costa - Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst

Can you help us understand more how the revenue stream is going to flow from these various products in terms of -- and concepts that you have in specialty because of more of a clearer strategy from you in terms of what your goal is to deliver?

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

Well, I think -- I'd go back to the central model, which is the predominant one at the moment in terms of the model there. You can see that our growth has been pretty reasonable this year in 20%. And that will continue as a market growth. We want to grow with Prime and grow it with that model.

The other -- and, of course, 340B, again, is another area where we're growing as well. So that's pretty clear. Now, again, we're not the biggest, but we're a lot bigger than we were 2 years ago and growing faster than we were 2 years ago.

With the Shields one, it's an early stage investment. We're a minority shareholder, and we're developing the local community model and specialty. We believe that more and more patients will want to be taken care of closer to their home and closer to the community. And as drugs develop, there'll be new payment models. So we believe this model will be more suited, too.

Peter Heinz Costa - Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst

That's helpful. And then just separately, I just want to clarify something. The tobacco pressure from e-cigarettes of 1% next year, is that the only tobacco pressure? Or is there further of the tobacco deemphasis in next year's numbers?

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

We see continuing -- obviously, we will cycle, for example, New York City on January 1 when that was confirmed by the status coming out of tobacco for all pharmacies, and other states may well take action in a similar vein. We don't know yet. So we expect the pressure on tobacco sales to continue into next year, but not at the same extent as we had in the last 12 months.

Peter Heinz Costa - Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst

Okay. So that will be on top of that 1%?

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

Yes, but not as much as we've seen this year. This year, we've seen about 1% due to normal tobacco, and we think that will be less next year as we cycle particularly New York.

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

Yes. Just to confirm, the 1% only covers the exit of e-cigarettes, 1% of EPS, actually. And you would have a further pressure in the retail segment in the U.S., more on the revenue line as a result of the continued decline of tobacco.
Alexander W. Gourlay - Walgreens Boots Alliance, Inc. - Co-COO
Yes, yes. More than ready, yes, yes.

Operator
Next question comes from Kevin Caliendo with UBS.

Kevin Caliendo - UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare IT and Distribution
I'm a little confused in one of the comments you made earlier and that you expected reimbursement to be a little bit better than it had been over the last 3 years. Did I hear that correctly?

And I just wanted to make sure that was -- we did hear that correctly. And if you're referring to pharmacy reimbursement, as I thought there were some PBM renewals that were coming up, and I was wondering what the impact of those might be in terms of your guidance.

James Kehoe - Walgreens Boots Alliance, Inc. - Executive VP & Global CFO
I'll correct that. No, no. We actually said it will be worse than the average of the last 3 years. So -- and you're exactly right. The main reasons why '20 would be worse than the last 3-year average would be there's probably, I would say, higher percentage of PBM renewals in '20 than there is over the following 2 years. So that's the reason why we've planned that way. But you're exactly right, it's worse than the average over the last few years. Yes.

Alexander W. Gourlay - Walgreens Boots Alliance, Inc. - Co-COO
Okay, it's perfect. And what's happening with the commercial and the Medicaid plans? They're moving from 3-year renewals to more like 2-year renewals on average. And the bigger -- you know that there's been more consolidation that's happened. So that's actually the reason for James' comments.

Kevin Caliendo - UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare IT and Distribution
One quick follow-up. I think you're no longer a preferred pharmacy in SilverScript. Is that correct? And if so, can you just talk about what that might have done to the comps going forward?

Alexander W. Gourlay - Walgreens Boots Alliance, Inc. - Co-COO
Our position in SilverScript's hasn't changed. We've been generally either in the open or non-preferred really for quite a while. So that piece has not changed.

Operator
Next question comes from Ricky Goldwasser with Morgan Stanley.
Rivka Regina Goldwasser - Morgan Stanley, Research Division - MD

I’d start it with the direct savings. I think in the past, you said that the long-term plan is to save 50% to 60% of reimbursement pressure to be offset by generic savings. So when you think about that long-term goal, where are you at now into 2020?

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

We’re probably in the range of 40% to 50%. As I said, we change the planning assumptions quite frequently based on the latest visibility. We saw generic deflation in 2019 of around 8%. That’s mix-constant. So it would actually be lower than that if you include all the changes and new molecules that comes in. And we’ve planned relatively consistent with that, but I think, realistically, I think generic deflation over the next 3 years is probably a single digit kind of number, with some years going up a high single digit. I don’t think we’ll turn back to double digit kind of numbers. So we’ve adjusted. We’re probably in the range of 40% to 50% as we look forward in terms of how much of the reimbursement we expect to offset through procurement initiatives.

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

And I would answer -- sorry, Ricky, you go.

Rivka Regina Goldwasser - Morgan Stanley, Research Division - MD

No, no, go ahead.

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

I would just say that we’ve got good line of sight into these savings as well. We’ve been working on this pretty hard to make sure we protect our customers and we drive efficiency. And again, the volume increase that we spoke to earlier in the call, which will improve as the year develops is another important component of driving a more efficient pharmacy.

Rivka Regina Goldwasser - Morgan Stanley, Research Division - MD

So just to confirm, when we think about this updated number of 40% to 50%, is that 40% to 50% that you’re going to achieve in 2020? Or is that 40% to 50% that’s in the long-term plan?

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

Yes, that’s too specific a goal to be setting ourselves right now. I think we’ve already given enough thoughts, I think. But you can plot out -- I think if you can kind of triangulate this, if you assume by single digit deflation on generics, you can get close to the number.

Rivka Regina Goldwasser - Morgan Stanley, Research Division - MD

Okay. And then when we think about the modern multichannel strategy, you’ve announced a few months ago that you were going to close 200 stores in the U.S. Really, when you think about the strategy that it’s shaping out, when we think longer term over time, what is the type of the infrastructure? What’s the size of the store infrastructure you think needed in the U.S. compared to existing?
Alexander W. Gourlay - Walgreens Boots Alliance, Inc. - Co-COO

It’s Alex here, Ricky. We don’t see a lot of change. I’ve always been of the view that we can have roundabout 10,000 pharmacies probably more than we have today, although at different formats. So the format that we have today, really you see that a suburban or the urban store that we have in the big cities, we’re developing a small store pharmacy. We’ve got about, I think, 30 or 40 now actively in the ground. And we’re pleased with the results, lower cost, more focus on pharmacy and OTC health care, and, obviously, pick up as well. So we’re developing that format. So we still got opportunities to fill in some networks. And going forward -- and I think also remember, there are 65,000 pharmacies thereabouts in the U.S. today, and they’re coming down in number. So we believe that our efficient supply chain, the strength of our brand and the quality of our pharmacists and the support they’re getting through the new IT information structures and digital capabilities we’re investing in that we will be able to improve not only just the efficiency of the pharmacy, but the quality of the care that we provide to patients and payers going forward and have more percent of the pharmacies in the U.S. over time.

Operator

Next question comes from Brian Tanquilut with Jefferies.

Brian Gil Tanquilut - Jefferies LLC, Research Division - Equity Analyst

Just a follow-up to that comment and question from Ricky. So as we think about where the store base is going, going forward, where you’re adding a lot of services, Kroger, LabCorp, FedEx, how should we be thinking about the gross profit dollars per store? I get the gross margin commentary of how you guys are obviously doing a lot of things there, but how should we be thinking about the gross margin profile — or the gross profit dollars, given that it becomes more like rent revenue rather than true gross profit margins?

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

Yes. It’s Alex here. Again, we do have a successful front-end-business. And I know we’ve not spoken about that very much today, and that’s improved materially from a profitability point of view over the last period. So I think that you should think about costs coming down from a rental point of view, for sure, both in terms of -- as we rent space, but also as we take advantage of the fact that we’re overrented today and a lot of these leases are coming towards us in the years ahead.

In terms of cost profit dollars, our intention is to drive sales and drive profitable growth going forward. I don’t know, James. You want to speak about the rental opportunity?

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

I think if you think about it, though, the first place you go to is the storage in the stores. So these stories were built in a time when a lot of inventory was in the physical location. If you plot out 3 years from now, there’ll be no inventory in the stores in the back-office. So that freed up a couple 1,000, 2,000 square feet per stores. So if you think about it, the first piece of the development was free because we’ve downsized the back-office and the storage space. So the impact on our revenue throughput was minimal.

And as we go through each of the partnerships, because we’re getting an uplift, there’s a lot of science that goes into this. So we’ll be losing -- if you shrink the size of your retail footprint, how much you are losing versus you’re going to get some uplift from the increased traffic, I don’t think you’re going to see a massive reduction in the space -- sorry, in the revenue as a result of this. Quite the contrary. So what you end up with is a more efficient box, where you’re probably dedicating less space to some categories where you weren’t making very much money. You’ve gotten rid of your storage. You got rid of your back-office. And then you’ve got value-added services who are attracting different customers in there. And ideally, your foot traffic has gone up as a result of that and a more efficient sales per square foot. So I don’t think you’ll see the revenue. I think Alex is right. I think you’ll see the revenue find consistent with what we have potentially improving. And then you see a big change in the rent. And bear in mind that we’re quite overrented, so it’s a long-term opportunity for the company. Or versus our competitors, we probably, years ago, entered
into lease contracts that were in the best locations, the nicest places and probably overpaid a bit. So as you look forward over a multiyear horizon, we would expect consistent, quite material reductions in the cost of rent.

And then at the same time, we make each store more efficient in what’s in each of the stores. I hope that gives you enough insights on it.

Brian Gil Tanquilut - Jefferies LLC, Research Division - Equity Analyst

No, that’s great. Just my follow-up. As we think about 2020, are there any network changes you want to -- you need to call out just so that we're aware of? Or is it clear?

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

Oh, it’s pretty clear. I mean, I think there’s been -- obviously, there’s been the conversation high over the weekend, which we were aware of a few weeks ago. Disappointed that CareSource have taken this decision, but recognize that’s their decision to take. But we are -- have got other games to make that up in other networks. So we think it’s pretty balanced over the year, and we’re very confident in our ability to grow the market in 2020.

Operator

We have a question from Steve Valiquette with Barclays.

Steven James Valiquette - Barclays Bank PLC, Research Division - Research Analyst

Yes, so with Walmart announcing a big push in the primary care clinical services and a perception among some investors that Walmart may be offering these services at lower prices than the competition, I guess, I'm just curious to hear your high-level thoughts on whether this may influence your pricing or marketing strategy and/or the timing of rollout of your own clinical services strategy at Walgreens over the next couple of years. And then on the plus side of this, could the -- just the notion of greater visibility overall on primary care offerings in the traditional retail setting maybe be a net positive for Walgreens and really all the players at this early stage?

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

Thanks, Steve. Yes. No, we think that it's a good move for retail to be involved in health care as that happens in a place like Walmart in 206, huge, successful company, and they do it well, then we think that'll help us because we've got a great brand. We think we've got strong, better community locations. And we've got more focus on pharmacy there and more focus on health care relationships. So overall, we think that's going to be an advantage to us. And we will continue with our own strategy developing and investing in the way that James and I have described this morning.

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

You see, we have declared that we have been very open sometimes ago that we wanted to change our model, that we wanted to really create not just a physical transformation of our pharmacies offering more and more services to our customers, but we wanted to change the model. Having a complete different relationship with our customers, and this is what we are doing, and you can see small things here and there that are already public that give -- can give you this feeling.

Now everybody is coming to this concept, but I can assure you that we are quite advanced -- more advanced than you can see outside the company. And we have done a lot of tests because when you change something in the company and you roll over your new ideas to the stores, you have to invest a huge amount of capital. And so you have to be sure that you are doing the right things. And this is why we are doing so many tests, and this is why we are working behind the scenes to prepare our future in something that could give us the right return in a reliable way. So we are not
worried to see that everybody's going into this direction because this is what we saw 2 years ago, maybe more, 3 years ago. And we are working on that. And we believe that at the end, we are more advanced than other people, even though this is not clearly understandable outside the company.

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

Thank you, Stefano. And we haven't, I know, answered all your questions, but that's all we do have time for on the call. As ever, Jay and the IR team are here to take any further questions you have off call, but thank you all for joining us today.

Operator

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

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