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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Rite Aid Second Quarter Fiscal 2020 Earnings Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions). Thank you.

I would now like to hand the conference over to one of your speakers today, Byron Purcell, Treasurer and Investor Relations. Please go ahead, sir.

Byron Purcell - *Rite Aid Corporation - Senior Director of Treasury Services & IR*

Thank you, and good morning, everyone. We welcome you to our second quarter earnings conference call. On the call with me today are Heyward Donigan, Chief Executive Officer; Bryan Everett, Chief Operating Officer; Ben Bulkley, Chief Executive Officer of EnvisionRxOptions; and Matt Schroeder, Chief Financial Officer.

On today's call, Heyward will provide introductory comments, Bryan and Ben will provide an update on the business, Matt will provide an update to our second quarter results and review guidance for 2020, and then we will take questions.

As we mentioned in our release, we are providing slides related to the material we'll be discussing today. These slides are provided on our website www.riteaid.com under the Investor Relations information tab. We will not be referring to them in our remarks, but hope you'll find them helpful as they summarize some of the key points made on the call.

Before we start, I'd like to remind you that today's conference call includes certain forward-looking statements. These forward-looking statements are presented in the context of certain risks and uncertainties that can cause actual results to differ. These risks and uncertainties are described in our press release, in Item 1A of our most recent annual report on Form 10-K and in other documents that we file or furnish to the Securities and Exchange Commission. Also, we will be using certain non-GAAP measures in our release and in the accompanying slides. The definition of the non-GAAP measures along with the reconciliation to the related GAAP measure are described in the press release and the slides.

With these remarks, I'd now like to turn it over to Heyward.

Heyward Rutledge Donigan - *Rite Aid Corporation - CEO & Director*

Thank you, Byron. And thanks to everyone for joining us. I am very pleased to be here with my team at Rite Aid.

Our company's associates, loyal customers and communities are a strong foundation for Rite Aid. I've spent the bulk of my career in the health care industry focused on meeting the needs of employers, health plans, health care providers and most importantly, consumers in the need of health care. I've served in leadership roles at companies like Cigna HealthCare, Premera Blue Cross, ValueOptions and Sapphire Digital. So I really understand both the basic needs of the health care consumers and really the complexity of the system that's tasked with addressing these needs. Rite Aid pharmacists play a crucial role in this health care delivery system. Our teams are on the frontlines of health care delivery, engaging with health care consumers every day, including promoting prevention and wellness in our communities. Millions of Americans depend on Rite Aid pharmacies for their health care and wellness needs. Millions of Americans also shop with Rite Aid for their everyday items and millions more rely on EnvisionRxOptions to provide important pharmacy services. I am committed to growing the Rite Aid brand as this company continues to evolve even more as a health and wellness destination.

At the same time, I recognize this is a challenging time for our company. And in the spirit of the transparency, I acknowledge that Rite Aid is right for a turnaround. Rite Aid needs a clear new strategic vision and a pathway to execution that drives future organic growth and profitability. I have a track record of organic growth in both revenue and profits. I also held roles where my job was to disrupt the status quo and jump-start corporate transformation. This is the focus I'm bringing to Rite Aid. I've been with this team now for 45 days. I have visited stores on the East Coast, the West Coast. I've met with our field leadership teams, our store teams and our pharmacy teams. I've also met with the EnvisionRx team to review their pharmacy services strategy. I've worked closely with our leadership teams to understand the challenges they face day-to-day. This discovery will continue with urgency in the months to come. We are developing a go-forward strategy for all aspects of this business. It is a new day at Rite Aid, and I'm excited to take some important first steps in the weeks to come. We will be finalizing our strategic plan in the coming months and look forward to communicating the key elements of our strategy with all of our stakeholders.

Now for the quarter. In the second quarter, I'm pleased that our team has been able to see the fruit of their hard work materialize into solid results. The team delivered prescription count growth and tight expense control, which helped us beat our plan for adjusted EBITDA. In the Retail Pharmacy Segment, we continue to have success growing our clinical pharmacy services business and building momentum behind our private brand offerings. In the Pharmacy Services Segment, EnvisionRxOptions delivered increased revenue and continued to grow its Medicare Part D business. While one quarter alone is not enough, the trends we are seeing in prescription count growth, current and anticipated future growth in pharmacy services membership, generic cost savings and SG&A expense control provide us with the momentum needed to deliver a solid finish to fiscal 2020.

Our team has worked hard to deliver these results, and I'm proud of our leadership team and our associates. It's my pleasure to introduce one of the key leaders to you now for additional details about our second quarter performance and an update on our key initiatives.

With that, I'd like to turn it over to our Chief Operating Officer, Bryan Everett. Bryan?

Bryan Bruce Everett - *Rite Aid Corporation - COO*

Thank you, Heyward, and thanks again to everyone for joining the call. I'd like to start by saying I'm pleased with the momentum we're building in key areas of our business as we continue launching unique and innovative experiences that engage our customers in new ways. A key highlight for the quarter was our continued growth in the pharmacy, with a same-store prescription count improvement of 2.7%. Our focus on clinical services as well as the high level of engagement from our pharmacists helped us deliver our fifth consecutive quarter of same-store pharmacy sales and prescription count growth. Ancillary immunizations, which protect against illnesses like shingles, pneumonia and measles, were a key driver and grew 65% during the quarter. This growth will provide us with important momentum as we enter the peak season of our flu immunization campaign. While visiting stores, I've seen firsthand how our teams are highly engaged in recommending that our customers receive their flu shot, which will be critical in protecting even more customers against the flu this year. In addition to strong in-store engagement, we're supporting our flu immunization campaign with a full 360-degree marketing plan that includes TV, radio, social, search and more.

Immunizations are a key part of our AIM strategy to deliver best-in-class clinical pharmacy services through adherence, immunizations and medication therapy management. To help support this additional volume growth in a cost-effective manner, we must also free up additional time for our pharmacists to provide these services to our customers. We're taking an important step forward by expanding our central fill capabilities from roughly 800 stores on the East Coast to approximately 1,100 stores, including locations on the West Coast. This means that additional stores will begin receiving shipments of predictive refill maintenance medications so our pharmacists can place a higher focus on this clinical care, and we expect to complete this expansion in quarter 3. By operating more efficiently and freeing up time for our pharmacists, we'll enhance our ability to deliver best-in-class clinical services. And while we continue to experience reimbursement rate pressure, our prescription count growth and better-than-expected drug cost savings helped us beat our pharmacy margin plan for the quarter.

In quarter 2, we also launched RediClinic Express to provide our customers with access to efficiently delivered virtual care. RediClinic Express delivers an enhanced assessment with integrated medical devices and point-of-care testing, distinguishing this solution from other virtual offerings. Since July, we have opened 5 pilot locations, and we will continue to evaluate the performance.

In the front end, same-store sales decreased by 0.6% when excluding cigarettes and tobacco. We had strong performance in OTC, personal care, skin care, vitamins and summer seasonal categories, but not enough to offset tougher comps in household chemicals and certain consumable items. At the same time, our front-end margin rate improved for the quarter, partly due to our focus on seasonal merchandising, circular advertising optimization and improving our own brand penetration. We recently achieved a year-to-date owned-brand penetration rate of 19%, which is a new record for our organization.

We have successfully expanded our iconic Thrifty Ice Cream brand to 900 additional stores in the Northwest and the Northeast, including the launch of our refreshed brand campaign and new packaging designs, and customer response has been positive.

We also have a robust pipeline of new own-brand items that feature increased focus on health, beauty and better-for-you natural and organic consumables. We will continue working diligently to further accelerate our own-brand growth heading forward.

Also during the quarter, we removed e-cigarettes and vaping products from all Rite Aid stores. We also increased the age for purchasing any tobacco product to 21 throughout our chain. Both of these important changes were completed ahead of schedule following our announcement in April.

As we reimagine our front-end offering, we also know that enhancing our digital capabilities presents a significant opportunity to develop stronger relationships with our customers while driving growth. Our digital business, although still relatively small, grew 58% in the second quarter. And as we continue to focus on growing our digital business, we're excited about our partnership with Adobe to leverage their new capabilities to help create a seamlessly connected experience for our customers across all in-store, online and mobile touch points. As a proven leader in marketing and digital experience solutions recognized by Gartner and Forrester, Adobe will play a central role in Rite Aid's digital journey. Leveraging these solutions, Rite Aid will optimize marketing investments to acquire customers and leverage rich customer insights to enable highly personalized experiences across digital channels, resulting in increased in-store and online revenue. Rite Aid will launch this new end-to-end personalized experience early next year.

We also recognize the importance of driving additional foot traffic into our stores to experience the high level of care and service we provide. Our partnership with Amazon to add locker and counter services to Rite Aid stores represents a key opportunity to drive incremental traffic and win new customers. We have now completed the rollout of Amazon Locker to more than 900 Rite Aid locations. In addition, we've rolled out Amazon's new Counter service to more than 650 stores and plan to have this service launched at over 1,500 locations in quarter 3, providing an Amazon pickup option at every Rite Aid location.

We're encouraged by the initial success of our self-checkout pilot, which is currently underway. Customers are responding positively, and we are seeing increased transaction counts and sales growth in these stores without adding incremental expense. Our plan is to expand to 100 higher-volume stores throughout the third quarter, and we are optimistic about the potential this has to deliver an enhanced experience to additional customers and drive sales.

As I conclude my remarks, I'd like to thank the entire Rite Aid team for all they're doing to deliver great customer experiences and grow our business while controlling costs. Our associates continue to embrace the many innovations we are launching and the tremendous opportunity we have to engage our customers in new and exciting ways. I continue to be inspired by the extraordinary passion and commitment of the Rite Aid team.

Thank you for your time. Now I'd like to turn it over to EnvisionRxOptions' CEO, Ben Bulkley, for an update on our Pharmacy Services Segment. Ben?

Benjamin Earle Bulkley - *Envision Rx Options Holdings, Inc. - CEO*

Thank you, Bryan. Despite some modest margin compression in the EnvisionRxOptions' second quarter results, we feel good about achieving our business plan for the quarter. We have won a substantial amount of lives in our health plan and MedTrak businesses as well as in our Part D plan. As we have mentioned previously, the margin compression in quarter 2 is attributable to a few large off-market contracts that did not renew as of December 31, 2018. We also successfully modified several contractual relationships that contributed positively to EBITDA in quarter 2 and will beyond as well.

Our progress in attaining more lives in the health plan business is because of our position as an independent pharmacy services alternative offering a flexible model. Clients and prospects indeed share their support for EnvisionRx as an essential option in the marketplace. We're excited about being an experienced, independent solution at a time when there is meaningful concern about the larger PBMs combining with their health plan competitors. Our MedTrak PBM business, a traditional PBM focused on small, self-insured employers, continues to perform well and is a growing component of our company. And while core Envision PBM offers our transparent pricing model, we have seen some clients renew under a traditional pricing arrangement in that business because of the improved client-side pricing guarantees this allows.

We will continue to follow our clients' preferences on contracting traditional or transparent pricing models. Part of our improved performance is because we're better managing our pharmacy network relationships. We're better optimizing the balance between client-side pharmacy contracts as well as the network side of pharmacy agreements, which has contributed to our improved financial performance. We are also pleased with our momentum in the current 2020 commercial selling season with now having won over 360,000 commercial lives and several prospects in the pipeline to wrap up the year.

We have also won new white-label PBM arrangements with our Laker Software business. Our health plan segment and our MedTrak business are both achieving strong double-digit growth. We are working to improve retention in our commercial client base and at this stage are still seeing double-digit growth of net new lives for calendar year 2020.

Our Medicare Part D enrollment continues to expand as well. All told, over the past calendar year, we've gained approximately 107,000 lives in the Part D sector and now have roughly 672,000 enrolled Part D members for plan year 2019. Importantly, our number of chooser members in our Med D plans has increased from approximately 77,000 in calendar year 2016 to 369,000 today.

As with our other lines of business, specialty pharmacy continues to be an important opportunity in our go-forward strategy, and Envision specialty second quarter revenue continued its growth in this key area of our business. Year-over-year specialty revenues for the second quarter increased by approximately 28% compared to the second quarter of the previous year. Operationally, we've made important progress by leveraging our lean approach to the business. We are focused in a few areas of the business to improve our operating performance, our cost structure and the service levels so important to our clients and their employees and members. We are very excited by the traction we're beginning to see everywhere we deploy this approach to better manage our workflows end-to-end. We are very optimistic about the potential for this business at a time the market is seeking an independent alternative.

Thank you for your time. Now I'll turn it over to Matt Schroeder, our Chief Financial Officer, for more information on our financial results.

Matthew Schroeder - *Rite Aid Corporation - CFO*

Thanks, Ben, and thanks to everyone for joining us today. On this morning's call, I will walk through our second quarter results and review our fiscal 2020 guidance.

Revenues for the quarter were $5.4 billion, which were down approximately $55 million from the prior year's second quarter. Adjusted net income in the current quarter was $6.3 million or $0.12 per diluted share versus an adjusted net loss of $7.9 million or $0.15 per diluted share in the prior year quarter. The improvement in our adjusted net income was due to lower impairment charges in the current quarter partially offset by a decline in adjusted EBITDA, which was $134.2 million in the current quarter compared to $148.6 million in the prior year quarter.

Retail Pharmacy Segment revenue for the quarter was $3.85 billion, which was $63.4 million lower than last year's second quarter. Our increase in same-store sales was offset by the impact of the 62 stores that we have closed since the end of last year's second quarter. Same-store sales increased 40 basis points in the quarter. Front-end same-store sales were down and 1.8% but down 60 basis points when excluding cigarette and tobacco sales. Pharmacy same-store sales increased by 1.5%, with same-store prescription count of 2.7% on a 3-day adjusted basis due to the success of our clinical initiatives and immunization programs. We expect prescription count growth in the back half of the year to continue to be solid due to our immunization and clinical programs and the regaining of access to a large managed Medicaid network.

Total Retail Pharmacy Segment gross profit dollars in the quarter were $19.2 million lower than last year's second quarter, and gross margin was flat as a percent of revenues. Adjusted EBITDA gross profit was unfavorable to last year's second quarter by $12.5 million, but 12 basis points better than prior year as a percent of revenues. Our decline in adjusted EBITDA gross profit was primarily due to our decline in front-end sales. Pharmacy gross profit dollars were flat as continued reimbursement rate pressures were offset by generic cost savings and same-store prescription count growth.

Retail Pharmacy Segment SG&A expense for the quarter was $24.1 million and 18 basis points better than last year's second quarter. Our adjusted EBITDA SG&A was flat to the prior year as the current quarter's strong payroll and expense control offset lower TSA fee income from Walgreens.

Our Pharmacy Services Segment had revenues of $1.58 billion, which was an increase of $17.3 million or 1.1% due to an increase in our Medicare Part D revenues as we continue to grow our membership. Adjusted EBITDA for the Pharmacy Services Segment of $41.5 million was $3.5 million lower than last year's second quarter.

Pharmacy Services Segment adjusted EBITDA benefited from improvements in pharmacy network performance but these improvements were offset by increases in SG&A expense as we continued to invest for current and future growth.

Our cash flow statement for the quarter shows the use of cash from operating activities of $279 million in the current year's quarter compared to a use of cash from operating activities of $285 million in the prior year quarter. As I mentioned on our last call, we expect our fiscal 2020 cash flow from operations to fluctuate from quarter-to-quarter due to seasonal inventory builds in our retail business and the timing of the build of the current year's CMS receivable, which occurs primarily in our second quarter, versus receipt of the prior year receivable from CMS, which occurs in our third quarter. We expect to generate positive cash flow during the back half of the year due to the receipt of payment of the 2018 CMS receivable and initiatives to reduce inventory and improve payable terms.

Our debt balance net of cash was approximately $3.7 billion at the end of our second quarter, and our pro forma leverage ratio was 6.8x adjusted EBITDA, which takes into account the pro forma impact of proceeds from the sale of the remaining distribution centers to Walgreens. We are projecting our leverage ratio at the end of fiscal 2020 to be around 6 due to the receipt of the CMS receivable, seasonal inventory activity and the working capital initiatives I referenced earlier. Our liquidity of approximately $1.4 billion at quarter end was very strong. And with no debt maturing until 2023, we have the flexibility and runway to execute our strategic initiatives.

Now let's turn to our fiscal 2020 guidance, which we are updating at this time. Our guidance assumptions for the remainder of the year reflect expectations for continued prescription count growth, generic drug cost savings and strong SG&A expense control offset by reimbursement rate pressure. Our guidance also assumes Pharmacy Services Segment performance consistent with what we saw in the second quarter driven by continued improvement in pharmacy network performance. We expect total revenues to be between $21.5 billion and $21.9 billion and same-store sales to be in a range of flat to an increase of 1%. We expect net loss to be between $235 million and $275 million. We expect adjusted EBITDA to be between $510 million and $550 million and expect adjusted net income per share to be between 0 and $0.56 per share. Our net loss guidance includes an estimate of $90 million for restructuring expenses related to the rightsizing of our organization that we announced at the end of fiscal 2019 and our transformation initiatives. A large portion of the restructuring expense is for severance costs related to headcount reductions. We expect the amount of restructuring cost incurred to decline in the back half of fiscal 2020. Keep in mind that this restructuring expense is not part of adjusted EBITDA or adjusted net income.

Our fiscal 2020 capital expenditure plan continues to be $250 million. As we work on building out the elements of our strategy, we will be taking a critical look at our capital spending for the remainder of fiscal 2020 and fiscal 2021. Our remaining capital expenditure spending for fiscal 2020 will include a continued emphasis on prescription file buys and investments in technology that will drive growth.

This completes my portion of the presentation. And with that, we will now be opening the phone lines for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Robert Jones with Goldman Sachs.

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

Heyward, good to connect with you again. I appreciate the comments about the turnaround and the need for a new strategic vision for the company. I feel like many investors probably see some of these issues facing Rite Aid as really driven at an industry level, if you will, so anything about persistent reimbursement rate pressure, this trend toward more narrow networks, I know it's early days and you'll be updating us on your vision over the next few quarters, but I just wondered maybe at a high level if you could share how much do you see as within the company's control and if you kind of think forward, how do you think Rite Aid can be repositioned to turn around in this challenging environment?

Heyward Rutledge Donigan - *Rite Aid Corporation - CEO & Director*

Yes. Thank you. Great to hear from you again, and I -- listen, I've been in health care my whole career and I've served in different areas of health care and on boards that have faced these same exact pressures, just different industry, but same reimbursement pressure, same environmental issues, health care in less of a world we live in. And so I do fundamentally believe that we have to overcome these headwinds, and we can overcome these headwinds. That's just a part of being in health care. I, having been here now I think enough time to really understand the economics of the business and the fundamentals of the company, do believe that this is mostly an execution issue, and that we can thrive in this environment. Especially, in the EnvisionRxOptions business where there aren't these same headwinds where there are actually more tailwinds in the business. So we're pretty excited about our opportunity to execute against this -- I'm very excited about the opportunity to execute against this fundamental basic blocking and tackling is going to take us a long way. More to come, though, on the strategy.

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

And then, Matt, maybe just a tactical one. I know you guys had expected the TSA income to decline this year. Can you just give us an overview of how much TSA income declined in the quarter? And then how should we be thinking about that in the model over the back half?

Matthew Schroeder - *Rite Aid Corporation - CFO*

Sure. So in fiscal '19, Bob, we had about $80 million in TSA fee income. The amount we expect to have this year is roughly half of that, roughly $40 million. I think the headwind that we had in the quarter was around that kind of 1/4 of that at $10 million number, and I would expect that headwind to continue through the remaining quarters of the year.

Operator

Glen Santangelo with Guggenheim.

Glen Joseph Santangelo - *Guggenheim Securities, LLC, Research Division - Analyst*

First question for Bryan. Could you maybe comment on the reimbursement pressure you did see this quarter? Kind of sounds like that maybe we're starting to see that pressure abate somewhat, and I was wondering if you could sort of characterize that for us and maybe give us a sense for what you're thinking in terms of the back half of the fiscal year.

Matthew Schroeder - *Rite Aid Corporation - CFO*

Glen, it's Matt. I would say that reimbursement rate pressure is largely what we expected and I think relatively consistent to what we saw not only in the first quarter but probably in the prior year as well. I think -- if you look back a little bit further, I think we've seen some stabilization compared to the levels we saw back in fiscal '17 and '18. But look, it's still a pretty decent-sized headwind that we need to overcome. I think -- for the back half of the year, I think we're going to see pressures kind of consistent with what we've seen in the first 2 quarters.

Bryan Bruce Everett - *Rite Aid Corporation - COO*

Glen, it's Bryan. I would just add I don't think characterizing the reimbursement rate pressures fading is the best way to describe it and would agree with what Matt said around we -- it was about what we expected.

Glen Joseph Santangelo - *Guggenheim Securities, LLC, Research Division - Analyst*

Okay. And maybe a longer-term question for both you, Matt and Heyward. I mean, there's a lot of concern here around the balance sheet and the leverage. And if you just sort of look at your current EBITDA run rate and your cash flow situation, I mean, given that what you're paying in interest expense and you're talking about the CapEx and more file buys and investments in technology, Heyward, how do you think about the $3 billion that's coming due in 2023 with the facility, the term loan and the notes all seemingly bunched together? I mean, do you feel like you can improve the cash flow enough? Do you anticipate sort of refinancing before you get to that date? Like how do you think about the long-term leverage issues that everyone seems to be concerned about?

Heyward Rutledge Donigan - *Rite Aid Corporation - CEO & Director*

Yes. Well, I think the leverage is an issue that we have to be concerned about, and I am very concerned about and very focused on that particular issue. That will be one of our most paramount objectives is to reduce our leverage. And at the same time, my goal is to try to become much more efficient and scale down this organization appropriately to its current regions in which we serve. That means scaling down our cost structure and freeing up cash, and we're going to be really judicious with our investments. We're going to be also using the lean methodology here at Rite Aid Corporate to take a substantial amount of -- free up a substantial amount of working capital and also take costs out of the system. So I do have to invest in this company. There's no doubt about it that there are some investments different maybe than the ones in the past that we'll have to make, but leverage is going to be a key focus for us. I'll turn it over to Matt maybe to say a few words as well.

Matthew Schroeder - *Rite Aid Corporation - CFO*

Yes. Thanks, Heyward. Glen, I think Heyward kind of laid out very well kind of what our focus is on leverage. I do think we have opportunities that we do call risk toss. I do think we have opportunities to be more efficient with our working capital, and we're going to be working on those. The other thing is, we're very cognizant of the maturity wall we have in 2023. And I think we'll be taking a hard look at opportunities to address that wall certainly before we get anywhere close to that date. And I think, ultimately, we'll deal with that maturity wall with a combination of reducing our overall debt as well as, frankly, some refinancing activity as we get our leverage ratio to a better place and get to the point where we can refinance attractively.

Heyward Rutledge Donigan - *Rite Aid Corporation - CEO & Director*

And obviously, growing our EBITDA and our revenue is something that I remain bullish on and something that we're really focused on as well. It's going to be both.

Operator

Lisa Gill with JPMorgan.

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

Heyward, I look forward to meeting you at some point. I just really wanted to follow-up back on your strategic vision. I heard you talk about blocking and tackling in some of the opportunities. But just given where you came from in health care and understanding what health plans are thinking and looking for, we've heard a lot of the retailers talk about the opportunity to change the current retail reimbursement business model, really moving away from the way it is today and the traditional model to really being paid for services, getting paid for outcomes. I'm just curious as to where you stand around those potential opportunities.

Heyward Rutledge Donigan - *Rite Aid Corporation - CEO & Director*

Well, I, obviously, want to finish up my strategic thinking in a robust and thoughtful manner before I get too far into this. But I will say that given my background, it's going to be obvious that health plans are going to be a key focus for this company. The partnership between us and health plans in the regions that we serve is going to be crucial to our future, and I think we can really add a tremendous amount of value to their future. Listen, pharmacists are the ultimate physician extender, if you think about it. We are -- our pharmacists touch probably more members on a daily basis and engage more consumers on a daily basis than any other provider in America and that has got to have tremendous value, not only to us, to our consumers, but also to our health plan partners. And so we are really going to be focused on these relationships, and I look forward to spelling this out more specifically for you in the coming months.

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

Okay. Great. And then just as a follow-up. Ben, I just want to understand the 360,000 incremental lives that you won on the commercial side this year, can you just remind us how many commercial lives you have today? And you also talked about a shift to more of the traditional PBM business model. Can you maybe also just talk about anything that you thought in shifts or changes around plan design for 2020?

Benjamin Earle Bulkley - *Envision Rx Options Holdings, Inc. - CEO*

Thank you, Lisa. So that 360,000 increase is on a base of around 3 million. And we view our go-forward strategy in being flexible with health plans and other clients as a key strength of our. So adjusting plan design is our wheelhouse. That's what we do every day. We have our own formularies, we have our own adjudication platform. That gives us enormous flexibility with our partners to adapt to their needs.

Operator

Elizabeth Anderson with Evercore.

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

This is Elizabeth Anderson. I was wondering if you could comment a little bit more on the generic (inaudible) improvement that you guys are seeing. And anything to -- that you can say in terms of how you see the change or pacing of that going out for the rest of the year and into 2020?

Matthew Schroeder - *Rite Aid Corporation - CFO*

Sure. Elizabeth, it's Matt. I think part of -- if you look at our EBITDA improvement from first to second quarter and our pharmacy margin improvement, certainly part of -- a lot of our EBITDA improvement was in the PBM business, but we also did see an improvement in pharmacy margin and gross profit quarter-over-quarter, and it was really kind of the results of our largest generic bid, annual bid really coming to fruition in the second quarter. I expect that benefit to really continue through the remainder of the year. Too early really to talk about anything beyond that, but I expect kind of the cost savings trends that we had this quarter to be -- to extend throughout the back half of the year.

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

Okay. Great. That's very helpful. And then in terms of just on Envision, the broader selling season color. I mean, obviously, there have been a lot of changes to the selling season overall. I was just wondering if you can talk about anything in particular that has sort of resonated with your client base? And sort of what you're seeing in terms of any pressure on pricing or anything else?

Benjamin Earle Bulkley - *Envision Rx Options Holdings, Inc. - CEO*

Thank you, Elizabeth. So what we see is actually a bit of a dustup in the marketplace because as Health Plans are rethinking their partnerships and alliances with the larger PBMs, it's giving them some pause, and that's a good opportunity for us. That's the principal change we see this year.

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

And then has there been any changing pricing wise?

Benjamin Earle Bulkley - *Envision Rx Options Holdings, Inc. - CEO*

It's consistent with our expectations.

Operator

George Hill with Deutsche Bank.

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

I will echo everyone's welcome into the call, Heyward. I guess one thing we haven't talked about a little bit yet is, can you guys comment on what percent of your PBM payer contracts have been negotiated for 2020? And is there any way to quantify kind of the calendar year expectation for change in reimbursement rates? And kind of what percentage of the book is nailed down?

Matthew Schroeder - *Rite Aid Corporation - CFO*

George, it's Matt. We constantly are working through PBM payer contracts. I think we've got a pretty good line of sight in the reimbursement rate environment for fiscal 2020. Probably a little early to get any further ahead of that.

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

Okay. And then kind of 2 quick follow-ups. One is on the PBM wins on the lives. If I'm doing the math right, that seems like it's about $250 million to $300 million in dollar value. Is that a gross number or a net number as we think about the wins going into calendar 2020?

Bryan Bruce Everett - *Rite Aid Corporation - COO*

The 360,000 is a gross number. Those are wins.

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

Okay. Is there a -- are we able to -- are you guys able to talk about what the net number is turning like for calendar '20?

Bryan Bruce Everett - *Rite Aid Corporation - COO*

Our net number is still double-digit growth. And very importantly, we have renewed our most important contracts at this stage.

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

Okay. Well, one more. Another about 1/3 of the stores have been migrated to wellness stores. I guess, can we talk about where we think about the CapEx diversion goes from that? And how much do we think about as debt pay down versus kind of other investment opportunities that the company sees available?

Matthew Schroeder - *Rite Aid Corporation - CFO*

George, it's Matt. I think we're still working through kind of how we're going to think about our CapEx spend and the allocation of our CapEx resources as we kind of finalize our strategic view here. I'll turn it over to Heyward for her comments.

Heyward Rutledge Donigan - *Rite Aid Corporation - CEO & Director*

Yes. You see what our CapEx budget is. And needless to say as someone coming in, it's a sizable amount of money, and I really want to get my final thoughts together about what our strategic plan is and specifically, what the next year looks like. And then we will take that money and allocate what hasn't been spent according to our highest priorities, which are to drive EBITDA, to pay down -- get our leverage under control and to also continue to invest. I mean, we do have some sizable strategic initiatives underway and some that are now on the horizon, near horizon, including tech -- all of this work on technology that you've heard about. So we will be rethinking the spending of that money for the remainder of the fiscal year.

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

Maybe if I can just sneak one more in on the tech side. I know -- I guess can you guys just breakdown how you think about what I would call beneficiary or consumer-facing technology versus I know Rite Aid has a bit of an aging technology infrastructure around business ops. Kind of how do you think about the spend there?

Heyward Rutledge Donigan - *Rite Aid Corporation - CEO & Director*

Well, I'll let Justin maybe jump in, but I'd like to introduce you to our Chief Information Officer and let him address that issue.

Justin Mennen - *Rite Aid Corporation - Senior VP and Chief Information Officer*

Justin Mennen. I look at it as -- we have to look at is as both, right? We have to continue to invest to drive a seamlessly connected user experience in our stores and in our online footprint, and we also have to give our associates the tools they need to be productive and efficient in their jobs. So as we look in our capital investment, we're going to continue to look at where we can get the largest ROI. And as Heyward and team roll out our strategy in the coming months, we'll continue to look at where those investments should go.

Heyward Rutledge Donigan - *Rite Aid Corporation - CEO & Director*

Yes. And I think one of the big ones is driving revenue growth through our new partnership with Adobe, and that is really a significant, significant opportunity for us. To your question, it's putting power in the hands of the consumers in terms of how they can select and pay for prescriptions, how they can select and pay for and get delivery of both prescriptions and front-end items, and how they can buy products online. And we are in a partnership with Adobe that -- where actually they've signed up for revenue growth here, and so we are really, really bullish on this opportunity for the company, from leveraging technology in new and current ways to really drive the business forward economically.

Operator

Karru Martinson with Jefferies.

Karru Martinson - *Jefferies LLC, Research Division - Analyst*

Just on the TSA income, I thought we had done a cost savings plan to kind of offset the declines. I'm wondering how much of that $10 million headwind in the quarter is getting offset by that?

Matthew Schroeder - *Rite Aid Corporation - CFO*

It's all getting offset, Karru. I think I was answering the question more on just what's the headwind that we got to cover on the TSA side, but we're offsetting that with the cost savings initiatives that we've already executed on.

Karru Martinson - *Jefferies LLC, Research Division - Analyst*

Okay. And I know it's early days, but in terms of the Amazon stores where you have the lockers or -- and you have the counters, what are you seeing there in terms of traffic versus your other locations?

Bryan Bruce Everett - *Rite Aid Corporation - COO*

Karru, it's Bryan. The Amazon partnership is building or driving additional traffic into the stores, but it's just too early to share any additional sales results at this time.

Karru Martinson - *Jefferies LLC, Research Division - Analyst*

Okay. And just lastly, in terms of the front-end gross margins, what's the outlook there in terms of increasing private-label penetration and then also the competitive response that you've seen?

Bryan Bruce Everett - *Rite Aid Corporation - COO*

As I mentioned, private label -- own brand for us is -- will continue to be a priority. We're pleased with the rate performance from quarter-to-quarter, from year-over-year rather. And so we will continue to look at how we promote, how we merchandise and how we curate the assortment with own brand being a -- as we mentioned before, a significant part of that.

Operator

Carla Casella with JPMorgan.

Carla Casella - *JP Morgan Chase & Co, Research Division - MD & Senior Analyst*

I had one follow-up on your working capital discussion. You mentioned that you expect cash from ops to be positive in the back half. Can you just give us a little bit more color on the inventory increase in the quarter and the payable greater use of cash? Is there -- are you changing anything on your inventory or payable terms with vendors?

Matthew Schroeder - *Rite Aid Corporation - CFO*

So on the inventories side, I think we've already started SKU -- kind of a look at SKU rationalization with the idea of looking at some of the breadth of SKU offerings we have as well as I think, over the coming months, not to get too far ahead of the strategy and taking a hard look at assortment in general. And we think there's going to be some pretty good working capital initiatives coming out of that. I think on the payable side, we're trying to strike the right line between obviously being good partners with our vendors and also being kind of within the same market terms that we would expect that -- within market terms. And I think there's some opportunity to get to market terms with some of those vendors that we're currently exploring.

Heyward Rutledge Donigan - *Rite Aid Corporation - CEO & Director*

Yes. I think it's really fair to say that we are undertaking a very, very substantial change in our merchandising approach in terms of what's in the store, what's the variety offered, how we manage the merchandising, how we update the merchandising to make it an exciting destination for our consumers, but also aligning with our health and wellness vision for the future and aligning with what our hopeful health plan partners and others might want to see as well in that destination. As a part of that, we have what we believe to be a opportunity in terms of inventory management, and we are approaching this with a lean methodology with the whole team decked out against this to try to see if we could see some substantial upside improvement in how we manage our inventories. So these are all things that are well under way, have been under way before even I got here, and so we're really excited to see the fruits of these particular initiatives bear out.

Carla Casella - *JP Morgan Chase & Co, Research Division - MD & Senior Analyst*

That's great. And then just one follow-up. You mentioned the 6x leverage target by year-end. I'm wondering whether that's net of cash and whether it includes $157 million of asset sale proceeds from those 2 remaining distribution centers to Walgreen. And then also where you expect the ABL balance to be at year-end?

Matthew Schroeder - *Rite Aid Corporation - CFO*

Yes. I probably will stay away from an exact projection of the ABL balance. I think the 6x leverage is consistent with the way we've been showing the calculation over the last several quarters, which is net of cash and assuming the receipt of the proceeds of the Walgreens distribution center sales, which is about $150 million.

Carla Casella - *JP Morgan Chase & Co, Research Division - MD & Senior Analyst*

Okay. And did you give an update on your file buy expectation? I think I had 60 was the target originally this year?

Matthew Schroeder - *Rite Aid Corporation - CFO*

We didn't give a specific number, Carla. I would say that, that's still -- as we do relook at how we spend CapEx, I think it's fair to say that file buys is still an important good way to drive growth into our stores and something we're going to take a hard look at. I think I'd probably shy away from giving a specific number.

Operator

William Reuter with Bank Of America.

William Michael Reuter - *BofA Merrill Lynch, Research Division - MD*

It seems like one part of the strategy to drive growth on the retail side is these clinical pharmacy services. Can you talk about how large those are at this point? And how quickly they're going?

Bryan Bruce Everett - *Rite Aid Corporation - COO*

Well, Bill, it's Bryan. They are a critical part of the pharmacy growth. And as we think about not only the adherence services but the immunizations, as I mentioned, up 65% again over the prior year, but also the MTMs, the medication therapy management, that's really part of the whole effort to free up this time and capacity for these pharmacists so we can repurpose and absorb this additional volume without adding incremental labor. So that hits squarely on what we're trying to do here with some of our additional initiatives.

William Michael Reuter - *BofA Merrill Lynch, Research Division - MD*

All right. And then following up on the file buys, it seems like you guys still think it's important. Given that there are -- there have been pharmacy closures across the industry, are the prices that you're paying for these scripts coming down or are they relatively unchanged?

Matthew Schroeder - *Rite Aid Corporation - CFO*

Bill, it's Matt. It all depends on the market. I would say overall, they're probably on a very high-level basis relatively unchanged. But the file buys are really a market-by-market item. It all depends on what the competition is like for the scripts for the -- in the given market.

William Michael Reuter - *BofA Merrill Lynch, Research Division - MD*

All right. And then just lastly for me. In terms of your store base, there are -- some of your competitors are closing stores. Do you feel that largely, over the next couple of years, you have the store base at the right size? Or do you expect that you guys will be closing stores as well?

Heyward Rutledge Donigan - *Rite Aid Corporation - CEO & Director*

Well. Listen, we are firmly committed to the markets that we're serving right now. These are excellent geographies for us based on my preliminary view of where I think we're heading as a company. And we're always going to be looking to continue to make sure that we have the right performing stores in the right locations. So that'll certainly be something we continue to assess on an incremental basis. But for now, I think we're firmly committed to these geographies, and we will take a look at this through the lens of our strategy in the coming months and sort of report back to you if anything changes.

Operator

We do have time for one final question. Hale Holden from Barclays.

Hale Holden - *Barclays Bank PLC, Research Division - MD*

I had two. Heyward, can you talk a bit about how you got comfortable or how do you -- how you make sure that the opioid litigation that's kind of lingering in the background doesn't become a distraction for the company? And then I have a follow-up.

Heyward Rutledge Donigan - *Rite Aid Corporation - CEO & Director*

Yes. I mean, listen, we are absolutely committed to doing everything that we can to help with this opioid crisis. We are a key partner to the agencies to the law enforcement and to our consumers as they try to deal with this incredibly difficult situation. It affects us every minute of every day. We are impacted by this in real and difficult ways, just the day-to-day of the opioid crisis. The litigation itself is really a separate matter. It's something that we are managing with our attorneys and our compliance organization. It will not be a distraction to our day-to-day organization. The bigger opportunity for us is to help fix this and help people going forward and that is part of our mission and something that we're committed to. But the litigation itself, I feel very confident. It's going to be difficult, but we will not allow this to affect our day-to-day operations.

Hale Holden - *Barclays Bank PLC, Research Division - MD*

Great. And then I just wanted to ask about Walmart's announcement to do hundreds of broader health clinics over the next year or 2. But my assumption is because they're focusing on what they're calling health care deserts, given your footprint that it isn't really a concern or an overlap issue for you, but we just wanted to get further color or your thinking on it.

Heyward Rutledge Donigan - *Rite Aid Corporation - CEO & Director*

Well, I mean, listen, everybody is really committed to helping their communities right now, from a health care delivery and a health care perspective, and so are we. And I don't see -- I see this as all boats rise. I think we're all seeing the opportunity that is in front of us, which is to be able to deliver health care to consumers in a real community-based setting. I think we have a unique opportunity ourselves. I don't think our overlap is particularly significant, and I do think our destinations will be different. But I just see everybody -- I think it's exciting that everyone's recognizing this opportunity, in particular for our pharmacists to really be delivering clinical services in the community to the people that they're engaging every minute of every day. So more to come on that, but not -- I think all boats rise on this one.

Okay. Well, thanks, everyone, for your questions. Before we end the call, I'd like to thank our associates for welcoming me to the company and for the great work they're doing every day, as I mentioned just now, to deliver outstanding not only pharmacy but front-end services and experiences to our customers with Envision and with the Rite Aid stores as well. And as I said earlier, this is important work ahead of us, but also really it's a unique and exciting opportunity to build on our momentum right now and position Rite Aid to be an innovative health and wellness leader in the communities we serve. We will be working hard in the coming weeks and months to deliver a solid finish to the year and more importantly, make sure our company is on the right path to meet its full potential heading forward. So with that, we will now conclude today's call, and thank you.

Operator

This concludes the Rite Aid Second Quarter Fiscal 2020 Earnings Call. We thank you for your participation. You may now disconnect.