Seeking Alpha ^{α}

Walgreens: Earnings Preview

by: Trefis

June 20, 2011 | about: WAG

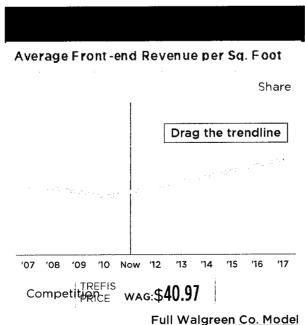
Walgreens (NYSE:<u>WAG</u>), the leading drugstore chain in the US, is expected to come out with its third quarter earnings on June 21st. Walgreens competes with the other leading pharmacy services provider CVS Caremark (NYSE:<u>CVS</u>). We value Walgreens with a <u>\$41 Trefis price estimate of its stock</u>.

As Walgreens has recently offloaded its pharmacy benefits management business with the sale of Walgreens Health Initiatives (WHI) to Catalyst Health Solutions for \$525 million (See CVS Sees Value in Pharmacy Benefits Business While Walgreens Is Selling) to focus solely on its retail leg of business and even acquired drugstores.com to further strengthen its online presence in retail pharmacy (See Looking at Walgreen Bid for Drugstore.com), we're keeping a close watch on how Walgreens has expanded its retail footprint while maintaining its profit margins.

How has Walgreens expanded its retail footprint?

Walgreens' now exclusively retail business is impacted by the number of stores as well as by the sales per store. To enhance the sales per store, Walgreens has expanded the breadth of products it offers under general merchandise to include fresh foods, groceries and even a private label beer (See <u>Walgreens Can Add Fiz to Sales with Private Label Beer Offering)</u> with more space allocated to groceries (See <u>Why Walgreen & CVS Are Shifting to Selling Groceries</u>).

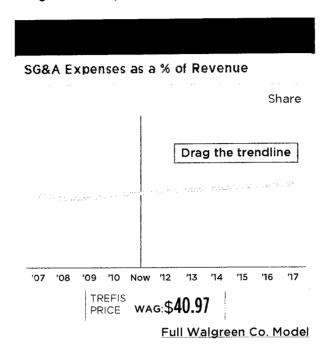
Walgreens' average OTC drugs and general merchandise sale per square foot of retail space has been declining consistently from \$293 in 2007 to \$282 by 2010. We expect Walgreens to arrest any further decline and an expanded product offering only reflects the management's effort at posting improvements in this metric.



(Chart created by using Trefis' app)

How has Walgreens fared with margins?

Walgreens' SG&A expenses as a percentage of revenues have declined from 22.4% in 2007 to 22.1% over 2008-09 but recovered to 22.4% in 2010. Carrying more groceries comes with added pressure on administrative expenses particularly related to inventory and logistics. Given the relatively lower margins on groceries compared to pharmaceutical drugs, we expect Walgreen to sharpen its focus on working capital and SG&A expenses.



(Chart created by using Trefis' app)

Disclosure: No positions