

October 12, 2012

Question: I am considering the purchase of Walgreen's (WAG). What do you think?
Jim

Answer:

Walgreens is a thoughtful choice. The company has been buying back a lot of its stock without borrowing much money, for the past three years. It looks like the strategy has moved from debt reduction to stock buyback. You have to ask the question as to why buy stock versus repaying debt. You will want to do some homework on this issue. I could not see where the company is going to grow, until I found out about the Alliance Boots GmbH deal. There appeared to be no international component, or moves in that direction. All of the company stores are U.S. located. Then in June, they made a first step into the European market.

The Deerfield-based company said Tuesday it has agreed to buy a 45 percent stake in the European pharmacy and health-and-beauty retailer Alliance Boots GmbH for \$6.7 billion in a cash-and-stock transaction that will create a network of 11,000 drugstores in 12 countries.

Thus far, this purchase has not shown up on the company's balance sheet. How are they going to finance \$3bn for the purchase? Perhaps the stock buybacks over the last three years will be used - partial payment in WAG stock?

Synergies are expected to provide immediate accruals to the WAG balance sheet. It is not clear how such a participation (45%) can create the projected accruals. Frankly, I suspect that the price for Alliance Boots GmbH is a pretty good one, with what is happening in Europe.

The financials for the past three years are pretty stagnant, and it is clear why the stock price has been flat. You might be right, however, about buying WAG now. This is a "big time" commitment of resources on the company's part. It appears that the market is waiting to see if the deal will close, and then, if it will produce the expected returns. Otherwise, there would be more of a rally in the stock price.

How did you come up with Walgreens as a company of interest?

The stock looks pretty reasonable in terms of price and you do have a pretty good dividend. The global market is untapped, from the viewpoint of the company, so there should be a lot of room to grow - assuming this European purchase works out successfully. My guess is that your idea is a good one, but with some significant downside due to the magnitude of the purchase. That being said, this may be a decent long term bet. At least, it is intriguing.

You will want to read the Chicago Tribune article I am referring to:

http://articles.chicagotribune.com/2012-06-20/business/ct-biz-0620-walgreen-boots-20120620_1_walgreen-shares-walgreen-plans-pharmacy

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