



Walgreens Boots Alliance (WBA)

Updated June 28th, 2018 by Nick McCullum

Key Metrics

Current Price:	\$66	5 Year CAGR Estimate:	19.9%	Quality Percentile:	N/A
Fair Value Price:	\$99	5 Year Growth Estimate:	9.0%	Momentum Percentile:	N/A
% Fair Value:	67%	5 Year Valuation Multiple Estimate:	8.5%	Total Return Percentile:	N/A
Dividend Yield:	2.4%	5 Year Price Target	\$150	Valuation Percentile:	N/A

Overview & Current Events

Walgreens is the largest retail pharmacy in both the United States and Europe. Through its flagship *Walgreens* business and other business ventures (including equity method investments), Walgreens has a presence in more than 25 countries and employs more than 385,000 people. In its leading retail pharmacy business, Walgreens operates approximately 13,200 stores in 11 countries. The company also operates one of the largest global pharmaceutical wholesale and distribution networks, with more than 390 centers that deliver to upwards of 230,000 pharmacies, doctors, health centers, and hospitals each year. Walgreens operates in three financial segments: Retail Pharmacy USA, Retail Pharmacy International, and Pharmaceutical Wholesale.

In late June, Walgreens reported (6/28/18) financial results for the third quarter of fiscal 2018. Revenue increased by 14.0% while GAAP earnings-per-share increased 26.2% and adjusted earnings-per-share increased by 15.0%. The company's strong financial performance was driven by the recently-closed acquisition of a basket of Rite Aid pharmacy stores, which boosted performance in the Retail Pharmacy USA segment. On a trailing-nine-month basis, Walgreens has generated 10.2% GAAP earnings-per-share growth and 19.8% growth in adjusted earnings-per-share. Sales increased by 11.4% through the first nine months of fiscal 2018. To reward its shareholders for this strong financial performance, Walgreens announced a new \$10 billion share repurchase authorization (approximately 16% of its current market capitalization) and increased its quarterly dividend by 10%.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$2.17	\$2.02	\$2.16	\$2.64	\$2.53	\$2.61	\$2.90	\$3.88	\$4.59	\$5.10	\$5.95	\$9.00
DPS	\$0.49	\$0.48	\$0.59	\$0.80	\$0.95	\$1.14	\$1.28	\$1.37	\$1.46	\$1.53	\$1.65	\$2.90

Walgreens has compounded its adjusted earnings-per-share at 9.6% per year over the last decade. Due to the company's expanding international presence and competency in the mergers and acquisitions arena, we believe that Walgreens is capable of delivering similarly high single-digit growth for the foreseeable future. Our earnings growth estimate for Walgreens is 9.0% per year, which combined with the company's 2018 financial guidance for \$5.90-\$6.05 of earnings-per-share gives us a \$9/share earnings estimate for 2023. Note that Walgreens is likely to increase its dividend at a faster pace than its earnings for the foreseeable future.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	17.1	13.9	15.9	14.8	13.2	16.3	21.8	20.2	18.0	16.2	11.1	16.7
Avg. Yld.	1.1%	1.7%	1.7%	2.1%	2.8%	2.7%	2.0%	1.8%	1.8%	1.9%	2.4%	1.9%

Walgreens increased its fiscal 2018 earnings guidance with the release of its second quarter earnings report. The company now expects to report adjusted earnings-per-share in the range of \$5.85 to \$6.05. The midpoint of this guidance band implies a current price-to-earnings ratio of just 11.1. Walgreens has traded at an average price-to-earnings ratio of 16.7 over the last decade, implying a fair value of \$99. The company is deeply undervalued. If Walgreens' stock can revert to this historical valuation over the next 5 years, this will add 8.5% per year to the company's annualized returns during that time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	74.3%	70.1%	72.2%	74.6%	60.8%	59.5%	57.9%	38.9%	41.1%	44.2%	45.0%	55.0%
Debt/A	42.6%	42.8%	45.2%	45.9%	45.5%	45.2%	44.9%	55.1%	58.9%	58.4%	55.0%	50.0%
Int. Cov.	312.8	39.1	40.7	61.5	39.4	24.8	26.9	7.7	10.1	8.0	9.0	12.0
Payout	22.6%	23.8%	27.3%	30.3%	37.5%	43.7%	44.1%	35.3%	31.8%	30.0%	27.7%	32.2%
Std. Dev.	41.2%	31.0%	27.7%	23.3%	22.1%	28.8%	27.5%	27.5%	20.7%	18.5%	22.0%	22.0%

Walgreens is a very safe blue-chip investment. Consumers are very unlikely to cut spending on prescriptions and other healthcare products, even when disposable income declines noticeably. Walgreens' adjusted earnings-per-share declined by just 7% during 2009 – the worst of the global financial crisis – and the company actually grew its adjusted earnings-per-share from 2007-2010, following this up with 20%+ earnings growth in 2011.

Walgreens has a number of competitive advantages, the first being scale. The company's global presence helps differentiate it from its major peer, CVS Health Corporation (CVS). Walgreens' expertise in acquisitions is also very beneficial, allowing it to penetrate new markets with less risk than a more organic approach. Walgreens' Chief Executive Officer Stefano Pessina stated on a recent conference call that *"we are convinced that our strategy of entering markets through strong local partners with excellent local management teams is the best approach."* Based on this statement, we believe more acquisition-based growth is likely.

The downside to acquisition-based growth is its impact on the company's balance sheet. As the table above demonstrates, Walgreens' leverage metrics and interest coverage have fluctuated tremendously over the last decade. While this may sound some quantitative alarms, our qualitative analysis combined with the company's track record lead us to believe that acquisition-based growth is a sound approach for the company moving forward.

Final Thoughts & Recommendation

With 9% earnings growth and a 2.4% dividend yield, Walgreens already has attractive total return potential. Combine this with the company's compelling valuation and it presents a rare opportunity indeed. Valuation reversion will contribute 8.5% per year to Walgreens returns if such multiple expansion occurs over a 5-year period. All said, this gives approximately 20% annualized total return potential and earns the company a buy recommendation from Sure Analysis.

Total Return Breakdown by Year

