



Walgreens Boots Alliance (WBA)

Updated December 20th, 2018 by Eli Inkrot

Key Metrics

Current Price:	\$70	5 Year CAGR Estimate:	17.3%	Volatility Percentile:	30.4%
Fair Value Price:	\$98	5 Year Growth Estimate:	8.0%	Momentum Percentile:	57.5%
% Fair Value:	72%	5 Year Valuation Multiple Estimate:	6.8%	Growth Percentile:	72.2%
Dividend Yield:	2.5%	5 Year Price Target	\$143	Valuation Percentile:	85.7%
Dividend Risk Score:	A	Retirement Suitability Score:	A	Total Return Percentile:	85.3%

Overview & Current Events

Walgreens Boots Alliance is the largest retail pharmacy in both the United States and Europe. Through its flagship *Walgreens* business and other business ventures (including equity investments), Walgreens has a presence in more than 25 countries and employs more than 415,000 people. In its leading retail pharmacy business, Walgreens operates approximately 18,500 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.

On December 20th, 2018 Walgreens reported Q1 fiscal year 2019 results for the period ending November 30th, 2018. Highlights included a 9.9% increase in sales to \$33.8 billion, a 6.1% increase in operating income to \$1.4 billion and an increase of 14.6% in adjusted earnings-per-share. The Retail Pharmacy USA segment, led by pharmacy sales, increase by 14.4% due to higher prescription volumes from the acquisition of Rite Aid stores. Meanwhile, the Retail Pharmacy International segment saw a 5.9% decrease in sales due to negative currency impacts, the divestiture of Boots Contract Manufacturing and weak UK market conditions. Sales in the Pharmaceutical Wholesale segment were basically flat due to a significant currency headwind. Walgreens reiterated its guidance of 7% to 12% growth in fiscal 2019 adjusted EPS at constant currency rates. In addition, the company is launching a cost management program, targeting \$1 billion in annual savings by the end of the third year.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$2.02	\$2.16	\$2.64	\$2.53	\$2.61	\$2.90	\$3.88	\$4.59	\$5.10	\$6.02	\$6.50	\$9.55
DPS	\$0.48	\$0.59	\$0.80	\$0.95	\$1.14	\$1.28	\$1.37	\$1.46	\$1.53	\$1.64	\$1.82	\$3.34
Shares	989	939	889	944	947	950	1,090	1,083	1,024	952	940	850

From 2009 through 2018, Walgreens grew earnings-per-share by 12.9% per annum. This was driven by a combination of factors including solid top-line growth (\$63 billion to \$132 billion), net profit margin expansion (3.7% to 4.6%) and a reduction in the number of shares outstanding. Moving forward we see growth slowing, as the company has expanded internationally and domestically with the Walgreens Boots Alliance store count jumping from 7,500 to over 14,000. Further, margin expansion has become a hot topic as political pressures have brought new attention to drug pricing.

Given this much higher base from which to grow, we do anticipate the company's growth rate to slow from the low double-digits to the high single-digits. That being said, Walgreens international expansion and other merger activity has proven to be a bright spot and one that ought to continue to drive sales growth in a diversified way. Furthermore, the company still has a long industry tailwind as aging populations continue to be a demand driver.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	13.9	15.9	14.8	13.2	16.3	21.8	20.2	18.0	16.2	11.5	10.8	15.0
Avg. Yld.	1.7%	1.7%	2.1%	2.8%	2.7%	2.0%	1.8%	1.8%	1.9%	2.3%	2.6%	2.3%

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During the past decade shares of Walgreens have traded with an average price-to-earnings ratio of 16.2. We have reduced this slightly in our estimate, reflecting a slightly slower anticipated growth rate moving forward.

The dividend ought to add meaningfully in the years to come. Walgreens has a storied track record of increasing its dividend every year. With a modest payout ratio, and an expectation of high single-digit earnings growth, there is ample room for the dividend to grow by double-digits.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	22%	25%	27%	35%	42%	43%	34%	31%	31%	29%	28%	35%

Walgreens payout ratio tells an interesting story. From 2009 through 2014, earnings-per-share grew by 7.5% annually but the dividend was increased at a rate of 21.7% per year. This resulted in the payout ratio expanding from 22% up to 43%. Then, from the end of 2014 through 2018, Walgreens grew earnings-per-share by 20.0% annually while the dividend was boosted by an average compound rate of just 6.4%. As such, the payout ratio has since declined from 43% down to 29% of earnings. We believe something in the 30% to 40% range is more than reasonable considering the strength of the business and indeed the current mark allows for outsized dividend growth in the years ahead.

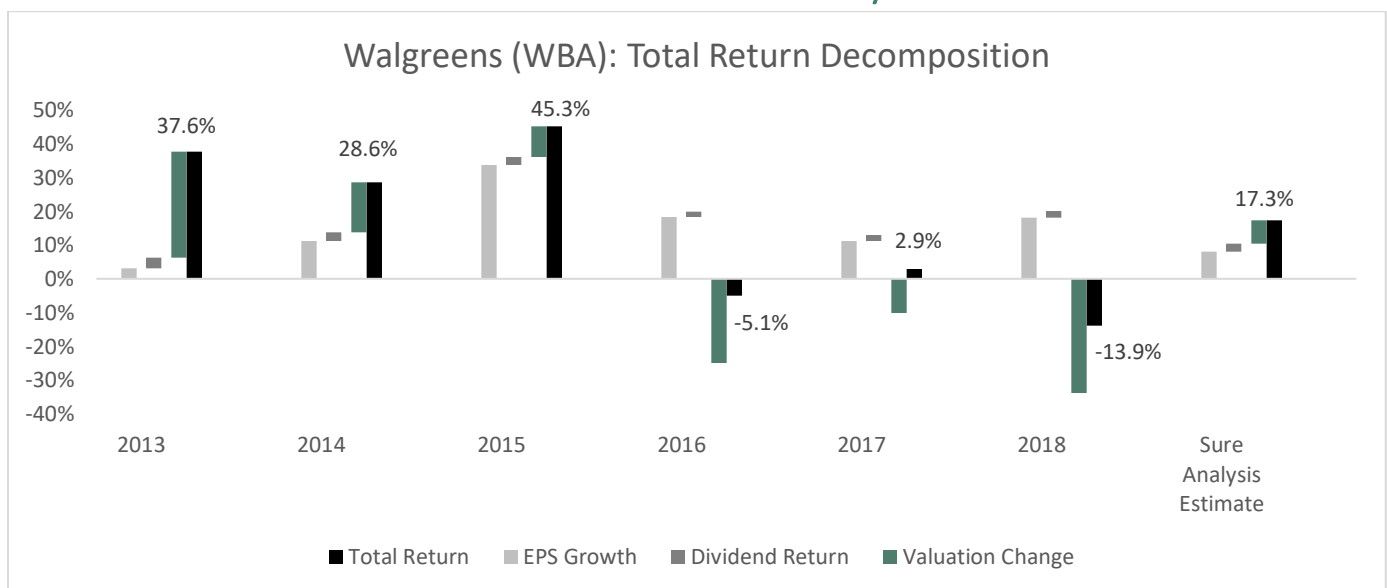
Walgreens' earnings dipped 6.9% in 2009 and 4.2% in 2012, but otherwise has reported very solid results.

As of the most recent quarter Walgreens held \$980 million in cash against \$11.6 billion in long-term debt. Interest payments are well covered, with ample room for dividends, share repurchases and outside activities.

Final Thoughts & Recommendation

Walgreens has proven to be an exceptional company over the years. The dividend track record is excellent, earnings growth has been robust and the company still maintains a relatively conservative stance even while digesting acquisitions. While the industry faces some headline risk, we continue to view the business as both essential and a true growth driver in the years to come. On the security side, Walgreens looks very compelling due to a number of factors – solid growth expectations, a below average valuation and a well-covered and ample dividend. We are enthusiastic about both the business and the security at recent quotations. Walgreens is a strong buy at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue (\$B)	63.34	67.42	72.18	71.63	72.22	76.39	103.44	117.35	118.21	131.54
Gross Profit	17613	18976	20492	20342	21119	21569	26753	29874	29162	30792
Gross Margin	27.8%	28.1%	28.4%	28.4%	29.2%	28.2%	25.9%	25.5%	24.7%	23.4%
SG&A Exp.	14366	15518	16561	16878	17543	17992	22400	23910	23740	24569
D&A Exp.	975	1030	1086	1166	1283	1316	1742	1718	1654	1770
Operating Profit	3247	3458	3931	3464	3576	3577	4353	5964	5422	6223
Op. Margin	5.1%	5.1%	5.4%	4.8%	5.0%	4.7%	4.2%	5.1%	4.6%	4.7%
Net Profit	2006	2091	2714	2127	2548	1932	4220	4173	4078	5024
Net Margin	3.2%	3.1%	3.8%	3.0%	3.5%	2.5%	4.1%	3.6%	3.4%	3.8%
Free Cash Flow	2184	2730	2430	2881	3089	2787	4413	6522	5900	6898
Income Tax	1158	1282	1580	1249	1499	1526	1056	997	760	998

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	25142	26275	27454	33462	35481	37250	68782	72688	66009	68124
Cash & Equivalents	2087	1880	1556	1297	2106	2646	3000	9807	3301	785
Acc. Receivable	2496	2450	2497	2167	2632	3218	6849	6260	6528	6573
Inventories	6789	7378	8044	7036	6852	6076	8678	8956	8899	9565
Goodwill & Int.	2158	3001	3229	3447	3717	3539	28723	25829	25788	28697
Total Liabilities	10766	11875	12607	15226	16027	16633	37482	42407	37735	41435
Accounts Payable	4308	4585	4810	4384	4635	4315	10088	11000	12494	13566
Long-Term Debt	2351	2401	2409	5392	5047	4490	14383	19028	12935	14397
Total Equity	14376	14400	14847	18236	19454	20513	30861	29880	27466	26007
D/E Ratio	0.16	0.17	0.16	0.30	0.26	0.22	0.47	0.64	0.47	0.55

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	8.4%	8.1%	10.1%	7.0%	7.4%	5.3%	8.0%	5.9%	5.9%	7.5%
Return on Equity	14.7%	14.5%	18.6%	12.9%	13.5%	9.7%	16.4%	13.7%	14.2%	18.8%
ROIC	12.9%	12.5%	15.9%	10.4%	10.6%	7.8%	11.9%	8.8%	9.0%	12.2%
Shares Out.	989	939	889	944	947	950	1,090	1,083	1,024	952
Revenue/Share	63.89	68.25	78.08	81.39	75.60	79.15	98.15	107.55	109.61	132.20
FCF/Share	2.20	2.76	2.63	3.27	3.23	2.89	4.19	5.98	5.47	6.93

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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