

denverpost.com

THE DENVER POST

Walgreen fiscal 2Q profit climbs but shares tumble

By TOM MURPHY AP Business Writer

Posted: 03/22/2011 05:57:36 AM MDT

Updated: 03/22/2011 12:05:36 PM MDT

1 INDIANAPOLIS—Walgreen Co. said Tuesday its fiscal second-quarter earnings climbed 10 percent, but company shares tumbled after results were released and analysts said they expected more from the largest U.S. drugstore operator.

2 The Deerfield, Ill., company said its gross profit margin—which measures gross profit over net sales—stayed flat at 28.8 percent after expanding the past few quarters. The flat margin generated "widespread disappointment," Hapoalim analyst Ajay Jain said in an email.

3 Walgreen also met Wall Street earnings expectations when many analysts thought they would beat the consensus, said another analyst, Jeff Jonas of Gabelli & Co.

4 Shares dropped 6.6 percent, or \$2.75, to \$39.22 in afternoon trading. The tumble left Scotia Capital analyst Patricia A. Baker "somewhat perplexed."

5 "People must have expected a bigger beat (of consensus expectations), but to punish the stock for meeting expectations ... is a little absurd," she said.

6 Walgreen's net income rose to \$739 million, or 80 cents per share, in the quarter that ended Feb. 28. That compares with earnings of \$669 million, or 68 cents per share, in the previous year's quarter.

7 Revenue climbed 9 percent to \$18.5 billion.

8 Analysts polled by FactSet expected, on average, a profit of 80 cents per share on revenue of \$18.39 billion.

9 Total sales and prescription sales at stores open more than a year each rose about 4 percent.

10 Revenue at stores open more than a year is a closely-watched gauge of retail health because it leaves out results from stores that have opened, closed or been acquired within the last year. For Walgreen, these results don't count the Duane Reade chain stores the company purchased last spring.

11 Walgreen filled 205 million prescriptions in the second quarter, up 6.9 percent from last year, and its retail prescription market share rose to 20.1 percent. That meant the company filled one out of every five retail prescriptions for the first time in its history. Walgreen ran 7,690 drugstores nationwide as of Feb. 28.

12 The company said front-end, or non-pharmacy,

denverpost.com

THE DENVER POST

sales rose 4.3 percent in the quarter at stores open more than a year. That was helped by December holiday season and Valentine's Day performances that "solidly beat" last year's numbers, CEO Greg Wasson told analysts in a Tuesday morning conference call.

13

A later onset to the cough/cold and flu season compared with the previous year also helped non-pharmacy sales.

14

The company said its gross margin stayed steady despite increasing commodity prices. Walgreen also took a higher "last-in-first-out" inventory charge of \$56 million in the quarter, up from \$27 million last year. LIFO is a method of accounting for inventory that assumes a company sells its newest inventory first. The company takes a credit or charge each quarter according to the anticipated inflation rate for the year.

15

Investors have become "hyper sensitive" to gross margins over the past year, and they expected Walgreen's momentum to continue after its margins expanded over the past few quarters, said Lazard Capital Markets analyst Tom Gallucci.

16

"I think the expectation, at least for us, was modest margin expansion," he said.

17

Earlier this month, Walgreen said it is getting out of the pharmacy benefits management business and selling its benefits operation to Catalyst Health Solutions Inc. for \$525 million. The companies expect to complete the deal by the end of June, assuming regulators approve.