Walgreens: the corporate financial decision making analysis

Walgreens: The Corporate Financial Decision Making Analysis Walgreens' principal activity is to operate a chain of retail drugstores that sells prescription and nonprescription drugs. The company also carries additional product lines like general merchandise including cosmetics, food, beverages and photofinishing. Walgreens is one of the fastest growing retailers in the United States and led the chain drugstore industry in retail sales and profits last year.

The capital structure of this retail drugstore is determined by 42, 5% Debt and 57, 50% Equity due to $8. 39 of the total debt and $11, 104, 30 of Equity resulting in $19, 313. 60 of Total Liabilities and Shareholders' Equity for 2007. Among the main debt-financing sources, Walgreens has different letter of credits standing since 2006 to guarantee foreign trade purchases, payments of casualty claims as well as performance of construction contracts.

The letters of credits for payments of casualty claims are annually renewable and until the casualty claims are paid in full, they might remain in place. In addition, short-term debt was acquired to finance the need of capital. According to Walgreens' Notes to Consolidated Financial Statement, the company issued commercial paper to support working capital needs and furthermore, in connection with the purchase of Option Care, Inc. and affiliated companies, $146.

8 million of convertible debt was acquired. Moreover, Walgreens has lines of credit that total $1. 2 billion. The first $600 million facility expires on August 12, 2008, the second on August 12, 2012. Walgreens has a stock

compensation plan that gives non-executive employees the opportunity to purchase common stock over a ten-year period upon the purchase of company shares, subject to certain restrictions. The share-buy-procedure is through cash purchase or loans made by eligible employees.

On the other hand, the company's strategy is to be the nation's most convenient healthcare provider, that is why long-term borrowings may be necessary due to the planned increase in owned locations as well as a growing number of Walgreen pharmacies in hospitals and other medical centers to serve outpatient prescription needs. Walgreens is also mainly funded by store sales so the company sees long-term potential for about 13, 000 U. S. stores.

Additionally, the company long-term-expansion strategies are entering new markets, and improving customer service, investing heavily in technology enhancements that improve pharmacy efficiency and reduce costs. In view of the current business, economic and industry trends, Walgreens may not be able to raise as much sales as it would like because the company has come under pressure in recent months, reflecting a slowdown in sales because of a weakening economy and intensifying competition. However, Walgreen's long-term prospects remain appealing, and the stock is attractively valued. I would calculate the optimal capital structure based on its debt/equity ratio that according to the author of Pharmacy Management Book, Shane P. Desselle, pharmacist typically have a debt-to-equity ratio of 75%, which can help to find the optimal capital structure. However, the Walgreens' capital structure is similar to its stronger competitor CVS' capital structure that I defined as the benchmark.

CVS has a total liabilities and shareholders’ equity of $54, 721. 90, where total debt is $23, 400 representing the 42. 76% and total equity is $31, 321. 90 which represents 57. 4%. Moreover, if we compare 2006 results to 2007, I realize that capital structure in 2006 was 40% debt and 60% equity resulting is a lower earnings per share, so we can conclude that having a slightly higher debt weight, it improves our earnings per share.

To calculate my cost of capital and analyze the effects of the change of the cost of capital, will assume a 43% debt and 57% equity as the optimal capital structure and assuming that the debt-to-equity ratio equals 75%. Based on my assumptions, I have a total liabilities and shareholders’ equity of $19, 432. 3, where total debt is $8, 355 and total equity is $11, 077. 53, representing the 43% and 57% respectively. If we are assuming a higher debt, which means that we will have an increase in interest expenses that will reduce our net earnings, hence I will have fewer shares and my earnings per share will be higher.

Interest expenses also works as a tax shield letting the company to pay less taxes. I will use the WACC formula to calculate Walgreens’ cost of capital based on 43/57 capital structure and using the assumption that the cost of equity is 12%. E/V = 0. 43 D/V = 0. 57 Re= 0.

12 Rd = 0. 0536 Tc = 0. 3599All the information above was calculated based on the information available in the 2007 Walgreens Annual Report. The WACC is 0. 712 which is 7. 12%.

Furthermore, using the Total Value of the Firm, the Equity, the Debt, and their respective costs along with the Corporate Tax Rate, I calculated the

WACC of 7. 12% for Walgreens. Hence, a WACC of 7. 12% means Walgreens must earn a return of 7.

12% on all its assets and business operations in order to maintain the current stock price. Walgreens typically pays dividends in March, June, September and December. As Its current dividend policy, the company declared a regular quarterly dividend of 9. cents per share, payable March 12, 2008, to shareholders of record Feb. 19, 2008, based on its earlier reported sales for the first quarter of fiscal 2008, ended Nov.

30, 2007, of $14 billion, up 10. 4 percent from a year earlier, where net earnings for the quarter were up 5. 5 percent from a year ago to a record $456 million. In contrary to all negative factors and the reverses of the economy, Walgreen has a great track record of growth and shareholder dividends. Good news are not only that Walgreens has the stock appreciated faster than the market in the past decade, but the dividend has grown at an annualized rate f 11.

2% in the past 10 years. Moreover, the company recently upped its dividend again by 18% due to Walgreen's management commitment to reduce high expenses. References Desselle, S. P. (2005).

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