

Analyst: Daniel Tseng

Date: February 3, 2023

COMPANY/TICKER: **WALGREENS 3.450% 06/01/2026**

Bond

SELL

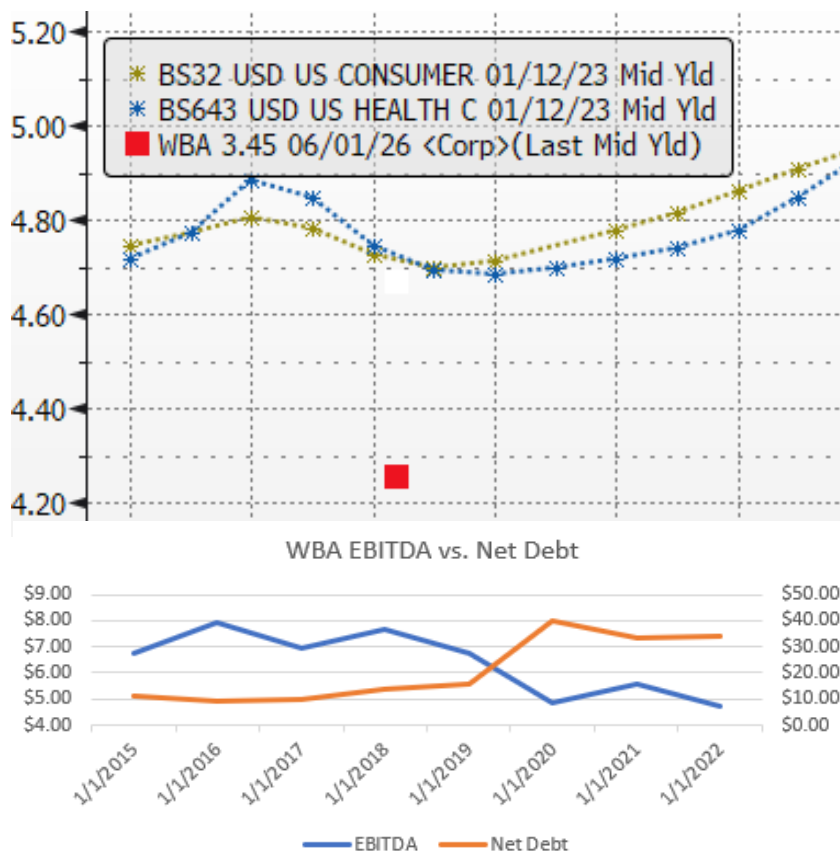
EXECUTIVE SUMMARY

The TCM Bond team recommends a sell of Walgreens Boots Alliance (WBA) 3.450% 2026 bond [931427AQ1] (2% of the TCM Bond portfolio). This WBA bond is rated Baa3/BBB and offers a yield-to-worst of 4.66% (91 bps OAS). With an uncertain economic environment in the near future, TCM plans to raise its duration target to the benchmark of 6.22 years in order to protect the portfolio from interest rate uncertainty in the coming year. The WBA bond duration of 3.08 years is inconsistent with this objective. In addition, Walgreens’ financial position is unfavorable in this economic environment as liabilities of the company have been increasing in the face of a potential declining economy in 2023. Despite these financial risks, this bond offers a low option-adjusted spread, providing inadequate reward for its risks. (*Please see appendix for 1st graph explanation)

The primary drivers behind this recommendation include: 1) Increasing Net Debt while EBITDA continues to fall, showing uncertainty in Walgreens’ debt repayment ability, 2) the company is in a transition phase to diversify its business which requires intensive capital for acquisitions, and 3) low OAS compared to peers which does not compensate for the high overall risk.

Key uncertainties include: 1) Walgreens may improve liquidity by selling Boots Alliance to pay off current debts, 2) their transition into a health-care player may become a driver of growth and cost savings, and 3) the strategic shift of company generates sustainable returns, raising the company’s credit rating and increasing bond prices.

Cusip:	931427AQ1
Price @ 02/03/2023:	95.62
Coupon:	3.450%
YTM:	4.66%
YTW:	4.66%
OAS (Trsy):	91 bps
Duration:	3.08 yrs.
Credit Rating:	Baa3/BBB
Seniority:	Senior Unsecured
Callable Date/Price:	03/01/2026 @100
Make whole call:	+25 bps
Offered Amt.:	\$1,900M
Amt. Outstanding:	\$1,447M

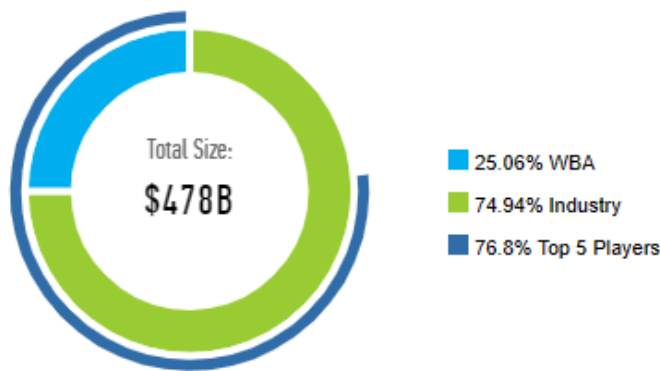


COMPANY OVERVIEW

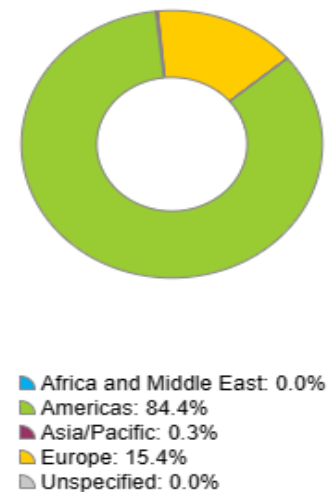
Walgreens Boots Alliance, Inc. specializes in healthcare and retail pharmacy services. The company operates through three main segments: U.S. Retail Pharmacy, International, and U.S. Healthcare. In stores, they sell over the counter prescription drugs and a variety of health, wellness, personal care, and other consumer products with locations in all 50 states, Europe, and Latin America. Walgreens is headquartered in Deerfield, IL.

The Pharmacies & Drug Stores industry is dominated by a few well-known companies. Walgreens biggest competitors and other major players within this industry include: CVS Health, Kroger, Albertsons, Rite Aid, Costco Wholesale etc. There has been a recent trend in primary retail pharmacy companies shifting their business strategy to become an inclusive healthcare player to drive growth. Additionally, Walgreen's front of store retail faces continuous disruptions by e-commerce, which has been increasingly adopted during the pandemic. Competitors such as Amazon have a competitive edge by providing greater convenience to consumer while having lower cost structures. While Walgreens is in a transitional phase, the benefit of their current and future acquisitions cannot be determined.

Revenue Share in Pharmacies and Drug Stores



Revenue Exposure By Super-region



WBA's historical financials illustrate uncertainty in their ability to generate revenue while **Operating Margin** and **EBIT/Interest Expense** both show negative growth which is unfavorable. Above-average LT Debt / Total Capital presents potential future challenges with liquidity and debt repayment.

Condensed Financial Data								Capital Structure		
	AUG '22	AUG '21	AUG '20	AUG '19	AUG '18	AUG '17	5-yr. Avg.	Walgreens Boots Alliance, Inc. (WBA)		
Revenue	\$132,488	\$132,218	\$119,793	\$128,122	\$114,285	\$94,758	\$120,277	Retail Trade <=Industry		
Growth	0.20%	10.37%	-6.50%	12.11%	20.61%		7.36%	Drugstore Chains <=Sub-Sector		
Operating Margin	2.09%	3.03%	3.07%	3.75%	4.67%	5.30%	3.65%	Fully Diluted Market Cap.	35,727	80.3%
Growth	-31.14%	-1.31%	-17.98%	-19.72%	-11.88%		-16.41%	+ Long-term Debt	10,615	23.9%
EBIT / Int. Expense	7.00x	8.18x	6.11x	7.28x	9.96x	9.03x	7.93x	+ Short-term Debt	1,059	2.4%
Growth	-14.49%	33.84%	-16.04%	-26.91%	10.31%		-2.66%	- In-the-Money Convertible Debt	-	-
Total Debt / EBITDA	2.65x	1.68x	2.98x	2.50x	1.82x	1.63x	2.21x	- Cash & Equivalents	-2,558	-5.8%
Growth	57.50%	-43.66%	19.28%	37.45%	11.39%		16.39%	+ Preferred Stock	-	-
LT Debt / Total Capital	53.55%	53.27%	57.09%	29.28%	30.77%	31.40%	42.56%	- In-the-Money Convertible Pfd.	-	-
Growth	0.52%	-6.69%	95.01%	-4.85%	-2.00%		16.40%	- Investments in Unconsol. Subs	-5,495	-12.4%
								+ Non-Controlling Interest	5,133	11.5%
								+ Pension Liabilities	0	0.0%
								Enterprise Value	\$44,481	100%

FINANCIAL COMPARISON

PROFITABILITY

PROFITABILITY Factors (1 - best, 6 - worst: high is better except Total Debt)

Company Name	Sales Growth	Gross Margin	EBIT Margin	ROIC	ROE				----- RANK -----						
	(3 yr.)	(NTM)	(NTM)	(NTM)	(NTM)	Sales	EBITDA	Total Debt	Sales Growth	Gross Margin	EBIT Margin	ROIC	ROE	Avg. Rank	Evaluation
Walgreens Boots AI	-3.80	20.82	3.68	-5.33	16.32	\$132,703	\$4,761	\$11,727	5	3	2	5	3	3.8	Less Profitable
CVS Health	29.01	17.10	5.49	2.19	15.01	\$291,935	\$19,450	\$52,211	1	4	1	4	4	2.5	More Profitable
Kroger	20.58	21.62	2.96	8.16	23.87	\$137,888	\$7,172	\$13,230	4	2	4	3	2	3.3	Profitable
Albertsons Compan	25.78	28.26	3.32	10.60	101.11	\$71,887	\$4,831	\$9,117	2	1	3	2	1	2.0	More Profitable
McKesson	21.76	4.57	1.69	62.66	-	\$263,966	\$3,724	\$6,473	3	5	5	1		3.5	Less Profitable
Average	18.67	18.47	3.43	15.66	39.08	\$179,676	\$7,988	\$18,552							

- Walgreens **Sales Growth** is ranked the worst in the peer group. Its **3 yr. Sales Growth** is -3.80, the only negative metric in the peer group
- WBA has the worst **Return on Invested Capital (NTM)**. While their **ROIC (NTM)** of 16.32 still comes ahead of CVS, it does not inspire confidence relative to the rest of the group.

LEVERAGE

LIQUIDITY, LEVERAGE, YIELD (1 - best, 6 - worst: high is better for current ratio, EBITDA/Int. Exp, and yield; low is better for debt ratios and beta)

Company Name	Curr Ratio	EBITDA / Int. Exp	Net Debt / EBITDA	LT Debt / Ttl Capital	FCF Yield	Dividend Yield	Beta	Diluted Shares	Curr Ratio	EBITDA / Int. Exp	Net Debt / EBITDA	LT Debt / Capital	Dividend Yield	FCF Yield	Debt Rank	Yield Rank
	Walgreens Boots AI	0.75	11.93x	7.11x	53.55	7.13	5.45	0.83	864.5	5	3	5	2	1	5	3.8
CVS Health	0.94	8.46x	2.58x	47.99	11.48	1.99	0.58	1,315.0	3	5	4	1	2	3	3.3	2.5
Kroger	0.76	14.55x	2.21x	62.27	12.76	1.86	0.66	724.0	4	2	2	3	3	2	2.8	2.5
Albertsons Compan	1.12	10.97x	2.29x	69.18	17.78	1.48	0.35	576.3	1	4	3	4	4	1	3.0	2.5
McKesson	0.96	22.72x	1.03x	112.54	9.33	0.60	0.57	144.1	2	1	1	5	5	4	2.3	4.5
Average	0.91	13.73x	3.04x	69.11	11.70	2.28	0.60									

- Walgreens presents the lowest **Current Ratio** and **FCF Yield** among the peer group, suggesting potential inability to meet short-term obligations.
- In comparison to its competitors, WBA also has the highest **Net Debt/EBITDA**, more than twice as leveraged as CVS, the next closest competitor. With a high amount of debt, their ability for debt repayment is at higher risk.
- While WBA's **EBITDA / Int. Exp** ranked 3rd among its peers, their history of **EBITDA** decreasing YoY and low **FCF Yield** presents greater risks to meet interest payments in the future.

VALUATION ANALYSIS

PEER COMPARISON

Company Name	Cusip	Coupon	Maturity	Credit Rating (Moody's/S&P)	YTW	OAS (Trsy)	Altman Z-score (Bloomberg)	Outstanding Issuance	Duration	Adjust weight if desired by changing these figures=>				Weighted Rank
										Yield Spread Rank	Default Risk Rank	Int. Rate Risk Rank	Financial Risk Score	
Walgreens Boots Al	931427AQ1	3.450%	6/2026	Baa3/BBB	4.66%	91	2.79	\$1,900,000,000	3.08 yrs.	2	5	2	3.75	3.6
CVS Health	126650DF4	3.000%	8/2026	Baa2/BBB	4.56%	88	3.66	\$750,000,000	3.25 yrs.	3	3	3	3.25	3.1
Kroger	501044DE8	2.650%	10/2026	Baa1/BBB	4.52%	87	4.65	\$750,000,000	3.44 yrs.	4	2	5	2.75	3.1
Albertsons Compan	013092AF8	3.250%	3/2026	Ba2/BB	5.91%	211	3.29	\$750,000,000	2.86 yrs.	1	4	1	3.00	2.6
McKesson	581557BR5	1.300%	8/2026	Baa1/BBB+	4.51%	86	6.42	\$500,000,000	3.36 yrs.	5	1	4	2.25	2.7
Average OAS and Z-score:						112	4.16							

Overall Ranking: 5th

Walgreens is overall ranked the lowest among all its peers for financial security and valuation. This WBA bond has the highest default and financial risk of the group. Walgreen's financial deterioration is a cause for concern about future ability to repay debt. Even when compared to its competition, WBA's OAS does not appropriately compensate for the company's financial risk.

Default Risk: 5th

WBA has an Altman Z-score of 2.79. WBA has the lowest Z-score out of its peers and scores below 3 which indicates a higher probability to file for bankruptcy. Furthermore, their financial performance does indicate a higher risk in comparison to the OAS offered.

Financial Risk: 5th

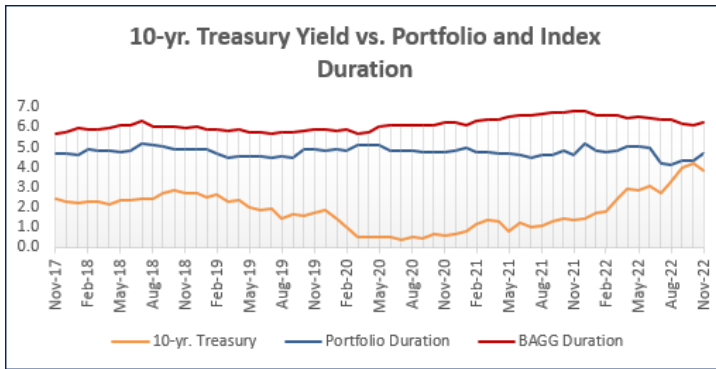
WBA ranked the worst for financial risk among its competitors based on the factors outlined in the previous tables. Walgreens has a large amount of Net Debt / EBITDA while their coverage ratio, EBITDA / Int. Exp, is on the weaker spectrum of the peer group. Their negative Sales Growth and low Current Ratio indicate financial deterioration, making WBA's outlook questionable.

Yield Spread: 2th

WBA has the 4th lowest option-adjust spread in the peer comparisons. While lower credit quality is usually compensated with higher returns, this WBA bond still provides lesser returns for the risks. We intend to reposition into other opportunities that provide a more adequate return for the risks taken.

Interest Rate Risk: 2nd

Walgreens duration ranked 2nd in the peer group at 3.08 yrs. The TCM Bond team plans to replace WBA with a higher duration bond to raise the average duration of the portfolio as interest rate increases are expected to slow in 2023.

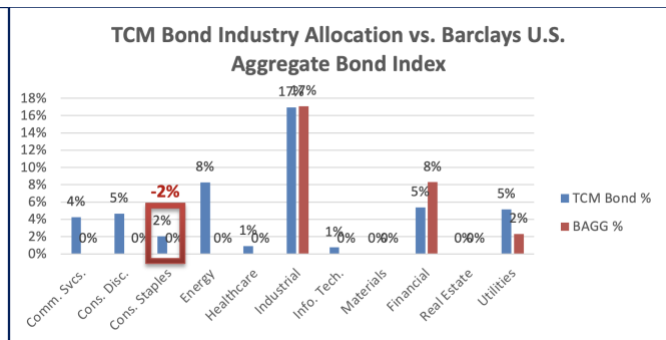
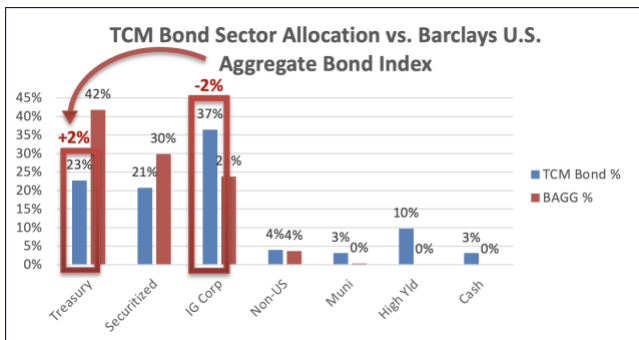


Weighted Average Statistics as of December 31, 2022	Duration	Credit Quality
TCM Bond Portfolio	4.81	A+
BAGG Index	6.22	AA
<i>Difference:</i>	-1.41	

PORTFOLIO IMPACT AND SUMMARY

The TCM Bond team recommends selling our 2% position in Walgreens 3.450% bond maturing in 2026 to raise the portfolio’s average duration and position ourselves closer to the benchmark in anticipation of slowing interest rate increases in 2023. WBA’s increasing accumulation of debt while EBITDA declines indicates deteriorating financials. Considering the peer analysis and analyzing WBA’s financials, the low OAS is an inferior reward for its risk. The company is in a transition period where the benefits of acquisitions cannot yet be determined while liquidity issues and debt repayment become a concern.

The TCM Bond team intends to swap this security with one that has a longer maturity to support our duration target. Treasuries are one of the potential options to reallocate into due to our underweight in Treasury and overweight in Investment-Grade Corporates when compared to the index. The trade should put our portfolio more in line with the benchmark by increasing our Treasury exposure from 23% to 25% and decreasing Consumer Stable sector exposure from 2% to 0%.



APPENDIX

YIELD CURVE GRAPH

Explanation: I have included both the healthcare and consumer staples yield curves in the 1st graph because FactSet classified WBA as healthcare while Bloomberg classified it as consumer staples.

REFERENCES

Bloomberg

FactSet

[Company/Security - Snapshot \(factset.com\)](https://www.factset.com/Company/Security)

IBISworld

[44611 Pharmacies & Drug Stores in the US - MyIBISWorld](https://www.ibisworld.com/industry-statistics/44611-pharmacies-and-drug-stores-in-the-us/)

Walgreens shelves pharmacy Boots' sale as market turmoil hits dealmaking

[Walgreens shelves pharmacy Boots' sale as market turmoil hits dealmaking | Reuters](https://www.reuters.com/business/healthcare-pharmaceuticals/walgreens-shelves-pharmacy-boots-sale-as-market-turmoil-hits-dealmaking-2022-08-11/)

Amazon Has, Is, And Will Continue To Disrupt Walgreen's Businesses

[Amazon \(AMZN\) To Continue To Disrupt Walgreen's \(WBA\) Businesses | Seeking Alpha](https://seekingalpha.com/news/3842421-amazon-amzn-to-continue-to-disrupt-walgreen-s-wba-businesses)