Walgreens’ renewal effort in full swing

BY JIM FREDERICK

What a difference a year makes.

Walgreens’ management and shareholders were long accustomed to steady, record-breaking gains in sales and earnings, and a pedal-to-the-metal store-development strategy that made Walgreens the nation’s fastest-growing pharmacy retailer and a market leader in cities across the country. As recently as the company’s annual meeting in January 2008, former chairman and CEO Jeff Rein reaffirmed that strategy, outlining a bold plan for filling in markets across the country by opening roughly one new store every 16 hours and buying the prescription files, and sometimes the stores, of rival independent and small-chain pharmacies. He also said the company would aggressively pursue new opportunities in specialty pharmacy and front-end merchandising.

Organic, ground-up store construction projects would add 550 new and replacement stores in fiscal 2008, Rein predicted, and more than 600 new units in 2009. And despite troubling signs of an extended economic slide and an operating cost structure that was out of sync with current sales and profit growth trends, he and other Walgreens managers continued to exude confidence that those hurdles could be overcome in relatively short order.

By historical standards, it wasn’t an unreasonable assumption. Walgreens’ “stick-to-the-basics” hedgehog strategy, emphasizing core drug store necessities, convenience of merchandise mix and store location, and the relentless pursuit of prescription business and market share was the right strategy for more than three remarkable decades of uninterrupted growth in sales and profits — so was the company’s proactive use of advanced technology to link together all its pharmacies and patient data, to replenish its stores and distribution centers efficiently while cutting inventory levels, to forecast seasonal demand and to get more insight into customer demand patterns and demographics.

Those strengths are still critical components of a successful strategy, but Walgreens’ managers continued to exude confidence that those hurdles could be overcome in relatively short order.

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In 2009, Walgreens launched a central-fill program so that pharmacists can focus less on dispensing.

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Greg Wasson, Walgreens president, CEO

Within a day of his elevation to CEO of Walgreens, Greg Wasson participated in an exclusive interview with Drug Store News to discuss the future of Walgreens and health care in America, the progress of the company’s revitalization efforts and his own reasons for feeling optimistic about Walgreens’ long-term ability to thrive in a changing economic and healthcare arena. Here are excerpts from that interview, which took place Jan. 26.

Drug Store News: First, congratulations on your appointment. Our questions probably can all be boiled down to two fundamental ones: What are the biggest challenges Walgreens faces? And how do you fix them?

First, what steps need to be taken short-term, and how will that lead to a long-term vision? It seems to be really about integrating all these different capabilities that Walgreens has brought to bear, and bringing those directly to employers and health plan players, as well as to customers in the stores — recharging both the pharmacy/health services end of the business, as well as the front end. Obviously, in this economy that’s a huge challenge. But can you lay out what you see in terms of both immediate needs and long-term potential?

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strategy. But it’s become increasingly clear that they’re no longer enough. Walgreens today is swimming upstream against a harrowing economic collapse, a consumer afraid to open her wallet, and a new breed of integrated healthcare retailer, exemplified by the company’s arch-rival, CVS Caremark, that blends the customer drawing power and data-generating abilities of thousands of stores with the market-moving clout of a massive pharmacy benefit management capability.

Even by early 2008, Rein and other Walgreens managers already were scrambling to cut operating costs and acknowledging that the chain had “lost focus on payroll and expenses.” Earnings growth was faltering amid a slowing economy and a pullback in consumer spending. And competition from CVS Caremark, Walmart and other rivals was intensifying as those retailers exploited new and powerful direct connections with employer-sponsored health plans and patients.

As the economic crisis deepened through 2008, those challenges piled up on Walgreens’ doorstep. Walgreens managed to eke out another year of record sales and earnings in fiscal 2008, ended Aug. 31, 2008, but company officials acknowledged that the 108-year-old drug chain was pushing hard against the headwinds of a souring economy and a pullback in consumer spending, both at the pharmacy and front end of the store.

They also admitted Walgreens had reacted too slowly to the financial meltdown by failing to rein in costs and throttle back on the breakneck store-expansion schedule. And they admitted that a big investment in promotional spending and discounting at the front end had failed to spark the surge in consumer demand they had hoped for.

Walgreens’ problems culminated in October, when the company jettisoned its chairman and CEO, launched a nationwide search for a new top manager, abandoned its breakneck store-development strategy and announced a massive strategic overhaul of Walgreens’ go-to-market strategy and an all-out campaign to shed operating costs. Amid the bleakest economic outlook since perhaps the Great Depression, interim chairman and CEO Alan McNally and Walgreens president Greg Wasson — soon to be tapped Next steps

Colored lighting helps draw attention to the beauty displays in Walgreens’ new Times Square store.

We announced a corporate and field management reduction of 1,000 positions a few weeks back, and we’re feeling good about where we are there. So that’s where we want to head. We’ve got a solid winning strategy. It’s all about execution now, and driving execution of that strategy. We’ve made

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Wasson: Right. Let me maybe start at the 30,000-ft. level and work down. We want to be a provider — the most convenient provider of consumer goods and services and pharmacy — and even health and wellness services — in the country. That means leveraging the 6,600 drug stores we have across the country — which we think is one of the best retail networks out there — to continue to offer more and more high-consumer-value goods and services, as well as more health-and-wellness services, such as nurse practitioner services and so forth. At the same time, by slowing store growth, we also want to take a little of that freed-up capital to reinvest back into those stores — to reinvent the front-end experience. It’s everything from reviewing our merchandise selection and our department adjacencies, our profile, our look and feel, and so forth within the stores, and also taking a good, hard look at our costs and our efficiencies and our processes, as to how we do business.

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good progress, and I think both short- and long-term, it’s about continued execution and driving our strategy to help us move both through the short-term environment we’re in, but also longer-term.

Short-term, I think the fortunate thing about the industry we’re in is that we sell a lot of what people need. So we’re focusing on all we can do to meet the new consumer needs and make sure we’re relevant in their everyday lives by offering high-value and good products and services.

DrSN: I know you’re trying to rejuvenate the front end and rationalize the SKU mix and adjacencies. Have we seen anything yet in the stores that dramatically demonstrates that effort?

Wasson: So far, it’s mostly in promotional items, what we call “affordable essentials.” It’s more prominence in our ads and in our stores for those items we believe people are looking for with good price and good value, so we can really swing the doors. We are about 40% or more through the reworking of our merchandise categories, and we’ve got some [planograms] in test stores. You’ll begin to see more of that by mid-summer as [EVP marketing]
Walgreens insiders are executing a transformation strategy based on a powerful assumption: that the sum of the company’s assets equals more than its individual parts.

Walgreens has dubbed its strategy “More from the Core.” Its goal: to unlock the massive potential within the company’s core businesses by leveraging and tying together its powerful and growing assets in drug store market penetration, ambulatory clinical care, specialty pharmacy, health services and on-site workplace pharmacy and health care.

The plan involves a top-to-bottom analysis of how the 108-year-old retailer goes to market and reaches its customers — and a dramatic shift in its long-term strategy for growth and profitability.

Walgreens chairman Alan McNally said it’s critical that Walgreens do a better job of leveraging the company’s assets and exploiting untapped synergies to bring new solutions to a healthcare system he describes as “in crisis.” On the pharmacy and healthcare front, that means creating a new business model that McNally said will “create value for our shareholders by being part of the healthcare solution in America.” At the front end, it means cutting out non-profitable items in a storewide “SKU rationalization” and sparking new life and more per-customer transactions in areas like beauty, basic staples and promotional items.

“Our intent,” said president and CEO Greg Wasson, “is to transform Walgreens into a more efficient and customer-focused company serving the needs of shoppers for consumer goods and services and for patients and payers seeking quality pharmacy, health- and-wellness services that are accessible and affordable.”

“DrSN: Do you have any sense of when things might begin to turn around economically in the United States?”

Wasson: I think every week that goes by things get a little more bearish. The work we’ve done with leading economists shows us it’s probably going to be the middle of 2010 before we potentially begin to see any time of up-turn in the economy. We could see unemployment anywhere from the high, single digits to the low, double digits.

So we’re gearing toward that. We’re saying, let’s focus on that being reality and on what adjustments and plans we need to make to maneuver through this time period. And again, I think a lot of it is merchandising mix, selection and value. And the cost reductions we’re looking at with the “Rewiring for Growth” effort will begin to see benefits between now and then.

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and merchandising] George Riedl’s group works through those.

Once we’re through all categories in the next couple of months in several stores, we’re going to begin to roll out those categories. Hopefully, by mid-summer we’ll be well on the way.

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Walgreens plans on creating a new business model for pharmacy.

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We’re going to leverage the best store network in America. We absolutely believe there’s tremendous opportunity to create more potential from our 6,500 stores.”

Greg Wasson,
President and CEO

Walgreens’ prescription numbers appear to be holding up pretty well, particularly in the last couple of months. As you’ve said yourself, you’d rather be in the drug store business right now than in a lot of other kinds of retailing.

Wasson: [laughing] I tell a lot of people, I’m glad I’m selling toothpaste and prescriptions and diapers and not high-ticket electronics.

DrSN: The overall trend at Walgreens’ front end also appears to be paring down the number of multiple SKUs.

Wasson: Yes, and I think it’ll vary by category.

We’re taking basic principles to every category. In some, there may be single-digit reduction in
“We believe CVS and Walgreens are best positioned to benefit from the growth of retail clinics, as the two combined currently have 70% of the health clinic market. We expect Walgreens’ TakeCare health clinics to lead the growth of clinics in 2009.”

Deborah Weinswig, Citi Investment Research

SKUs; in others, there may be upward of 20% to 30% reductions. There may be some categories we [no longer] even carry.

What I’m really excited about is that we brought in Kim Feil as our chief marketing officer. She has a tremendous background in consumer research and customer insights from her IRI days, and she’s really helping us get our arms around and understand more and more what our consumers are looking for, what our trends are, what our segments are — and helping us really determine what we should be offering in the stores to make that shopping experience better.

So you’re going to see a lot of exciting things coming out of the front of the store in the next several months.

DrSN: On the pharmacy and health side, one of the most promising things we see is the direct outreach Walgreens is making to employers through the Complete Care and Well-Being program, and the worksite pharmacies and clinics. It’s going right into the worksites of those health plan sponsors and offering Walgreens as a solutions provider, saying to employers, ‘We have solutions to your health plan costs.’

Have you had much reaction yet to the launch of that program?
After more than a century of growth and a 34-year streak of record-breaking sales and earnings, the nation’s premier drug store retailer is making a big break with its storied past.

Battered by an alarming decline in consumer confidence, out-of-control operating costs, an escalating economic crisis and slowing sales and profits, Walgreens is working its way through the painful but necessary process of reinventing itself.

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Walgreens leaders call the transformation of their company “Rewiring for Growth.” The massive project, they said, involves an all-out attack on bloated operating costs; a more productive leveraging of store and healthcare assets to produce a massive pharmacy operation with the data-gathering prowess, employer relationships and patient memberships wielded by a massive pharmacy benefit manager.

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Peter Hotz, the president of our Take Care Health employer solutions group … is a sharp, sharp individual. They’ve got some good data they’re able to show large employers and even managed care [plans] as to the improvement in chronic and disease management programs that large employers have been offering when services are provided on the campus. We’re showing improved enrollment, improved engagement, continued adherence [to drug therapy]. There are some pretty amazing numbers he’s able to share.
higher revenues and profits; and a go-to-market strategy that positions Walgreens as a broad-based, multi-faceted solution to the healthcare needs of cash-strapped consumers, financially stretched corporate health plan sponsors and overworked physicians and clinicians.

“Our value creation framework is simple: to drive smart top-line growth, take tough and necessary steps to get our earnings engine going again, intensify our focus on cash flow and return on invested capital, and ensure a strong balance sheet for ample liquidity and strategic flexibility,” said Wade Miquelon, Walgreens’ new SVP and CFO.

Central to the effort is a dramatic reduction in store construction and development in order to boost the performance of the company’s existing network of roughly 6,500 units. “Our first initiative is to slow our rate of new store expansion going forward,” explained president and CEO Greg Wasson in January. “We will reduce our new store expansion to between 4% and 4.5% in 2010, and down to 2.5% to 3% in 2011.”

Greg Wasson, President and CEO

Walgreens has positioned itself as a provider of consumer goods and services, pharmacy services and health-and-wellness services, like retail clinics, for employers and PBMs. By the end of fiscal 2009, Wasson said, POWER, he added boldly, “is transforming community pharmacy as we know it today.”

“We are doing this by removing as many administrative tasks from our stores as we can and moving these to a more efficient, centralized location,” Walgreens’ CEO explained.

DrSN: In these tough times, when you’re trying to allocate resources the right way, do you feel that the resources you’ve devoted so far to this employer-based model are adequate at this point, or are you still in the stage of staffing up and throwing more firepower at that effort?

Wasson: Good question. I feel pretty good with where we are now. I think we’ve put together a heck of a management team. Back when we first

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Wasson: Certainly; anywhere we already have an employer relationship helps. But the neat thing about this and our employer solutions model is that large employers and managed care organizations are interested in working with us because they see us as a provider of services they can work with; and pharmacy benefit managers look to us, too. We don’t have to be the PBM.

That’s the big advantage and the tremendous opportunity I believe we have. As I said at the beginning, want to be a provider of what we do well: consumer goods and services, pharmacy services and, now, a growing ability in health-and-wellness services.

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And we are also using our existing mail service facilities to centrally fill prescriptions.”

“With our government and employers … looking to control rising healthcare costs, we are seeing continued pressure on pharmacy reimbursement,” Wasson added. “As a result, we must lower our pharmacy-operating costs while improving service levels. This also allows our pharmacists to play a pivotal role in this nation’s healthcare reform.”

To reduce overhead, Walgreens also recently announced a reduction of 1,000 headquarters staff and field management positions this year. According to SVP operations Mark Wagner, all 29 of the company’s regional operations VPs are being moved out of headquarters in Deerfield, Ill., and into their respective regional offices to put them closer to customers.

“It’s about reducing costs and improving our productivity,” Wasson explained.

To target its promotional dollars more effectively, Walgreens also has reduced the number of ad pages in its circulars by roughly 20%.

Through projects like POWER, the workforce reduction and ongoing efforts to create “more efficient assortment and promotion in our stores, we are targeting $1 billion in annual cost reductions,” Miquelon said.

Investment analysts who follow the company are generally upbeat about Walgreens’ long-term prospects, convinced that the company’s tried-and-true management, long history of innovation, marketing fundamentals and vision for future excellence remain sound. But they predicted the “rewiring” campaign will take time to yield robust earnings growth.

Mark Miller, an analyst with William Blair & Co., noted that Walgreens’ management “made cautionary comments regarding the state of the consumer … that caused us to lower our EPS [earnings per share] projections going forward.”

Despite the lower expectations, he added, “we are encouraged that the company has made higher-level changes in its approach, including the moderation in capital expenditures, hiring of outside talent for key positions, plans to rationalize the SKU assortment and a heightened awareness of the need to become a more consumer-centric organization.”

It could be a year or more, however, before those changes yield significant financial improvements, he warned.

“Certainly, from a financial standpoint, we see greater urgency … to improve profitability,” said the analyst.

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started looking at retail clinics, we went out and partnered with three providers, and over the course of time decided on Take Care because we felt that Hal Rosenbluth [SVP and president of Walgreens Health and Wellness] and Peter Miller [divisional VP and president and CEO of Take Care Health Systems], who founded that organization, had the premier model. I believe they still do, and I think they’ve brought tremendous value to us.

When we began to see the value of the on-site services for employers in filling this model out, we looked at the two leading providers out there [Chadds Ford, Pa.-based I-trax and Cleveland-based Whole Health Management, both of which Walgreens purchased last spring]. They both had great management teams, and Hal Rosenbluth has done a terrific job in a short period of time bringing those two organizations together and retaining the best management talent of both. And now he’s doing the same bringing what we now call Take Care Consumer Solutions together with the employer solutions side, building a strong management team. I feel really good about it. I think we’ve got some top-notch talent in both our health-and-wellness division under Hal, as well as [Walgreens Health Services] under Stan Blaylock. Stan has...
Walgreens sharpens product focus to spark customer satisfaction

BY JIM FREDERICK

What to leave in, and what to take out?
That’s one of the fundamental questions Walgreens’ merchandisers are grappling with as they work their way through the entire front end of the company’s drug store prototype. The project, in line with the company’s “Rewiring for growth” and “More from the Core” initiatives, is an attempt to vastly improve the customer experience.

To do so, Walgreens has embarked on a top-to-bottom transformation project to rationalize and justify every SKU in the store. It means weeding out slow or redundant product facings, beefing up in-demand categories and making sure Walgreens is stocking the “affordable essentials” its customers buy every day — items like laundry detergent, mouthwash, batteries, shampoo and other staples.

The revitalization effort extends to the pharmacy, as well. To boost prescription market share and better tie together all its pharmacy, health-and-wellness and convenience services, Walgreens is putting its promotional prowess behind the Walgreens Prescription Savings Club, a customer loyalty and savings program that has already enrolled more than 1.5 million consumers.

“In the pharmacy, we’re making it easier for customers to get all services with Prescription Savings Club,” said Walgreens chairman Alan McNally. “This is not another $4 generic program. It’s a direct-to-consumer prescription drug plan and loyalty initiative with a tremendous upside.”

Alan McNally, Chairman

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brought us some tremendous talent. When we acquired Medmark a couple of years ago, followed by OptionCare, they were two very good platforms in specialty pharmacy and infusion with good management teams and systems. Stan’s bringing that together aggressively.

As far as resources go, I think that slowing new-store growth and focusing on our costs frees up some capital, so we can make sure we’re investing properly in our strategy. And it allows us to continue to open new stores in the markets where we need to, and to continue to invest in these other opportunities.

DrSN: As you develop more of these worksite pharmacies and health-and-wellness centers, do you think that will translate into new business in the stores, too, as these employer-sponsored patients become more familiar with Walgreens? Do you see them shifting some of their pharmacy purchasing to your stores?

Wasson: Absolutely. The patients who are using our retail clinics — about 20% to 25% of them, and in
“The average Walgreens shopper comes in our store to buy 1.5 items and leaves with 3.0 items. It has been that way for years. By providing a better and more relevant shopping experience, we plan to increase this basket size.”

Wade Miquelon, SVP and CFO

Waldgreens allows customers to save on more than 5,000 brand-name and generic medications, and can be used at any Walgreens store nationwide.

Waldgreens Prescription Club Card

The Walgreens Prescription Club Card allows customers to save on more than 5,000 brand-name and generic medications, and can be used at any Walgreens store nationwide.

JANE Q PUBLIC

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Prescription Savings Card Issued 01/01/09

The Walgreens Prescription Club Card allows customers to save on more than 5,000 brand-name and generic medications, and can be used at any Walgreens store nationwide.

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online,” said McNally, who noted that Walgreens enjoyed a 54% jump in traffic to its Web site in 2008.

At the front end, the goal of Walgreens’ remerchandising efforts is simply stated but ambitious: to add excitement to the store’s presentation, pull in more customers and add at least one item to the average per-customer shopping basket.

“By adding just one more item to the average basket, we can add $1 per share in earnings,” Miquelon said. “You can see why we are so focused on this as a core plank of getting more from the core.”

Eventually, the SKU rationalization project will spawn a new store prototype, Walgreens officials said.

“We’re reviewing every category of merchandise in our stores,” said president and CEO Greg Wasson.

The effort, he added, is already about 40% complet-
ed. “At the front end of the store, we’re really focused on trying to be relevant to what the consumer is looking for,” he told Drug Store News.

The remerchandising campaign already has yielded some tangible benefits, said company leaders. With the overhaul of the baby category, for instance, Walgreens drove up average shopping basket sales in that category by 41%.

To shake up the thinking of its front-end merchandisers, Walgreens has brought in some seasoned talent from outside the ranks. Among the highest-profile additions: the hiring of Kim Feil as VP and chief marketing officer, a new position that reports directly to Wasson. Feil, a 25-year veteran of Sara Lee, Kimberly-Clark and other firms, will lead a new marketing organization charged with responding to the evolving needs of Walgreens customers and pharmacy patients.

“Under Kim’s direction, our marketing folks will enhance the in-store customer experience and create stronger connections to our online offerings and Take Care Clinic services,” Wasson said. “Kim brings a strong consumer research and mar-

DrSN: Will the increasing emphasis on integrated healthcare services — moving beyond the pharmacy and into a broader healthcare role — also possibly shift the mix somewhat at the front end of the store? In other words, do you see Walgreens allocating more space to other health services and products like durable medical equipment, or targeted wellness services aimed at specific patient groups?

Wasson: I think that’s part of what gets us excited about this whole initiative. As we optimize the departments and potentially free up space, I think there are other opportunities, such as DME.

I don’t think it will be a one-size-fits-all approach, though. In other words, I think there’ll be much more of a focus on select stores and demographics. With
“This [customer-centric retailing project] will leverage consumer insights and data gathered by Walgreens and our strategic vendors to reorient the store experience around the customer and create merchandising solutions that make our stores easier and more convenient to shop.”

Greg Wasson, President and CEO

Walgreens in 2008 opened its first store in Hawaii in its quest to have stores in all 50 states.

DrSN: Typically, when Walgreens enters a new market, it goes in aggressively, with as rapid a store buildup as possible to capture market share and good locations quickly. What impact will the store-construction cutback have on plans to move in force into newer Walgreens markets like Hawaii? Does that remain a priority focus?

Wasson: I think what it does is allow us to strategically manage our real estate portfolio in strategic markets. Keep in mind, even a growth rate of 2.5% to 3% is still a lot of [new] drug stores. And we’re certainly looking to grow still in the Northeast and Southern California and Hawaii. This still allows us to continue to penetrate those markets we see as strategic.

The good thing is, we’ve entered most every major market out there. And there are many markets where we’ll probably spend more of our investment in refreshing and remodeling stores, and shift our real estate focus to the more strategic newer markets.