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Walgreen 3Q profit jumps but misses estimates

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Walgreen Co.'s fiscal third quarter earnings jumped 16 percent, but its shares plunged Tuesday as investors fretted over sluggish sales outside the drugstore chain's pharmacies and other troubling trends.

The Deerfield, Illinois, company missed Wall Street forecasts, and its earnings grew largely because of the comparison with last year's quarter, when a business split had hurt its performance.

Several analysts said they were surprised by a weaker than expected expansion in this year's quarter of Walgreen's gross margin, which is a basic measure of profitability. That could indicate that the nation's largest drugstore operator is losing faster than expected a key boost it had been receiving from generic drugs, said Edward Jones analyst Judson Clark.

An influx of generic medications has helped drugstore bottom lines for several quarters now because they come with a wider margin between the cost for the pharmacy to purchase the drugs and the reimbursement it receives.

The generic wave was driven by the expiration of patents protecting top-sellers like the cholesterol fighter Lipitor. But that benefit is expected to wane because there are fewer significant patent expirations waiting to refuel it.

That decreasing generic benefit plus a promotional push to boost sales in store front ends, or the area outside the pharmacy, could hurt Walgreen's profitability in future quarters, said Credit Suisse analyst Edward J. Kelly, who called the results released Tuesday "fairly disappointing."

"This quarter is not a great signal for the near-term," he wrote in an email.

Walgreen shares sank 6.2 percent, or $2.99, to $45.06 Tuesday afternoon, while broader trading indexes climbed slightly. But the stock price had already advanced 30 percent so far this year before Tuesday, and Clark said that gain is part of the reason shares fell so much after the company released earnings.

"We think this is still a good business and an appropriate price," he said.

Overall, Walgreen earned $624 million, or 65 cents per share, in the quarter that ended in May. That's up from $537 million, or 62 cents per share, a year ago, when the company had fewer shares outstanding.

Revenue rose about 3 percent to $18.31 billion.

Adjusted earnings amounted to 85 cents per share, excluding expenses such as acquisition and legal costs.

Analysts forecast earnings of 91 cents per share on $18.4 billion in revenue, according to FactSet.

Last year, Walgreen and the nation's biggest pharmacy benefits manager, Express Scripts Holding Co., had a contract squabble that kept them from doing business for about nine months. That hurt the drugstore chain's results as many Walgreen customers to migrate to competitors for their prescriptions, at least temporarily.

The companies resumed business last September, and Walgreen says customers have been returning to its stores.

Walgreen said Tuesday results in this year's quarter also were helped by its acquisition of a stake in European health and beauty retailer Alliance Boots, which contributed about 10 cents per share to the U.S. company's adjusted earnings.

Earlier this month, Walgreen said revenue from stores open at least a year climbed 1.3 percent in the quarter, but front-end sales barely rose.

Company leaders said that did not meet their expectations. They said a soft economy has hurt those results, especially in stores in lower-income neighborhoods.

"I can assure you that improving our front end is a high priority," CEO Greg Wasson said.

He said the company has started to customize its advertising circulars more toward individual communities. Walgreen also is using buying trends it gleans from its Balance Rewards customer loyalty program to tailor its promotions. The program lets shoppers pile up points for purchases that they can then translate into cash rewards to use at company stores, and it also gives Walgreen more insight into customer buying patterns.

Walgreen runs 8,097 drugstores nationwide, or 207 more than it did last year. That's more than the totals for CVS Caremark Corp. and Rite Aid Corp.