

DID WALGREENS AND RITE AID BENEFIT FROM THEIR 2017 DEAL?

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ABSTRACT

Purpose- After several attempts that extended over two years, in 2017 the U.S. Federal Trade Commission approved Walgreens' proposal to buy nearly half of Rite Aid stores. The two companies were in the same line of business making the merger fall in the category of horizontal mergers. The main benefits of horizontal mergers are cost savings from improved operational efficiency and superior bargaining power with respect to suppliers. Using annual financial statements, we examined the performance of Walgreens and Rite Aid over the four-year period since the acquisition of Rite Aid stores by Walgreens. The examination is useful because the Federal Trade Commission was not in favor of Walgreens' earlier proposal to merge completely with Rite Aid, but later allowed it to buy almost half of Rite Aid stores. The present study examines whether the revised proposal benefitted both Walgreens and Rite Aid.

Methodology- We collected annual financial statement data of the two companies from Mergent database and analyzed the common size statements and the relevant financial ratios.

Findings- Analysis of profitability ratios indicate profit margins (gross as well as net) continued to decrease for both companies even after the acquisition. Both companies showed improved operational efficiency as reflected in Inventory turnover and employee productivity, but Walgreens had a superior performance.

Conclusion- Only four years have passed since Walgreens acquired Rite Aid stores. Our analysis of the limited data indicates that Walgreen seems to have benefitted more from the deal. Rite Aid, by selling about 46% of its stores to Walgreens in 2017, became a much smaller company. The smaller size did not affect the cost of inventory or financing, but its profitability did not improve.

Key Words: Walgreens, Rite Aid, drugstores, pharmacies, mergers

JEL Codes: G34, M41, M10

1. INTRODUCTION

Drugstores and pharmacies have always been an integral part of the healthcare system. Although most drugstore businesses started as a single store and remained so, a few grew to become regional and national chains. In the U.S., three such large drug store chain companies are Walgreens, CVS, and Rite Aid. The three companies were ranked as the top three drug store chains in the U.S. for several years. Despite competition among themselves and other companies, these three companies retained their positions as major drug store chains in the U.S. through consistent growth. The growth of these companies has been internal as well as through acquisitions. Walgreens was founded in 1901 as a single store in Chicago. It took seven years to start the second Walgreens store. However, by 1926 it grew to become a chain of 100 stores. It crossed the 1,000 mark in 1982, and by the year 2015 it operated at approximately 8,200 locations and became the largest pharmacy chain in the U.S. It gained exposure to the European markets also through its acquisition of Boots Alliance, a large European drug store chain. Walgreens hoped to further increase its operations in the U.S. market and, in 2015, it offered to buy Rite Aid for \$9.4 billion.

Rite Aid Corporation also started as a single drug store. It began operations in 1962, opening its first store in Scranton, Pennsylvania. The number of locations it operated grew to 267 by 1972 and to 4,000 by 1996. When Walgreens made its offer to buy Rite Aid in October 2015, Rite Aid had about 4,600 stores. Walgreens and Rite Aid wanted to merge into one company and sought the Federal Trade Commission's approval in 2015. The commission was not in favor of the proposal. Two

years later, in 2017, the commission approved Walgreens' proposal to buy about half of Rite Aid's stores. This study examines whether the two companies benefitted from the transaction.

2. LITERATURE REVIEW

In their review of the literature pertaining to the effect of mergers and acquisitions on corporate performance, Ismail, Abdou, and Annis (2011) categorize the studies into the following four groups: (1) Market Measures-Based Studies, (2) Accounting Measures-Based Studies, (3) Mixed Measures-Based Studies, and (4) Qualitative Measures-Based Studies. The first group that uses market measures, generally examines the effect of merger related events and actions on the price of stocks of companies involved in the mergers. The second group of studies examines the changes in the structure and operations of the firms after mergers and acquisitions. These investigations mostly use accounting ratios computed from the financial statements of the companies. The third group of studies [e.g Healy, Palepu, and Ruback (1992)] uses market-based measures (mostly changes in stock price) of the acquirer and the acquired, as well as accounting measures computed from financial statements to investigate whether the changes in market measures were corroborated or not by accounting data and ratios computed from them. The fourth group of studies use qualitative information to investigate the effect of mergers and acquisitions on performance. The most relevant literature for us is the second group of studies that use accounting measures. Some of the studies are briefly mentioned below. Rhoades (1998), in a study of nine bank mergers in the U.S., uses conventional accounting ratios to examine the changes in efficiency of the banks after merger. For example, to quantify operating efficiency, he uses the ratio of expenses to revenue; and to quantify profitability he uses the ratios of net income to total assets and net income to owners' equity. Avkiran (1999) investigates the post merger performance of Australian trading banks in the 1986-1995 period. In that study, he uses the ratio of expenses to operating income to measure operating efficiency and return on assets and return on equity to measure profitability. Ibrahim and Meghhouar (2019) analyze a sample of ninety French-listed firms to examine value creation and destruction from horizontal mergers using conventional accounting measures.

Studies mentioned above test hypotheses on whether mergers result in improving operating and financial efficiency and thereby increase value to the shareholders. These investigations require samples of companies for analyzing the data and to accept or not to accept the proposed hypotheses. In contrast to examining a sample of mergers or acquisitions for making generalizations, some studies restricted their analysis to case studies of a single acquisition or merger. For example, Cabanda and Pajara-Pascual (2007) examine the financial and operating performance of two shipping companies after merger. Their analysis involves ratios of profitability, leverage, solvency, operating efficiency, and investment spending. Similarly, Agarwal and Mittal (2014) compare the pre-merger and post-merger performance of Reliance Industries Ltd. and IPCL. – companies in the Indian Petrochemical industry. Using company financial data, they compute conventional financial ratios such as Returns on Total Assets, Equity, and Gross and Net profit margins for their analysis. More recently, using accounting measures, Bilbeisi and Narayanaswamy (2018) examine whether the acquisition of Dollar Tree by Family Dollar (the second and third largest U.S. discount variety stores in 2014) resulted in improved performance. The present study is a case-study of the performance of Walgreens and Rite Aid—two large drug store chains in the U.S.—before and after Walgreens bought hundreds of Rite Aid stores. As in the case studies mentioned above, we use conventional accounting measures for the analysis. The acquisition of Rite Aid drug stores by Walgreens extended over two years. In October 2015, when Walgreens and Rite Aid made the announcement to merge, Walgreens was the top ranked drugstore chain and Rite Aid was ranked third. The combination would have made the merged company the largest drug chain store in the U.S. with about 13,000 stores. The merger was expected to be synergic because of its potential to save costs. The proposed merger announcement was well received by the financial markets as evidenced by increase in stock price of both companies. On the day of the announcement Rite Aid's stock price increased by 43% and that of Walgreens by 6.4% [Matitioli, Siconolfi, & Similluca (2015)]. However, the merger proposal of Walgreens and Rite Aid raised concerns because the combined firm would have become much larger than CVS, the second largest firm in the industry with operations in 7,800 locations at the time. The merged firm was also expected to exercise influence on other pharmaceutical drug related business that handled corporate and government plans [Hufford (2017)]. Because of the potential concentration of market due to the merger, the proposal was expected to attract considerable scrutiny by the Federal Trade Commission (FTC). But Walgreens and Rite Aid were expected to defend the merger proposal by pointing out that there was competition for the business from drugstores located and operated by grocery store chains and clubs such as Costco.

As expected, the 2015 Walgreen-Rite Aid agreement was subjected to intense regulatory scrutiny. Realizing that the proposal was not likely to be approved by the regulators, in January 2017, Walgreens and Rite Aid came up with a plan to reduce their size as a merged firm. Both firms planned on selling more than 1,000 of their stores so that the total number of stores of the merged firm will be smaller than the initial plan and make the industry competitive enough to avoid antitrust concerns. Because of the reduced size of Rite Aid under this proposal, the offer price for Rite Aid was also expected to be lower than the initial \$9.4 billion to an amount somewhere between \$6.8 billion and \$7.4 billion, depending on the number of stores Rite Aid would shed. The financial market's reaction was mixed to the announcement. Rite Aid's shares fell by 17% on the day of the announcement. Walgreens' shares also fell, but by a much smaller amount of 0.1%. In June 2017, in view of the

reluctance of the FTC to approve even the revised deal, Walgreens and Rite Aid abandoned the merger proposal altogether and, instead, came up with a new proposal according to which Walgreens would buy only 2,186 Rite Aid's stores (46% of the total Rite Aid stores) for \$5.18 billion in cash and pay a penalty of \$325 million for breaking up the initial offer made in October 2015. To ease the concern of Rite Aid's reduced bargaining power, Walgreens gave Rite Aid the option to purchase generic drugs through an affiliate of Walgreens' for a period of ten years following the transaction. But one of the FTC commissioners at the time opined that Rite Aid will be at a disadvantage in buying the generic drugs after the elapse of the ten-year period due to its diminished size [Terrel McSweeney (2017)]. The transaction went through, however. The revised offer by Walgreens was for Rite Aid's stores located mainly in the North East, Mid Atlantic, and South Eastern parts of the U.S. After the purchase, Walgreens planned to close about 600 stores (mostly Rite Aid) that were in close proximity (less than two miles) to Walgreens stores. The day the new offer was announced, Rite Aid's stock price dropped by 26% but Walgreen's stock price went up by 1.7% [Terlep and Kendall (2017)]. The revised offer was approved by the Federal Trade Commission on September 19, 2017. Walgreens bought 1,932 Rite Aid stores for \$4.38 billion.

There were three major announcements regarding Walgreens' plans to purchase Rite Aid stores. The first announcement made in 2015 was that Walgreens would buy the entire Rite Aid company, which resulted in the increase in the stock price of both companies. The next two announcements on Walgreens' offer to buy fewer Rite Aid stores resulted in considerable decrease in Rite aid's stock price, but Walgreens' stock price changed very little. Stock price reactions to announcements indicate investors' perception of future performance of the companies. In this case, the steep drop in price of Rite Aid could have portended its future performance. The absence of change in the stock price of Walgreens' stock must have also reflected investors' expectation that there may not be significant change in performance of Walgreens. Using financial statements, we examine the performance of Rite Aid and Walgreens before and after Rite Aid sold its stores to Walgreens in 2017.

3. DATA AND METHODOLOGY

Our primary focus of the study is to examine the performance of Walgreen and Rite Aid after Walgreen acquired almost half of Rite Aid stores in 2017. Several stores sold by Rite Aid to Walgreens were located close to Walgreens stores. Walgreen closed many of these Rite Aid stores after the acquisition. By closing the stores, Walgreens could have increased the sales in stores that remained, and thereby, reduced the cost per unit sold. Rite Aid could have also benefitted from the transaction because it did not have to compete with Walgreens in those areas and focus on the remaining stores. Further, with the proceeds of the sale of its stores, it could have reduced its debt and its interest commitments and invested in upgrading its facilities to reduce the cost of its operations.

For our analysis, we mainly use the annual reports published by the companies primarily for the shareholders and the public. The Securities and Exchange Commission requires large, publicly held companies to annually file a 10-K report. This filing is generally a detailed document, which regulators, analysts, and researchers use. Although financial statements are available on a quarterly basis, we use annual data to avoid seasonal fluctuations and focus on annual changes. However, the fiscal year reporting date for the two companies differed somewhat. The reporting dates were August 31st for Walgreens, and end of February or beginning of March for Rite Aid. The maximum gap between the dates was about six months. We used the end of the year closest to the reporting date as the year for which the report was made. For example, we used the report made by Walgreen on August 31, 2021, as the annual report for 2021, whereas the Rite Aid annual data reported in February of 2022 was used as the data for the year 2021. We used Mergent Online as the primary source of data. Mergent, in addition to reporting the financial statements, also publishes several financial ratios. But some ratios we needed were not readily available in the Mergent database. We therefore computed these ratios from the reported income statements and balance sheets. However, to confirm consistency, we compared our estimates with the ratios available in Mergent. We did not find significant difference between the two.

The primary purpose of the paper is to examine whether the transaction between Walgreens and Rite Aid benefitted both companies. We do it by analyzing the performance of the companies using the financial ratios that measure a firm's profitability, activity, costs, etc. Improvements in performance of the company after the reorganization should be reflected in better financial ratios for the post-acquisition period compared to the pre-acquisition period. To obtain a perspective of Walgreens and Rite Aid, we first graph their total assets, sales, and number of employees from 2012-2021. Figure 1 indicates the annual ending book value of the total assets of Walgreens and Rite Aid from 2012 to 2021. During those ten years, as the chart indicates, Walgreens' size grew considerably. The increase in size of Walgreens was mostly through its acquisitions of Alliance Boots and Rite Aid stores. It bought Alliance Boots in two stages: 45% in 2012 for \$6.7 billion and the remaining 55% in 2014 for \$15.3 billion. After completing the acquisition of Alliance Boots, Walgreens purchased 1,932 stores from Rite Aid for \$4.38 billion in 2017. While the total assets of Walgreens increased, the assets of Rite Aid's decreased mainly because of the sale of its stores to Walgreens.

Figure 1: Total Assets (USD billion)

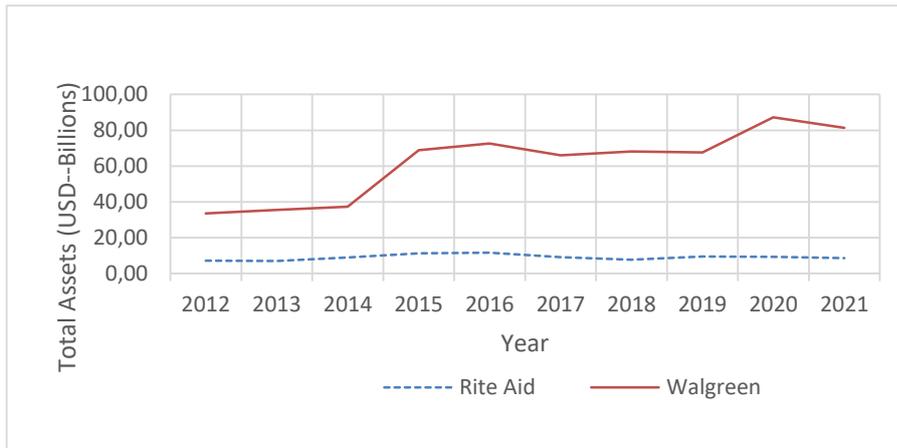


Figure 2 shows the annual sales (revenue) of the companies during the 2012-2021 period. Net annual sales of Walgreens increased from approximately \$72 billion in 2012 to \$133 billion in 2021. Significant annual increase in sales were in the years Walgreens acquired Alliance Boots and the Rite Aid stores. For Rite Aid, annual sales decreased from \$25.53 billion in 2013 to \$24.57 in 2021. The year-to-year total sales of Rite Aid increased in most years except in 2017 when it sold its stores to Walgreens. In that year, Rite Aid’s sales decreased by \$11.32 billion -- to \$21.53 billion from its previous year sales of \$32.85 billion.

Figure 2: Net Sales (Billions--USD)

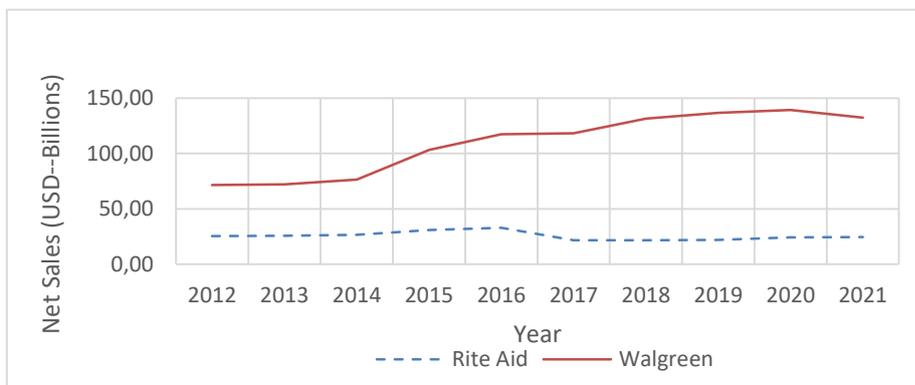
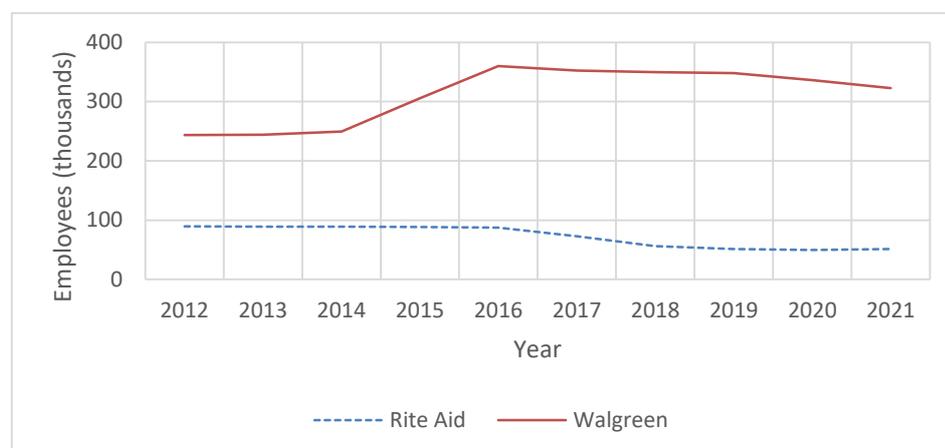


Figure 3 shows the total number of people employed by Rite Aid and Walgreens during the past ten years. The number reported is “total employees”, which includes permanent as well as non-permanent employees. It may be noted that, over time, the total number of employees increased for Walgreens. The largest increase was in 2017 when it bought Rite Aid stores. The number started declining somewhat thereafter, probably due to planned store closings. As mentioned earlier, after the acquiring Rite Aid stores in 2017, Walgreens closed most Rite Aid stores if they were within two miles of its branch. On the other hand, the number of employees decreased significantly in 2017 for Rite Aid and remained so after selling its stores to Walgreens.

Figure 3: Total Employees

4. FINDINGS AND DISCUSSIONS

Four years have passed since the FTC gave its approval to the 2017 proposal that resulted in Walgreens buying almost half of Rite Aid's stores. We use two four-year time segments for comparing performance of the two companies. These are the four-year period before 2017 and the four-year period after 2017. The transaction between Rite Aid and Walgreens reduced the size of Rite Aid significantly. The size of Walgreens increased but was relatively not by as much as Rite Aid lost. Walgreens was a much bigger firm compared to Rite Aid. However, the transaction was expected to affect the performance of both companies.

4.1. Profitability and expenses

We begin our analysis of the performance of Rite Aid and Walgreens by first examining the changes in their profitability before and after Walgreens bought Rite Aid stores. Profitability is the key to long term survival of a firm. Shareholders invest in firms with the hope of getting a fair return on their investment. Before the shareholders get the returns, however, the firm must pay for the inventory used for generating the sale, operating expenses it incurred, and the taxes it owed. The amount left from the revenue after each of the above-mentioned expenses are categorized as gross profit, operating profit, and net profit, respectively.

We first compute the gross profit margin for Rite Aid and Walgreens. To compute the gross profit margin, we subtract the cost of goods sold from annual sales and divide it by sales. In order to find out whether Rite Aid's sale of its stores resulted in changes in performance, we compare its gross profit margin before and after it sold its stores to Walgreens in 2017. We do the same for Walgreens also to examine whether its purchase of Rite Aid stores improved its profitability.

Table 1: Gross Profit Margin (%)

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Rite Aid	28.69	28.56	25.46	23.67	22.20	21.61	21.56	19.57	20.78
Walgreens	29.24	28.23	26.03	25.46	24.67	23.41	21.97	20.08	21.18
Rite Aid - Walgreens	-0.55	0.33	-0.57	-1.79	-2.47	-1.80	-0.42	-0.51	-0.40

Table 1 contains the gross profit margin for the two companies for the period 2013-2021. Figures in the table indicate that the gross profit margin of both Rite Aid and Walgreens decreased in the post-2017 period compared to the pre-2017 period. For Rite Aid, the average annual gross profit margin during the years 2013-2016 was 26.60% and for the 2018-2021 period it was 20.88% -- a decrease of 5.72%. For Walgreens, the average annual gross profit margin fell from 27.24% to 21.66%, a decrease of 5.58%, for the same four-year periods. For both companies the gross profit margin fell by almost the same amount.

We can also note that the year-by-year difference in gross profit margin between the two companies also did not change much in most of the years. Subtracting the gross profit margin for Walgreens from Rite Aid for each year, as shown in the last row of Table 1, we note that the difference was about 0.5% for most of the years. The largest differences were in 2016, 2017, and 2018, the years surrounding 2017 when the transaction between the two companies was approved. The figures indicate that Rite Aid and Walgreens generated about the same gross profit per dollar sold before and after Rite Aid's sale of its stores

to Walgreens in 2017. Based on this data, it appears that Rite Aid, despite its reduced size after 2017, was not disadvantaged in procuring its inventory.

Table 2: Net Income / Sales (%)

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Rite Aid	0.98	7.95	0.54	0.01	4.38	-1.95	-2.06	-0.38	-2.19
Walgreens	3.53	2.66	4.14	3.57	3.47	3.82	2.89	0.30	1.90
RAD-WG	-2.55	5.29	-3.60	-3.56	0.91	-5.78	-4.96	-0.68	-4.09

Table 2 shows the Net Profit margin for the two companies from 2013 to 2021. The net profit margin for Rite Aid was considerably lower than Walgreens' in all the years except 2014 and 2017. This was despite both companies having had almost the same gross profit margin. The average net income margin for Rite Aid during the pre-2017 four-year period was 2.37%. The margin was also positive in all the four years. In the post-2017 period, however, the average was negative 1.65%. It was not positive in any one those years. The decline in average net income margin for Rite Aid from the pre-2017 to post-2017 period was 4.02%. For Walgreens also there was a decline in average net income between the two periods, but the difference was much smaller. The decline in average net income for Walgreens was only 1.24%. Further, Walgreens did not have negative net income in any year. Comparison of year-by-year net income margin of the two companies also reveal that the net income of Rite Aid was less than Walgreen's in all the years except 2017. To gain understanding of this, we examine the components of expenses and associated activities that could have contributed to it. After the cost of inventory is accounted for in the gross profit margin, the largest component of expenses is attributed to selling, general and administrative expenses (SG&A).

Table 3: SG&A / Sales (%)

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Rite Aid	25.70	25.24	22.82	22.05	21.60	21.22	20.92	19.37	20.49
Walgreens	24.29	23.55	21.82	20.37	20.08	18.68	18.44	19.38	18.55
RAD-WG	1.41	1.69	1.00	1.68	1.52	2.54	2.48	-0.01	1.94

Table 3 contains the annual Selling, General & Administrative (SG&A) expenses as percentage of net sales, from 2013 to 2021. For the pre-2017 years, the averages were 23.95% for Rite Aid and 22.51% for Walgreens. For the post-2017 period, the average of this expense category was 20.50% for Rite Aid and 18.76% for Walgreens. For both companies, the SG&A expenses (as a proportion of net sales) fell by almost the same amount (3.45% for Rite Aid and 3.75% for Walgreens). But Walgreens had significantly lower SG&A expenses compared to Rite Aid every year except 2020. On average, Walgreens' SG&A (as a proportion of sales) was about 1.44% lower than Rite Aid's in the pre-2107 years and about 1.74% in the post-2017 years. It indicates that Walgreens has been more efficient in its operations compared to Rite Aid. We next investigated the possibility that the extent of debt financing could have affected the net income. Table 4 contains the data on net interest payments made by the two companies, expressed as percentage of sales. The table indicates that, Rite Aid performed well with respect to debt since 2017. After selling many of its stores to Walgreens for \$4.38 billion in 2017, Rite Aid reduced its debt by about \$3.92 billion. The annual interest paid on debt by Rite Aid (expressed as a percentage of sales), although higher than Walgreens' in the post-2017 period, the gap has been narrowing quickly.

Table 4: Interest / Sales (%)

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Rite Aid	1.66	1.50	1.46	1.32	0.94	1.05	1.05	0.84	0.78
Walgreens	0.23	0.20	0.58	0.51	0.59	0.47	0.51	0.46	0.68
RAD-WG	1.43	1.29	0.88	0.81	0.36	0.58	0.53	0.38	0.10

4.2 Activity Ratios: Asset Management Efficiency, Asset Liquidity, and Employee Productivity

Examination of financial statements indicate that the two companies, Rite Aid and Walgreens, differed significantly in their Net Income margin since 2017. The poorer performance of Rite Aid could not be due to inefficiency in procurement or costs related to inventory because the cost of goods sold were almost the same for the two companies. The difference in performance could not be due to higher levels of debt commitments either. Rite Aid in fact fared well by reducing its debt level after 2017 from the proceeds of the sale of its stores to Walgreens. The low net income of Rite Aid was likely due to its higher operating expenses. To investigate it we next examine their activity ratios.

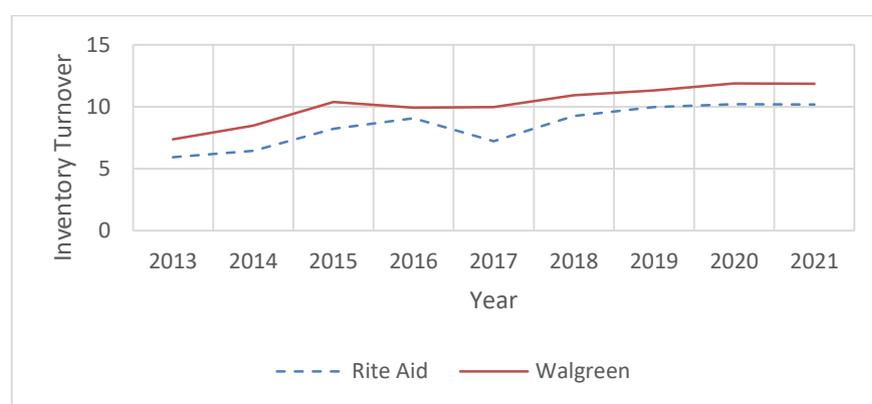
4.2.1 Inventory Turnover

Inventory turnover measures the efficiency of the firm in managing and selling inventory. It measures the number of times average inventory was sold during the accounting period. It is a gauge of the liquidity of a firm's inventory. The ratio is calculated by dividing the annual Cost of Goods Sold by average inventory for the corresponding year. As shown in Table 5, both firms increased their inventory turnover after 2017. However, Walgreens' inventory turnover ratio was higher than Rite Aid's every year, before and after 2017. For the post-2017 period, Walgreens' average inventory turnover ratio was about 1.81 higher than Rite Aid's. The higher measures for Walgreen indicate its inventory was being sold and replenished more frequently than for Rite Aid.

Table 5: Inventory Turnover

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Rite Aid	5.92	6.45	8.21	9.06	7.22	9.24	9.07	10.21	10.18
Walgreen	7.36	8.48	10.37	9.92	9.98	10.91	11.3	11.87	11.86

Figure 4: Inventory Turnover



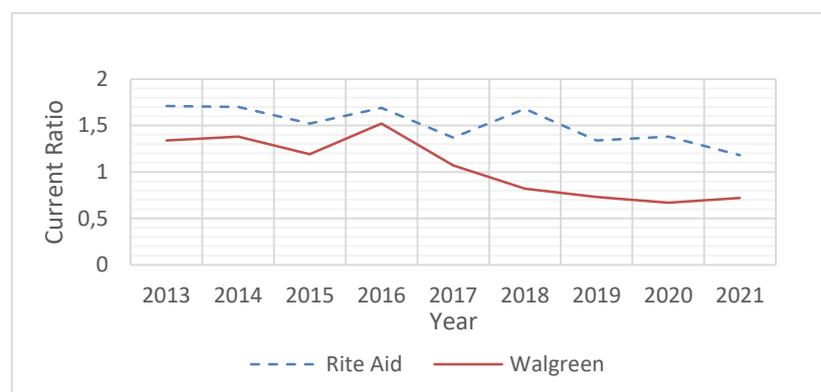
4.2.2 Short-Term Solvency (Current Ratio)

Current Ratio is a commonly used measure of short-term solvency, the ability of a firm to meet its debt requirements as they come due. Current Liabilities are used as the denominator of the ratio because they are considered to represent the most urgent debt, requiring retirement within one year or one operating cycle. The available cash resources to satisfy these obligations must come primarily from cash or conversions to cash of other current assets.

Table 6: Current Ratio

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Rite Aid	1.71	1.7	1.52	1.69	1.37	1.68	1.34	1.38	1.18
Walgreen	1.34	1.38	1.19	1.52	1.07	0.82	0.73	0.67	0.72

Table 6 shows the annual Current Ratio of Rite Aid and Walgreens for ten years from 2013 to 2021. Current ratio declined for both Rite Aid and Walgreen since 2018. The decline has been substantially greater for Rite Aid compared to Walgreen. The current ratio for Walgreen decreased from 0.82 in 2018 to 0.72 in 2021, whereas for Rite Aid the decrease was from 1.68 to 1.18. Although the ratio declined for both companies, the current ratio for Rite Aid has been significantly higher compared to Walgreens'. The high value of this ratio for Rite Aid could be indicative of carrying higher inventory compared to Walgreens. It could partly be the reason for Rite Aid's lower inventory turnover ratio discussed earlier.

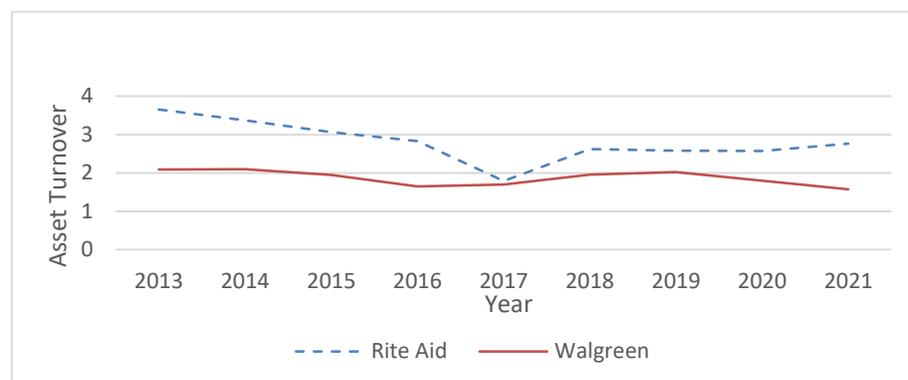
Figure 5: Current Ratio

4.2.3 Asset Turnover

The efficiency with which assets were utilized in the business can also be measured by Total Asset Turnover Ratio. It is computed by dividing net sales by average total assets for the period. The resulting number shows the dollars of net sales produced by each dollar invested in assets. Table 7 shows the total asset turnover for Rite Aid has been higher than Walgreens', every year, before and after 2017. Rite Aids assets turnover was higher averaging 2.63 compared with Walgreens' which averaged 1.84, for the four post-2017 years. These figures indicate that Rite Aid likely made better use of its non-current (fixed) assets.

Table 7: Total Asset Turnover

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Rite Aid	3.65	3.37	3.06	2.83	1.79	2.62	2.58	2.57	2.76
Walgreen	2.09	2.1	1.95	1.65	1.70	1.96	2.02	1.8	1.57

Figure 6: Total Asset Turnover

4.2.4. Employee Productivity

Turnover ratio measures the effectiveness with which physical assets were used to generate sales. But sales are also generated by employees. A popular measure of employee productivity reported annually is the revenue generated per employee. Like other items on the balance sheet, the number of employees reported in the annual financial statements are year ending figures. To get the annual sales per employee, therefore, we divide the annual sales by the average of the reported year ending employment figures. Table 8 shows the revenue generated per employee for the two firms during the years 2013-2021. To investigate employee productivity, we express the annual revenue per employee as a product of two components, namely "Total assets per employee" and "Sales per dollar of Total Assets". The second ratio is the same as "Total Assets Turnover Ratio" which we have already discussed. Revenue generated per employee can be written as a product of the two ratios.

$$\text{Revenue per employee} = \left(\frac{\text{Total Assets}}{\text{Employees}} \right) \times \left(\frac{\text{Sales}}{\text{Total Assets}} \right)$$

The decomposition of the “Revenue per employee” ratio, as shown above, implies that changes in revenue generated per employee, an important measure of the utilization of employees, can be due to the two factors that interact in a multiplicative fashion. Table 8 shows revenue per employee, total assets per employee, and total asset turnover for Rite Aid and Walgreens from 2013 to 2021. The table is divided into three panels, one for each of the three ratios. It can be noted that Rite Aid exceeded Walgreens in revenues generated per employee every year since 2017. It achieved higher revenue generation despite having, on average, lower amount of assets per employee compared to Walgreens. The higher annual revenue per employee, with lower assets per employee, indicates that Rite Aid’s employee productivity was better than that of Walgreens during the four years since 2017.

Table 8: Employee Productivity

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Sales per Employee									
Rite Aid	287	298	347	375	295	386	425	481	477
Walgreen	296	306	339	326	335	376	393	415	410
Assets per Employee									
Rite Aid	79	89	114	131	141	148	165	188	173
Walgreen	141	146	174	196	197	192	195	230	261
Total Asset Turnover									
Rite Aid	3.65	3.37	3.06	2.83	1.79	2.62	2.58	2.57	2.76
Walgreen	2.09	2.1	1.95	1.65	1.7	1.96	2.02	1.8	1.57

5. CONCLUSION AND IMPLICATIONS

Analysis of financial statements is an important, even necessary for making right decisions. Information obtained from financial analysis are the basis for making decisions, both internally and externally. The main objective of our analysis was to examine if both Rite Aid and Walgreens benefitted from the deal that was approved by the Federal Trade Commission in 2017. Rite Aid sold 1,932 of its stores to Walgreens in return for \$4.38 billion. Our analysis indicates that Walgreens and Rite Aid both had comparable performances in managing the costs of inventory. The cost of goods sold for both companies was not significantly different from each other. On the financing side, Rite Aid narrowed its debt financing cost (as a proportion of sales) since selling its stores to Walgreens. The main difference in the two company’s performance was in the operating expenses. The sales, general, and administrative expenses per dollar sales was significantly and consistently lower for Walgreens compared to Rite Aid. We attempted to find the underlying reasons for this difference in efficiency. Analysis of activity indicate that, Rite Aid had lower inventory turnover compared to Walgreens in all the years, before and after 2017. The lower inventory turnover ratio is also substantiated by higher Current Ratio of Rite Aid, indicating that Rite Aid might have been carrying more inventory relative to Walgreens. However, on another important measure of activity, namely “Revenue Generated per Employee,” Rite Aid did significantly better than Walgreens. Rite Aid’s employees achieved it although they had, on average, lower total assets per employee. A likely reason for Rite Aid’s lower net income margin compared to Walgreens seems to be its higher Sales, General, and Administrative expense. For a more detailed analysis, we need information on the components of the SG&A that are not currently available in published statements such as 10-K reports. One may note that, Rite Aid, after the sale of its stores to Walgreens, became a much smaller firm than it used to be prior to the 2017 deal with Walgreens. It was also subjected to competition from several drugstores located in grocery stores and clubs such as Costco and Walmart, in addition to the traditional drug store chains. As these changes in the landscape of drug store industry were anticipated, the Federal Trade Commission could have favorably considered the merger of the entire Rite Aid Corporation with Walgreens when the proposal was first made in 2015.

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