

# WALGREEN CO

## FORM 10-Q (Quarterly Report)

Filed 06/28/10 for the Period Ending 06/23/10

|             |   |
|-------------|---|
| Address     | 200 WILMOT RD<br>DEERFIELD, IL 60015      |
| Telephone   | 8479402500                                |
| CIK         | 0000104207                                |
| Symbol      | WAG                                       |
| SIC Code    | 5912 - Drug Stores and Proprietary Stores |
| Industry    | Retail (Drugs)                            |
| Sector      | Services                                  |
| Fiscal Year | 08/31                                     |

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)



QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED MAY 31, 2010

OR



TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number  
1-604



**WALGREEN CO.**

(Exact name of registrant as specified in its charter)

Illinois

(State of Incorporation)

36-1924025

(I.R.S. Employer Identification No.)

200 Wilmot Road, Deerfield, Illinois

(Address of principal executive offices)

60015

(Zip Code)

(847) 914-2500

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes

No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated Filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes

No

The number of shares outstanding of the registrant's Common Stock, \$.078125 par value, as of May 31, 2010 was 973,178,093.

**WALGREEN CO.**

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**PART 1. FINANCIAL INFORMATION**

**Item 1. WALGREEN CO. AND SUBSIDIARIES CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

The consolidated condensed financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. The Consolidated Condensed Balance Sheets as of May 31, 2010, August 31, 2009 and May 31, 2009, the Consolidated Condensed Statements of Earnings for the three and nine months ended May 31, 2010 and 2009, and the Consolidated Condensed Statements of Cash Flows for the nine months ended May 31, 2010 and 2009, have been prepared without audit. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these consolidated condensed financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's latest annual report on Form 10-K.

In the opinion of the Company, the consolidated condensed statements for the unaudited interim periods presented include all adjustments, consisting of normal recurring adjustments, necessary to present a fair statement of the results for such interim periods. Because of the influence of certain holidays, seasonal and other factors on the Company's operations, net earnings for any interim period may not be comparable to the same interim period in previous years or necessarily indicative of earnings for the full year.

**WALGREEN CO. AND SUBSIDIARIES  
CONSOLIDATED CONDENSED BALANCE SHEETS  
(UNAUDITED)  
(In millions, except per share amounts)**

|                           | May 31,<br>2010 | August 31,<br>2009 | May 31,<br>2009 |
|---------------------------|-----------------|--------------------|-----------------|
| <b>Assets</b>             |                 |                    |                 |
| <b>Current Assets:</b>    |                 |                    |                 |
| Cash and cash equivalents | \$ 1,712        | \$ 2,087           | \$ 2,300        |
| Short-term investments    | 600             | 500                | 100             |
| Accounts receivable, net  | 2,729           | 2,496              | 2,797           |

|  |                  |                  |                  |
|--|------------------|------------------|------------------|
| Inventories  | 7,110            | 6,789            | 6,891            |
| Other current assets   | 185              | 177              | 164              |
| Total Current Assets   | 12,336           | 12,049           | 12,252           |
| <b>Non-Current Assets:</b>   |                  |                  |                  |
| Property and equipment, at cost, less accumulated depreciation and amortization  | 11,154           | 10,802           | 10,595           |
| Goodwill   | 1,894            | 1,461            | 1,463            |
| Other non-current assets   | 1,323            | 830              | 833              |
| Total Non-Current Assets   | 14,371           | 13,093           | 12,891           |
| <b>Total Assets</b>  | <b>\$ 26,707</b> | <b>\$ 25,142</b> | <b>\$ 25,143</b> |
| <b>Liabilities &amp; Shareholders' Equity</b>  |                  |                  |                  |
| <b>Current Liabilities:</b>  |                  |                  |                  |
| Short-term borrowings  | \$ 9             | \$ 15            | \$ 10            |
| Trade accounts payable   | 4,584            | 4,308            | 4,599            |
| Accrued expenses and other liabilities   | 2,531            | 2,406            | 2,312            |
| Income taxes   | 217              | 40               | 52               |
| Total Current Liabilities  | 7,341            | 6,769            | 6,973            |
| <b>Non-Current Liabilities:</b>  |                  |                  |                  |
| Long-term debt   | 2,359            | 2,336            | 2,338            |
| Deferred income taxes  | 268              | 265              | 316              |
| Other non-current liabilities  | 1,627            | 1,396            | 1,329            |
| Total Non-Current Liabilities  | 4,254            | 3,997            | 3,983            |
| <b>Commitments and Contingencies (see Note 13)</b>   |                  |                  |                  |
| <b>Shareholders' Equity:</b>   |                  |                  |                  |
| Preferred stock \$.0625 par value; authorized 32 million shares, none issued   | -                | -                | -                |
| Common stock \$.078125 par value; authorized 3.2 billion shares; issued<br>1,025,400,000 at May 31, 2010, August 31, 2009 and May 31, 2009 | 80               | 80               | 80               |
| Paid-in capital  | 669              | 605              | 591              |
| Employee stock loan receivable   | (101)            | (140)            | (155)            |
| Retained earnings  | 16,543           | 15,327           | 15,027           |
| Accumulated other comprehensive income   | 35               | 37               | 59               |
| Treasury stock, at cost; 52,221,907 shares at May 31, 2010, 36,838,610 at<br>August 31, 2009 and 33,019,914 at May 31, 2009                | (2,114)          | (1,533)          | (1,415)          |
| Total Shareholders' Equity   | 15,112           | 14,376           | 14,187           |
| <b>Total Liabilities &amp; Shareholders' Equity</b>  | <b>\$ 26,707</b> | <b>\$ 25,142</b> | <b>\$ 25,143</b> |

The accompanying Notes to Consolidated Condensed Financial Statements are an integral part of these Statements.

**WALGREEN CO. AND SUBSIDIARIES**  
**CONSOLIDATED CONDENSED STATEMENTS OF EARNINGS**  
**(UNAUDITED)**  
**(In millions, except per share amounts)**

|  | Three Months Ended |                 | Nine Months Ended |                 |
|--|--------------------|-----------------|-------------------|-----------------|
|  | May 31,<br>2010    | May 31,<br>2009 | May 31,<br>2010   | May 31,<br>2009 |
| Net sales                                    | \$ 17,199          | \$ 16,210       | \$ 50,550         | \$ 47,632       |
| Cost of sales                                | 12,450             | 11,751          | 36,366            | 34,365          |
| Gross Profit                                 | 4,749              | 4,459           | 14,184            | 13,267          |
| Selling, general and administrative expenses | 3,920              | 3,613           | 11,474            | 10,722          |
| Operating Income                             | 829                | 846             | 2,710             | 2,545           |
| Interest expense, net                        | 24                 | 25              | 67                | 60              |
| Earnings Before Income Tax Provision         | 805                | 821             | 2,643             | 2,485           |
| Income tax provision                         | 342                | 299             | 1,022             | 915             |
| Net Earnings                                 | \$ 463             | \$ 522          | \$ 1,621          | \$ 1,570        |
| Net earnings per common share – basic        | \$ .47             | \$ .53          | \$ 1.65           | \$ 1.59         |
| Net earnings per common share – diluted      | \$ .47             | \$ .53          | \$ 1.64           | \$ 1.58         |

|  |                 |                 |                 |                 |
|--|-----------------|-----------------|-----------------|-----------------|
| Dividends declared                           | <u>\$ .1375</u> | <u>\$ .1125</u> | <u>\$ .4125</u> | <u>\$ .3375</u> |
| Average shares outstanding                   | 976.4           | 992.0           | 984.5           | 989.6           |
| Dilutive effect of stock options             | 5.6             | 1.0             | 6.1             | 1.4             |
| Average shares outstanding assuming dilution | <u>982.0</u>    | <u>993.0</u>    | <u>990.6</u>    | <u>991.0</u>    |

The accompanying Notes to Consolidated Condensed Financial Statements are an integral part of these Statements.

**WALGREEN CO. AND SUBSIDIARIES**  
**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**  
**(In millions)**

|  | Nine Months Ended May |                 |
|--|-----------------------|-----------------|
|  | 31,                   |                 |
|  | <u>2010</u>           | <u>2009</u>     |
| <b>Cash Flows from Operating Activities :</b>  |                       |                 |
| Net earnings   | \$ 1,621              | \$ 1,570        |
| Adjustments to reconcile net earnings to net cash provided by operating activities - |                       |                 |
| Depreciation and amortization  | 768                   | 741             |
| Deferred income taxes  | (19)                  | 253             |
| Stock compensation expense   | 64                    | 67              |
| Income tax savings from employee stock plans   | 6                     | -               |
| Other  | 28                    | 9               |
| Changes in operating assets and liabilities -  |                       |                 |
| Accounts receivable, net   | (139)                 | (298)           |
| Inventories  | (37)                  | 426             |
| Other assets   | 41                    | -               |
| Trade accounts payable   | 163                   | 303             |
| Accrued expenses and other liabilities   | 64                    | 55              |
| Income taxes   | 139                   | 116             |
| Other non-current liabilities  | 120                   | 17              |
| Net cash provided by operating activities  | <u>2,819</u>          | <u>3,259</u>    |
| <b>Cash Flows from Investing Activities :</b>  |                       |                 |
| Purchases of short-term investments held to maturity                                 | (2,400)               | (1,400)         |
| Proceeds from sale of short-term investments held to maturity                        | 2,300                 | 1,300           |
| Additions to property and equipment  | (786)                 | (1,534)         |
| Proceeds from sale of assets   | 29                    | 35              |
| Business and intangible asset acquisitions, net of cash received                     | (764)                 | (348)           |
| Other  | (31)                  | 11              |
| Net cash used for investing activities   | <u>(1,652)</u>        | <u>(1,936)</u>  |
| <b>Cash Flows from Financing Activities :</b>  |                       |                 |
| Net payments from short-term borrowings  | -                     | (70)            |
| Net proceeds from issuance of long-term debt   | -                     | 987             |
| Payments of debt   | (576)                 | -               |
| Stock purchases  | (754)                 | (140)           |
| Proceeds related to employee stock plans   | 206                   | 106             |
| Cash dividends paid  | (407)                 | (334)           |
| Other  | (11)                  | (15)            |
| Net cash (used for) provided by financing activities                                 | <u>(1,542)</u>        | <u>534</u>      |
| <b>Changes in Cash and Cash Equivalents :</b>  |                       |                 |
| Net (decrease) increase in cash and cash equivalents                                 | (375)                 | 1,857           |
| Cash and cash equivalents at September 1   | 2,087                 | 443             |
| Cash and cash equivalents at May 31  | <u>\$ 1,712</u>       | <u>\$ 2,300</u> |

The accompanying Notes to Consolidated Condensed Financial Statements are an integral part of these Statements.

**WALGREEN CO. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

(1) The consolidated condensed financial statements include the accounts of the Company and its subsidiaries. All intercompany transactions have been eliminated. The consolidated condensed financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and include amounts based on management's prudent judgments and estimates. Actual results may differ from these estimates. For a complete discussion of all our significant accounting policies please see our 2009 annual report on Form 10-K.

(2) On October 30, 2008, we announced a series of strategic initiatives, approved by the Board of Directors, to enhance shareholder value. One of these initiatives was a program designed to reduce cost and improve productivity through strategic sourcing of indirect spend, reducing corporate overhead and work throughout our stores, rationalization of inventory categories, and transforming the community pharmacy.

We have recorded the following pre-tax charges associated with our restructuring initiatives within the Consolidated Condensed Statements of Earnings (In millions):

|  | Three Months Ended |              | Nine Months Ended |               |
|--|--------------------|--------------|-------------------|---------------|
|  | May 31,            |              | May 31,           |               |
|  | 2010               | 2009         | 2010              | 2009          |
| Severance and other benefits                     | \$ 3               | \$ 6         | \$ 15             | \$ 65         |
| Project cancellation settlements                 | -                  | 8            | -                 | 8             |
| Inventory charges                                | -                  | 33           | 19                | 44            |
| Restructuring expense                            | 3                  | 47           | 34                | 117           |
| Consulting                                       | 10                 | 20           | 34                | 57            |
| Restructuring and restructuring related expenses | \$ 13              | \$ 67        | \$ 68             | \$ 174        |
| Cost of sales                                    | \$ -               | \$ 33        | \$ 19             | \$ 44         |
| Selling, general and administrative expenses     | 13                 | 34           | 49                | 130           |
|  | <u>\$ 13</u>       | <u>\$ 67</u> | <u>\$ 68</u>      | <u>\$ 174</u> |

Severance and other benefits include the charges associated with employees who were separated from the Company. In the current fiscal year, 179 employees have been separated from the Company. Since inception, a total of 876 employees have been separated from the Company as a result of these initiatives.

Inventory charges relate to on-hand inventory that has been reduced from cost to a selling price below cost.

Additionally, as a part of our Customer Centric Retailing (CCR) initiative, we are enhancing the store format to ensure we have the proper assortments, better category layouts and adjacencies, better shelf height and sight lines and brand and private brand layout, all of which are designed to positively enhance the shopper experience and increase customer frequency and purchase size. This format will be rolled out to approximately 5,500 to 6,000 existing stores. As of May 31, 2010, in total, we have remodeled 915 stores and plan to enhance approximately 500 stores in the next three months of fiscal 2010, with the remaining store remodels during fiscal 2011 and 2012. Although we will continue to refine our estimates as the rollout progresses, based on our experience with the first 915 stores, we expect the total cost, which includes both selling, general and administrative expenses and capital, to be \$40 thousand to \$55 thousand per store. For the three months ended May 31, 2010, we incurred \$29 million in total program costs, of which \$20 million was included in selling, general and administrative expenses and \$9 million in capital costs. For the nine months ended May 31, 2010, we incurred \$41 million in total program costs, of which \$28 million was included in selling, general and administrative expenses and \$13 million in capital costs.

We have recorded the following balances in accrued expenses and other liabilities on our Consolidated Condensed Balance Sheets (In millions):

|                              | August 31, 2009 |         | May 31, 2010  |                 |
|------------------------------|-----------------|---------|---------------|-----------------|
|                              | Reserve Balance | Charges | Cash Payments | Reserve Balance |
| Severance and other benefits | \$ 4            | \$ 17   | \$ (21)       | \$ -            |

(3) Short-term investments at May 31, 2010, include Treasury Bills totaling \$600 million maturing in June and July 2010. The interest rate on the Treasury Bills is less than one percent. The investments are held to maturity and recorded at cost in accordance with ASC topic 320 (formerly SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*). The fair value of the Treasury Bills at May 31, 2010, approximated cost.

(4) Inventories are valued on a lower of last-in, first-out (LIFO) cost or market basis. At May 31, 2010, August 31, 2009 and May 31, 2009, inventories would have been greater by \$1,318 million, \$1,239 million and \$1,191 million respectively, if they had been valued on a lower of first-in, first-out (FIFO) cost or market basis. LIFO inventory costs can only be determined annually when inflation rates and inventory levels are finalized; therefore, LIFO inventory costs for interim financial statements are estimated. Inventory includes product cost, inbound freight, warehousing costs and vendor allowances not included as a reduction of advertising expense.

(5) The Company provides for future costs related to closed locations. The liability is based on the present value of future rent obligations and other related costs (net of estimated sublease rent) to the first lease option date. During the three and nine month periods ended May 31, 2010, the Company recorded charges of \$11 million and \$35 million for facilities that were closed or relocated under long-term leases. This compares to \$22 million and \$43 million for the three and nine month periods ended May 31, 2009, respectively.

The changes in reserve for facility closings and related lease termination charges include the following (In millions):

|   | Nine Months Ended<br>May 31 |       |
|---|-----------------------------|-------|
|   | 2010                        | 2009  |
| Balance – beginning of period   | \$ 99                       | \$ 69 |
| Provision for present value of non-cancellable lease payments of closed facilities    | 27                          | 26    |
| Assumptions about future sublease income, terminations, and changes in interest rates | (9)                         | 2     |
| Interest accretion  | 17                          | 15    |
| Cash payments, net of sublease income   | (32)                        | (27)  |
| Reserve acquired through acquisitions   | 7                           | -     |
| Balance – end of period   | \$ 109                      | \$ 85 |

(6) The principal retirement plan for employees is the Walgreen Profit-Sharing Retirement Trust to which both the Company and participating employees contribute. The Company's contribution, which has historically related to pre-tax income and a portion of which is in the form of a guaranteed match, is determined annually at the discretion of the Board of Directors. The profit-sharing provision was \$72 million for the current quarter and \$235 million for the nine month period compared to \$73 million and \$221 million in the same periods last year. The Company's contributions, which are made annually in the second quarter, were \$293 million during the nine month period ended May 31, 2010. This compares to \$301 million for the prior year.

(7) The Company granted 119,620 and 7,546,259 stock options under the Walgreen Co. Executive Stock Option Plan and the Walgreen Co. Stock Purchase/Option Plan (Share Walgreens) for the quarter and nine month period ended May 31, 2010. This compares to 234,716 and 16,906,061 stock options granted in the quarter and nine month period ended May 31 under the plans last year. Total stock-based compensation expense was \$20 million for the quarter and \$64 million for the nine month period ended May 31, 2010 compared to \$19 million and \$67 million for the same periods last year. In accordance with ASC topic 718 (formerly SFAS No. 123(R), *Share-Based Payment*), compensation expense is recognized on a straight-line basis over the employee's vesting period or to the employee's retirement eligible date, if earlier. There was no fully recognized retiree eligible expense recorded in the quarter and \$6 million recorded for the first nine months. This compares to \$1 million of fully recognized retiree eligible expense for the quarter and \$15 million for the nine month period ended May 31, 2009. Therefore, compensation expense for the quarter and nine month periods are not representative of compensation expense for the entire fiscal year. There have been no material changes in the assumptions used to compute compensation expense during the current quarter.

The Company granted 12,752 and 700,187 restricted stock units under the Walgreen Co. Restricted Stock Unit Award Program for the quarter and nine months ended May 31, 2010 compared to 15,423 and 514,470 in the same periods last year. The Company also granted 9,759 and 629,082 performance shares under the Walgreen Co. Performance Share Program for the quarter and nine months ended May 31, 2010 versus 17,443 and 546,096 shares in the same periods last year. In accordance with ASC topic 718, compensation expense is recognized on a straight line basis based on a three year cliff vesting schedule for the Restricted Stock Unit Award Program and straight line over a three year performance period for the Performance Share Program. For the quarter and nine month period ended May 31, 2010 the Company recognized \$6 million and \$16 million of expense related to these plans, respectively. In the same periods last year, the Company recognized \$3 million and \$13 million.

(8) The dilutive effect of outstanding stock options on earnings per share is calculated using the treasury stock method. Stock options are anti-dilutive and excluded from the earnings per share calculation if the exercise price exceeds the average market price of the common shares for the periods presented. At May 31, 2010 and 2009, outstanding options to purchase common shares of 25,196,994 and 49,354,716, respectively were excluded from the calculation.

(9) The Company provides certain health insurance benefits for retired employees who meet eligibility requirements, including age, years of service and date of hire. The costs of these benefits are accrued over the service life of the employee. The Company's postretirement health benefit plans are not funded.

| Components of Net Periodic Benefit Costs (In millions): | Three Months Ended<br>May 31, |      | Nine Months Ended<br>May 31, |       |
|---|-------------------------------|------|------------------------------|-------|
|   | 2010                          | 2009 | 2010                         | 2009  |
| Service cost  | \$ 3                          | \$ 3 | \$ 9                         | \$ 10 |
| Interest cost   | 5                             | 7    | 15                           | 20    |

|                                    |             |               |              |              |
|------------------------------------|-------------|---------------|--------------|--------------|
| Amortization of actuarial loss     | 2           | 1             | 6            | 3            |
| Amortization of prior service cost | (3)         | (1)           | (9)          | (3)          |
| Special retirement benefit         | -           | -             | -            | 4            |
| Curtailement gain                  | -           | (16)          | -            | (16)         |
| Total postretirement benefit cost  | <u>\$ 7</u> | <u>\$ (6)</u> | <u>\$ 21</u> | <u>\$ 18</u> |

In May 2009, we amended the Company's postretirement health benefit plans to change eligibility requirements. As a result of this amendment we recognized curtailment income of \$16 million for the quarter ended May 31, 2009.

Additionally in the second quarter of fiscal 2009, the Company recognized a special retirement benefit expense of \$4 million related to accelerating eligibility for certain employees who elected special early retirement as a part of our initiative to increase shareholder value.

(10) Short-term borrowings and long-term debt consists of the following at May 31, 2010, August 31, 2009 and May 31, 2009 (In millions):

|   | May 31,<br>2010 | August 31,<br>2009 | May 31,<br>2009 |
|---|-----------------|--------------------|-----------------|
| <b>Short-Term Borrowings -</b>  |                 |                    |                 |
| Current maturities of loans assumed through the purchase of land, buildings and equipment; various interest rates from 5.00% to 8.75%; various maturities from 2010 to 2035 | \$ 4            | \$ 10              | \$ 5            |
| Other   | 5               | 5                  | 5               |
| Total short-term borrowings   | <u>\$ 9</u>     | <u>\$ 15</u>       | <u>\$ 10</u>    |
| <b>Long-Term Debt -</b>   |                 |                    |                 |
| 4.875% unsecured notes due 2013 net of unamortized discount and interest rate swap fair market value adjustment (see Note 11)   | \$ 1,318        | \$ 1,294           | \$ 1,296        |
| 5.250% unsecured notes due 2019 net of unamortized discount   | 995             | 995                | 995             |
| Loans assumed through the purchase of land, buildings and equipment; various interest rates from 5.00% to 8.75%; various maturities from 2010 to 2035                       | 50              | 57                 | 52              |
|   | 2,363           | 2,346              | 2,343           |
| Less current maturities   | (4)             | (10)               | (5)             |
| Total-long term debt  | <u>\$ 2,359</u> | <u>\$ 2,336</u>    | <u>\$ 2,338</u> |

Short-term borrowings under the Company's commercial paper program had the following characteristics (In millions):

|                                      | May 31,<br>2010 | August 31,<br>2009 | May 31,<br>2009 |
|--------------------------------------|-----------------|--------------------|-----------------|
| Balance outstanding at end of period | \$ -            | \$ -               | \$ -            |
| Maximum outstanding at any month-end | -               | 1,068              | 1,068           |
| Average daily short-term borrowings  | -               | 272                | 364             |
| Weighted-average interest rate       | -               | 1.51%              | 1.97%           |

We had no commercial paper outstanding at May 31, 2010. In connection with our commercial paper program, we maintain two unsecured backup syndicated lines of credit that total \$1,200 million. The first \$600 million facility expires on August 9, 2010, and allows for the issuance of up to \$400 million in letters of credit, which reduces the amount available for borrowing. The second \$600 million facility expires on August 12, 2012. Our ability to access these facilities is subject to our compliance with the terms and conditions of the credit facilities, including financial covenants. The covenants require us to maintain certain financial ratios related to minimum net worth and priority debt, along with limitations on the sale of assets and purchases of investments. As of May 31, 2010, we were in compliance with all such covenants. The Company pays a facility fee to the financing banks to keep these lines of credit active. As of May 31, 2010, there was \$194 million in letters of credit issued against these credit facilities. We do not expect borrowings under these facilities, together with our outstanding commercial paper, to exceed \$1,200 million.

On July 17, 2008, we issued notes totaling \$1,300 million bearing an interest rate of 4.875% paid semiannually in arrears on February 1 and August 1 of each year, beginning on February 1, 2009. The notes will mature on August 1, 2013. We may redeem the notes, at any time in whole or from time to time in part, at our option at a redemption price equal to the greater of: (1) 100% of the principal amount of the notes to be redeemed; or (2) the sum of the present values of the remaining scheduled payments of principal and interest thereon (not including any portion of such payments of interest accrued as of the date of redemption), discounted to the date of redemption on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the Treasury Rate, plus 30 basis points, plus accrued interest on the notes to be redeemed to, but excluding, the date of redemption. If a change of control triggering event occurs, unless we have exercised our option to redeem the notes, we will be required to offer to repurchase the notes at a purchase price equal to 101% of the principal amount of the notes plus accrued and unpaid interest to the date of redemption. The notes are unsecured senior debt obligations and rank equally with all other unsecured senior indebtedness of the Company. The notes are not convertible or exchangeable. Total issuance costs relating to this offering were \$9 million, which included \$8 million in underwriting fees. The fair value of the notes as of May 31, 2010, was \$1,438 million. Fair value for these notes was determined based upon discounted future cash flows using available market data.

On January 13, 2009, we issued notes totaling \$1,000 million bearing an interest rate of 5.25% paid semiannually in arrears on January 15 and July 15 of each year, beginning on July 15, 2009. The notes will mature on January 15, 2019. We may redeem the notes, at any time in whole or from time to time in part, at our option at a redemption price equal to the greater of: (1) 100% of the principal amount of the notes to be redeemed; or (2) the sum of the present values of the remaining scheduled payments of principal and interest thereon (not including any portion of such payments of interest accrued as of the date of redemption), discounted to the date of redemption on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the Treasury Rate, plus 45 basis points, plus accrued interest on the notes to be redeemed to, but excluding, the date of redemption. If a change of control triggering event occurs, unless we have exercised our option to redeem the notes, we will be required to offer to repurchase the notes at a purchase price equal to 101% of the principal amount of the notes plus accrued and unpaid interest to the date of redemption. The notes are unsecured senior debt obligations and rank equally with all other unsecured senior indebtedness of the Company. The notes are not convertible or exchangeable. Total issuance costs relating to this offering were \$8 million, which included \$7 million in underwriting fees. The fair value of the notes as of May 31, 2010, was \$1,116 million. Fair value for these notes was determined based upon discounted future cash flows using available market data.

(11) We use a derivative instrument to manage our interest rate exposure associated with some of our fixed-rate borrowings. We do not use derivative instruments for trading or speculative purposes. All derivative instruments are recognized in the consolidated condensed balance sheets at fair value. We designate interest rate swaps as fair value hedges of fixed-rate borrowings. For derivatives designated as fair value hedges, the change in the fair value of both the derivative instrument and the hedged item are recognized in earnings in the current period. At the inception of a hedge transaction, we formally document the hedge relationship and the risk management objective for undertaking the hedge. In addition, we assess both at inception of the hedge and on an ongoing basis, whether the derivative in the hedging transaction has been highly effective in offsetting changes in fair value of the hedged item and whether the derivative is expected to continue to be highly effective. The impact of any ineffectiveness is recognized currently in earnings.

Counterparties to derivative financial instruments expose us to credit-related losses in the event of nonperformance, but we currently do not expect any counterparties to fail to meet their obligations given their high credit ratings.

#### Fair Value Hedges

For derivative instruments that are designated and qualify as fair value hedges, the gain or loss on the derivative, as well as the offsetting gain or loss on the hedged item attributable to the hedged risk, are recognized in current earnings.

On January 27, 2010, we terminated all of our existing one month future LIBOR swaps. Upon termination, we received payment from our counterparty which consisted of accrued interest and an amount representing the fair value of our swaps. The related fair value benefit attributed to our debt will be amortized over the life of the debt. We then entered into six month LIBOR in arrears swaps with two counterparties. As of May 31, 2010, we had net unamortized fair value benefit attributed to our debt of \$21 million.

The notional amounts of derivative instruments outstanding as of May 31, 2010, were as follows (In millions):

|                                   | <u>Notional Amount</u> |       |
|-----------------------------------|------------------------|-------|
| Derivatives designated as hedges: |                        |       |
| Interest rate swaps               | \$                     | 1,300 |

The changes in fair value of the notes attributable to the hedged risk are included in long-term debt on our Consolidated Condensed Balance Sheets (see Note 10), and amortized through maturity.

The fair value and balance sheet presentation of derivative instruments as of May 31, 2010, were as follows (In millions):

|   | <u>Location in Consolidated Condensed</u> |    | <u>Fair Value</u> |
|---|---|----|-------------------|
|   | <u>Balance Sheet</u>                      |    |                   |
| Asset derivatives designated as hedges: |   |    |                   |
| Interest rate swaps                     | Other non-current assets                  | \$ | 12                |

Gains and losses on derivative instruments are recorded in interest expense on our consolidated condensed statement of earnings. The amount recorded for the quarter ended May 31, 2010, was a gain of \$1 million.

(12) In the first quarter of fiscal 2010, we adopted the full provisions of ASC topic 820 (formerly SFAS No. 157, *Fair Value Measurements*) for assets and liabilities. ASC topic 820 defines fair value as the price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. In addition, it establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels:

Level 1 - Quoted prices in active markets that are accessible at the measurement date for identical assets and liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2 - Observable inputs other than quoted prices in active markets.

Level 3 - Unobservable inputs for which there is little or no market data available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

Assets and liabilities measured at fair value on a recurring basis were as follows (In millions):

|         | <u>May 31, 2010</u> | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
|---------|---------------------|----------------|----------------|----------------|
| Assets: |                     |                |                |                |

|                     |    |    |   |    |    |   |
|---------------------|----|----|---|----|----|---|
| Interest rate swaps | \$ | 12 | - | \$ | 12 | - |
|---------------------|----|----|---|----|----|---|

Interest rate swaps are valued using six month LIBOR in arrears rates.

Our debt instruments are not reported at fair value in our statement of financial position and as a result, we will continue to report under the guidance of ASC topic 825 (formerly SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*) that requires us to disclose the fair value of our debt in the footnotes.

(13) The Company is involved in legal proceedings, and is subject to investigations, inspections, audits, inquiries and similar actions by governmental authorities, incidental to the normal course of the Company's business.

On April 16, 2008, the Plumbers and Steamfitters Local No. 7 Pension Fund filed a putative class action suit against the Company and its former and current chief executive officers in the United States District Court for the Northern District of Illinois. The plaintiffs amended the complaint on October 16, 2008, which upon the Company's motion the District Court dismissed on September 24, 2009. Subsequently, the plaintiffs moved for the District Court to reconsider the dismissal and to allow plaintiffs leave to further amend the complaint. The District Court granted plaintiffs' motion on November 11, 2009. The second amended complaint was then filed on behalf of purchasers of Company common stock during the period between June 25, 2007 and October 1, 2007. As in the first amended complaint, the second amended complaint charges the Company and its former and current chief executive officers with violations of Section 10(b) of the Securities Exchange Act of 1934, claiming that the Company misled investors by failing to disclose (i) declining rates of growth in generic drug sales and (ii) increasing selling, general and administrative expenses in the fourth quarter of 2007, which allegedly had a negative impact on earnings. The Company is vigorously contesting these charges. On February 1, 2010, the Company filed a motion to dismiss the second amended complaint.

On August 31, 2009, a Walgreen Co. shareholder named Dan Himmel filed a lawsuit, purportedly on the Company's behalf, against several current and former officers and directors (each, an "Individual Defendant"). The case is captioned *Himmel v. Wasson, et. al.* and was filed in the Circuit Court of Lake County, Illinois. The allegations in the lawsuit are similar to the securities fraud lawsuit described above. Himmel alleges that the Company's management: (i) knew, or was reckless in not knowing, that selling, general and administrative expenses in the fourth quarter of 2007 were too high, in light of decreased profits from generic drug sales; (ii) knew, or was reckless in not knowing, that the Company would not realize gross profits near what many Wall Street analysts were predicting; and (iii) the directors and officers had a duty both to prevent the drop in gross profits and to disclose the expected drop to the public and failed to do either. The Company's investigation to date suggests that the allegations are without merit, and that the Individual Defendants acted in good faith, exercised prudent business judgment and acted in a manner that they reasonably believed to be in the Company's best interests during the period at issue. The Company intends to vigorously contest the allegations. The Individual Defendants' time to file a responsive pleading to the complaint was extended by agreement until 30 days after the District Court in the Plumbers case rules on the pending motion to dismiss.

Although the outcome in the Himmel suit, the Plumbers and Steamfitters suit, and other legal proceedings and investigations to which the Company is subject, cannot be forecast with certainty, management believes the final disposition of these matters will not have a material adverse effect on the Company's consolidated financial position or results of operations.

The Company guarantees a credit agreement on behalf of SureScripts-RxHub, LLC, which provides electronic prescription data services. This credit agreement, for which SureScripts-RxHub, LLC is primarily liable, has an expiration date of June 30, 2011. The liability was \$10 million at May 31, 2010, August 31, 2009 and May 31, 2009. The maximum amount of future payments that could be required under the guaranty is \$25 million, of which \$13 million may be recoverable from another guarantor. In addition, under certain circumstances the Company may be required to provide an additional guarantee of up to \$10 million, of which \$8 million may be recoverable from other guarantors. This guarantee arose as a result of a business decision between parties to ensure that the operations of SureScripts-RxHub, LLC would have additional support to access financing. Should SureScripts-RxHub, LLC default or become unable to pay its debts, the Company would be required to fulfill its portion of this guarantee.

(14) On April 9, 2010, the Company completed the stock acquisition of Duane Reade Holdings, Inc., and Duane Reade Shareholders, LLC, (Duane Reade) which consisted of 258 Duane Reade stores located in the New York City metropolitan area, as well as the corporate office and two distribution centers. Total purchase price was \$1,075 million, which included the assumption of debt. The Company's operating statements include Duane Reade's results since the date of acquisition, which were immaterial. This acquisition will increase the Company's presence in the New York metropolitan area.

The preliminary allocation of the purchase price of Duane Reade was accounted for under the purchase method of accounting with the Company as the acquirer in accordance with ASC Topic 805, *Business Combinations*. Goodwill, none of which is deductible for tax purposes, and other intangible assets recorded in connection with the acquisition totaled \$409 million and \$474 million, respectively. Goodwill consists of expected purchasing synergies, consolidation of operations and reductions in selling, general and administrative expenses. Intangible assets consist of \$291 million of favorable lease interests (10 year weighted average useful life), \$115 million in customer relationships (10 year useful life), \$46 million in trade name (5 year useful life) and \$22 million in other intangible assets (3 year weighted average useful life).

The following table summarizes the allocation of the purchase price to the estimated fair value of the assets acquired and liabilities assumed as of the acquisition date, April 9, 2010. Assets acquired and liabilities assumed in the transaction were recorded at their acquisition date fair values while transaction costs associated with the acquisition were expensed as incurred. The Company's allocation was based on an evaluation of the appropriate fair values and represented management's best estimate based on available data. The final purchase accounting has not yet been completed.

The preliminary estimated fair values of assets acquired and liabilities assumed on April 9, 2010 are as follows (In millions):

|                          |    |            |
|--------------------------|----|------------|
| Cash                     | \$ | 6          |
| Accounts receivable      |    | 52         |
| Inventory                |    | 240        |
| Other current assets     |    | 23         |
| Property and equipment   |    | 248        |
| Other non-current assets |    | 4          |
| Intangible assets        |    | 474        |
| Goodwill                 |    | 409        |
| Total assets acquired    |    | 1,456      |
| Liabilities assumed      |    | 316        |
| Debt assumed             |    | 574        |
| Net assets acquired      | \$ | <u>566</u> |

We assumed federal net operating losses of \$261 million and state net operating losses of \$252 million, both which begin to expire in 2018, in conjunction with the Duane Reade acquisition.

The unaudited condensed pro forma consolidated statements of income for 2010 and 2009 (assuming the acquisition of Duane Reade as of the beginning of each fiscal period) are as follows (In millions, except per share amounts):

|                                | Three Months Ended |           | Nine Months Ended |           |
|--------------------------------|--------------------|-----------|-------------------|-----------|
|                                | May 31,            |           | May 31,           |           |
|                                | 2010               | 2009      | 2010              | 2009      |
| Net sales                      | \$ 17,459          | \$ 16,681 | \$ 51,733         | \$ 49,001 |
| Net earnings                   | 463                | 525       | 1,613             | 1,564     |
| Net earnings per common share: |                    |           |                   |           |
| Basic                          | .47                | .53       | 1.64              | 1.58      |
| Diluted                        | .47                | .53       | 1.63              | 1.58      |

These pro forma statements have been prepared for comparative purposes only and are not intended to be indicative of what the Company's results would have been had the acquisition occurred at the beginning of the periods presented or the results which may occur in the future.

The aggregate purchase price of all business acquisitions, excluding Duane Reade, was \$204 million for the nine month period ended May 31, 2010. These acquisitions added \$34 million to goodwill and \$144 million to intangible assets, primarily prescription files. The remaining fair value relates to immaterial amounts of tangible assets, less liabilities assumed. Operating results of the businesses acquired have been included in the consolidated statements of earnings from their respective acquisition dates forward. Pro forma results of the Company, assuming all of the acquisitions had occurred at the beginning of each period presented, would not be materially different from the results reported.

(15) We have recorded the following depreciation and amortization expense in the Consolidated Condensed Statements of Earnings (In millions):

|   | Three Months Ended |               | Nine Months Ended |               |
|---|--------------------|---------------|-------------------|---------------|
|   | May 31,            |               | May 31,           |               |
|   | 2010               | 2009          | 2010              | 2009          |
| Depreciation expense                        | \$ 200             | \$ 216        | \$ 605            | \$ 603        |
| Intangible asset amortization               | 52                 | 38            | 129               | 108           |
| System development costs amortization       | 11                 | 10            | 34                | 30            |
| Total depreciation and amortization expense | <u>\$ 263</u>      | <u>\$ 264</u> | <u>\$ 768</u>     | <u>\$ 741</u> |

(16) Cash interest paid for the nine month period ended May 31, 2010 was \$46 million compared to \$33 million in the prior year's nine month period. Cash paid for income taxes was \$896 million and \$523 million for the nine months ended May 31, 2010 and 2009, respectively.

(17) There were no non-cash transactions in the current nine month period. Non-cash transactions in the nine month prior fiscal period include \$97 million due to the reduction in the liability for postretirement health benefit plans and \$19 million in deferred tax assets related to the identification of net operating losses in acquired businesses.

(18) In June 2009, the Financial Accounting Standards Board (FASB) issued ASC topic 810 (formerly SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*), which amends the consolidation guidance applicable to variable interest entities. The amendments will significantly affect the overall consolidation analysis under ASC topic 810. The application of the new provisions under this topic, which will be effective for the first quarter of fiscal 2011, is not expected to have a material impact on our consolidated financial position or results of operations.

## Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

## INTRODUCTION

Walgreens is principally a retail drugstore chain that sells prescription and non-prescription drugs and general merchandise. General merchandise includes, among other things, household items, personal care, convenience foods, beauty care, photofinishing, candy and seasonal items. Customers can have prescriptions filled in retail pharmacies, as well as through the mail, and order refills by telephone and via the Internet. As of May 31, 2010, we operated 8,019 locations in 50 states, the District of Columbia, Guam and Puerto Rico. Total locations do not include 359 convenient care clinics operated by Take Care Health Systems, Inc.

| Location Type           | Number of Locations |              |
|-------------------------|---------------------|--------------|
|                         | May 31, 2010        | May 31, 2009 |
| Drugstores              | 7,522               | 6,857        |
| Worksite Facilities     | 378                 | 373          |
| Home Care Facilities    | 103                 | 112          |
| Specialty Pharmacies    | 14                  | 17           |
| Mail Service Facilities | 2                   | 2            |
| Total                   | 8,019               | 7,361        |

The drugstore industry is highly competitive. In addition to other drugstore chains, independent drugstores and mail order prescription providers, we compete with various other retailers including grocery stores, convenience stores, mass merchants and dollar stores.

The Company's sales, gross profit margin and gross profit dollars are impacted by both the percentage of prescriptions that we fill that are generic and the rate at which new generic versions are introduced to the market. In general, generic versions of drugs generate lower total sales dollars per prescription, but higher gross profit margins and gross profit dollars, as compared with patent-protected brand name drugs. The positive impact on gross profit margins and gross margin dollars are particularly significant in the first several months after a generic version of a drug is first allowed to compete with the branded version, which is generally referred to as a "generic conversion." In any given year, the number of blockbuster drugs that undergo a conversion from branded to generic status can increase or decrease, which can have a significant impact on our sales, gross profit margins and gross profit dollars. And, because any number of factors outside of the Company's control or ability to foresee can affect timing for a generic conversion, we face substantial uncertainty in predicting when such conversions will occur and what effect they will have on particular future periods.

The long-term outlook for prescription utilization is strong due in part to the aging population, the increasing utilization of multi-source (i.e., generic) drugs, the continued development of innovative drugs that improve quality of life and control health care costs, and the expansion of healthcare insurance coverage under the Patient Protection and Affordable Care Act signed into law on March 23, 2010 (the ACA).

Certain provisions of the Deficit Reduction Act of 2005 (the DRA) sought to reduce federal spending by altering the Medicaid reimbursement formula (AMP) for multi-source drugs. Those reductions did not go into effect. The ACA enacted a modified reimbursement formula for multi-source drugs, which, when implemented, is expected to reduce Medicaid reimbursements. Also, in conjunction with a class action settlement with two entities that publish the average wholesale price (AWP) of pharmaceuticals, the methodology used to calculate the AWP, a pricing reference widely used in the pharmacy industry, was changed in a way that reduced the AWP for many brand-name prescription drugs effective September 26, 2009. The Company has reached understandings with most of its third-party payors to adjust reimbursements to correct for this change in methodology however, most state Medicaid programs that utilize AWP as a pricing reference have not taken action to make similar adjustments, resulting in reduced Medicaid reimbursement for drugs affected by the change.

Total front-end sales have continued to grow due primarily to new store openings. However, total front-end sales continue to be negatively impacted by lower demand for discretionary goods such as household, seasonal and beauty products primarily due to the overall economic impact of the recession and high unemployment rates.

We continue to expand into new markets and increase penetration in existing markets. To support our growth, we are investing in prime locations, technology and customer service initiatives. We continue to focus on retail organic growth; however, consideration is given to retail and other acquisitions that provide unique opportunities and fit our business strategies.

## RESTRUCTURING CHARGES

On October 30, 2008, we announced a series of strategic initiatives, approved by the Board of Directors, to enhance shareholder value. One of these initiatives was a program designed to reduce cost and improve productivity through strategic sourcing of indirect spend, reducing corporate overhead and work throughout our stores, rationalization of inventory categories, and transforming the community pharmacy.

We have recorded the following pre-tax charges associated with our restructuring initiatives within the Consolidated Condensed Statements of Earnings (In millions):

|                                  | Three Months Ended |      | Nine Months Ended |       |
|----------------------------------|--------------------|------|-------------------|-------|
|                                  | May 31,            |      | May 31,           |       |
|                                  | 2010               | 2009 | 2010              | 2009  |
| Severance and other benefits     | \$ 3               | \$ 6 | \$ 15             | \$ 65 |
| Project cancellation settlements | -                  | 8    | -                 | 8     |
| Inventory charges                | -                  | 33   | 19                | 44    |
| Restructuring expense            | 3                  | 47   | 34                | 117   |

|  |       |       |       |        |
|--|-------|-------|-------|--------|
| Consulting                                       | 10    | 20    | 34    | 57     |
| Restructuring and restructuring related expenses | \$ 13 | \$ 67 | \$ 68 | \$ 174 |
| Cost of sales                                    | \$ -  | \$ 33 | \$ 19 | \$ 44  |
| Selling, general and administrative expenses     | 13    | 34    | 49    | 130    |
|  | \$ 13 | \$ 67 | \$ 68 | \$ 174 |

Severance and other benefits include the charges associated with employees who were separated from the Company. In the current fiscal year, 179 employees have been separated from the Company. Since inception, a total of 876 employees have been separated from the Company as a result of these initiatives.

Inventory charges relate to on-hand inventory that has been reduced from cost to a selling price below cost. In addition, as a part of our restructuring efforts we sold an incremental amount of inventory below traditional retail prices. The dilutive effect of these sales on gross profit was \$4 million in the current quarter and \$19 million for the nine month period ended May 31, 2010. For the quarter and nine month period ended May 31, 2009 we reported a dilutive effect on sales of \$32 million.

We incurred pre-tax costs of \$17 million (\$13 million restructuring and restructuring related expenses and \$4 million of gross profit dilution) in the third quarter and \$87 million (\$68 million of restructuring and restructuring related expenses, and \$19 million of gross profit dilution) for the nine month period ended May 31, 2010. Since inception, we have incurred \$339 million (\$288 million of restructuring and restructuring related expenses, and \$51 million of gross profit dilution). We anticipate approximately \$70 million of pre-tax restructuring and restructuring related expenses and gross profit dilution in the remaining months of fiscal 2010.

We have recorded the following balances in accrued expenses and other liabilities on our Consolidated Condensed Balance Sheets (In millions):

|                              | August 31, 2009 |         |               | May 31, 2010    |
|------------------------------|-----------------|---------|---------------|-----------------|
|                              | Reserve Balance | Charges | Cash Payments | Reserve Balance |
| Severance and other benefits | \$ 4            | \$ 17   | \$ (21)       | \$ -            |

We have realized incremental savings related to these initiatives of approximately \$73 million in the quarter and \$335 million for the nine month period ended May 31, 2010. Selling general and administrative expenses realized incremental savings of \$56 million and \$275 million in the quarter and nine month period, respectively, while cost of sales benefited by \$17 million and \$60 million in the same periods. Since inception, we have realized total savings related to these initiatives of approximately \$585 million. Selling, general and administrative expenses realized total savings of \$525 million, while cost of sales benefited by approximately \$60 million. The savings are primarily the result of reduced store labor, expense initiatives and personnel reductions.

Additionally, as a part of our Customer Centric Retailing (CCR) initiative, we are enhancing the store format to ensure we have the proper assortments, better category layouts and adjacencies, better shelf height and sight lines and brand and private brand layout, all of which are designed to positively enhance the shopper experience and increase customer frequency and purchase size. This format will be rolled out to approximately 5,500 to 6,000 existing stores. As of May 31, 2010, in total, we have remodeled 915 stores and plan to enhance approximately 500 stores in the next three months of fiscal 2010, with the remaining store remodels during fiscal 2011 and 2012. In addition, through May 31, 2010 we have opened 295 new stores with the CCR format and we expect to open approximately 50 new stores with the CCR format in the remaining fiscal year. We expect to remodel approximately 1,600 stores and open approximately 400 new stores with the CCR format in the 2010 calendar year. Although we will continue to refine our estimates as the rollout progresses, based on our experience with the first 915 stores, we expect the total cost, which includes both selling, general and administrative expenses and capital, to be \$40 thousand to \$55 thousand per store. For the three months ended May 31, 2010, we incurred \$29 million in total program costs, of which \$20 million was included in selling, general and administrative expenses and \$9 million in capital costs. For the nine months ended May 31, 2010, we incurred \$41 million in total program costs, of which \$28 million was included in selling, general and administrative expenses and \$13 million in capital costs.

## OPERATING STATISTICS

|  | Percentage Increases/(Decreases) |       |                   |       |
|--|----------------------------------|-------|-------------------|-------|
|  | Three Months Ended               |       | Nine Months Ended |       |
|  | May 31,                          |       | May 31,           |       |
|  | 2010                             | 2009  | 2010              | 2009  |
| Net Sales                                    | 6.1                              | 8.0   | 6.1               | 7.2   |
| Net Earnings                                 | (11.4)                           | (8.8) | 3.2               | (8.4) |
| Comparable Drugstore Sales                   | 0.7                              | 2.8   | 1.7               | 1.9   |
| Prescription Sales                           | 5.7                              | 8.2   | 6.2               | 7.4   |
| Comparable Drugstore Prescription Sales      | 1.0                              | 3.8   | 2.5               | 3.1   |
| Front-End Sales                              | 6.9                              | 7.4   | 6.0               | 6.7   |
| Comparable Drugstore Front-End Sales         | 0.1                              | 0.9   | 0.3               | (0.2) |
| Gross Profit                                 | 6.5                              | 5.0   | 6.9               | 5.2   |
| Selling, General and Administrative Expenses | 8.6                              | 8.4   | 7.0               | 8.5   |

|  | Percent to Net Sales |      |                   |      |
|--|----------------------|------|-------------------|------|
|  | Three Months Ended   |      | Nine Months Ended |      |
|  | May 31,              |      | May 31,           |      |
|  | 2010                 | 2009 | 2010              | 2009 |
| Gross Margin                                 | 27.6                 | 27.5 | 28.1              | 27.9 |
| Selling, General and Administrative Expenses | 22.8                 | 22.3 | 22.7              | 22.6 |

|  | Other Statistics   |      |                   |       |
|--|--------------------|------|-------------------|-------|
|  | Three Months Ended |      | Nine Months Ended |       |
|  | May 31,            |      | May 31,           |       |
|  | 2010               | 2009 | 2010              | 2009  |
| Prescription Sales as a % of Net Sales               | 65.4               | 65.6 | 64.9              | 64.9  |
| Third Party Sales as a % of Total Prescription Sales | 95.7               | 95.4 | 95.3              | 95.4  |
| Total Number of Prescriptions (in millions)          | 177                | 168  | 522               | 488   |
| 30 Day Equivalent Prescriptions (in millions) *      | 198                | 187  | 583               | 541   |
| Total Number of Locations                            |                    |      | 8,019             | 7,361 |

\* Includes the adjustment to convert prescriptions greater than 84 days to the equivalent of three 30-day prescriptions. This adjustment reflects the fact that these prescriptions include approximately three times the amount of product days supplied compared to a normal prescription.

## RESULTS OF OPERATIONS

Net earnings for the third quarter ended May 31, 2010 were \$463 million or \$.47 per share (diluted). This was an 11.4% decrease over the same quarter last year. The net earnings decrease in the quarter was attributable to a lower rate of sales growth, higher income tax expense primarily related to the Patient Care Act and higher selling, general and administrative expenses as a percentage of sales, partially offset by improved gross margins. For the nine month period ended May 31, 2010, net earnings increased 3.2% to \$1,621 million or \$1.64 per share (diluted). The net earnings increase for the nine months ended May 31, 2010 was primarily attributable to higher gross margins partially offset by lower sales growth, higher selling, general and administrative expenses as a percentage of sales and higher income tax expense primarily related to the Patient Care Act. The dilutive effect of Duane Reade net earnings was approximately \$.02 per share (diluted) for the current quarter and nine month period ended May, 31 2010, primarily due to one-time charges related to the acquisition. In the current quarter we recorded \$13 million in restructuring and restructuring related expenses and \$4 million in margin dilution as compared to the prior year's restructuring and restructuring related expenses of \$67 million and \$32 million in margin dilution. For the nine month period we recorded \$68 million in restructuring and restructuring related expenses and \$19 million in margin dilution related to our restructuring activities. This compares to \$174 million in restructuring and restructuring related expenses and \$32 million in margin dilution in the prior year's period.

Net sales for the quarter ended May 31, 2010 increased by 6.1% to \$17,199 million. The impact of the Duane Reade acquisition increased total sales by 1.7% in the current quarter. Drugstore sales increases resulted from gains in existing stores and added sales from new stores, each of which include an indeterminate amount of market-driven price changes. Sales in comparable drugstores were up 0.7% in the current quarter and 1.7% for the nine month period ended May 31, 2010. Comparable drugstores are defined as those that have been open for at least twelve consecutive months without closure for seven or more consecutive days and without a major remodel or a natural disaster in the past twelve months. Remodels associated with our CCR initiative are not considered major and therefore do not affect comparable drugstore results. Relocated and acquired stores are not included as comparable stores for the first twelve months after the relocation or acquisition. We have also excluded Duane Reade sales from comparable sales. We operated 8,019 locations (7,522 drugstores) as of May 31, 2010, compared to 7,361 locations (6,857 drugstores) a year earlier.

Prescription sales increased by 5.7% for the third quarter and 6.2% for the first nine months and represented 65.4% and 64.9% of total sales, respectively. The impact of the Duane Reade acquisition increased prescription sales by 1.1% in the quarter and 0.4% for the nine month period. In the prior year, prescription sales increased 8.2% for the quarter and 7.4% year to date and represented 65.6% and 64.9% of total sales. Comparable drugstore prescription sales were up 1.0% in the current quarter and 2.5% in the nine month period. The effect of generic drugs, which have a lower retail price, replacing brand name drugs reduced prescription sales by 1.9% in the quarter and 2.2% for the first nine months versus 3.8% in the previous quarter and 2.8% in the previous nine month period. The effect of generics on total sales was a reduction of 1.2% in the current quarter and 1.3% year to date compared to 2.1% in the quarter and 1.5% in the nine month period in the prior year. Third party sales, where reimbursement is received from managed care organizations as well as government and private insurance, were 95.7% of prescription sales for the quarter and 95.3% for the first nine months compared to 95.4% for the quarter and first nine months last year. The total number of prescriptions filled for the third quarter was approximately 177 million compared to 168 million for the same period last year. Prescriptions adjusted to 30 day equivalents were 198 million in the third quarter versus 187 million last year.

Front-end sales increased 6.9% for the current quarter and 6.0% for the first nine months and were 34.6% and 35.1% of total sales, respectively. In comparison, prior year front end sales increased 7.4% and 6.7% and comprised 34.4% and 35.1% of total sales. The impact of the Duane Reade acquisition increased front-end sales by 2.7% in the quarter and 0.9% for the nine month period. Additionally, the increase is due in part to new store openings and increased sales dollars related to non-prescription drugs, convenience foods and personal care

products. Comparable drugstore front-end sales increased 0.1% for the current quarter and increased 0.3% year to date compared to the prior year, which increased 0.9% for the quarter and decreasing 0.2% year to date. The increase in comparable front end sales in the quarter was primarily attributed to non-prescription drugs, which was partially offset by decreased sales in household and photo products. The increase in year to date comparable front-end sales was attributed to non-prescription drugs and convenience foods which were partially offset by decreased sales in household, seasonal and beauty products.

Gross margin as a percent of sales was 27.6% in the current quarter and 28.1% for the first nine months compared to 27.5% and 27.9% last year. Overall margins in the quarter and nine month period were positively impacted by higher front-end margins due to lower restructuring and restructuring related costs and decreased markdown activity. Also, a lower provision for LIFO benefitted margins in the quarter and nine month period. Partially offsetting the front-end margin increase in the quarter and nine month periods was a decrease in retail pharmacy margins, where market driven reimbursements offset the positive impact of generic drug sales.

We use the LIFO method of inventory valuation, which can only be determined annually when inflation rates and inventory levels are finalized; therefore, LIFO inventory costs for the interim financial statements are estimated. Cost of sales included a LIFO provision of \$18 million and \$79 million for the quarter and nine month period ended May 31, 2010 versus \$32 million and \$124 million a year ago. This quarter, our estimated annual inflation rate was reduced to 1.25% from our estimate of 1.50% at February 28, 2010, primarily due to lower than projected non-prescription drug inflation. Last year, during the third quarter the estimated annual inflation rate was reduced to 2.00% from 2.25%, due to lower than projected prescription drug inflation.

Selling, general and administrative expenses as a percentage of sales were 22.8% for the third quarter and 22.7% for the first nine months compared to 22.3% and 22.6% a year ago. As a percentage of sales, the current quarter increase was due to higher occupancy, Duane Reade operational expenses, transaction expenses associated with the Duane Reade acquisition and CCR remodeling expenses partially offset by lower advertising and restructuring and restructuring related costs. The increase for the nine months, as a percentage of sales was attributed to higher occupancy expense, insurance and expenses related to the Duane Reade acquisition, partially offset by lower restructuring and restructuring related costs and advertising expense. Also positively impacting selling, general and administrative expenses was incremental savings from our restructuring activities in the quarter and year to date periods.

Selling, general and administrative expenses increased 8.6% in the third quarter and 7.0% for the nine month period ended May 31, 2010 compared to 8.4% and 8.5% a year ago. In the current quarter, Duane Reade operational expenses and transaction expenses associated with the acquisition were partially offset by savings from our restructuring activities primarily in store related salary and expenses and lower restructuring and restructuring related expenses as compared to the prior year. The decrease in the nine month period rate of growth as compared to the prior period was due to savings from our restructuring activities, primarily in store related salary and expense and lower restructuring and restructuring related expenses.

Interest was a net expense of \$24 million in the quarter and \$67 million year to date compared to \$25 million and \$60 million for the prior quarter and year to date, respectively. The increase in interest expense for the nine month period is primarily attributed to the issuance of long-term debt. The current year's interest expense is net of \$3 million in the quarter and \$9 million year to date, which was capitalized to construction projects, versus \$3 million and \$12 million capitalized for the prior quarter and year to date last year.

The effective tax rate was 42.5% for the current quarter compared to 36.4% in the prior year's quarter. In conjunction with the ACA, one provision of which repealed the tax benefit for the Medicare Part D subsidy for retiree benefits, we recorded a charge of \$43 million to deferred taxes in the current quarter. Excluding this adjustment, the effective rate for the quarter was 37.1%. The increase in the adjusted rate as compared to the prior period is primarily attributable to prior year additional permanent tax benefits. For the current nine month period the effective tax rate was 38.7% compared to 36.8% in the prior year. Excluding the ACA adjustment the rate was 37.0%. The increase over the prior year was attributed to prior year additional permanent tax benefits.

## **CRITICAL ACCOUNTING POLICIES**

The consolidated condensed financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and include amounts based on management's prudent judgments and estimates. Actual results may differ from these estimates. Management believes that any reasonable deviation from those judgments and estimates would not have a material impact on our consolidated financial position or results of operations. To the extent that the estimates used differ from actual results, however, adjustments to the statement of earnings and corresponding balance sheet accounts would be necessary. These adjustments would be made in future statements. For a complete discussion of all our significant accounting policies please see our 2009 annual report on Form 10-K. Some of the more significant estimates include goodwill and other intangible asset impairment, allowance for doubtful accounts, vendor allowances, liability for closed locations, liability for insurance claims, cost of sales, and income taxes. We use the following methods to determine our estimates:

### **Goodwill and other intangible asset impairment -**

Goodwill and other indefinite-lived intangible assets are not amortized, but are evaluated for impairment annually during the fourth quarter, or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. As part of our impairment analysis for each reporting unit, we engaged a third-party appraisal firm to assist in the determination of estimated fair value for each unit. This determination included estimating the fair value using both the income and market approaches. The income approach requires management to estimate a number of factors for each reporting unit, including projected future operating results, economic projections, anticipated future cash flows and discount rates. The market approach estimates fair value using comparable marketplace fair value data from within a comparable industry grouping.

The determination of the fair value of the reporting units and the allocation of that value to individual assets and liabilities within those

reporting units requires us to make significant estimates and assumptions. These estimates and assumptions primarily include, but are not limited to: the selection of appropriate peer group companies; control premiums appropriate for acquisitions in the industries in which we compete; the discount rate; terminal growth rates; and forecasts of revenue, operating income, depreciation and amortization and capital expenditures. The allocation requires several analyses to determine fair value of assets and liabilities including, among other things, purchased prescription files, customer relationships and trade names. Although we believe our estimates of fair value are reasonable, actual financial results could differ from those estimates due to the inherent uncertainty involved in making such estimates. Changes in assumptions concerning future financial results or other underlying assumptions could have a significant impact on either the fair value of the reporting units, the amount of the goodwill impairment charge, or both. We also compared the sum of the estimated fair values of the reporting units to the Company's total value as implied by the market value of the Company's equity and debt securities. This comparison indicated that, in total, our assumptions and estimates were reasonable. However, future declines in the overall market value of the Company's equity and debt securities may indicate that the fair value of one or more reporting units has declined below its carrying value.

We have not made any material changes to the method of evaluating goodwill and intangible asset impairments during the last three years. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine impairment.

#### Allowance for doubtful accounts -

The provision for bad debt is based on both specific receivables and historic write-off percentages. We have not made any material changes to the method of estimating our allowance for doubtful accounts during the last three years. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine the allowance.

#### Vendor allowances -

Vendor allowances are principally received as a result of purchase levels, sales or promotion of vendors' products. Allowances are generally recorded as a reduction of inventory and are recognized as a reduction of cost of sales when the related merchandise is sold. Those allowances received for promoting vendors' products are offset against advertising expense and result in a reduction of selling, general and administrative expenses to the extent of advertising incurred, with the excess treated as a reduction of inventory costs. We have not made any material changes to the method of estimating our vendor allowances during the last three years. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimate or assumptions used to determine vendor allowances.

#### Liability for closed locations -

The liability is based on the present value of future rent obligations and other related costs (net of estimated sublease rent) to the first lease option date. We have not made any material changes to the method of estimating our liability for closed locations during the last three years. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine the liability.

#### Liability for insurance claims -

The liability for insurance claims is recorded based on estimates for claims incurred and is not discounted. The provisions are estimated in part by considering historical claims experience, demographic factors and other actuarial assumptions. We have not made any material changes to the method of estimating our liability for insurance claims during the last three years. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine the liability.

#### Cost of sales -

Drugstore cost of sales is derived based on point-of-sale scanning information with an estimate for shrinkage and adjusted based on periodic inventories. Inventories are valued at the lower of cost or market determined by the last-in, first-out (LIFO) method. We have not made any material changes to the method of estimating cost of sales during the last three years. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine cost of sales. Cost of sales will continue to be impacted by our restructuring initiatives which include inventory rationalization and the subsequent write-down of inventory to the lower of cost or market.

#### Income taxes -

We are subject to routine income tax audits that occur periodically in the normal course of business. U.S. federal, state and local and foreign tax authorities raise questions regarding our tax filing positions, including the timing and amount of deductions and the allocation of income among various tax jurisdictions. In evaluating the tax benefits associated with our various tax filing positions, we record a tax benefit for uncertain tax positions using the highest cumulative tax benefit that is more likely than not to be realized. Adjustments are made to our liability for unrecognized tax benefits in the period in which we determine the issue is effectively settled with the tax authorities, the statute of limitations expires for the return containing the tax position or when more information becomes available. Our liability for unrecognized tax benefits, including accrued penalties and interest, is included in other long-term liabilities on our consolidated balance sheets and in income tax expense in our consolidated statements of earnings.

In determining our provision for income taxes, we use an annual effective income tax rate based on full year income, permanent differences between book and tax income, and statutory income tax rates. The effective income tax rate also reflects our assessment of the ultimate outcome of tax audits. Discrete events such as audit settlements or changes in tax laws are recognized in the period in which they occur. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimate or assumptions used to determine income taxes.

## LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were \$1,712 million at May 31, 2010, compared to \$2,300 million at May 31, 2009. Short-term investment objectives are to minimize risk, maintain liquidity and maximize after-tax yields. To attain these objectives, investment limits are placed on the amount, type and issuer of securities. Investments are principally in U.S. Treasury market funds and Treasury Bills.

Net cash provided by operating activities for the nine months ended May 31, 2010 was \$2,819 million compared to \$3,259 million a year ago. The decrease is primarily attributed to reduced cash flows from working capital improvements. For the nine months ended May 31, 2010, cash flows from working capital improvements was \$231 million as compared to the prior year where working capital improvements generated \$602 million of cash flows. Partially offsetting the reduced working capital improvements was an increase in net earnings. Cash provided by operations is the principal source of funds for expansion, acquisitions, remodeling programs, dividends to shareholders and stock repurchases. In fiscal 2009 we supplemented cash provided by operations with long-term debt.

Net cash used for investing activities was \$1,652 million versus \$1,936 million last year. In the current year, we invested \$2,400 million in short-term Treasury Bills and \$2,300 million matured. Last year, we invested \$1,400 million in short-term Treasury Bills and \$1,300 million matured. Additions to property and equipment were \$786 million compared to \$1,534 million last year. During the first nine months we added a total of 601 locations (523 net) compared to 525 last year (427 net). There were 74 owned locations added during the first nine months and 60 under construction at May 31, 2010 versus 140 owned locations added and 53 under construction last year.

|                 | Drugstores | Worksites | Home Care | Specialty<br>Pharmacy | Mail<br>Service | Total |
|-----------------|------------|-----------|-----------|-----------------------|-----------------|-------|
| August 31, 2009 | 6,997      | 377       | 105       | 15                    | 2               | 7,496 |
| New/Relocated   | 294        | 24        | 2         | -                     | -               | 320   |
| Acquired        | 280        | -         | 1         | -                     | -               | 281   |
| Closed/Replaced | (49)       | (23)      | (5)       | (1)                   | -               | (78)  |
| May 31, 2010    | 7,522      | 378       | 103       | 14                    | 2               | 8,019 |

Business acquisitions this year were \$764 million versus \$348 million in the prior year. Business acquisitions in the current year primarily include the purchase of all 258 Duane Reade stores located in the New York City metropolitan area, as well as the corporate office and two distribution centers for \$560 million net of assumed cash of \$6 million. The remaining business acquisitions of \$204 million in the current year and \$348 million in the prior year are primarily for the purchase of prescription files.

Capital expenditures throughout fiscal 2010 are expected to be \$1.2 billion, excluding business acquisitions and prescription file purchases. We expect new drugstore organic growth of between 4.5 percent and 5.0 percent in fiscal 2010 and between 2.5 percent and 3.0 percent in 2011. In the first nine months, we added a total of 601 locations, of which 574 were new, relocated or acquired drugstores, with a net gain of 525 drugstores after relocations and closings. We are continuing to relocate stores to more convenient and profitable freestanding locations. In addition to stores, expenditures are planned for distribution centers and technology. Capital expenditures for fiscal 2011 are expected to be approximately \$1.4 billion, excluding business acquisitions and prescription file purchases.

Net cash used for financing activities was \$1,542 million compared to the prior year where financing activities provided net cash of \$534 million. Upon the closing of the Duane Reade acquisition we assumed debt of \$574 million. Subsequent to closing, we retired all Duane Reade debt for \$576 million. In the prior year we had net proceeds from the issuance of long term debt of \$987 million and repayments of short term borrowing of \$70 million. On October 14, 2009, our Board of Directors approved a long-term capital policy. Our long-term capital policy is to maintain a strong balance sheet and financial flexibility; reinvest in our core strategies; invest in strategic opportunities that reinforce our core strategies and meet return requirements; and return surplus cash flow to shareholders in the form of dividends and share repurchases over the long term. In connection with our capital policy, our Board of Directors authorized a new stock repurchase program ("2009 repurchase program") and set a long-term dividend payout ratio target between 30 and 35 percent. The 2009 repurchase program allows for the repurchase of up to \$2,000 million of the Company's common stock prior to its expiration on December 31, 2013. Shares totaling \$638 million were purchased in conjunction with the 2009 repurchase program during the first nine months. In addition, we will continue to repurchase shares to support the needs of the employee stock plans. Shares totaling \$116 million were purchased to support the needs of the employee stock plans during the current period as compared to \$140 million a year ago. In the first nine months of the current year, we had proceeds related to employee stock plans of \$206 million versus \$106 million for the same period last year. Cash dividends paid were \$407 million during the first nine months versus \$334 million for the same period a year ago.

We had no commercial paper outstanding at May 31, 2010. In connection with our commercial paper program, we maintain two unsecured backup syndicated lines of credit that total \$1,200 million. The first \$600 million facility expires on August 9, 2010, and allows for the issuance of up to \$400 million in letters of credit, which reduces the amount available for borrowing. The second \$600 million facility expires on August 12, 2012. Our ability to access these facilities is subject to our compliance with the terms and conditions of the credit facilities, including financial covenants. The covenants require us to maintain certain financial ratios related to minimum net worth and priority debt, along with limitations on the sale of assets and purchases of investments. As of May 31, 2010, we were in compliance with all such covenants. The Company pays a facility fee to the financing banks to keep these lines of credit active. As of May 31, 2010, there was \$194 million in letters of credit issued against these credit facilities. We do not expect borrowings under these facilities, together with our outstanding commercial paper, to exceed \$1,200 million.

Our current credit ratings are as follows:

Long-Term Debt

Commercial Paper

| Rating Agency     | Rating | Outlook  | Rating | Outlook  |
|-------------------|--------|----------|--------|----------|
| Moody's           | A2     | Negative | P-1    | Negative |
| Standard & Poor's | A      | Stable   | A-1    | Stable   |

In assessing our credit strength, both Moody's and Standard & Poor's consider our business model, capital structure, financial policies and financial statements. Our credit ratings impact our future borrowing costs, access to capital markets and operating lease costs.

## CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The following table lists our contractual obligations and commitments as of May 31, 2010:

|   | Payments Due by Period (In millions) |                  |                 |                 |                  |
|---|--------------------------------------|------------------|-----------------|-----------------|------------------|
|   | Total                                | Less than 1 Year | 1-3 Years       | 3-5 Years       | Over 5 Years     |
| Operating leases (1)  | \$ 36,413                            | \$ 2,229         | \$ 4,527        | \$ 4,364        | \$ 25,293        |
| Purchase obligations (2):                                       |                                      |                  |                 |                 |                  |
| Open inventory purchase orders                                  | 1,805                                | 1,805            | -               | -               | -                |
| Real estate development   | 418                                  | 248              | 157             | 13              | -                |
| Other corporate obligations                                     | 523                                  | 206              | 193             | 100             | 24               |
| Long-term debt*(3)  | 2,350                                | 4                | 4               | 1,310           | 1,032            |
| Interest payment on long-term debt                              | 694                                  | 114              | 232             | 136             | 212              |
| Insurance*  | 579                                  | 186              | 120             | 53              | 220              |
| Retiree health*   | 345                                  | 10               | 24              | 28              | 283              |
| Closed location obligations*                                    | 109                                  | 27               | 30              | 18              | 34               |
| Capital lease obligations *(1)                                  | 50                                   | 4                | 5               | 5               | 36               |
| Other long-term liabilities reflected on the balance sheet* (4) | 836                                  | 65               | 163             | 152             | 456              |
| <b>Total</b>  | <b>\$ 44,122</b>                     | <b>\$ 4,898</b>  | <b>\$ 5,455</b> | <b>\$ 6,179</b> | <b>\$ 27,590</b> |

\* Recorded on balance sheet.

- (1) Amounts for operating leases and capital leases do not include certain operating expenses under the leases such as common area maintenance, insurance and real estate taxes. These expenses for the Company's most recent fiscal year were \$335 million.
- (2) The purchase obligations include agreements to purchase goods or services that are enforceable and legally binding and that specify all significant terms, including open purchase orders.
- (3) Total long-term debt on the Consolidated Condensed Balance Sheet includes a \$21 million fair market value adjustment and \$8 million of unamortized discount.
- (4) Includes \$70 million (\$21 million due in 1-3 years, \$33 million due in 3-5 years and \$16 million due in over 5 years) of unrecognized tax benefits recorded under ASC topic 740.

## OFF-BALANCE SHEET ARRANGEMENTS

Letters of credit are issued to support purchase obligations and commitments (as reflected on the Contractual Obligations and Commitments table) as follows (In millions):

|                         |               |
|-------------------------|---------------|
| Insurance               | \$ 234        |
| Inventory obligations   | 96            |
| Real estate development | 20            |
| Other                   | 8             |
| <b>Total</b>            | <b>\$ 358</b> |

At May 31, 2010, \$194 million of insurance letters of credit were issued under the provisions of our \$600 million credit facility that expires on August 9, 2010.

We have no off-balance sheet arrangements other than those disclosed on the Contractual Obligations and Commitments table and a credit agreement guaranty on behalf of SureScripts-RxHub, LLC. This agreement is described more fully in Note 13 in the Notes to Consolidated Condensed Financial Statements.

Both on-balance sheet and off balance-sheet financing alternatives are considered when pursuing our capital structure and capital allocation objectives.

## RECENT ACCOUNTING PRONOUNCEMENTS

In June 2009, the Financial Accounting Standards Board (FASB) issued ASC topic 810 (formerly SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*), which amends the consolidation guidance applicable to variable interest entities. The amendments will significantly affect the overall consolidation analysis under ASC topic 810. The application of the new provisions under this topic, which will be effective for the first quarter of fiscal 2011, is not expected to have a material impact on our consolidated financial position or results of operations.

## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain information in this quarterly report on Form 10-Q, as well as in other public filings, the Company website, press releases and oral statements made by our representatives, is forward-looking information based on the Company's current expectations and plans which involve risks and uncertainties. Forward-looking information includes statements concerning pharmacy sales trends, prescription margins, number and location of new store openings, outcomes of litigation, the level of capital expenditures, and demographic trends. Forward looking information includes statements with words such as "expects," "estimates," "intends," "believes," "plans," "anticipates" or similar language. For such statements, we claim the protection of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements involve risks and uncertainties, known or unknown to the Company that could cause results to differ materially from management expectations as projected in such forward-looking statements. These risk and uncertainties are discussed in Item 1A of the Company's annual report on Form 10-K for the fiscal year ended August 31, 2009 as well as other documents filed with the Securities and Exchange Commission. Unless otherwise required by applicable securities laws, the Company assumes no obligation to update its forward-looking statements to reflect subsequent events or circumstances.

### Item 3. QUALITATIVE AND QUANTITATIVE DISCLOSURE ABOUT MARKET RISK

In January 2010, we entered into two interest rate swap transactions converting our \$1,300 million 4.875% fixed rate notes to a floating interest rate tied to the six month LIBOR in arrears plus a constant spread. These financial instruments are sensitive to changes in interest rates. On May 31, 2010, we had \$1,050 million in long-term debt obligations that had fixed interest rates. A one percentage point increase or decrease in interest rates would increase or decrease the annual interest expense we recognize and the cash we pay for interest expense by approximately \$13 million.

### Item 4. CONTROLS AND PROCEDURES

Based on their evaluation as of May 31, 2010, pursuant to Exchange Act Rule 13a-15(b), the Company's management, including its Chief Executive Officer and Chief Financial Officer, has concluded that the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e)) are effective.

In connection with the evaluation pursuant to Exchange Act Rule 13a-15(d) of the Company's internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) by the Company's management, including its Chief Executive Officer and Chief Financial Officer, no changes during the quarter ended May 31, 2010 were identified that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

In the second quarter of fiscal 2010 we signed an agreement to outsource select accounting transaction-processing activities. This is part of an ongoing initiative to transform our accounting organization to a new model which includes shared services and multiple centers of excellence. The Company's management has concluded that the outsourcing agreement has not materially affected, and is not reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. LEGAL PROCEEDINGS

The information in response to this item is incorporated herein by reference to Note 13 of the Consolidated Condensed Financial Statements of this Quarterly Report.

### Item 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended August 31, 2009 and in Part II, "Item 1A. Risk Factors" in our subsequent Quarterly Reports on Form 10-Q, which could materially affect our business, financial condition or future results.

**We derive a significant portion of our sales from prescription drug sales reimbursed by pharmacy benefit management companies.**

We derive a significant portion of our sales from prescription drug sales reimbursed through prescription drug plans administered by pharmacy benefit management (PBM) companies. PBM companies typically administer multiple prescription drug plans that expire at various times and provide for varying reimbursement rates. If our participation in the prescription drug programs administered by one or more of the large

PBM companies is terminated, we expect that our sales would be adversely affected, at least in the short term. If we are unable to replace any such lost sales, either through an increase in other sales or through a resumption of participation in those plans, our operating results may be materially adversely affected.

## Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- (c) The following table provides information about purchases by the Company during the quarter ended May 31, 2010 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

| Issuer Purchases of Equity Securities |                                      |                              |   |   |
|---------------------------------------|--------------------------------------|------------------------------|---|---|
| Period                                | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced \$2,000 Million Stock Repurchase Program (2) | Approximate Dollar Value of Shares that May Yet Be Purchased Under the \$2,000 Million Stock Repurchase Program (2) |
| 3/1/2010 – 3/31/2010                  | 1,900,727                            | \$ 35.25                     | 1,900,727   | \$ 1,533,005,222  |
| 4/1/2010 - 4/30/2010                  | 1,842,069                            | \$ 36.37                     | 1,842,069   | \$ 1,466,009,675  |
| 5/1/2010 - 5/31/2010                  | 4,486,323                            | \$ 35.05                     | 2,986,323   | \$ 1,361,819,057  |
| Total                                 | 8,229,119                            | \$ 35.39                     | 6,729,119   | \$ 1,361,819,057  |

- (1) The Company purchased 1,500,000 shares of its common stock in open-market transactions to satisfy the requirements of the Company's employee stock purchase and option plans, as well as the Company's Nonemployee Director Stock Plan.
- (2) On October 14, 2009, the Board of Directors authorized a new stock repurchase program ("2009 repurchase program") which replaced the 2007 repurchase program. The 2009 repurchase program allows for the repurchase of up to \$2,000 million of the Company's common stock prior to its expiration on December 31, 2013. The total remaining authorization under the repurchase program is \$1,362 million as of May 31, 2010.

## Item 6. EXHIBITS

### (a) Exhibits

- 3.1 Articles of Incorporation of Walgreen Co., as amended, filed with the Securities and Exchange Commission as Exhibit 3(a) to Walgreen Co.'s Quarterly Report on Form 10-Q for the quarter ended February 28, 1999 (File No. 1-00604), and incorporated by reference herein.
- 3.2 Amended and Restated By-Laws of Walgreen Co., as amended effective as of September 1, 2008, filed with the Securities and Exchange Commission on September 5, 2008 as Exhibit 3.1 to Walgreen Co.'s Current Report on Form 8-K (File No. 1-00604), and incorporated by reference herein.
- 10.1 Separation and Release Agreement, effective April, 2, 2010, between Stanley B. Blaylock and Walgreen Co.
- 12 Computation of Ratio of Earnings to Fixed Charges.
- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.
- 32.2 Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

WALGREEN CO.  
\_\_\_\_\_  
(Registrant)

Dated: 6/28/10    /s/ W.D. Miquelon  
\_\_\_\_\_  
W.D. Miquelon  
Executive Vice President  
(Chief Financial Officer)

Dated: 6/28/10    /s/ M.M. Scholz  
\_\_\_\_\_  
M.M. Scholz  
Controller  
(Chief Accounting Officer)

**Separation and Release Agreement for Stanley B. Blaylock**

This Separation and Release Agreement (“Agreement”) is entered into between the undersigned employee (“Employee”) and Walgreen Co., its parents, subsidiaries, affiliated companies, predecessors, successors and assigns (“Walgreens” or the “Company”), who agree as follows:

**1. Termination Date .**

The parties agree that Employee’s employment with the Company is terminated effective April 2, 2010 (the “Termination Date”).

**2. General Waiver & Release .**

(a) Employee waives and releases any and all claims, known or unknown, arising on or before the date Employee signs this Agreement, that Employee has or might have against the Company, its parents, subsidiaries, affiliated companies, predecessors, successors, and assigns, as well as all of its and their past and present officers, directors, managers, employees, attorneys, and agents (collectively “Released Parties”), subject only to the exceptions identified in paragraph 3 below. These waived and released claims include but are not limited to: (i) claims that in any way relate to Employee’s employment, separation from employment and other dealings of any kind with any Released Party or Parties; (ii) claims of unlawful discrimination, harassment, retaliation or other alleged violations arising under federal, state, local or others laws and regulations, including but not limited to claims arising under the federal Age Discrimination in Employment Act (ADEA); Title VII of the Civil Rights Act of 1964; the Civil Rights Act of 1866; the Employee Retirement Income Security Act (ERISA); the Americans with Disabilities Act (ADA); the Fair Labor Standards Act (FLSA); the Worker Adjustment and Retraining Notification Act (WARN); and the Family and Medical Leave Act (FMLA); (iii) claims of wrongful discharge, emotional distress, defamation, misrepresentation, fraud, detrimental reliance, breach of alleged contractual obligations, promissory estoppel, negligence, assault and battery, and violation of public policy; and (iv) claims for monetary damages, other personal recovery or relief, costs, expenses, and attorneys’ fees of any kind.

(b) Walgreens is not currently aware of any claims or causes of action it may have against Employee.

**Claims and Rights Not Waived or Released .**

The only claims not waived and not released by Employee under paragraph 2 are (i) claims arising after the date that Employee signs this Agreement; (ii) any claim that as a matter of law cannot be waived; and (iii) claims for vested benefits and all benefits that are specifically described and provided for in this Agreement. In addition, nothing in this Agreement shall affect or interfere with Employee’s right to participate, cooperate, initiate or assist in an investigation or proceeding conducted within the Company or by any government agency, oversight board, commission or other regulatory or investigative body. Again, however, Employee is waiving and releasing all rights to recover money or other individual relief in connection with any investigation or proceeding related to claims covered by paragraph 2 above (General Waiver & Release).

**3. No Disparagement .**

Employee will not make derogatory statements, either written or oral, or otherwise disparage any Released Party or Walgreens products or services, except as may be required to be permitted by law. Nor shall Employee direct, arrange or encourage others to make any such derogatory or disparaging statements on Employee’s behalf. Walgreens CEO and Corporate Officers will not make, and will cause others not to make on their behalf, derogatory statements, either written or oral, or otherwise disparage Employee, except as may be required or permitted by law.

**4. Return of Company Property .**

Employee agrees that he has returned all Company property, and no Company property has been retained by the Employee, regardless of the form in which it was acquired or held by Employee; provided, however, that the Company acknowledges and agrees that Employee’s cellular phone and cellular phone number (410-336-9236) are the property of Employee and not the property of Walgreens and that Walgreens will take all reasonable action to assist Employee to transfer Employee’s cellular phone number from a corporate account owned by the Company to Employee’s personal account.

**5. Restrictive Covenants .**

Employee is subject to the Non-Competition, Non-Solicitation and Confidentiality provisions attached hereto as Exhibit B (the “Walgreens Non-Compete”).

**6. Non-Admissions .**

Nothing in this Agreement constitutes or shall be portrayed or regarded as an admission of any wrongdoing, fault, violation, liability, or unlawful activity by the Company, Employee or any Released Party.

**7. Cooperation .**

Subject to paragraph 3 above and upon reasonable prior notice, Employee agrees to fully and completely cooperate with the Company and its

agents and representatives during and in connection with all litigation, potential litigation, and internal or external investigations in which the Company is involved or may become involved, subject to reimbursement of reasonable travel expenses if travel is requested.; provided, however, that the Company acknowledges that the application of Section 3 and this Section 7 shall be subject to any future employment of Employee and that the Company acknowledges and agrees that it will endeavor to accommodate Employee in such regard. During the 18-month severance period Employee's assistance hereunder shall be without additional compensation. Thereafter, the Company shall provide reasonable compensation to Employee for time required providing litigation assistance except for litigation matters where Employee is a named party to the litigation. In such cases, no additional compensation will be provided to Employee.

#### **8. Non-Inducement .**

Employee agrees that he will not directly or indirectly assist or encourage any person or entity in carrying out any activity that would be prohibited by the provisions of this Agreement if such activity were carried out by Employee.

#### **9. Separation Payments .**

In exchange for Employee's obligations to Walgreens under this Agreement, including the Release and Waiver, Walgreens agrees to pay Employee the Separation Benefits set forth in the attached Exhibit A . Employee acknowledges that these Separation Benefits are in full settlement of any severance rights he may have under the Medmark Severance Agreement.

#### **10. Indemnification .**

Walgreens agrees to indemnify Employee, to the fullest extent permitted by law, for any and all acts occurring during the course of his employment, including for any and all claims brought after the Termination Date. Walgreens acknowledges that Employee is and will remain covered by the Company's director and officer insurance policy for any and all acts up to and through the Termination Date.

#### **11. Alternative Employment .**

Employee's benefits hereunder shall not be subject to offset or reduction in the event Employee obtains alternate employment or income, nor shall Employee be under any obligation of mitigation in connection with the benefits to be paid under this Agreement.

#### **12. [Reserved]**

#### **13. No Assignment by Employee .**

Employee represents and warrants that Employee has not sold, assigned, transferred, conveyed, or otherwise disposed of any claim covered by paragraph 2 above (General Waiver Release) and that Employee has the sole right and exclusive authority to execute this Agreement on Employee's behalf.

#### **14. Severability .**

In the event that any portion of this Agreement is held by a court of competent jurisdiction to be invalid or unenforceable, the invalid or unenforceable portion shall be construed or modified in a manner that gives force and effect, to the fullest extent possible, to all other portions and provisions of this Agreement. If any invalid or unenforceable portion of any provision in this Agreement cannot be construed or modified to render it valid and enforceable, that portion shall be construed as narrowly as possible and shall be severed from the remainder of this Agreement, and the remainder of this Agreement (including the remainder of the section, paragraph, subparagraph or sentence containing any invalid or unenforceable words) shall remain in effect to the fullest extent possible.

#### **15. OWBPA Provisions – Additional Understandings .**

In compliance with the Older Workers Benefit Protection Act ("OWBPA"), the Company and Employee agree to the following:

- (a) **Understandability** . This Agreement is written in a manner calculated to be understood by the Employee, and Employee understands all terms of this Agreement;
- (b) **Age Discrimination (ADEA) Waiver** . This Agreement includes a waiver and release of claims under the Age Discrimination in Employment Act (ADEA) as described in paragraph 2 above;
- (c) **No Future Waiver** . This Agreement only waives and releases claims and rights arising prior to the date Employee signs this Agreement;
- (d) **Valid Consideration** . In exchange for Employee's release and waiver as part of this Agreement, Employee acknowledges that he/she is receiving adequate consideration in the form of Separation Payments as described herein that exceed those to which Employee is entitled apart from this Agreement.
- (e) **Employee Advised to Consult with an Attorney** . By this Agreement, the Company advises Employee to consult with an attorney before signing this Agreement;
- (f) **Period to Consider this Agreement** . Employee has been given a period of 21 calendar days in which to consider this Agreement, and

to decide whether he wishes to sign it;

- (g) **Period to Revoke Agreement** . After Employee signs this Agreement, Employee has 7 calendar days in which Employee can change his mind and revoke this Agreement. Walgreens and Employee agree that, to revoke this Agreement, Employee must notify Walgreens in writing that Employee is revoking this Agreement. Any such notice of revocation must be received by Mark Wattley, Divisional Vice President, within the 7-day period; Mail: 1411 Lake Cook Road M.S. #L414, Deerfield, Illinois 60015 Fax: (847) 964-6492 Email: mark.wattley@walgreens.com
- (h) **Effective Date** . This Agreement shall not become effective or enforceable until the 7-day revocation period described above has expired with no revocation by Employee.

**16. Governing Law .**

The laws of the State of Illinois shall govern the validity, performance, enforcement, interpretation and any other aspect of this Agreement, notwithstanding any state's choice of law provisions to the contrary.

**17. Binding Effect .**

This Agreement shall be binding upon and inure to the benefit of Employee and the Company and his and its respective heirs, executors, successors, agents and representatives.

**18. Counterparts and Facsimile Signatures .**

This Agreement may be executed in counterparts which, taken together, constitute a single, enforceable instrument.

**19. Complete Agreement .**

This Agreement (including without limitation the Walgreens Non-Compete which is attached hereto as Exhibit B ) constitutes the parties' entire agreement and cancels, supersedes, and replaces any and all prior proposals, understandings, and agreements (written, oral or implied) regarding all matters addressed herein, including without limitation the Medmark Severance Agreement and any other Non-Competition, Non-Solicitation and Confidentiality Agreement Employee may have executed with the Company. The terms of this Agreement (including without limitation the Walgreens Non-Compete which is attached hereto as Exhibit B ) may not be altered or modified except by written agreement of the Employee and the Company. In connection with this Agreement's acceptance and execution, neither Employee nor the Company is relying on any representation or promise that is not expressly stated in this Agreement.

**20. Full Knowledge and Authority to Sign .**

Other than as stated herein, Employee and Walgreens attest that each of them has the authority to enter into this Agreement (including the provisions set forth on Exhibit A and Exhibit B hereto), that no promise or inducement other than as stated herein has been offered for this Agreement, that they are legally competent to execute this Agreement, and that they accept the full responsibility therefor. Walgreens further acknowledges that the individual set forth below has full corporate power and authority to execute this Agreement on behalf of the Company and to bind the Company in all respects.

Entered and Agreed to:

Dated: \_\_\_\_\_  
Stanley B. Blaylock

Walgreen Co.

By: \_\_\_\_\_  
Mark A. Wattley  
Divisional Vice President

**EXHIBIT A**

**Summary of Separation Benefits for Stanley B. Blaylock**

|                      |  |
|----------------------|--|
| Paid Through Date    | June 23, 2010 (the "PTD")  |
| Vacation             | \$131,818.19, paid within 30 days after April 2, 2010  |
| Severance            | \$900,000 (less tax withholdings and benefit deductions); represents 18 months of base salary; paid in monthly installments, in accordance with the Company's normal payroll processes, over the course of the 18-month severance period beginning after April 2, 2010.  |
| Fiscal 2010 Bonus    | Pro-rated bonus for the portion of the fiscal year ending on the PTD, to be paid when FY2010 bonuses are paid (the "Bonus"); <u>provided</u> , <u>however</u> , that the Bonus shall be calculated in the same manner as it is calculated for other comparable senior executives who remain employed by the Company; <u>provided</u> , <u>further</u> , that if the Company pays a bonus to a majority of the Corporate Officers of the Company for FY2010, then the Company shall be required to pay the Bonus to Employee.   |
| Benefits             | If Blaylock, his spouse and all dependent children enroll in COBRA, all medical, prescription and/or dental, premiums will be subsidized such that Blaylock only pays the premium rates that are in effect for all other active employees who select the same coverage as Blaylock and his family. The Company acknowledges that even upon the death of Blaylock, it will continue the coverage for Blaylock's spouse and all dependent children on the same terms and conditions.   |
| Long-Term Incentives | A pro-rated portion of the not yet vested long-term incentive awards listed below will become vested and distributed based on service through the PTD as set forth on <u>Exhibit C</u> . All other long-term incentive awards will be forfeited as of the PTD. <ul style="list-style-type: none"> <li>• Restricted stock awards granted in April 2007 and April 2008.</li> <li>• Restricted cash and restricted stock granted for fiscal years 2007 and 2008 under the former Restricted Performance Share Program.</li> <li>• Restricted stock units granted on September 1, 2008 and September 1, 2009.</li> </ul> |
| Outplacement         | Up to 12 months of executive-level outplacement with Challenger, Gray and Christmas.   |

## EXHIBIT B

### WALGREEN CO. NON-COMPETITION, NON-SOLICITATION AND CONFIDENTIALITY AGREEMENT

This Exhibit forms a part of the Separation and Release Agreement (the "Separation Agreement") between Stanley B. Blaylock and Walgreen Co. or one of its subsidiary companies (hereinafter referred to as "Employee" and the "Company").

WHEREAS, the Company develops and/or uses valuable business, technical, proprietary, customer and patient information it protects by limiting its disclosure and by keeping it secret or confidential;

WHEREAS, Employee acknowledges that during the course of employment, he has or will receive, contribute, or develop such confidential information; and

WHEREAS, the Company desires to protect from its competitors such confidential information and also desires to protect its legitimate business interests and goodwill in maintaining its employee and customer relationships.

NOW THEREFORE, in consideration of his initial employment offer with the Company, the restricted stock unit awards issued to Employee and the compensation and benefits provided pursuant to the Separation Agreement to which this is attached as Exhibit B, Employee agrees to the following:

#### **1. Non-Disclosure And Non-Use**

Employee agrees not to disclose any Confidential Information, as defined below, to any person or entity other than the Company, either during or after Employee's employment, without the Company's prior written consent. Employee further agrees not to use any Confidential Information, either during or at any time after his employment, without the Company's prior written consent, except as may be necessary to perform his job duties during employment with the Company. In the event Employee is required to disclose any Confidential Information by law, Employee will provide the Company with prompt written notice of any such requirement and provide reasonable cooperation to the Company so that the Company may seek a protective order or other appropriate remedy. The Company acknowledges and agrees that any disclosure of Confidential Information by Employee as required by law shall not be a breach of the Separation Agreement, including this Exhibit B, provided that Employee has provided the required notice to the Company, if possible.

Confidential Information means information not generally known by the public about processes, systems, products, services, including proposed products and services, business information, know-how, or trade secrets of the Company. Confidential Information includes, but is

not limited to, the following:

- (a) Customer records, identity of vendors, suppliers, or landlords, profit and performance reports, prices, selling and pricing procedures and techniques, and financing methods of the Company;
- (b) Customer lists and information pertaining to identities of the customers, their special demands, and their past, current and anticipated requirements for the products or services of the Company;
- (c) Specifications, procedures, policies, techniques, manuals, databases and all other information pertaining to products or services of the Company, or of others for which the Company has assumed an obligation of confidentiality;
- (d) Business or marketing plans, accounting records, financial statements and information, and projections of the Company;
- (e) Software developed or used by the Company;
- (f) Information related to the Company's retailing, distribution or administrative facilities; and
- (g) Any other information identified or defined as confidential information by Company policy.

Notwithstanding anything to the contrary contained herein, Confidential Information does not include, the following:

- (a) information which becomes available to the public from a source other than the Employee and through no fault of Employee;
- (b) information that is legally obtained by the Employee at any time from other sources who are not subject to confidentiality restrictions;
- (c) information that came into Employee's possession prior to or independent of his employment relationship with the Company; and
- (d) information that consists of general industry knowledge.

## **2. Non-Competition and Non-Solicitation .**

In order to protect the legitimate business interests and goodwill of the Company, and to protect Confidential Information, Employee covenants and agrees that for the entire period of his employment with the Company, and for a period of 18 months commencing on April 3, 2010, (the "Non-Compete Period"), Employee will not:

- (a) contact any Customer of the Company for the benefit of a Competing Business or interfere with, or attempt to disrupt the relationship, contractual, or otherwise, between the Company and any of its Customers.
- (b) hire employees of the Company. This restriction includes without limitation a prohibition on Blaylock directly or indirectly employing, or knowingly permitting any Person or business directly or indirectly controlled by Blaylock, regardless of whether such Person or business is a Competing Business, from employing, any person employed by the Company as of January 1, 2010.
- (c) solicit employees of the Company. This restriction includes without limitation a prohibition on directly or indirectly (i) interfering with, or attempting to disrupt the relationship, contractual, or otherwise, between the Company and any of its employees, and (ii) soliciting, inducing, or attempting to induce employees of the Company to terminate employment with the Company. The foregoing non-solicitation provision shall not be applicable to general solicitations in newspapers, trade magazines, internet job sites or other similar media not specifically targeting employees of the Company, and any hiring resulting therefrom.
- (d) compete with the Company. This restriction includes without limitation a prohibition on directly or indirectly engaging or investing in, owning, managing, operating, financing, controlling, participating in the ownership, management, operation, financing or control of, or being associated or in any manner connected with, any Competing Business, whether as a consultant, independent contractor, agent, employee, officer, partner, director, shareholder (except (i) limited partnership investments in private equity funds which may invest in venture capital-backed companies (where Employee's investment represents less than 1% percent ownership interest of any such company) or (ii) investments of less than 1% ownership interest of the outstanding securities of a corporation or other entity whose securities are listed on a stock exchange or quotation system and such entity files periodic reports with the Securities and Exchange Commission), distributor, representative, or otherwise, alone or in association with any other Person(s). Notwithstanding the foregoing, Employee may render services for a Competing Business if: such service does not conflict with any other restrictions noted in this Paragraph 2; the Competing Business is diversified, and Employee becomes employed in a part of the business that is not in direct or indirect competition with Company; and, prior to the Employee beginning employment with the Competing Business, the Company receives written assurances from Employee, that Employee will not render services directly or indirectly in connection with any product, system, service, or process of any person or organization which is the same as, comparable to, or competes directly or indirectly with a product, system, service, or process of the Company.

Employee further acknowledges and agrees that for a 12 month period commencing after the Non-Compete Period, Employee shall not consult with, or accept employment with (a) CVS/Caremark, (b) Express Scripts, or (c) Medco Health Solutions, or any successors thereto of the foregoing corporations, nor shall Employee provide services on behalf of the foregoing corporations with respect to the pricing or negotiation of network pharmacy contracts.

Employee agrees that the restrictions contained in paragraphs 2(a), 2(b) and 2(c) have no geographic limitation. Employee agrees that the restrictions contained in Paragraph 2(d) are geographically limited to (a) the entirety of the United States and (b) any other country if the Company conducts business within such country at any time during Employee's employment with the Company.

Employee acknowledges that (i) the Company's business is and following the date hereof will be national in scope, (ii) the Company's products and services are and following the date hereof will be marketed throughout the United States and (iii) the Company has competed and following the date hereof will compete with other businesses that are or could be located in any part of the United States. Employee further covenants and agrees that restrictive covenants contained in this Agreement are reasonable and necessary to protect the legitimate business interests of the Company because of the nature and scope of the Company's business.

If a court or arbitrator of competent jurisdiction determines that one or more of the provisions of this Paragraph 2 are invalid, illegal, or unenforceable for any reason, then such provision or provisions shall be deemed to be reduced in scope or length, as the case may be, to the extent required to make this Paragraph enforceable. If Employee violates the provisions of this Paragraph 2, the periods described therein shall be extended by that number of days which equals the aggregate of all days during which at any time any such violations occurred.

For purposes of this Paragraph 2, the following definitions shall apply:

- (1) "Competing Business" means any business engaged in by any Person that is in competition with any business engaged in by the Company ("Company Business") during the term of Employee's employment with the Company; provided that the foregoing shall only apply to any Company Business with respect to which Employee possesses Confidential Information and was substantially engaged or was active in the management of such business during Employee's employment with the Company.
- (2) "Customer" means any patient or other customer or prospective customer of any Company business unit with respect to which Employee was substantially engaged or was active in the management of such business during Employee's employment with the Company.
- (3) "Person" means any individual, corporation, partnership, limited liability company or other entity.

### **3. Non-Inducement .**

Employee agrees that during the term of his employment and for one year following the Employee's termination of employment, Employee will not directly or indirectly assist or encourage any Person or entity in carrying out any activity that would be prohibited by the provisions of this Agreement if such activity were carried out by Employee.

### **4. [Reserved].**

### **5. Consideration and Acknowledgments .**

Employee acknowledges and agrees that the covenants described in Paragraphs 1 through 3 of this Agreement are essential terms, and the underlying restricted stock unit award and the Separation Payments under the Separation and Release Agreement would not be provided by the Company in the absence of these covenants. Employee further acknowledges that these covenants are supported by adequate consideration as set forth in this Agreement, that full compliance with these covenants will not prevent Employee from earning a livelihood following the termination of his employment, and that these covenants do not place undue restraint on Employee and are not in conflict with any public interest. Employee further acknowledges and agrees that Employee fully understands these covenants, has had full and complete opportunity to discuss and resolve any ambiguities or uncertainties regarding these covenants before signing this Agreement, that these covenants are reasonable and enforceable in every respect, and has voluntarily agreed to comply with these covenants for their stated term. Employee agrees that in the event he is offered employment with a Competing Business at any time in the future, Employee shall immediately notify the Competing Business of the existence of the covenants set forth in Paragraphs 1 through 3 above.

### **6. Enforcement of This Agreement .**

Employee acknowledges that compliance with the covenants set forth in Paragraphs 1 through 4 of this Agreement is necessary to enable the Company to maintain its competitive position, and that any actual or threatened breach of these covenants will result in irreparable and continuing damage to the Company for which there will be no adequate remedy at law. In the event of any actual or threatened breach of these covenants, the Company shall be entitled to injunctive relief, including the right to a temporary restraining order, and other relief. The foregoing stipulated remedies of the Company are in addition to, and not to the exclusion of, any other damages the Company may be able to prove. In addition, if any court shall at any time hold these covenants to be unenforceable or unreasonable in scope, territory or period of time, then the scope, territory or period of time of the covenants shall be that determined by the court to be reasonable. Employee consents to the jurisdiction of the Circuit Court of Lake or Cook County, Illinois for purposes of the enforcement of this agreement.

### **7. Notification .**

Employee further agrees that the Company may notify anyone later employing him of the existence and provisions of this Agreement; provided, however, that prior to any notification, the Company shall be required to provide Employee with an advance copy of such correspondence.

## **Exhibit C**

**Stan Blaylock**

Last day Worked 4/2/2010

Paid-Through 6/23/2010

Date

|                  | Grant Date        | Vest Date | Initial Grants |           | Prorate Based on Paid-Through Date |           |            |  |
|------------------|-------------------|-----------|----------------|-----------|------------------------------------|-----------|------------|--|
|                  |                   |           | Shares         | Cash      | #                                  | Stk Price | Value      |  |
| RSU Grant        | 9/1/2008          | 8/31/2011 | 8,303          |           | 5,074                              | \$ 35.00  | \$ 177,592 | Vests over 36 months                       |
|                  | 9/1/2009          | 8/31/2012 | 10,374         |           | 2,882                              | \$ 35.00  | \$ 100,858 | Vests over 36 months                       |
| Restricted Stock | 4/13/2007         | 4/13/2010 | 2,000          |           | 2,000                              | \$ 35.00  | \$ 70,000  | Grant distributed before paid-through date |
|                  | 4/13/2007         | 4/13/2011 | 2,000          |           | 1,583                              | \$ 35.00  | \$ 55,417  | vests over 48 months                       |
|                  | 4/13/2007         | 4/13/2012 | 2,000          |           | 1,267                              | \$ 35.00  | \$ 44,333  | Vests over 60 months                       |
|                  | 4/9/2008          | 4/9/2011  | 1,333          |           | 963                                | \$ 35.00  | \$ 33,695  | Vests over 36 months                       |
|                  | 4/9/2008          | 4/9/2012  | 1,333          |           | 722                                | \$ 35.00  | \$ 25,271  | Vests over 48 months                       |
|                  | 4/9/2008          | 4/9/2013  | 1,334          |           | 578                                | \$ 35.00  | \$ 20,232  | Vests over 60 months                       |
|                  |                   |           |                |           |                                    |           |            |  |
| RPSP             | Cash Fiscal 2007  | 8/31/2010 |                | \$ 7,994  |                                    |           | \$ 7,550   | Vests over 36 months                       |
|                  | Stock Fiscal 2007 | 8/31/2010 | 161            |           | 152                                | \$ 35.00  | \$ 5,322   | Vests over 36 months                       |
|                  | Cash Fiscal 2007  | 8/31/2011 |                | \$ 7,994  |                                    |           | \$ 5,662   | Vests over 48 months                       |
|                  | Stock Fiscal 2007 | 8/31/2011 | 162            |           | 114                                | \$ 35.00  | \$ 3,991   | Vests over 48 months                       |
|                  | Cash Fiscal 2008  | 8/31/2010 |                | \$ 10,359 |                                    |           | \$ 9,496   | Vests over 24 months                       |
|                  | Stock Fiscal 2008 | 8/31/2010 | 229            |           | 210                                | \$ 35.00  | \$ 7,347   | Vests over 24 months                       |
|                  | Cash Fiscal 2008  | 8/31/2011 |                | \$ 10,359 |                                    |           | \$ 6,331   | Vests over 36 months                       |
|                  | Stock Fiscal 2008 | 8/31/2011 | 230            |           | 141                                | \$ 35.00  | \$ 4,919   | Vests over 36 months                       |
|                  | Cash Fiscal 2008  | 8/31/2012 |                | \$ 10,359 |                                    |           | \$ 4,748   | Vests over 48 months                       |
|                  | Stock Fiscal 2008 | 8/31/2012 | 230            |           | 105                                | \$ 35.00  | \$ 3,690   | Vests over 48 months                       |
|                  |                   |           |                |           |                                    |           |            |  |
|                  |                   |           |                |           |                                    |           |            |  |
|                  |                   |           |                |           |                                    |           |            |  |
|                  | Totals            |           |                | 29,689    | \$ 47,065                          | 15,791    |            | \$ 586,455                                 |

( 1) Dollar value of shares is an estimate based on the indicated stock price.

|               | Grant Date | Vest Date  | # Shares |                         |
|---------------|------------|------------|----------|-------------------------|
| Stock Options | 8/1/2006   | 8/1/2009   | 534      | Option Price is \$46.78 |
|               | 9/1/2006   | 9/1/2009   | 6,065    | Option Price is \$49.46 |
|               | 10/31/2006 | 10/31/2008 | 572      | Option Price is \$43.68 |
|               | 1/8/2007   | 1/8/2010   | 697      | Option Price is \$45.50 |
|               | 9/1/2007   | 9/1/2010   | 13,545   | Option Price is \$45.07 |
|               | 10/9/2007  | 10/9/2010  | 4,325    | Option Price is \$39.19 |
|               | 9/1/2008   | 8/31/2011  | 33,214   | Option Price is \$36.43 |
|               | 9/1/2009   | 8/31/2012  | 41,497   | Option Price is \$34.04 |

WALGREEN CO. AND SUBSIDIARIES  
COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

|   | Nine Months Ended |                 |
|---|-------------------|-----------------|
|   | 5/31/2010         | 5/31/2009       |
| Income before income taxes and minority interest          | \$ 2,643          | \$ 2,485        |
| Add:  |                   |                 |
| Minority interest   | -                 | -               |
| Fixed charges   | 808               | 733             |
| Less: Capitalized interest                                | (9)               | (12)            |
| Earnings as defined                                       | <u>\$ 3,442</u>   | <u>\$ 3,206</u> |
| Interest expense, net of capitalized interest             | \$ 67             | \$ 60           |
| Capitalized interest                                      | 9                 | 12              |
| Portions of rentals representative of the interest factor | 732               | 661             |
| Fixed charges as defined                                  | <u>\$ 808</u>     | <u>\$ 733</u>   |
| Ratio of earnings to fixed charges                        | 4.26              | 4.37            |

## CERTIFICATION

I, Gregory D. Wasson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Walgreen Co.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Gregory D. Wasson President and Chief Executive Officer  
Gregory D. Wasson

Date: June 28, 2010

## CERTIFICATION

I, Wade D. Miquelon, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Walgreen Co.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Wade D. Miquelon Executive Vice President and Chief  
Wade D. Miquelon Financial Officer

Date: June 28, 2010

**CERTIFICATION PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

In connection with the Quarterly Report of Walgreen Co., an Illinois corporation (the "Company"), on Form 10-Q for the quarter ended May 31, 2010 as filed with the Securities and Exchange Commission (the "Report"), I, Gregory D. Wasson, Chief Executive Officer of the Company, certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Gregory D. Wasson  
Gregory D. Wasson  
Chief Executive Officer  
Dated: June 28, 2010

A signed original of this written statement required by Section 906 has been provided to Walgreen Co. and will be retained by Walgreen Co. and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

In connection with the Quarterly Report of Walgreen Co., an Illinois corporation (the "Company"), on Form 10-Q for the quarter ended May 31, 2010 as filed with the Securities and Exchange Commission (the "Report"), I, Wade D. Miquelon, Chief Financial Officer of the Company, certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Wade D. Miquelon  
Wade D. Miquelon  
Chief Financial Officer  
Dated: June 28, 2010

A signed original of this written statement required by Section 906 has been provided to Walgreen Co. and will be retained by Walgreen Co. and furnished to the Securities and Exchange Commission or its staff upon request.