

Appointment

From: Watts, Colin F. [/O=WALGREENS/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/CN=F0234C7F-DD27-462E-BC07-178DC56F5385]
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Subject: Beta Executive Review (8:00-9:00 CST)
Location: Telepresence - 108 3rd Floor
Start: 12/9/2011 2:00:00 PM
End: 12/9/2011 3:00:00 PM
Show Time As: Busy

Required Attendees: Miquelon, Wade D.; Crawford, Kermit R.; Zimmerman, Robert G.; Vainisi, Mark E.; Doyle, Daniel F.; Reutzel, Erich T.; Romanski, Kimberly A.; Corwin, Mitchell P.; Rosan, Jay; Cantlin, John P.; Kang, Jeffrey L.

If you need to connect remotely, please use the following numbers:

Colin PIN

Hi All,

Attached is the Beta presentation for our Beta Executive Review meeting on Friday morning at 8am.

Given that we haven't had a detailed executive review of Beta for some time we thought it was important to give you a level of depth on what has been occurring over the past several months as well as an overall recommendation. To that end the deck is relatively lengthy, so we plan on hitting the high points on some slides and diving into detail on specific topics as needed.

Beta Senior Mgmt Presentation Dec. 2011 Main vfinal.potx

We look forward to the meeting on Friday and a good discussion.

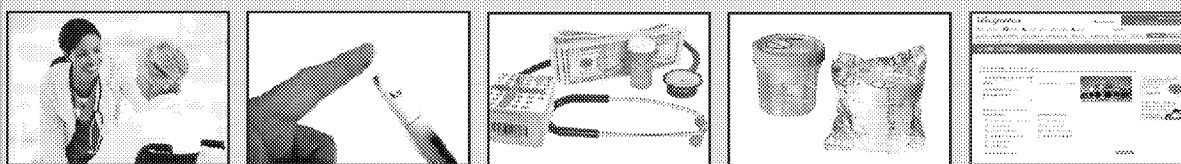
Take Care,

Kim Romanski & Colin Watts

Project Beta DRAFT

Senior Management Presentation

December 9, 2011



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Agenda



- Health and Wellness Strategy
- Theranos Update
- Walgreens Laboratory Services Strategic Plan
- Next Steps

Health and Wellness Strategy



Advance community pharmacy to play a greater role in healthcare through integration and expanded services

Enterprise Health and Wellness Strategic Goals

- Advance Walgreens NP and RPh services to primary care
- Align Walgreens services and programs with physicians
- Take advantage of gain sharing opportunity

Laboratory Services Strategic Goals

- Use laboratory services as an enabler for Walgreens as a primary care destination
- Leverage Walgreens strengths to provide convenient and efficient lab services
- Use laboratory testing, data and delivery of test results as a tool to enhance other services
- Establish laboratory services as financially viable business

Lab Services Executive Summary



	Consumer Ordered Testing		Physicians & Consumer Ordered Testing	
	A. Wait for Technology	B. Health Testing	C. Regional Partnership / WAG Access	D. Walgreens Lab – Acquire/JV
			← Continuum of Partnership to Acquisition →	
Addressable Market	TBD	\$1.9B	\$4B	\$20-25B
Walgreens Share	TBD	\$95M	\$200M	\$1B
Strength of Business Model	High Potential	Medium	Low	High
Investment Level (Capital + Start-up Losses)	TBD	\$	\$\$	\$\$\$
Risk Level	High Uncertainty	Low	Medium	High

Recommendation

- **Learn:** Experiment in the near term with a hospital partner to provide laboratory services
- **Be a Lab:** Target laboratories for Joint Venture/ Acquisition in order to realize strategic and financial potential
- **Systematically nourish** new point of care technology that aligns with Walgreens vision

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Theranos Update – New Point of Care Technology



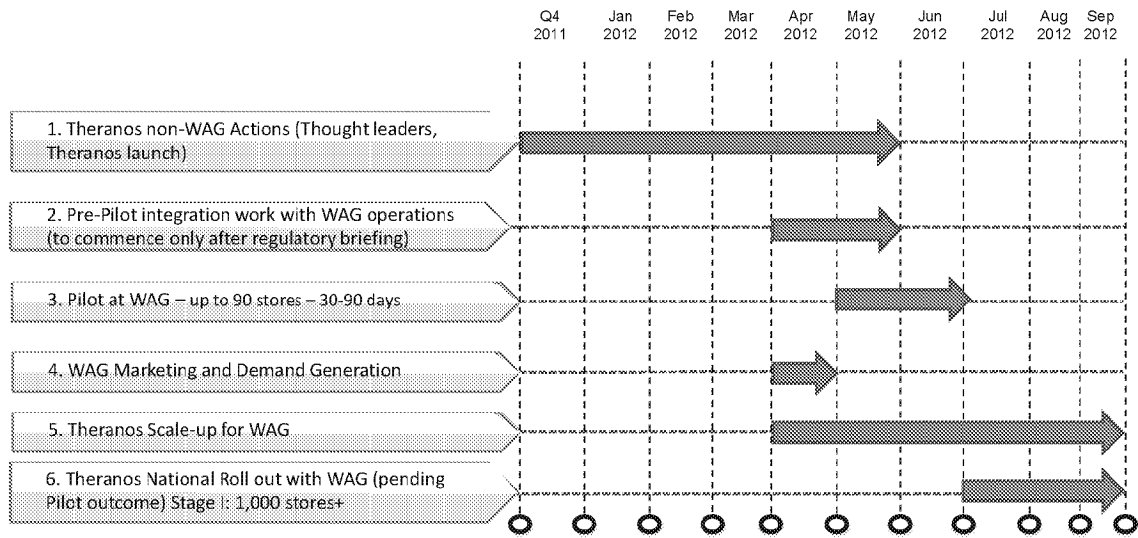
Retained rights to existing contract

- Equity Investment: Walgreens may choose to make an equity investment in Theranos: the right to convert \$25mm of prepayments into convertible securities equating to 2.7% of the company's equity (post-money valuation of \$932mm)
- Walgreens retains an option to launch with Theranos
- Contract expires July 30, 2013

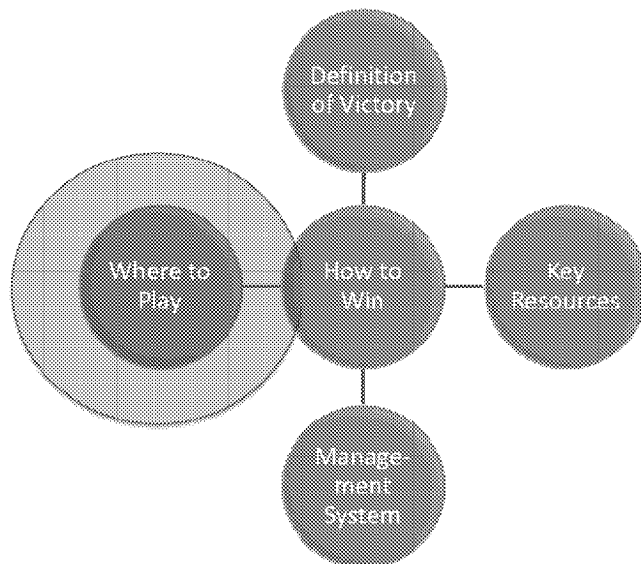
Amendment discussions will begin when the following milestones are achieved

- Theranos is piloting in key thought leaders
- Theranos shares laboratory information with Walgreens
- Theranos has regulatory approval discussions with the FDA and OIG

Proposed Theranos-WAG Timeline Draft based on 10/11 Contract Discussions



Why Laboratory Services



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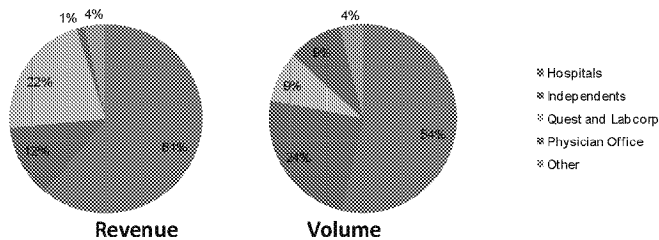
Industry Economics



Overall Industry

- Lab Industry: \$60B , 7.7B Tests in 2009
- 10 Yr Forecasted Avg Yearly Growth: 7-8%/year

Market Share



Consumer Ordered

- Market: \$1.9B
- WAG Health Testing Goal: \$95M (5%)

Physician Ordered

- Market: \$58.1B
- WAG Addressable Market: \$20-\$25B

Notable Trends with Key Players

- Hospitals: Segment has highest reimbursement rates, using 'outreach' to get more test volume
- Independents: Some starting up, differentiating based on service, access is an issue
- Quest & LabCorp: Primarily growth through acquisition of specialty labs, acquisitions 'tapped out'
- Physician office: Decreasing growth due to reimbursement and regulatory pressures
- Specialty Labs: Fastest growing segment, small volume, highest prices, access is an issue

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Highlight Players Trends

National Labs – Quest & LabCorp – slow growth, acquisitions 'tapped out'

Hospital – Inpatient & Outpatient – push to capture volume at higher prices

Regional labs – fewer but some starting up

Anatomic pathology/Cancer Testing – starting up, faster growing

Specialty Lab – starting up, fast growing

Industry Trends & Issues



- Performing routine tests alone is a commodity business
 - Challenge for labs to add services
 - Challenge to fit into ACOs due to the lack of clinical care at the point of testing
 - New entrants
- Payor Reimbursement and Billing
 - Pending legislation for copays
- Trend towards providing patients direct access to their test results
- New Technology
 - Molecular technology is rapidly growing
 - Point of Care technology timing is unclear
- Challenge with access to patients

Unexpected New Entrants

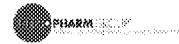
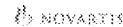


Companies outside of the laboratory testing space have entered to leverage services and testing and offer alternative health care delivery models

- **CVS Caremark** strategic investment in **Generation Health**
- **Medco** buys **DNA Direct**
- **Walmart** released an RFI for healthcare vendor/partners
- **Nestle** buys **Prometheus Diagnostics**
- **Debiopharm Group™** and **Biocartis** partner
- **Novartis** acquires **Genoptix, Inc.**

Key Takeaways:

- Lab testing is being added to existing services
- Acquisitions are being used as a channel to bring new technology/tests to market
- Lab testing will help get access to physicians as part of clinical workflow
- Pharma's using technology companies to speed the launching of drugs
 - Clinical Trials, REMS
- All companies face the same challenges which is access



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Remove detail lines and add a conclusion and emphasizing, in general, Why entering

Adding lab testing to other services

Using as a channel to bring new technology/tests to market

Get access to physicians as part of clinical workflow

Faster launching of drugs

-Challenge for all - access

Why Walgreens Should Do Laboratory Testing



Large, existing market in an industry primed for new models

- Hard for existing traditional players to modify models and add services

Creates a new connection for Walgreens to the Physician and ACO's as part of the clinical flow for diagnosis and treatment of patient

- Enables a foundation for current and future Walgreens Healthcare Services

Laboratory testing can play a fundamental role in delivering an integrated care model

- Combining pharmacy and lab testing can be game changer in convenience
- Enables new services combining lab and pharmacy especially for the chronic patient

Entering now creates a platform for launching new point of care technologies

- Having established Walgreens as a lab testing destination will accelerate adoption of new technologies when they are ready

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Laboratory Services – How To Win



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How Walgreens Will Win



Provide Convenient Patient Access

- Higher quality locations
- Better hours that fit into patients lives
- Provide a better consumer experience by combining pharmacy and lab testing

Percent of Total population within PSC/Stores			
	LabCorp	Quest	Walgreens
1 Mile	4%	6%	26%
2 Miles	12%	18%	52%
3 Miles	21%	31%	63%
5 Miles	36%	48%	74%
10 Miles	55%	64%	84%

Enables Walgreens to be a more comprehensive center of care

- Decide that Walgreens can use laboratory results in store to provide pharmacists counseling in conjunction with prescriptions
- High volume of new clinical encounters

Offer competitive lab services to payors and providers

- Provide competitive pricing level for “full routine testing menu”
- Capturing patient volume will reduce “leakage” to hospitals for payors
- Match services for lab test ordering, resulting, billing with emphasis on stores as patient service centers

The top 10 reason Kaisers members use their EHR:	
1.	Test Results
2.	Appointments
3.	E-mail My Doctor
4.	Prescription Refill
5.	Facility Directory
6.	Past Visit Information
7.	Health Encyclopedia
8.	Medical Staff Directory
9.	Act for a Family Member
10.	My Prescriptions

Take advantage of beneficial economics for patient access

- Efficiency of variable labor for phlebotomy and management of patient services
- Efficiency in sales and marketing of Walgreens overall services
- Synergy of pharmacist or other coaches for new lab-enabled services

When ready, Point of Care technology amplifies the impact

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Potential Value To Other Services



Existing Services	How Laboratory Services Contributes
HSS	Supports discharge solutions for hospitals/ACO requires lab testing
Specialty	Increases clinical encounters for retail medications and identifies new specialty patients
Adherence	Increases clinical encounters and enables use of testing results in counseling
Well Experience	Leverages existing store design and with move to patient lab results enables new pharmacist counseling
Infusion	New revenue opportunity for testing currently sent to Quest or Lab Corp ~1.2M tests per year
Coaching	Creates an additional revenue source for coaching programs
CSG/ESG	Provides additional EBIT to CSG and ESG
NEW Opportunities	
REMS	Enables a more efficient REMS model with Lab + Pharmacist delivered in retail stores
Clinical Trials	Enables option more convenient collection of specimens and identification of participants
Pharmaco/Diagnostics	Enables Companion testing

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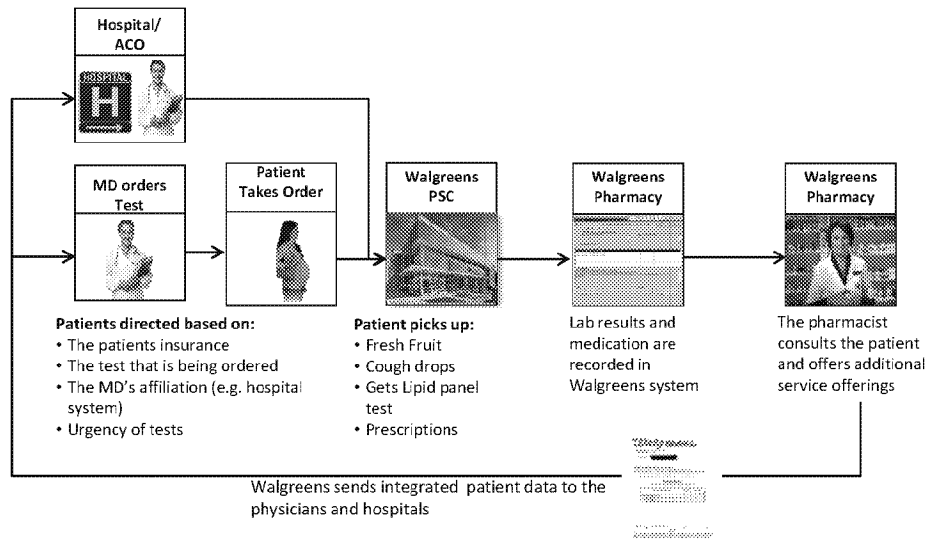
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Walgreens Lab Patient Experience



The Physicians and Patient experience are combined into one seamless process



Laboratory Services – How to Execute



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What Walgreens Needs To Deliver



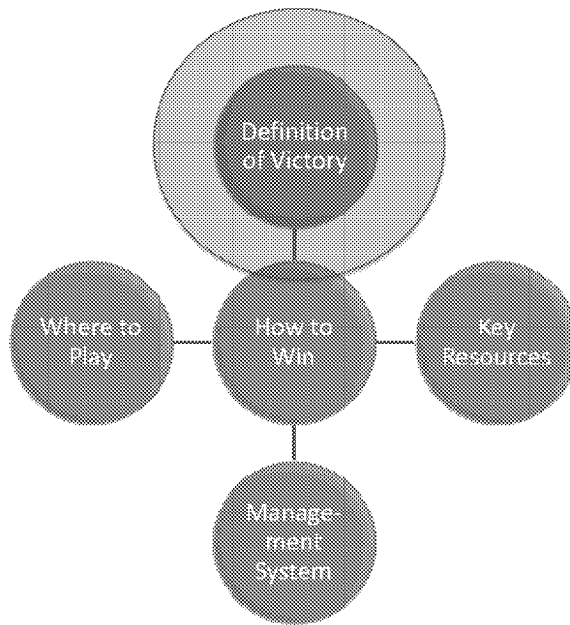
Tapping Into Existing Walgreens Assets	Laboratory Testing Specific Resources
Walgreens Stores: Dedicated 10x10 Space – use existing multi-purpose rooms, takecare clinics, community corner Labor – Use existing staffing structure	Lab specific draw equipment Dual trained labor in phlebotomy
Payor Contracting – Leverage existing sales force	Augment with a national resource with lab-specific payor contracting expertise
Physician Sales/Service – Leverage enterprise physician sales force	Regional resources with lab-specific expertise, lab account set-up/IT set-up
Health Cloud – Leverage the enterprise solution for integrated healthcare services	Augment for laboratory specific needs
New Capability	Laboratory Testing Logistics

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Laboratory Services – Definition Of Victory



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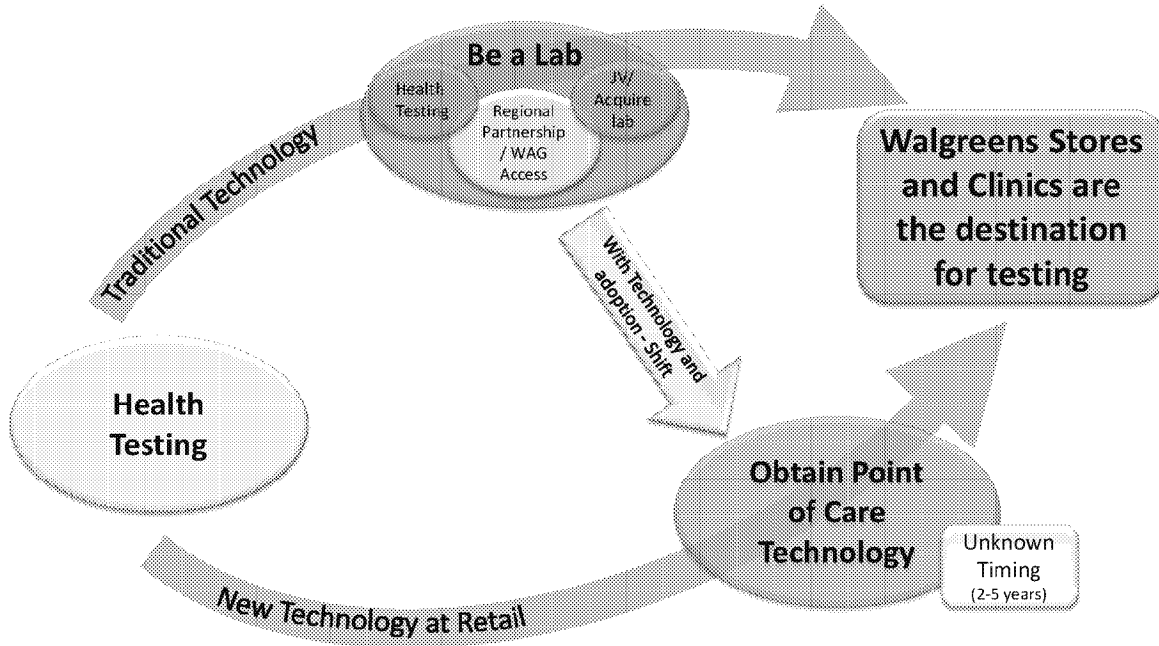
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Opportunities Within Physician Ordered Lab Testing



Be a lab positions Walgreens better and accelerates adoption for new technology.



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Options Considered



	Consumer Ordered Testing		Physicians & Consumer Ordered Testing	
	A. Wait for Technology	B. Health Testing	C. Regional Partnership / WAG Access	D. Walgreens Lab – JV/Acquire
	Wait until the point of care technology has regulatory approval	Continue consumer directed testing with additional offerings	Learn: Experiment in the near term with a hospital partner to provide laboratory services at retail	Be a Lab: Target laboratories for Joint Venture/ Acquisition in order to realize strategic and financial potential
Addressable Market	TBD	\$1.9B	\$4B	\$20-25B
Walgreens Share	TBD	\$95M	\$200M	\$1B
Key Resources	<ul style="list-style-type: none"> Corporate resources to monitor technology 	<ul style="list-style-type: none"> Pharmacy Technician Pharmacist 	<ul style="list-style-type: none"> WAG Phlebotomist Dedicated space IT system 	<ul style="list-style-type: none"> Laboratory WAG Phlebotomist Dedicated space Payor contracts
Business Model	<ul style="list-style-type: none"> Depends on technology, should fit into other business models 	<ul style="list-style-type: none"> Health screenings direct to consumer 	<ul style="list-style-type: none"> Walgreens provides access Partner(s) is the lab Limited connection to payor and physician 	<ul style="list-style-type: none"> Walgreens is the lab JV/Acquire for speed & capabilities Strong connection to payor and physician
Risks	<ul style="list-style-type: none"> Strategic opportunity cost 	<ul style="list-style-type: none"> Strategic opportunity cost 	<ul style="list-style-type: none"> Complex operations and systems to manage Walgreens is marginalized as a distributor Enterprise buy-in 	<ul style="list-style-type: none"> Large upfront investment with a long-term horizon Enterprise buy-in
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Walgreens Option Comparisons



	Regional Partnership / WAG Access		Walgreens Lab JV/Acquire
Positioning	Partner Lab, available at Walgreens		Walgreens Laboratory Services
Payor	<ul style="list-style-type: none"> Partner has contract not WAG WAG gets paid by partner: \$10-\$15/draw 		WAG has payor contract
Provider	<ul style="list-style-type: none"> Account set-up by partner Order and Results to partner WAG promotes a lab access 		WAG is the lab so sets up accounts, receives order and delivers results
Patient	<ul style="list-style-type: none"> Results come from partner Service level dependent on partner 		WAG delivers service
Data	<ul style="list-style-type: none"> WAG has to negotiated with each partner to get access to data – likely delayed with limited use 		WAG has access at time of encounter

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Comparison – Pharmacy To WAG Labs & LabCorp



Metric	Retail Pharmacy	WAG Labs*	LabCorp
Revenue/ Transaction**	\$90	\$43	\$42
EBIT/ Transaction	\$12	~\$8	\$8-\$9
EBIT Margin***	13%	~19%	~20%
Bad Debt - % of Sales	< 1%	5.0%	4.8%
Cash Flow - DSO	29 Days	55 Days	48 Days

Income Statement

- At maturity, WAG Labs could produce economics similar to LabCorp despite processing less than a fifth of LabCorp's requisition volume.
- EBIT margins for labs are lower for Retail Pharmacy due to acquisition cost of drug
- Lab services have higher gross margins but greater administrative expenses, primarily due to billing costs

Cash Flow

- Conversion of earnings to cash flow trails Retail Pharmacy due to slower collections of Accounts Receivable

*Reflects figures from Year 10 inflation adjusted to the current year.

**Retail pharmacy assumption is 1.5 scripts/patient transaction. WAG Labs assumption is 2.5 tests per patient transaction. Labcorp revenue/transaction includes Canadian business. Excluding Canadian business, revenue/requisition is \$43.

***Labcorp EBIT adjusted for restructuring and other one-time charges.

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After proving out in a pilot and launch

\$1B non-pharmacy, profitable revenue

Have enabled new services

Created a retail laboratory model that patients, physicians and payors value for convenient combination of pharmacy and laboratory services

Walgreens Lab – Financial Summary



Base Case – Lab Services alone	Year 5	Year 10
Revenue	\$470M	\$1.02B
EBIT	\$35M	\$194M
EBIT Margin	7.4%	19.0%
Free Cash Flow	(\$24M)	\$116M
<i>EBIT Break-even – Year 4</i>		

Assumptions

- Standard test mix of \$43 revenue/patient
- 5 years to ramp of 25 patients/store/day
- Capture 5% of the market
- Back-end operates similar to national labs
- Limited to 'Lab' only revenue

Levers

- Ramp up in 18 months
- Esoteric mix/specialty tests
- Physician and Patient adoption
- Sales and marketing
- Operation model - efficiencies

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Proposed Next Steps



Learn from a Pilot with partnership/access model in a region

- Goal:
 - Test assumptions of ramp, speed, acceptance
 - Rework JV/Acquisition business case based on learning's
 - Decide if JV/Acquisition is the best path forward
- Resources Needed: Funding for pilot in 10 stores (Total of \$2M (\$1.5M Expense, \$500k Capital)), limited IT and marketing, dedicated deployment team (4.5 people)

Size the opportunity for JV/Acquisition: Target laboratories for Joint Venture/ Acquisition in order to realize strategic and financial potential

- Goal:
 - Tap into the M&A team to identify potential target opportunities
 - When learnings from Pilot are sufficient, decide if JV/Acquisition is the best path forward
- Resources Needed: M&A team

Systematically work to identify and obtain new point of care technology

- Goal:
 - Dedicate resources to state the Walgreens Point of Care technology need
 - Place multiple bets...Invest in multiple technologies to drive the future of POC testing
- Resources Needed: Experts in POC technology (HLM), 1 WAG contact