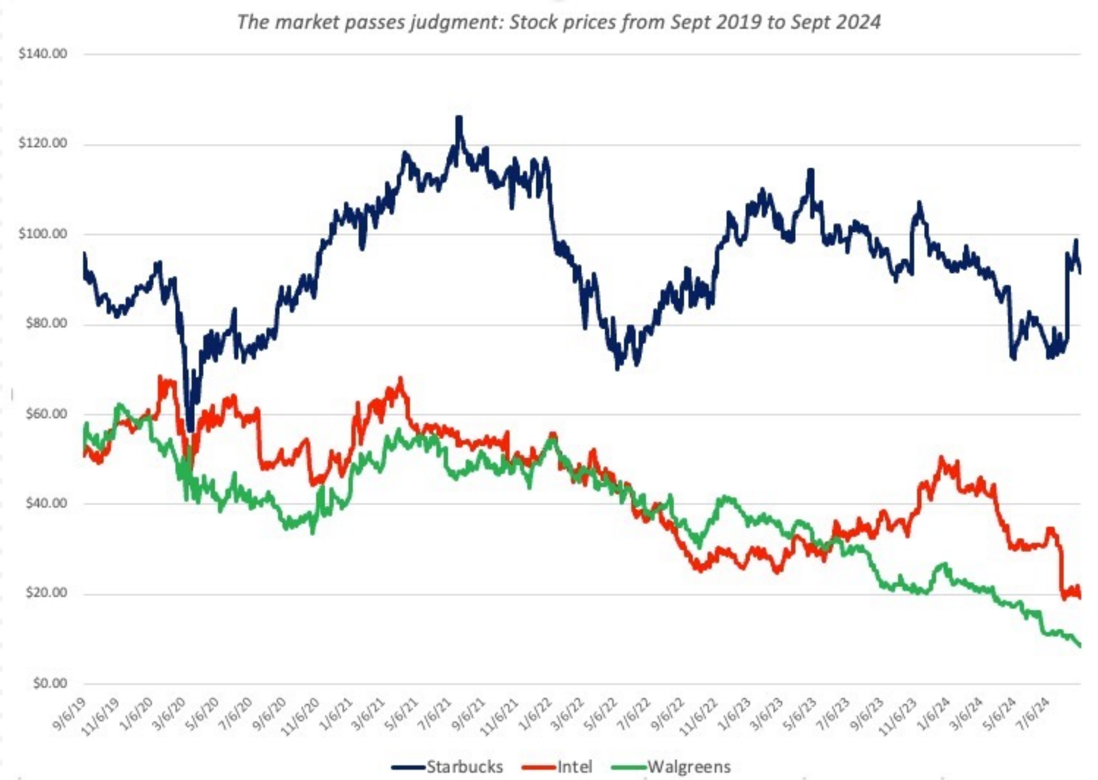
DEALING WITH DECLINE: INTEL, WALGREENS AND STARBUCKS!

The Personal Disruption Manual

The Lead In..

- A few weeks ago, I posted on the corporate life cycle, the subject of my latest book. I argued that the corporate life cycle can explain what happens companies as they age, and why their actions, choices and management have to adapt to aging.
- In the closing section, I also argued that managing and investing in companies becomes most difficult when companies enter the last phases of their life cycles, with revenues stagnating or even declining and margins under pressure.
- While consultants, bankers and even some investors push companies to reinvent themselves, and reincarnate, the truth is that for most companies, the best pathway is to accept decline, shrink and even shut down.
- In this post, I will look at three high profile companies, Intel, Starbucks and Walgreens, that have hit the skids, and examine how they go to where they are, and what the options are looking forward.

The Market passes judgment…

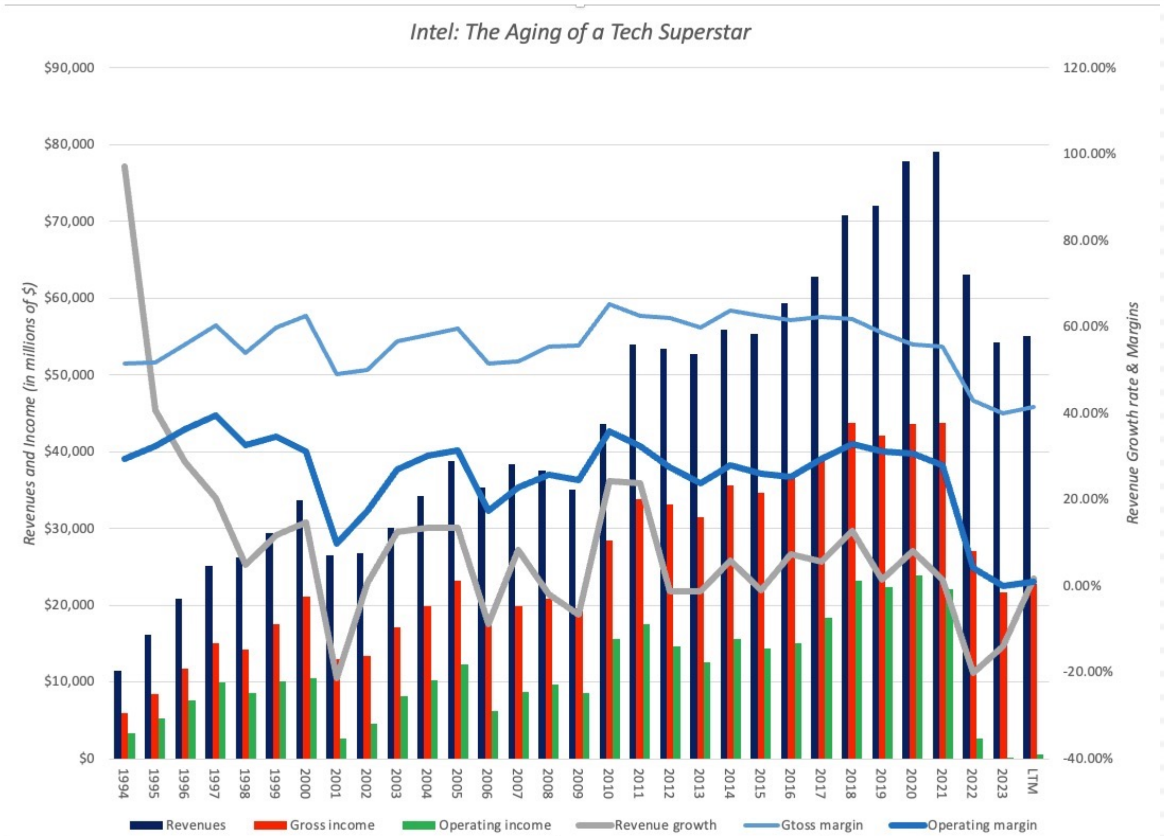


Period	*Starbucks*	*Intel*	*Walgreens*
9/6/19-9/5/20	-9.89%	-1.65%	-29.81%
9/6/20-9/5/21	35.84%	6.85%	39.03%
9/6/21-9/5/22	-29.23%	-41.66%	-31.23%
9/6/22-9/5/23	16.76%	17.58%	-35.55%
9/6/22-9/5/24	-5.45%	-47.15%	-61.55%
Compounded annual return (Last 5 years)	-0.89%	-17.55%	-30.15%

1. Intel: A Tech Superstar Stumbles

- Inel is not old, in terms of chronological age, but at fifty six (it was founded in 1968), the question is whether its best years are behind it, rather than ahead.
- The company's growth in the 1990s to reach the peak of the semiconductor business is the stuff of case studies, and it stayed at the top for longer than most of its tech contemporaries.
- Intel's CEO for its glory years was Andy Grove, who joined the company on its date of incorporation in 1968, and stayed on to become chairman and CEO before stepping down in 1998.
- He argued for constant experimentation and adaptive leadership, and the title of his book, "Only the Paranoid Survive", captured his management ethos.

Intel's Operating History



Period	Revenue Growth	Gross Margin	Operating Margin
1994-2001	14.82%	55.64%	30.68%
2002-2011	7.36%	56.72%	26.47%
2012-2021	3.88%	60.40%	28.24%
2022-2024	-11.31%	41.48%	1.69%

And its market slippage…

1990	2000	2010	2020	2022	2024
1. NEC	1. Intel	1. Intel	1. Intel	1. TSMC	1. Nvidia
2. Toshiba	2. Toshiba	2. Samsung	2. Samsung	2. Samsung	2. TSMC
3. Hitachi	3. NEC	3. TSMC	3. TSMC	3. Intel	3. Broadcom
4. Intel	4. Samsung	4. Texas Instruments	4. SK Hynix	4. Qualcomm	4. Samsung
5. Motorola	5. Texas Instruments	5. Toshiba	5. Micron	5. SK Hynix	5. ASML
6. Fujitsu	6. Motorola	6. Renesas	6. Qualcomm	6. Broadcom	6. AMD
7. Mitsubishi	7. STMicro	7. Qualcomm	7. Broadcom	7. Micron	7. Texas Instruments
8. Texas Instruments	8. Hitachi	8. STMicro	8. NVIDIA	8. NVIDIA	8. Qualcomm
9. Philips	9. Infineon	9. Hynix	9. Texas Instruments	9. Applied Materials	9. Applied Materials
10. Panasonic	10. Philips	10. Micron	10. Infineon	10. Texas Instruments	10. Arm Holdings

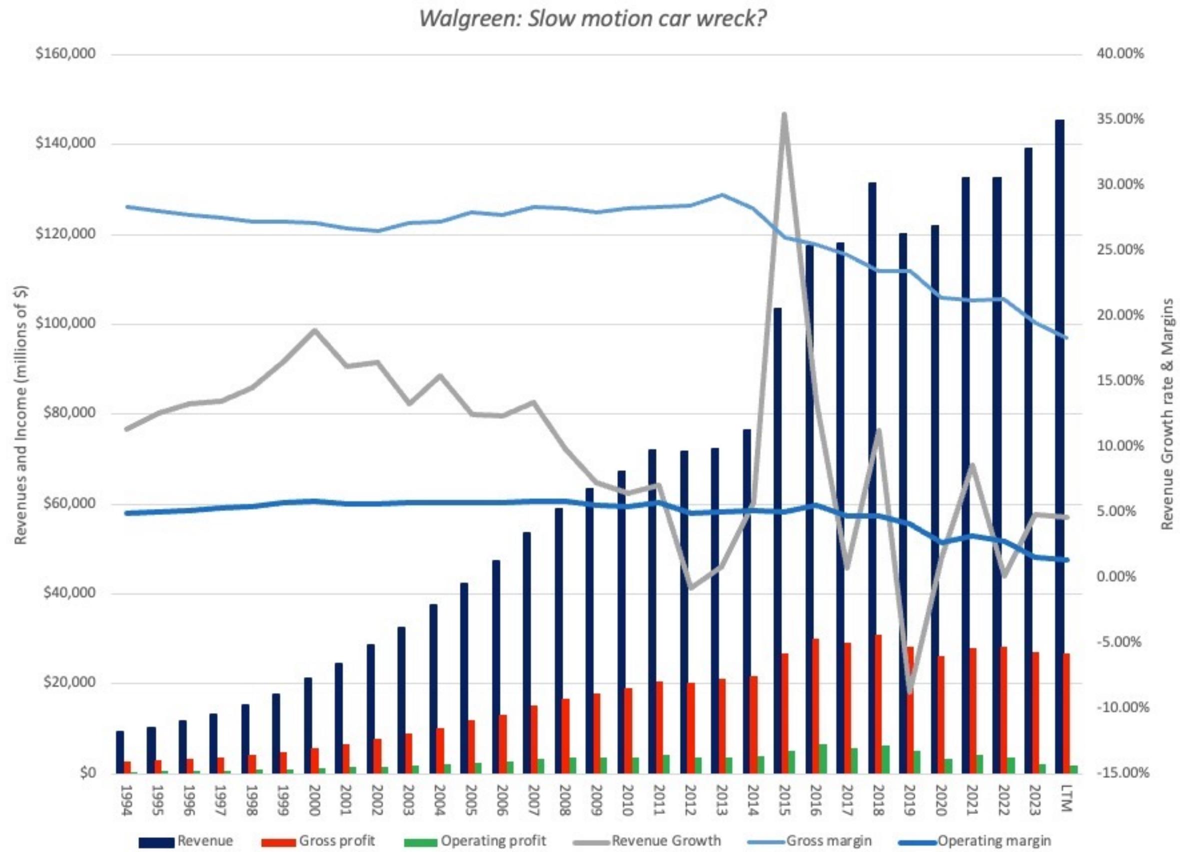
Trying too hard?

- Intel has invested massive amounts into its chip manufacturing business (Intel Foundry), trying to compete with TSMC, and almost as much into its new generation of AI chips, hoping to claim market share of the fastest growing markets for AI chips from Nvidia.
- In fact, a benign assessment of Intel would be that they are making the right moves, but that these moves will take time to pay off, and that the market is being impatient.
- A not-so-benign reading is that the market does not believe that Intel can compete effectively against either TSMC (on chip manufacture) or Nvidia (on chip design), and that the money spent on both endeavors will be wasted.

2. Walgreens – Your neighborhood pharmacy!

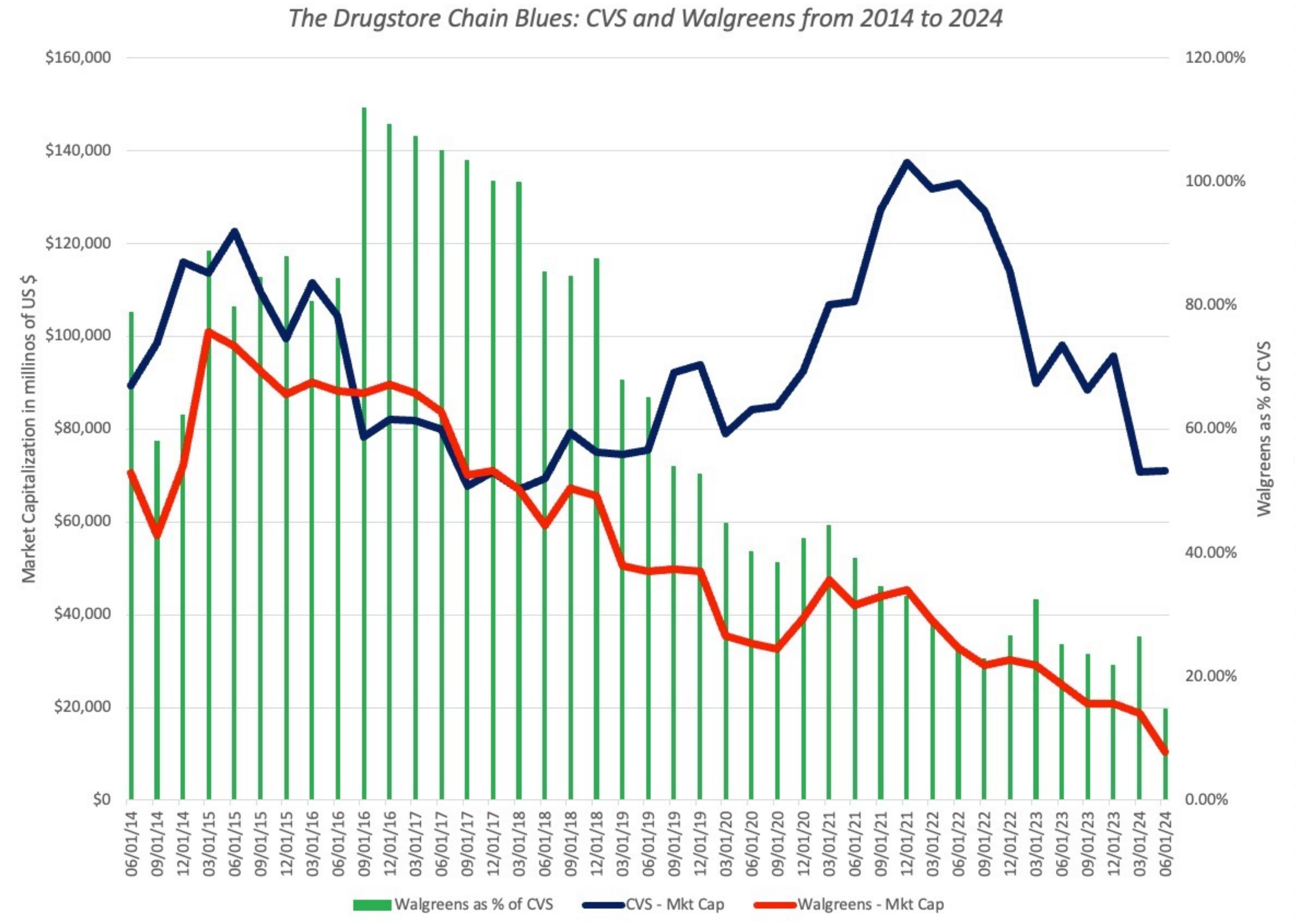
- From humble beginnings in Chicago, Walgreen has grown to become a key part of the US health care system as a dispenser of pharmacy drugs and products.
- The company went public in 1927, and in the century since, the company has acquired the characteristics of a mature company, with growth spurts along the way. Its acquisition of Alliance Boots made it a larger presence, albeit at a high price, with the acquisition costing $15.3 billion.

Walgreen's operating history



Period	Revenue Growth	Gross Margin	Operating margin
1994-2001	14.57%	27.49%	5.38%
2002-2011	11.36%	27.76%	5.68%
2012-2021	6.26%	25.14%	4.49%
2022-2024	3.17%	19.71%	1.88%

The Pharmacy Business in trouble?



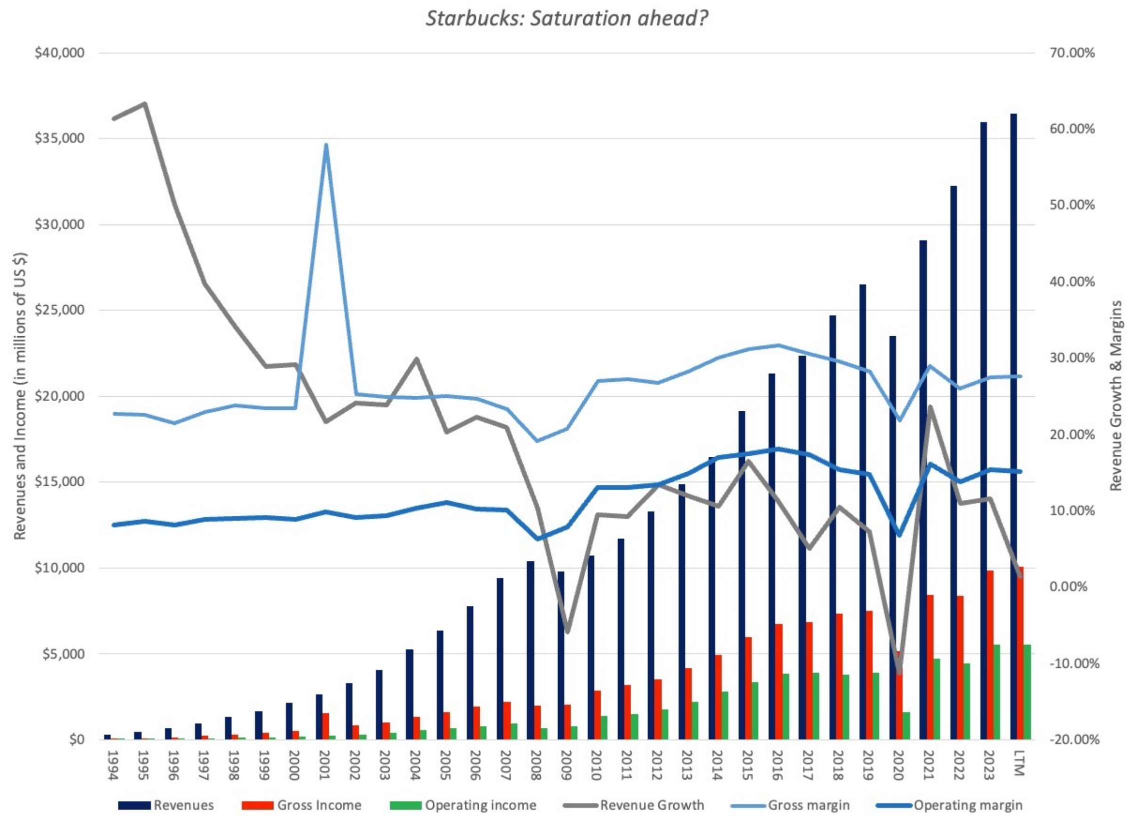
The Acquisition Growth Option

- In response to the slowing down of the pharmacy business, Walgreens has tried, again perhaps much too hard.
- A new CEO, Roz Brewer, was brought into the company in 2021, from Sam's Club, and wagered the company's future on acquisitions, buying four companies in 2021, with a majority stake in Village MD, a chain of doctor practices and clinics, representing the biggest one.
  - That acquisition, which cost Walgreens $5.2 billion, has been more cash drain than flow, and in 2024, Ms. Brewer was replaced as CEO by Tim Wentworth, and Village MD scaled back its growth plans.

3. Starbucks – Reinventing coffee?

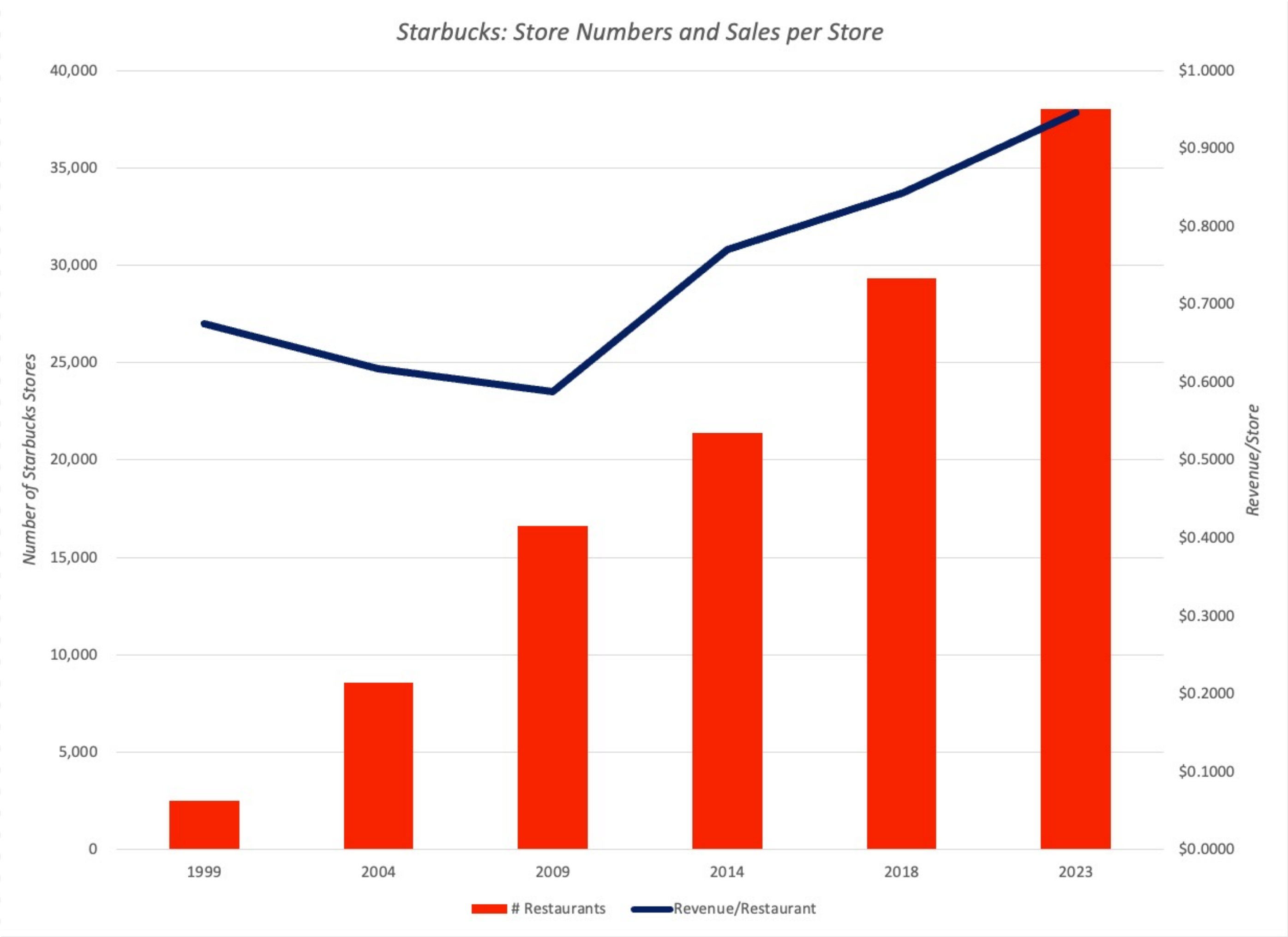
- it is undeniable that Starbuckshas found a way into the lives of many people, whose day cannot begin without their favorite Starbucks drink in hand.
- Early on, Starbucks eased the process by opening more and more stores, often within blocks of each other, and more recently, by offering online ordering, with pick up, with rewards supercharging the process.
- Howard Schulz, who nursed the company from a single store front in Seattle to an ubiquitous presence across America, was CEO of the company from 1986, and while he retired from the position in 2000, he returned from 2008 to 2017, to rescore the company after the financial crisis, and again from 2022 to 2023, as an interim CEO to bridge the gap between the retirement of Kevin Johnson in 2022 and the hiring of Laxman Narasimhan in 2023.

Starbucks' Operating History



Period	Revenue Growth	Gross Margin	Operating margin
1994-2001	40.29%	27.30%	8.80%
2002-2011	16.01%	24.22%	10.05%
2012-2021	9.52%	28.71%	15.14%
2022-2024	7.87%	27.01%	14.75%

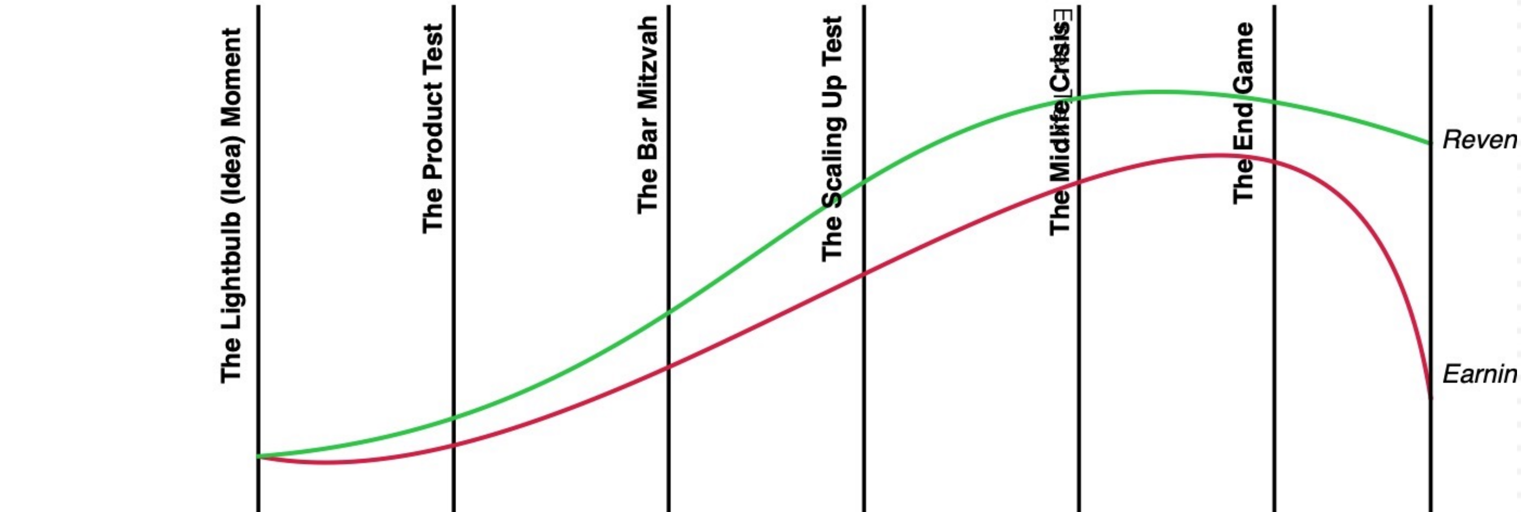
But a changing business model..



So, why the angst?

- Disappointing growth investor base: The first is that there are some investors who continue to hold on to the hope that the company will be able to return to double digit growth, and the only pathway to get there requires that Starbucks be able to succeed in China and India.
- A changing story: The second problem is that the narrative for the company, where coffee shops become a gathering spot for friends and acquaintances, has broken down, partly because of the success of its online ordering expansion.
- Inflation's toll: The third problem is that inflation in product and employee costs has made its products expensive, leading to less spending even from its most loyal customers.

A Corporate Life Cycle Perspective



Life Cycle Stage	**Start-Up**	**Young Growth**	**High Growth**	**Mature Growth**	**Mature Stable**	**Decline**
Key Tasks	Convert idea to a product/ service	Create a business model that converts ideas into revenues	Scale up the business, with economies of scale	Grow a bigger business, while building profitability	Defend the business against competitors	Manage decline
Key Risks	Failure (in converting idea to product)	Failure (in creating a business model)	Business is not scalable	No growth at scale	Increased competition and disruption	Futile attempts to reverse aging

Dealing with Decline

Choices in Decline

Constructive	*It depends...*	*Destructive*
Acceptance Response: Accept that your business has changed and is in decline. Action: Divest parts of business, adjust debt and return more cash. Outcome: Company will get smaller over time, but will be healthier and deliver more value to its owners.	**Me-tooism** Response: Attribute decline to not following the right path. Action: Look at the more successful members in your peer group, and imitate what they do. Outcome: In most cases, you spend large amounts of money on me-tooism, with little to show in terms of growth or profits. In some cases, it can work.	**Denial** Response: Attribute decline to extraordinary circumstances, macro developments or bad luck. Action: Stay with existing investing, financing and dividend policies. Outcome:Truth will eventually catch up with the company, but not before more money has been sunk into a business that is un-investable.
Revamp Response: Accept that existing business is in decline, but believe that there are ways of fixing that decline. Action: Look for new products or markets, building on existing strengths. Outcome: Company reverts back to earlier life cycle stage (mature, perhaps even growth) but in a different form than the existing one.	Declining firm **Symptoms** 1. Stagnant or **declining revenues** 2. **Shrinking** gross and operating **margins** 3. If indebted, signs of **distress**	**Desperation** Response: Sense that decline is real but incentivized, by money or fame, try anything to recover. Action: Make big bets, with low odds, hoping for a hit . Outcome: While the owners of these businesses lose much of the time, the managers who get hits become superstars.
Reincarnation Response: Use existing business cash flows to enter a new and more lucrative business. Action: Seek out a new business where you can enter with strengths, and invest & grow business. Outcome: Company reinvents itself in the new business, with the old business staying on and shrinking over time.	Drivers of choice 1. Health of busness/sector 2. Skin in the game for decision makers 3. Management quality & fit 4. Company strengths/weaknesss 5. Investor characteristics 6. Capital market access and health 7. External factors (Government etc.) 8. Luck	**Sruvival (at any cost)** Response: Recognize that core business is in decline, but prioritize corporate over corporate health. Action: Corporate financial policies to ensure that business survives. Outcome: Zombie or walking dead companies that survive, but as bad businesses that shed value over time.

Setting the odds: Intel

- It is my view that Intel's problems stem largely from too much me-too-ism and perhaps aspiring for growth levels that they cannot reach.
- On both Ai and the chip manufacturing business, Intel is going up against competition (Nvidia on AI and TSMC on manufacturing) that has a clear lead and significant competitive advantages.
- However, the market is large enough and has sufficient growth for Intel to find a place in both, but not as a leader. It is likely that even if it succeeds, Intel will revert to middle age, not high growth, but that should still make it a good investment.

Intel: Value per share
Revenue Growth & Operating Margin

Revenue growth rate	Target Operating Margin: 15%	20%	25%	30%
3%	$ 11.46	$ 17.58	$ 23.70	$ 29.82
6%	$ 13.51	$ 20.85	$ 28.20	$ 35.54
9%	$ 15.88	$ 24.66	$ 33.45	$ 42.24
12%	$ 18.63	$ 29.10	$ 39.58	$ 50.06

Stock was trading at $18.89/share on 9/8/24

Historical Growth & Margins

Period	Revenue Growth	Operating Margin
1994-2001	14.82%	30.68%
2002-2011	7.36%	26.47%
2012-2021	3.88%	28.24%
2022-2024	-11.31%	1.69%

Setting the odds: Walgreens

- Even with its store closures, Walgreens remains the second largest drugstore chain in the United States, after CVS.
- Shrinking its presence to its most productive stores and shedding the rest may be the pathway to steady state, but the company will have to figure out a way to bring down its debt proportionately.
- There is the risk that a macro slowdown or a capital market shock, causing default risk and spreads to widen, could cause equity investors to fold.

Walgreens: Value per share
Revenue Growth & Operating Margin

		Target Operating Margin			
		2.00%	3.00%	4.00%	5.00%
Revenue growth rate	2%	$(13.29)	$ 0.51	$ 14.32	$ 28.12
	3%	$(14.86)	$ 0.06	$ 14.99	$ 29.91
	4%	$(16.55)	$ (0.42)	$ 15.72	$ 31.86
	5%	$(17.59)	$ (0.72)	$ 16.14	$ 33.01

Stock was trading at $ 8.77/share on 9/8/24

Historical Growth & Margins

Period	Revenue Growth	Operating margin
1994-2001	14.57%	5.38%
2002-2011	11.36%	5.68%
2012-2021	6.26%	4.49%
2022-2024	3.17%	1.88%

Setting the odds: Starbucks

- Starbucks is the outlier among the three companies, insofar as its revenue growth is still robust and it remains a money-making firm.
- Its biggest problem is that it has lost its story line, and it needs to rediscover a narrative that can not only give investors a sense of where it is going, but will redirect how it is managed.
- As I noted in my post on corporate life cycle, story telling requires visionaries, and in the case of Starbucks, that visionary has to understand the logistical challenges of running coffee shops.

Does Brian Niccol fit the bill?

- I do not know enough about Brian Niccol to determine whether he fits the bill. As someone who led Taco Bell and Chipotle, I think that he can get the second part (understanding restaurant logistics) nailed down, but is he a visionary?
- He might be, but visionary CEOs generally do not live a thousand miles from corporate headquarters and fly corporate jets to work part time at their jobs, and Niccol has provided no sense of what he sees as the new Starbucks narrative yet.

Starbucks: Value per share
Revenue Growth & Operating Margins

	Revenue Growth	Operating Margin	Value per share
2022-24 levels	7.87%	14.75%	$54.69
2012-21 levels	9.52%	15.14%	$63.88
2002-2011 levels	16.01%	10.05%	$47.53
2002-2011 growth, 2012-21 Margins	16.01%	15.14%	$96.83

Historical Growth & Margins

Period	Revenue Growth	Operating margin
1994-2001	40.29%	8.80%
2002-2011	16.01%	10.05%
2012-2021	9.52%	15.14%
2022-2024	7.87%	14.75%

Stock was trading at $ 91.15/share on 9/8/24

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The Endgame

- There is a reason that so many people want to be entrepreneurs and start new businesses. Notwithstanding the high mortality rate, building a new business is exciting and, if successful, hugely rewarding.
- A healthy economy will encourage entrepreneurship, providing risk capital and not tilting the playing field towards established players; it remains the strongest advantage that the United States has over much of the rest of the world.
- However, it is also true that the measure of a healthy economy is in how it deals with declining businesses and firms. If capitalism is all about creative destruction, it follows that companies, which are after all legal entities that operate businesses, should fade away as the reasons for their existence fade.
- We need a healthier framing of corporate decline, as inevitable at all firms, at some stage in their life cycle, rather than something that should be fought.
  - In business schools and books, we need to highlight not just the empire builders and the reincarnations, i.e., CEOs who made their companies bigger, but the empire shrinkers, i.e., CEOs who are brought into declining firms, who preside over an orderly (and value adding) shrinkage or breaking of their firms.
  - In investing, it is true that the glory gets reserved for the Mag Seven and the FANGAM stocks, companies that have seen their market capitalization climb into the trillions, but we should also pay attention to companies that nimbly navigate their way through bad businesses to deliver value to shareholders.