

MCKESSON CORP
Form 10-Q
January 30, 2012
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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 quarterly period ended December 31, 2011

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: 1-13252

McKESSON CORPORATION

(Exact name of registrant as specified in its charter)

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Delaware (State or other jurisdiction of incorporation or organization)	94-3207296 (I.R.S. Employer Identification No.)
One Post Street, San Francisco, California (Address of principal executive offices)	94104 (Zip Code)
(415) 983-8300 (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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding as of December 31, 2011
Common stock, \$0.01 par value	246,104,738 shares

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Table of Contents**MCKESSON CORPORATION****PART I FINANCIAL INFORMATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In millions, except per share amounts)****(Unaudited)**

	Quarter Ended		Nine Months Ended	
	December 31,		December 31,	
	2011	2010	2011	2010
Revenues	\$ 30,839	\$ 28,247	\$ 91,035	\$ 83,231
Cost of Sales	29,273	26,786	86,313	79,012
Gross Profit	1,566	1,461	4,722	4,219
Operating Expenses	1,047	965	3,135	2,808
Litigation Charges	27	189	145	213
Total Operating Expenses	1,074	1,154	3,280	3,021
Operating Income	492	307	1,442	1,198
Other Income (Expense), Net	(2)	7	12	19
Interest Expense	(64)	(53)	(192)	(140)
Income from Continuing Operations Before Income Taxes	426	261	1,262	1,077
Income Tax Expense	(126)	(106)	(380)	(369)
Income from Continuing Operations	300	155	882	708
Discontinued Operation gain on sale, net of tax				72
Net Income	\$ 300	\$ 155	\$ 882	\$ 780
Earnings Per Common Share				
Diluted				
Continuing operations	\$ 1.20	\$ 0.60	\$ 3.51	\$ 2.69
Discontinued operation gain on sale				0.27
Total	\$ 1.20	\$ 0.60	\$ 3.51	\$ 2.96
Basic				
Continuing operations	\$ 1.22	\$ 0.61	\$ 3.57	\$ 2.73
Discontinued operation gain on sale				0.28
Total	\$ 1.22	\$ 0.61	\$ 3.57	\$ 3.01
Dividends Declared Per Common Share	\$ 0.20	\$ 0.18	\$ 0.60	\$ 0.54
Weighted Average Common Shares				

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Diluted	251	258	252	264
Basic	246	254	247	259

See Financial Notes

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	December 31, 2011	March 31, 2011
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 4,191	\$ 3,612
Receivables, net	9,673	9,187
Inventories, net	10,376	9,225
Prepaid expenses and other	329	333
Total Current Assets	24,569	22,357
Property, Plant and Equipment, Net	1,015	991
Goodwill	4,497	4,364
Intangible Assets, Net	1,341	1,456
Other Assets	1,735	1,718
Total Assets	\$ 33,157	\$ 30,886
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Drafts and accounts payable	\$ 15,677	\$ 14,090
Deferred revenue	1,471	1,321
Deferred tax liabilities	1,038	1,037
Current portion of long-term debt	409	417
Other accrued liabilities	2,120	1,861
Total Current Liabilities	20,715	18,726
Long-Term Debt	3,578	3,587
Other Noncurrent Liabilities	1,408	1,353
Commitments and Contingent Liabilities (Note 12)		
Stockholders Equity		
Preferred stock, \$0.01 par value, 100 shares authorized, no shares issued or outstanding		
Common stock, \$0.01 par value, 800 shares authorized at December 31, 2011 and March 31, 2011, 372 and 369 shares issued at December 31, 2011 and March 31, 2011	4	4
Additional Paid-in Capital	5,641	5,339
Retained Earnings	8,981	8,250
Accumulated Other Comprehensive Income	2	87
Other	6	10
Treasury Shares, at Cost, 126 and 117 at December 31, 2011 and March 31, 2011	(7,178)	(6,470)
Total Stockholders Equity	7,456	7,220
Total Liabilities and Stockholders Equity	\$ 33,157	\$ 30,886

See Financial Notes

Table of Contents**McKESSON CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In millions)****(Unaudited)**

	Nine Months Ended December 31,	
	2011	2010
Operating Activities		
Net income	\$ 882	\$ 780
Discontinued operation gain on sale, net of tax		(72)
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation and amortization	408	352
Asset impairment charge capitalized software held for sale		72
Share-based compensation expense	113	99
Other non-cash items	102	58
Changes in operating assets and liabilities, net of acquisitions:		
Receivables	(575)	(198)
Inventories	(1,200)	22
Drafts and accounts payable	1,636	52
Deferred revenue	122	82
Litigation charges	145	213
Litigation settlement payments	(26)	(26)
Deferred tax benefit on litigation charges	(42)	(56)
Other	151	(40)
Net cash provided by operating activities	1,716	1,338
Investing Activities		
Property acquisitions	(170)	(157)
Capitalized software expenditures	(137)	(111)
Acquisitions, less cash and cash equivalents acquired	(204)	(292)
Proceeds from sale of business		109
Other	81	(15)
Net cash used in investing activities	(430)	(466)
Financing Activities		
Repayments of debt	(23)	
Common stock repurchases, including shares surrendered for tax withholding	(672)	(1,548)
Common stock issuances	122	238
Dividends paid	(146)	(126)
Other	22	40
Net cash used in financing activities	(697)	(1,396)
Effect of exchange rate changes on cash and cash equivalents	(10)	6
Net increase (decrease) in cash and cash equivalents	579	(518)
Cash and cash equivalents at beginning of period	3,612	3,731

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Cash and cash equivalents at end of period	\$ 4,191	\$ 3,213
Non-cash item:		
Fair value of debt assumed on acquisition	\$	\$ (1,910)

See Financial Notes

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McKESON CORPORATION

FINANCIAL NOTES

(UNAUDITED)

1. Significant Accounting Policies

Basis of Presentation: The condensed consolidated financial statements of McKesson Corporation (McKesson, the Company, or we and other similar pronouns) include the financial statements of all wholly-owned subsidiaries and majority-owned or controlled companies. Intercompany transactions and balances have been eliminated. The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial reporting and the rules and regulations of the U.S. Securities and Exchange Commission (SEC) and, therefore, do not include all information and footnote disclosures normally included in the annual consolidated financial statements.

To prepare the financial statements in conformity with GAAP, management must make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of these financial statements and income and expenses during the reporting period. Actual amounts may differ from these estimated amounts. In our opinion, the accompanying unaudited condensed consolidated financial statements include all normal recurring adjustments necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods presented.

The condensed consolidated balance sheet at March 31, 2011 has been derived from the audited consolidated financial statements at that date but does not include all the information and footnotes required by GAAP for complete financial statements.

The results of operations for the quarter and nine months ended December 31, 2011 are not necessarily indicative of the results that may be expected for the entire year. These interim financial statements should be read in conjunction with the annual audited financial statements, accounting policies and financial notes included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2011 previously filed with the SEC on May 5, 2011 (2011 Annual Report). Certain prior period amounts have been reclassified to conform to the current period presentation.

The Company s fiscal year begins on April 1 and ends on March 31. Unless otherwise noted, all references to a particular year shall mean the Company s fiscal year.

Recently Adopted Accounting Pronouncements

Revenue Recognition: On April 1, 2011, we adopted amended accounting guidance on a prospective basis for multiple-element arrangements entered into or materially modified on or after April 1, 2011. The amended guidance incorporates the use of a vendor s best estimate of selling price, if neither vendor specific objective evidence nor third party evidence of selling price exists, to allocate arrangement consideration and eliminates the use of the residual method. Implementation of this new guidance did not have a material impact on reported net revenues as compared to net revenues under previous guidance as the incorporation of the use of a vendor s best estimate of selling price and the elimination of the residual method for the allocation of arrangement consideration did not materially change how we allocate arrangement consideration to our various products and services or the amount and timing of reported net revenues.

On April 1, 2011, we adopted amended guidance for certain revenue arrangements that include software elements. The guidance amends pre-existing software revenue guidance by removing from its scope tangible products that contain both software and non-software components that function together to deliver the product s functionality. The amended guidance was adopted on a prospective basis for revenue arrangements entered into or materially modified on or after April 1, 2011. The adoption of this amended guidance did not have a material effect on our condensed consolidated financial statements.

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FINANCIAL NOTES (CONTINUED)

(UNAUDITED)

On April 1, 2011, we adopted amended accounting guidance for vendors who apply the milestone method of revenue recognition to research and development arrangements. The amended guidance applies to arrangements with payments that are contingent, at inception, upon achieving substantively uncertain future events or circumstances. The amended guidance was adopted on a prospective basis for milestones achieved on or after April 1, 2011. The adoption of this amended guidance did not have a material effect on our condensed consolidated financial statements.

Recently Issued Accounting Pronouncements Not Yet Adopted

In May 2011, the Financial Accounting Standards Board (FASB) issued amended accounting guidance related to fair value measurements and disclosure requirements. The amended guidance clarifies the application of existing fair value measurement requirements. The amended guidance is effective for us on a prospective basis commencing in the fourth quarter of 2012. We do not expect the adoption of the amended guidance to have a material effect on our consolidated financial statements.

In June 2011, the FASB issued amended guidance related to the presentation of other comprehensive income requiring that comprehensive income, the components of net income and the components of other comprehensive income be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. While the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income as determined under current accounting guidance. In December 2011, the FASB issued an amendment to this guidance to defer the requirement to present reclassification adjustments for each component of other comprehensive income in both net income and other comprehensive income on the face of the financial statements. The amended guidance is effective for us on a retrospective basis commencing in the first quarter of 2013. We do not expect the adoption of the amended guidance to have a material effect on our consolidated financial statements.

In September 2011, the FASB issued amended accounting guidance related to goodwill impairment testing. The new guidance provides the option to perform a qualitative assessment by applying a more likely than not scenario to determine whether the fair value of a reporting unit is less than its carrying amount, which may then allow a company to skip the annual two-step quantitative goodwill impairment test depending on the determination. The amended guidance is effective for us commencing in the first quarter of 2013. Earlier adoption is permitted. We are in the process of adopting this amended guidance in 2012 and do not expect it to have a material effect on our consolidated financial statements.

In September 2011, the FASB issued amended accounting guidance related to an employer's participation in a multiemployer pension and other postretirement benefit plans to require that employers provide additional quantitative and qualitative disclosures for these types of plans. The amended guidance is effective for us on a retrospective basis commencing in the fourth quarter of 2012. Earlier adoption is permitted. We are currently evaluating the impact of this new guidance on our consolidated financial statements.

In December 2011, the FASB issued disclosure guidance related to the offsetting of assets and liabilities. The guidance requires an entity to disclose information about offsetting and related arrangements for recognized financial and derivative instruments to enable users of its financial statements to understand the effect of those arrangements on its financial position. The amended guidance is effective for us on a retrospective basis commencing in the first quarter of 2014. We are currently evaluating the impact of this new guidance on our consolidated financial statements.

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FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

2. Business Combinations

On December 30, 2010, we acquired all of the outstanding shares of US Oncology Holdings, Inc. (US Oncology) for approximately \$2.1 billion, consisting of cash consideration of \$0.2 billion, net of cash acquired, and the assumption of liabilities with a fair value of \$1.9 billion. The cash paid at acquisition was funded from cash on hand. As an integrated oncology company, US Oncology is affiliated with community-based oncologists, and works with patients, hospitals, payers and the medical industry across all phases of the cancer research and delivery continuum. The acquisition of US Oncology expands our existing specialty pharmaceutical distribution business and adds practice management services for oncologists. Financial results for US Oncology have been included in the results of operations within our Distribution Solutions segment beginning in the fourth quarter of 2011.

During the third quarter of 2012, the fair value measurements of assets acquired and liabilities assumed as of the acquisition date were completed. The following table summarizes the final amounts of the fair values recognized for the assets acquired and liabilities assumed as of the acquisition date, as well as measurement period adjustments made in the first nine months of 2012 to the amounts initially recorded in 2011. The measurement period adjustments during the first nine months of 2012 did not have a significant impact on our condensed consolidated statements of operations, balance sheets or cash flows in any period, and, therefore, we have not retrospectively adjusted our financial statements.

<i>(In millions)</i>	Amounts Previously Recognized as of Acquisition Date (Provisional) ⁽¹⁾	Measurement Period Adjustments	Amounts Recognized as of Acquisition Date (Final)
Current assets, net of cash acquired	\$ 662	\$ (13)	\$ 649
Goodwill	808	20	828
Intangible assets	1,007	(14)	993
Other long-term assets	354	(6)	348
Current liabilities	(489)	(1)	(490)
Current portion of long-term debt	(1,735)		(1,735)
Other long-term liabilities	(338)	16	(322)
Other stockholders' equity	(25)	(2)	(27)
Net assets acquired, less cash and cash equivalents	\$ 244	\$	\$ 244

⁽¹⁾ As previously reported in our Form 10-K for the year ended March 31, 2011.

During the last two years, we also completed a number of other smaller acquisitions within both of our operating segments. Financial results for our business acquisitions have been included in our condensed consolidated financial statements since their respective acquisition dates. Purchase prices for our business acquisitions have been allocated based on estimated fair values at the date of acquisition.

Goodwill recognized for our business acquisitions is generally not expected to be deductible for tax purposes. The pro forma results of operations for our business acquisitions and the results of operations for these acquisitions since the acquisition date have not been presented because the effects were not material to the condensed consolidated financial statements on either an individual or an aggregate basis.

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FINANCIAL NOTES (CONTINUED)

(UNAUDITED)

3. Product Alignment and Asset Impairment Charges

During the third quarter of 2012, we approved a plan to align our hospital clinical and revenue cycle healthcare software products within our Technology Solutions segment. As part of this alignment strategy, we will be converging our core clinical and revenue cycle Horizon and Paragon product lines onto Paragon's Microsoft based platform over time. Additionally, we have stopped development of our Horizon Enterprise Revenue Management (HzERM) software product. The plan resulted in a pre-tax charge of \$42 million for the quarter, of which \$26 million was recorded to cost of sales and \$16 million was recorded to operating expenses within our Technology Solutions segment. The pre-tax charge includes \$22 million of non-cash asset impairment charges, primarily for the write-off of prepaid licenses and commissions and capitalized internal use software, \$6 million for severance, \$6 million for customer allowances and \$8 million for other charges.

Our capitalized software held for sale is amortized over three years. At each balance sheet date, or earlier if an indicator of an impairment exists, we evaluate the recoverability of unamortized capitalized software costs based on estimated future undiscounted revenues net of estimated related costs over the remaining amortization period. At the end of the second quarter of 2010, our HzERM software product became generally available. In October 2010, we decreased our estimated revenues over the next 24 months for our HzERM software product and as a result, concluded that the estimated future revenues, net of estimated related costs, were insufficient to recover its carrying value. Accordingly, we recorded a \$72 million non-cash impairment charge in the second quarter of 2011 within our Technology Solutions segment's cost of sales to reduce the carrying value of the software product to its net realizable value.

4. Discontinued Operation

In July 2010, our Technology Solutions segment sold its wholly-owned subsidiary, McKesson Asia Pacific Pty Limited (MAP), a provider of phone and web-based healthcare services in Australia and New Zealand, for net sales proceeds of \$109 million. The divestiture generated a pre-tax and after-tax gain of \$95 million and \$72 million. As a result of the sale, we were able to utilize capital loss carry-forwards for which we previously recorded a valuation allowance of \$15 million. The release of the valuation allowance is included as a tax benefit in our after-tax gain on the divestiture. The after-tax gain on disposition was recorded as a discontinued operation in our consolidated statement of operations in the second quarter of 2011. The historical financial operating results and net assets of MAP were not material to our condensed consolidated financial statements for all periods presented.

5. Income Taxes

As of December 31, 2011, we had \$657 million of unrecognized tax benefits, of which \$437 million would reduce income tax expense and the effective tax rate if recognized. During the next twelve months, it is reasonably possible that audit resolutions and the expiration of statutes of limitations could potentially reduce our unrecognized tax benefits by up to \$164 million. However, this amount may change because we continue to have ongoing negotiations with various taxing authorities throughout the year.

In November 2011, the U.S. Internal Revenue Service (IRS) began its examination of 2007 through 2009.

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FINANCIAL NOTES (CONTINUED)

(UNAUDITED)

We have received tax assessments of \$98 million from the IRS relating to 2003 through 2006. We disagree with a substantial portion of the tax assessments primarily relating to transfer pricing. We are pursuing administrative relief through the appeals process. We have received assessments from the Canada Revenue Agency (CRA) for a total of \$169 million related to transfer pricing for 2003 through 2007. Payments of most of the assessments to the CRA have been made to stop the accrual of interest. We have appealed the assessment for 2003 to the Tax Court of Canada and have filed a notice of objection for 2004 through 2007. The trial between McKesson Canada Corporation and the CRA, argued in the Tax Court of Canada, concluded testimony in December 2011 and closing arguments will be completed in early February 2012. We continue to believe in the technical merits of our tax positions and that we have adequately provided for any potential adverse results relating to these examinations in our financial statements. However, the final resolution of these issues could result in an increase or decrease to income tax expense.

In nearly all jurisdictions, the tax years prior to 2003 are no longer subject to examination. We believe that we have made adequate provision for all remaining income tax uncertainties.

We report interest and penalties on tax deficiencies as income tax expense. At December 31, 2011, before any tax benefits, our accrued interest on unrecognized tax benefits amounted to \$146 million. We recognized an income tax expense of \$4 million and \$10 million, before any tax benefit, related to interest in our condensed consolidated statements of operations during the third quarter and first nine months ended December 31, 2011. We have no material amounts accrued for penalties.

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McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

6. Earnings Per Common Share

Basic earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding during the reporting period. Diluted earnings per common share are computed similar to basic earnings per common share except that it reflects the potential dilution that could occur if dilutive securities or other obligations to issue common stock were exercised or converted into common stock.

The computations for basic and diluted earnings per common share are as follows:

<i>(In millions, except per share amounts)</i>	Quarter Ended December 31,		Nine Months Ended December 31,	
	2011	2010	2011	2010
Income from continuing operations	\$ 300	\$ 155	\$ 882	\$ 708
Discontinued operation gain on sale, net of tax				72
Net income	\$ 300	\$ 155	\$ 882	\$ 780
Weighted average common shares outstanding:				
Basic	246	254	247	259
Effect of dilutive securities:				
Options to purchase common stock	2	2	2	3
Restricted stock units	3	2	3	2
Diluted	251	258	252	264
Earnings Per Common Share: ⁽¹⁾				
Basic				
Continuing operations	\$ 1.22	\$ 0.61	\$ 3.57	\$ 2.73
Discontinued operation gain on sale				0.28
Total	\$ 1.22	\$ 0.61	\$ 3.57	\$ 3.01
Diluted				
Continuing operations	\$ 1.20	\$ 0.60	\$ 3.51	\$ 2.69
Discontinued operation gain on sale				0.27
Total	\$ 1.20	\$ 0.60	\$ 3.51	\$ 2.96

⁽¹⁾ Certain computations may reflect rounding adjustments.

Potentially dilutive securities include outstanding stock options, restricted stock units and performance-based restricted stock units.

Approximately 1 million of potentially dilutive securities were excluded from the computations of diluted net earnings per common share for the quarters ended December 31, 2011 and 2010 and 4 million and 6 million for the nine months ended December 31, 2011 and 2010, as they were anti-dilutive.

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FINANCIAL NOTES (CONTINUED)
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7. Goodwill and Intangible Assets, Net

Changes in the carrying amount of goodwill were as follows:

<i>(In millions)</i>	Distribution Solutions	Technology Solutions	Total
Balance, March 31, 2011	\$ 2,662	\$ 1,702	\$ 4,364
Goodwill acquired, net of purchase price adjustments	21	135	156
Foreign currency translation adjustments	(4)	(19)	(23)
Balance, December 31, 2011	\$ 2,679	\$ 1,818	\$ 4,497

Information regarding intangible assets is as follows:

	Weighted Average Remaining Amortization Period (years)	December 31, 2011			March 31, 2011		
		Gross		Net	Gross		Net
		Carrying Amount	Accumulated Amortization	Carrying Amount	Carrying Amount	Accumulated Amortization	Carrying Amount
<i>(Dollars in millions)</i>							
Customer lists	7	\$ 1,074	\$ (526)	\$ 548	\$ 1,057	\$ (444)	\$ 613
Service agreements	17	701	(46)	655	723	(11)	712
Trademarks and trade names	13	77	(36)	41	76	(31)	45
Technology	4	234	(185)	49	204	(170)	34
Other	8	76	(28)	48	76	(24)	52

Total \$ 2,162 \$ (821) \$ 1,341 \$ 2,136 \$ (680) \$ 1,456

Amortization expense of intangible assets was \$49 million and \$147 million for the quarter and nine months ended December 31, 2011 and \$28 million and \$84 million for the quarter and nine months ended December 31, 2010. Estimated annual amortization expense of these assets is as follows: \$194 million, \$178 million, \$164 million, \$144 million and \$120 million for 2012 through 2016 and \$688 million thereafter. All intangible assets were subject to amortization as of December 31, 2011 and March 31, 2011.

8. Financing Activities*Accounts Receivable Sales Facility*

In May 2011, we renewed our existing accounts receivable sales facility for a one year period under terms substantially similar to those previously in place. The committed balance of this facility is \$1.35 billion, although from time-to-time the available amount of this facility may be less than \$1.35 billion based on accounts receivable concentration limits and other eligibility requirements. The renewed accounts receivable sales facility will expire in May 2012.

At December 31, 2011 and March 31, 2011, there were no securitized accounts receivable balances or secured borrowings outstanding under this facility. Additionally, there were no sales of interests to third-party purchaser groups in the quarters and nine months ended December 31, 2011 and 2010.

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This facility contains requirements relating to the performance of the accounts receivable and covenants relating to the Company. If we do not comply with these covenants, our ability to use this facility may be suspended and repayment of any outstanding balances under this facility may be required. At December 31, 2011 and March 31, 2011, we were in compliance with all covenants.

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FINANCIAL NOTES (CONTINUED)

(UNAUDITED)

Revolving Credit Facility

In September 2011, we renewed our existing syndicated \$1.3 billion five-year senior unsecured revolving credit facility, which was scheduled to mature in June 2012. This new credit facility has terms and conditions substantially similar to those previously in place and matures in September 2016. Borrowings under this renewed credit facility bear interest based upon either the London Interbank Offered Rate or a prime rate. There were no borrowings under this facility during the first nine months of 2012 and 2011. As of December 31, 2011 and March 31, 2011, there were no borrowings outstanding under this facility.

9. Pension and Other Postretirement Benefit Plans

Net periodic expense for the Company's defined pension and other postretirement benefit plans was \$10 million and \$31 million for the quarter and nine months ended December 31, 2011 and \$11 million and \$29 million for the quarter and nine months ended December 31, 2010. Cash contributions to these plans were \$18 million and \$15 million for the first nine months of 2012 and 2011.

10. Financial Instruments

At December 31, 2011 and March 31, 2011, the carrying amounts of cash and cash equivalents, restricted cash, marketable securities, receivables, drafts and accounts payable and other current liabilities approximated their estimated fair values because of the short maturity of these financial instruments. All highly liquid debt instruments purchased with original maturity of three months or less at the date of acquisition are included in cash and cash equivalents. Included in cash and cash equivalents at December 31, 2011 and March 31, 2011 were money market fund investments of \$2.5 billion and \$1.7 billion, which are reported at fair value. The fair value of these investments was determined by using quoted prices for identical investments in active markets, which are considered to be Level 1 inputs under the fair value measurements and disclosure guidance. The carrying value of all other cash equivalents approximates their fair value due to their relatively short-term nature.

The carrying amounts and estimated fair values of our long-term debt and other financing were \$4.0 billion and \$4.6 billion at December 31, 2011 and \$4.0 billion and \$4.3 billion at March 31, 2011. The estimated fair value of our long-term debt and other financing was determined using quoted market prices and other inputs that were derived from available market information. These are considered to be Level 2 inputs under the fair value measurements and disclosure guidance, and may not be representative of actual values that could have been realized or that will be realized in the future.

11. Financial Guarantees and Warranties

Financial Guarantees

We have agreements with certain of our Canadian customers' financial institutions under which we have guaranteed the repurchase of our customers' inventory or our customers' debt in the event that our customers are unable to meet their obligations to those financial institutions. For our inventory repurchase agreements, among other conditions, inventories must be in resalable condition and any repurchases would be at a discount. Inventory repurchase agreements mostly range from one to two years. Our customer debt guarantees are primarily provided to facilitate financing for certain customers and are generally secured by certain assets of the customer. We also have an agreement with one software customer that, under limited circumstances, may require us to secure standby financing. Because the amount of the standby financing is not explicitly stated, the overall amount of this guarantee cannot reasonably be estimated. At December 31, 2011, the maximum amounts of inventory repurchase guarantees and other customer guarantees were \$121 million and \$52 million, none of which had been accrued.

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MCKESSON CORPORATION

FINANCIAL NOTES (CONTINUED)

(UNAUDITED)

In addition, at December 31, 2011, our banks and insurance companies have issued \$87 million of standby letters of credit and surety bonds, which were issued on our behalf mostly related to our customer contracts and in order to meet the security requirements for statutory licenses and permits, court and fiduciary obligations and our workers' compensation and automotive liability programs.

Our software license agreements generally include certain provisions for indemnifying customers against liabilities if our software products infringe a third party's intellectual property rights. To date, we have not incurred any material costs as a result of such indemnification agreements and have not accrued any liabilities related to such obligations.

In conjunction with certain transactions, primarily divestitures, we may provide routine indemnification agreements (such as retention of previously existing environmental, tax and employee liabilities) whose terms vary in duration and often are not explicitly defined. Where appropriate, obligations for such indemnifications are recorded as liabilities. Because the amounts of these indemnification obligations often are not explicitly stated, the overall maximum amount of these commitments cannot be reasonably estimated. Other than obligations recorded as liabilities at the time of divestiture, we have historically not made significant payments as a result of these indemnification provisions.

Warranties

In the normal course of business, we provide certain warranties and indemnification protection for our products and services. For example, we provide warranties that the pharmaceutical and medical-surgical products we distribute are in compliance with the U.S. Federal Food, Drug, and Cosmetic Act and other applicable laws and regulations. We have received the same warranties from our suppliers, who customarily are the manufacturers of the products. In addition, we have indemnity obligations to our customers for these products, which have also been provided to us from our suppliers, either through express agreement or by operation of law.

We also provide warranties regarding the performance of software and automation products we sell. Our liability under these warranties is to bring the product into compliance with previously agreed upon specifications. For software products, this may result in additional project costs, which are reflected in our estimates used for the percentage-of-completion method of accounting for software installation services within these contracts. In addition, most of our customers who purchase our software and automation products also purchase annual maintenance agreements. Revenues from these maintenance agreements are recognized on a straight-line basis over the contract period, and the cost of servicing product warranties is charged to expense when claims become estimable. Accrued warranty costs were not material to the condensed consolidated balance sheets.

12. Commitments and Contingent Liabilities

In addition to commitments and obligations in the ordinary course of business, we are subject to various claims, other pending and potential legal actions for damages, investigations relating to governmental laws and regulations and other matters arising out of the normal conduct of our business. As described below, many of these proceedings are at preliminary stages and many seek an indeterminate amount of damages.

When a loss is considered probable and reasonably estimable, we record a liability in the amount of our best estimate for the ultimate loss. However, the likelihood of a loss with respect to a particular contingency is often difficult to predict and determining a meaningful estimate of the loss or a range of loss may not be practicable based on the information available and the potential effect of future events and decisions by third parties that will determine the ultimate resolution of the contingency. Moreover, it is not uncommon for such matters to be resolved over many years, during which time relevant developments and new information must be reevaluated at least quarterly to determine both the likelihood of potential loss and whether it is possible to reasonably estimate a range of possible loss. When a loss is probable but a reasonable estimate cannot be made, disclosure of the proceeding is provided.

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FINANCIAL NOTES (CONTINUED)

(UNAUDITED)

Disclosure also is provided when it is reasonably possible that a loss will be incurred or when it is reasonably possible that the amount of a loss will exceed the recorded provision. We review all contingencies at least quarterly to determine whether the likelihood of loss has changed and to assess whether a reasonable estimate of the loss or range of loss can be made. As discussed above, development of a meaningful estimate of loss or a range of potential loss is complex when the outcome is directly dependent on negotiations with or decisions by third parties, such as regulatory agencies, the court system and other interested parties. Such factors bear directly on whether it is possible to reasonably estimate a range of potential loss and boundaries of high and low estimates.

Significant developments in previously reported proceedings and in other litigation and claims since the filing of our 2011 Annual Report on Form 10-K and our Quarterly Reports on Form 10-Q for the periods ended June 30, 2011 and September 30, 2011, are set out below. Unless otherwise stated, we are currently unable to estimate a range of reasonably possible losses for the unresolved proceedings described below. Should any one or a combination of more than one of these proceedings be successful, or should we determine to settle any or a combination of these matters, we may be required to pay substantial sums, become subject to the entry of an injunction or be forced to change the manner in which we operate our business, which could have a material adverse impact on our financial position or results of operations.

A. Average Wholesale Price Litigation

In the previously reported coordinated public payer Average Wholesale Price (AWP) actions, collectively *In re McKesson Governmental Entities Average Wholesale Price Litigation*, filed against the Company in the United States District Court for Massachusetts and relating to alleged misstatements and manipulations of a benchmark for drug reimbursement known as AWP, on November 8, 2011, the court granted preliminary approval of the previously reported class action settlement in *Board of County Commissioners of Douglas County, Kansas et al. v. McKesson Corporation*, (No. 1:08-CV-11349-PBS) (Douglas County, Kansas Action), and set April 17, 2012, as the hearing date for final approval of the settlement.

As previously reported, the Company has engaged in ongoing settlement discussions to resolve potential and pending federal and state Medicaid program claims relating to AWP. The Company has now reached an agreement in principle with the Department of Justice to resolve the federal share of Medicaid claims related to AWP for payment by the Company of approximately \$187 million. This agreement is subject to execution of a written settlement agreement acceptable to all parties. The Company also has reached an agreement in principle with a coalition of State Attorneys General to resolve state Medicaid claims relating to AWP for payment by the Company of up to approximately \$173 million. This amount shall be reduced by the total amount allocated to any state that declines to subscribe to the settlement. This agreement is subject to execution of written settlement agreements acceptable to the Company and each participating state. Although the Company believes that there will be substantial participation by the states, the final level of participation is not yet known. The Company will continue to defend vigorously any action pursued by a non-settling state. With the adjustments referenced below, the Company has fully reserved for the financial effect of these agreements in principle.

On August 25, 2011, as previously reported, the Company filed a motion to dismiss the Second Amended Complaint in the previously reported action filed in Mississippi state court by the State of Mississippi against the Company, *State of Mississippi v. McKesson Corporation, et al.*, (No. 251-10-862CIV). The court has still not ruled on the Company's motion. On November 30, 2011, the court entered a scheduling order setting November 26, 2012, as the trial date.

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FINANCIAL NOTES (CONTINUED)

(UNAUDITED)

On November 11, 2011, an action was filed in the United States District Court for the Northern District of California by the State of Oregon against the Company as the sole defendant based on essentially the same factual allegations as alleged in *In re McKesson Governmental Entities Average Wholesale Price Litigation*, asserting violations of the federal and Oregon Racketeer Influenced and Corrupt Organizations Acts, and for unjust enrichment, civil conspiracy, tortious interference with contract, and fraud, seeking damages, treble damages, punitive damages, a constructive trust, as well as interest, attorneys' fees and costs of suit, all in unspecified amounts, *State of Oregon v. McKesson Corporation*, No. C11-05384-SI. The Company filed an answer to the complaint on January 9, 2012.

On November 29, 2011, the court denied the Company's motion to dismiss in the previously reported action filed in Michigan state court by the State of Michigan against the Company, First DataBank, Inc., and the Hearst Corporation, *Bill Schuette ex rel. State of Michigan v. McKesson Corporation, et al.*, (11-629-CZ). No trial date has been set.

On December 6, 2011, the Company entered into a settlement agreement with the State of Oklahoma with respect to the claims it asserted against the Company on behalf of the Oklahoma State and Education Employees Group Insurance Board (OSEEGIB) in the Douglas County, Kansas Action. Pursuant to the settlement, on December 14, 2011, the parties filed a stipulation of dismissal with prejudice as to the claims Oklahoma asserted on behalf of OSEEGIB.

On December 14, 2011, the court entered a judgment denying the Company's motion to dismiss in the previously reported action filed in Louisiana state court by the State of Louisiana against the Company, *State of Louisiana v. McKesson Corporation*, (No. C597634 Sec. 23). On December 19, 2011, the Company filed an application for a supervisory writ with the Louisiana Court of Appeals challenging the trial court's ruling that the State of Louisiana is the proper party to assert damages claims on behalf of Louisiana's Medicaid program. No trial date has been set.

On December 15, 2011, the Company entered into a settlement agreement with the San Francisco Health Plan and the City Attorney of San Francisco in *San Francisco Health Plan v. McKesson Corporation* (No. 1:08-CV-10843-PBS) (San Francisco Action). Pursuant to the settlement, on December 21, 2011, the court entered a stipulated judgment and order, dismissing with prejudice the claims asserted on behalf of the San Francisco Health Plan and the People of the State of California, and dismissing without prejudice the causes of action asserted on behalf of the State of California under the California False Claims Act.

On January 5, 2012, the Company, Oakland County, Michigan, and the City of Sterling Heights, Michigan, filed a stipulated order of dismissal, which is contingent on the court granting final approval of the settlement in the Douglas County, Kansas Action, in the previously reported action filed in the United States District Court for Massachusetts by these Michigan public entities against the Company, *Oakland County, Michigan et al. v. McKesson Corporation*, (No. 1:09-CV-10843-PBS). On January 12, 2012, the court entered the parties' stipulated order of dismissal.

On January 13, 2012, the court conducted a hearing on the Company's motion to dismiss in the previously reported action filed in Indiana state court by the State of Indiana against the Company and First DataBank, Inc., *State of Indiana v. McKesson Corp. et al.*, (No. 49D11-1106-PL-021595). The motion has not been ruled upon, and no trial date has been set.

As previously reported, as of March 31, 2010, the Company had a reserve relating to its AWP public entity claims of \$143 million. During the second quarter of 2011, the Company recorded an additional pre-tax charge of \$24 million for the settlement with the State of Connecticut. During the third quarter of 2011, the Company recorded an additional pre-tax charge of \$189 million following a review of the reserve, including consideration of the pace and progress of discussions relating to state and federal Medicaid claims. In 2011, the Company made a payment of \$26 million from the reserve, and as of March 31, 2011, the reserve relating to the Company's AWP litigation was \$330 million.

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MCKESSON CORPORATION

FINANCIAL NOTES (CONTINUED)

(UNAUDITED)

During the second and third quarters of 2012, the Company recorded pre-tax charges of \$118 million and \$27 million following a review of its AWP reserve, including consideration of the Douglas County, Kansas Action settlement and the pace and progress of discussions relating to potentially resolving other public entity claims. In 2012, the Company made payments of \$26 million from the reserve, and as of December 31, 2011, the reserve relating to the Company's AWP litigation was \$449 million. The Company's AWP litigation reserve is included in other current liabilities in the condensed consolidated balance sheets. Pre-tax charges relating to changes in the Company's AWP litigation reserve are recorded within its Distribution Solutions segment. In view of the number of outstanding cases and expected future claims, and the uncertainties of the timing and outcome of this type of litigation, it is possible that the ultimate costs of these matters may exceed or be less than the reserve.

B. Other Litigations

As previously reported, the Company's subsidiary, McKesson Medical-Surgical Inc. (MMS), has been named as a defendant in multiple cases pending in Nevada state court alleging that plaintiffs contracted Hepatitis C after being administered the drug Propofol during medical procedures conducted by third parties. The previously reported Propofol trial scheduled to commence on December 6, 2011, has been stayed pending a possible settlement involving no contribution from MMS, and the next related trial in which MMS is a named defendant is presently scheduled to commence in February 2012.

As previously reported, on October 3, 2008, the United States filed a complaint in intervention in a pending *qui tam* action in the United States District Court for the Northern District of Mississippi, naming as defendants, among others, the Company and its former indirect subsidiary, McKesson Medical-Surgical MediNet Inc. (MediNet), now merged into and doing business as McKesson Medical-Surgical MediMart Inc. (collectively the McKesson Defendants), *United States ex rel. Jamison v. McKesson Corporation, et al.*, (Civil Action No. 2:08-CV-00214-SA). The United States (USA) alleges violations of the federal False Claims Act, 31 U.S.C. Sections 3729-33, in connection with billing and supply services rendered by MediNet to the long-term care facility operator co-defendants under two contracts awarded to MediNet in calendar years 2003 and 2006. On March 25, 2010, the trial court, on defendants' motion, dismissed the relator and his complaint, which ruling was later affirmed on appeal by the United States Court of Appeals for the Fifth Circuit. On March 28, 2011, the trial court, on further motion of the Company and its co-defendants, dismissed all causes of action, including purported False Claims Act violations, which were based on an alleged failure to comply with Medicare Supplier Standards. The balance of the USA's allegations center on whether fees charged by MediNet to the customer for certain services were so low that they should be viewed as an illegal inducement of other business, in violation of the federal Anti-Kickback Statute, 42 U.S.C. Sections 1320a-7b(b), and whether all claims submitted to Medicare were, as a result, false claims. In September of 2011, the Company and MediNet moved for summary judgment on the USA's remaining causes of action on multiple grounds, and the parties are awaiting the trial court's rulings. In the event the USA's claims are not all dismissed by the trial court in its summary judgment rulings, a non-jury trial is scheduled to commence on February 21, 2012. In its most recent filings, the USA has stated that it intends to seek damages, which after trebling as allowed by the False Claims Act, total \$82 million, and will additionally seek between \$407 million to \$814 million in fines and penalties. The McKesson Defendants strongly dispute any liability, disagree with those claims for damages, fines and penalties and, based on experience, believe that such claimed damages amounts are not meaningful indicators of potential liability.

As previously reported, prior to its acquisition by the Company, US Oncology was informed that the United States Federal Trade Commission (FTC) and the Attorney General for the State of Texas (Texas AG) had opened investigations to determine whether the acquisition of certain physicians by an Austin, Texas based oncology practice with which US Oncology conducts business violated federal or state antitrust laws. US Oncology has reached an agreement with the Texas AG fully resolving its inquiry, and the FTC has informed US Oncology that it has closed its file regarding the matter.

Table of Contents**MCKESSON CORPORATION****FINANCIAL NOTES (CONTINUED)****(UNAUDITED)****13. Stockholders' Equity**

Each share of the Company's outstanding common stock is permitted one vote on proposals presented to stockholders and is entitled to share equally in any dividends declared by the Company's Board of Directors (the "Board").

In April 2011, the quarterly dividend was raised from \$0.18 to \$0.20 per common share for dividends declared on and after such date, until further action by the Board. The Company anticipates that it will continue to pay quarterly cash dividends in the future. However, the payment and amount of future dividends remain within the discretion of the Board and will depend upon the Company's future earnings, financial condition, capital requirements and other factors.

Share Repurchase Plans

In March 2011, we entered into an accelerated share repurchase ("ASR") program with a third party financial institution to repurchase \$275 million of the Company's common stock. The program was funded with cash on hand. As of March 31, 2011, we had received 3.1 million shares representing the minimum number of shares due under the program. We received 0.4 million additional shares in May 2011 upon the completion of this ASR program. The total number of shares repurchased under this ASR program was 3.5 million shares at an average price of \$79.65 per share.

In April 2011, the Board of Directors authorized the repurchase of up to an additional \$1.0 billion of the Company's common stock, bringing the total authorization outstanding to \$1.5 billion. In May 2011, we entered into another ASR program with a third party financial institution to repurchase \$650 million of the Company's common stock. The program was funded with cash on hand. As of June 30, 2011, we had received 6.7 million shares representing the minimum number of shares due under the program. We received 1.3 million additional shares in August 2011 upon completion of this ASR program. The total number of shares repurchased under this ASR program was 8.0 million shares at an average price of \$81.50 per share. As of December 31, 2011, \$850 million remained authorized for future common stock repurchases under the April 2011 authorization.

In January 2012, the Board of Directors authorized the repurchase of up to an additional \$650 million of the Company's common stock, bringing the total authorization outstanding to \$1.5 billion.

Stock repurchases may be made from time-to-time in open market transactions, privately negotiated transactions, through accelerated share repurchase programs, or by any combination of such methods. The timing of any repurchases and the actual number of shares repurchased will depend on a variety of factors, including our stock price, corporate and regulatory requirements, restrictions under our debt obligations and other market and economic conditions.

Comprehensive Income

Comprehensive income is as follows:

<i>(In millions)</i>	Quarter Ended		Nine Months Ended	
	December 31, 2011	December 31, 2010	December 31, 2011	December 31, 2010
Net income	\$ 300	\$ 155	\$ 882	\$ 780
Translation adjustments and other	23	53	(85)	45
Comprehensive income	\$ 323	\$ 208	\$ 797	\$ 825

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Translation adjustments and other are primarily the result of the impact of currency exchange rates on our foreign subsidiaries.

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McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

14. Segment Information

We report our operations in two operating segments: McKesson Distribution Solutions and McKesson Technology Solutions. The factors for determining the reportable segments included the manner in which management evaluates the performance of the Company combined with the nature of the individual business activities. We evaluate the performance of our operating segments on a number of measures, including operating profit before interest expense, income taxes and results from discontinued operations. Financial information relating to our reportable operating segments and reconciliations to the condensed consolidated totals is as follows:

<i>(In millions)</i>	Quarter Ended December 31,		Nine Months Ended December 31,	
	2011	2010	2011	2010
Revenues				
Distribution Solutions ⁽¹⁾				
Direct distribution & services	\$ 21,585	\$ 19,408	\$ 63,484	\$ 57,094
Sales to customers warehouses	5,198	4,731	14,998	14,133
Total U.S. pharmaceutical distribution & services	26,783	24,139	78,482	71,227
Canada pharmaceutical distribution & services	2,473	2,574	7,739	7,485
Medical-Surgical distribution & services	760	744	2,364	2,200
Total Distribution Solutions	30,016	27,457	88,585	80,912
Technology Solutions				
Services ⁽²⁾	643	629	1,916	1,828
Software & software systems	152	135	449	408
Hardware	28	26	85	83
Total Technology Solutions	823	790	2,450	2,319
Total	\$ 30,839	\$ 28,247	\$ 91,035	\$ 83,231
Operating profit				
Distribution Solutions ⁽³⁾	\$ 510	\$ 289	\$ 1,462	\$ 1,285
Technology Solutions ^{(2) (4) (5)}	69	106	277	184
Total	579	395	1,739	1,469
Corporate	(89)	(81)	(285)	(252)
Interest Expense	(64)	(53)	(192)	(140)
Income from Continuing Operations Before Income Taxes	\$ 426	\$ 261	\$ 1,262	\$ 1,077

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- (1) Revenues derived from services represent less than 2% of this segment's total revenues for the quarters and nine months ended December 31, 2011 and 2010.
- (2) Revenues and operating profit for the quarter and nine months ended December 31, 2010 include the recognition of \$23 million of revenue for a disease management contract for which the related expenses were previously recognized as incurred.
- (3) Operating profit includes AWP litigation charges of \$27 million and \$145 million for the quarter and nine months ended December 31, 2011 and \$189 million and \$213 million for the quarter and nine months ended December 31, 2010, which were recorded in operating expenses. Operating profit for the nine months ended December 31, 2010 includes the receipt of \$51 million representing our share of a settlement of an antitrust class action lawsuit brought against a drug manufacturer, which was recorded as a reduction to cost of sales.
- (4) Operating profit for the quarter and nine months ended December 31, 2011 includes charges of \$42 million for a product alignment plan, of which \$26 million and \$16 million were recorded in cost of sales and operating expenses.
- (5) Operating profit for the nine months ended December 31, 2010 includes a \$72 million asset impairment charge for capitalized software held for sale, which was recorded in cost of sales.

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McKESSON CORPORATION
FINANCIAL NOTES (CONCLUDED)
(UNAUDITED)

15. Subsequent Event

On January 30, 2012, we announced an agreement to acquire substantially all of the assets of Drug Trading Company Limited, the independent banner business of the Katz Group Canada Inc., and Medicine Shoppe Canada Inc., the franchise business of the Katz Group Canada Inc. The purchase price is approximately CAD \$920 million, which we expect to fund from available cash. The acquisition is subject to customary closing conditions including all necessary Canadian regulatory clearances. After the closing, the banner and franchise operations will be included in the results of our Canadian pharmaceuticals distribution and services business, which is part of our Distribution Solutions segment.

Table of Contents**MCKESSON CORPORATION****FINANCIAL REVIEW****(UNAUDITED)****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.
GENERAL**

Management's discussion and analysis of financial condition and results of operations, referred to as the Financial Review, is intended to assist the reader in the understanding and assessment of significant changes and trends related to the results of operations and financial position of the Company together with its subsidiaries. This discussion and analysis should be read in conjunction with the condensed consolidated financial statements and accompanying financial notes in Item 1 of Part I of this Quarterly Report on Form 10-Q and in Item 8 of Part II of our 2011 Annual Report on Form 10-K.

The Company's fiscal year begins on April 1 and ends on March 31. Unless otherwise noted, all references to a particular year shall mean the Company's fiscal year.

Certain statements in this report constitute forward-looking statements. See "Factors Affecting Forward-Looking Statements" included in this Quarterly Report on Form 10-Q.

Financial Overview

<i>(In millions, except per share amounts)</i>	Quarter Ended December 31,			Nine Months Ended December 31,		
	2011	2010	Change	2011	2010	Change
Revenues	\$ 30,839	\$ 28,247	9%	\$ 91,035	\$ 83,231	9%
Litigation Charges	\$ 27	\$ 189	(86)%	\$ 145	\$ 213	(32)%
Income from Continuing Operations Before Income Taxes	\$ 426	\$ 261	63%	\$ 1,262	\$ 1,077	17%
Income Tax Expense	(126)	(106)	19	(380)	(369)	3
Income from Continuing Operations	300	155	94	882	708	25
Discontinued Operation – gain on sale, net of tax					72	NM
Net Income	\$ 300	\$ 155	94	\$ 882	\$ 780	13
Diluted Earnings Per Common Share						
Continuing Operations	\$ 1.20	\$ 0.60	100%	\$ 3.51	\$ 2.69	