

MCKESSON CORP
Form 10-Q
October 29, 2008

**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 quarterly period ended September 30, 2008

**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)

Delaware

(State or other jurisdiction of incorporation or
organization)

94-3207296

(IRS 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)

Securities registered pursuant to Section 12(g) of the Act: None.

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 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. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes No

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 September 30, 2008

Common stock, \$0.01 par value

273,477,503 shares

McKESSON CORPORATION
TABLE OF CONTENTS

| Item | Page |
|---------------------------------------------------------------------------------------------------------------------|-------------|
| <u>PART I. FINANCIAL INFORMATION</u> | |
| 1. Condensed Consolidated Financial Statements | |
| <u>Condensed Consolidated Balance Sheets</u> September 30, 2008 and March 31, 2008 | 3 |
| <u>Condensed Consolidated Statements of Operations</u> Quarters and Six Months ended September 30, 2008 and 2007 | 4 |
| <u>Condensed Consolidated Statements of Cash Flows</u> Six Months ended September 30, 2008 and 2007 | 5 |
| <u>Financial Notes</u> | 6 |
| 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 19-27 |
| 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 28 |
| 4. <u>Controls and Procedures</u> | 28 |
| <u>PART II. OTHER INFORMATION</u> | |
| 1. <u>Legal Proceedings</u> | 28 |
| 1A. <u>Risk Factors</u> | 28 |
| 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 28 |
| 3. <u>Defaults Upon Senior Securities</u> | 29 |
| 4. <u>Submission of Matters to a Vote of Security Holders</u> | 29 |
| 5. <u>Other Information</u> | 29 |
| 6. <u>Exhibits</u> | 30 |
| <u>Signatures</u> | 31 |
| <u>EXHIBIT 10.1</u> | |
| <u>EXHIBIT 10.2</u> | |
| <u>EXHIBIT 10.3</u> | |
| <u>EXHIBIT 10.4</u> | |
| <u>EXHIBIT 10.5</u> | |
| <u>EXHIBIT 10.6</u> | |
| <u>EXHIBIT 10.7</u> | |

EXHIBIT 10.8
EXHIBIT 10.9
EXHIBIT 10.10
EXHIBIT 10.11
EXHIBIT 10.12
EXHIBIT 31.1
EXHIBIT 31.2
EXHIBIT 32

McKESSON CORPORATION
PART I. FINANCIAL INFORMATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions, except per share amounts)

| | September 30, 2008 (Unaudited) | March 31, 2008 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------|---------------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 1,123 | \$ 1,362 |
| Receivables, net | 7,025 | 7,213 |
| Inventories, net | 9,183 | 9,000 |
| Prepaid expenses and other | 207 | 211 |
| Total | 17,538 | 17,786 |
| | | |
| Property, Plant and Equipment, Net | 777 | 775 |
| Capitalized Software Held for Sale, Net | 209 | 199 |
| Goodwill | 3,524 | 3,345 |
| Intangible Assets, Net | 716 | 661 |
| Other Assets | 1,813 | 1,837 |
| Total Assets | \$ 24,577 | \$ 24,603 |
| | | |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current Liabilities | | |
| Drafts and accounts payable | \$ 12,086 | \$ 12,032 |
| Deferred revenue | 1,064 | 1,210 |
| Other accrued liabilities | 1,998 | 2,106 |
| Total | 15,148 | 15,348 |
| | | |
| Long-Term Debt | 1,795 | 1,795 |
| Other Noncurrent Liabilities | 1,285 | 1,339 |
| | | |
| Other 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 Shares authorized: September 30, 2008 and March 31, 2008 800 Shares issued: September 30, 2008 351 and March 31, 2008 351 | 4 | 4 |
| Additional Paid-in Capital | 4,340 | 4,252 |

Edgar Filing: MCKESSON CORP - Form 10-Q

| | | | | |
|----------------------------------------------|-----------------------|-----------|-----------|---------|
| Retained Earnings | | 5,910 | 5,586 | |
| Accumulated Other Comprehensive Income | | 103 | 152 | |
| Other | | (12) | (13) | |
| Treasury Shares, at Cost, September 30, 2008 | 77 and March 31, 2008 | 74 | (3,996) | (3,860) |
| Total Stockholders' Equity | | 6,349 | 6,121 | |
| Total Liabilities and Stockholders' Equity | | \$ 24,577 | \$ 24,603 | |

See Financial Notes

3

McKESSON CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except per share amounts)
(Unaudited)

| | Quarter Ended | | Six Months Ended | |
|-------------------------------------------------------|----------------------|-------------|-------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Revenues | \$ 26,574 | \$ 24,450 | \$ 53,278 | \$ 48,978 |
| Cost of Sales | 25,272 | 23,269 | 50,708 | 46,620 |
| | | | | |
| Gross Profit | 1,302 | 1,181 | 2,570 | 2,358 |
| Operating Expenses | 921 | 827 | 1,818 | 1,648 |
| Securities Litigation Credit, Net | | (5) | | (5) |
| | | | | |
| Total Operating Expenses | 921 | 822 | 1,818 | 1,643 |
| | | | | |
| Operating Income | 381 | 359 | 752 | 715 |
| Other Income, Net | 33 | 36 | 54 | 73 |
| Interest Expense | (35) | (36) | (69) | (72) |
| | | | | |
| Income from Continuing Operations Before Income Taxes | 379 | 359 | 737 | 716 |
| Income Tax Expense | (52) | (112) | (175) | (233) |
| | | | | |
| Income from Continuing Operations | 327 | 247 | 562 | 483 |
| Discontinued Operations, Net | | | | (1) |
| | | | | |
| Net Income | \$ 327 | \$ 247 | \$ 562 | \$ 482 |
| | | | | |
| Earnings Per Common Share | | | | |
| Diluted | \$ 1.17 | \$ 0.83 | \$ 2.00 | \$ 1.60 |
| Basic | \$ 1.19 | \$ 0.85 | \$ 2.04 | \$ 1.64 |
| | | | | |
| Dividends Declared Per Common Share | \$ 0.12 | \$ 0.06 | \$ 0.24 | \$ 0.12 |
| | | | | |
| Weighted Average Shares | | | | |
| Diluted | 280 | 299 | 281 | 302 |

Basic

275

293

276

295

See Financial Notes

4

McKESSON CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Unaudited)

| | Six Months Ended September | |
|----------------------------------------------------------------------------|-----------------------------------|--------------|
| | 30, | |
| | 2008 | 2007 |
| Operating Activities | | |
| Net income | \$ 562 | \$ 482 |
| Adjustments to reconcile to net cash provided by operating activities: | | |
| Depreciation and amortization | 218 | 178 |
| Deferred taxes | 62 | 41 |
| Income tax reserve reversals | (65) | |
| Share-based compensation expense | 53 | 47 |
| Excess tax benefits from share-based payment arrangements | (7) | (43) |
| Other non-cash items | (1) | 20 |
| Total | 822 | 725 |
| Changes in operating assets and liabilities, net of business acquisitions: | | |
| Receivables | (337) | (162) |
| Impact of accounts receivable sales facility | 497 | |
| Inventories | (169) | (65) |
| Drafts and accounts payable | 17 | 791 |
| Deferred revenue | (152) | (90) |
| Taxes | 48 | 192 |
| Other | (178) | (119) |
| Total | (274) | 547 |
| Net cash provided by operating activities | 548 | 1,272 |
| Investing Activities | | |
| Property acquisitions | (80) | (83) |
| Capitalized software expenditures | (90) | (78) |
| Acquisitions of businesses, less cash and cash equivalents acquired | (320) | (51) |
| Other | 37 | (16) |
| Net cash used in investing activities | (453) | (228) |
| Financing Activities | | |
| Proceeds from short-term borrowings | 3,532 | |
| Repayments of short-term borrowings | (3,532) | |
| Repayment of long-term debt | (2) | (8) |
| Capital stock transactions: | | |
| Issuances | 65 | 183 |

Edgar Filing: MCKESSON CORP - Form 10-Q

| | | |
|---------------------------------------------------------------------|----------|----------|
| Share repurchases, including shares surrendered for tax withholding | (147) | (695) |
| Share repurchases, retirements | (204) | |
| Excess tax benefits from share-based payment arrangements | 7 | 43 |
| ESOP notes and guarantees | 1 | 8 |
| Dividends paid | (50) | (36) |
| Other | 1 | 7 |
| Net cash used in financing activities | (329) | (498) |
| Effect of exchange rate changes on cash and cash equivalents | (5) | 18 |
| Net (decrease) increase in cash and cash equivalents | (239) | 564 |
| Cash and cash equivalents at beginning of period | 1,362 | 1,954 |
| Cash and cash equivalents at end of period | \$ 1,123 | \$ 2,518 |

See Financial Notes

5

McKESSON 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 majority-owned or controlled companies. Significant 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). Accordingly, certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with GAAP have been condensed.

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, these unaudited condensed consolidated financial statements include all adjustments necessary for a fair presentation of the Company s financial position as of September 30, 2008, the results of operations for the quarters and six months ended September 30, 2008 and 2007 and cash flows for the six months ended September 30, 2008 and 2007.

The results of operations for the quarters and six months ended September 30, 2008 and 2007 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 2008 consolidated financial statements previously filed with the SEC. 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: Effective March 31, 2007, we adopted Statement of Financial Accounting Standards (SFAS) No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. SFAS No. 158 requires the recognition of an asset or a liability in the condensed consolidated balance sheets reflecting the funded status of pension and other postretirement benefits, with current-year changes in the funded status recognized in stockholders equity. SFAS No. 158 did not change the existing criteria for measurement of periodic benefit costs, plan assets or benefit obligations. Additionally, SFAS No. 158 requires that the measurement of defined benefit plan assets and obligations are to be performed as of the Company s fiscal year-end. We will adopt this provision of SFAS No. 158 in the fourth quarter of 2009.

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements, which provides a consistent definition of fair value that focuses on exit price and prioritizes the use of market-based inputs over entity-specific inputs for measuring fair value. SFAS No. 157 requires expanded disclosures about fair value measurements and establishes a three-level hierarchy for fair value measurements. In February 2008, the FASB issued FASB Staff Position (FSP) Financial Accounting Standard (FAS) No. 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Interpretive Accounting Pronouncements That Address Leasing Transactions, which removes leasing from the scope of SFAS No. 157. In February 2008, the FASB also issued FSP FAS No. 157-2, Effective Date of FASB Statement No. 157, which permits companies to partially defer the effective date of SFAS No. 157 for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis.

McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

As required, we adopted SFAS No. 157 for financial assets and financial liabilities and for nonfinancial assets and nonfinancial liabilities that are remeasured at least annually as of April 1, 2008. We have elected to defer adoption of SFAS No. 157 for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. Accordingly, we have not applied the provisions of SFAS No. 157 in the fair value measurement of the nonfinancial assets and nonfinancial liabilities we recorded in connection with our business acquisitions during the year. The provisions of SFAS No. 157 are applied prospectively. The adoption of SFAS No. 157 on April 1, 2008 did not have a material impact on our condensed consolidated financial statements and no adjustment to retained earnings was required.

In October 2008, the FASB issued FSP No. FAS 157-3, *Determining the Fair Value of a Financial Asset in a Market That Is Not Active*, which applies to financial assets within the scope of accounting pronouncements that require or permit fair value measurements in accordance with SFAS No. 157. This FSP clarifies the application of SFAS No. 157 in a market that is not active and defines additional key criteria in determining the fair value of a financial asset when the market for that financial asset is not active. We are currently evaluating the impact of this standard on our consolidated financial statements which became effective for us upon issuance.

On April 1, 2008, we adopted SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, including an amendment of FASB Statement No. 115. SFAS No. 159 permits us to elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities that are not otherwise required to be measured at fair value, on an instrument-by-instrument basis. If we elect the fair value option, we would be required to recognize subsequent changes in fair value in our earnings. This standard also establishes presentation and disclosure requirements designed to improve comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. While SFAS No. 159 became effective for us in 2009, we did not elect the fair value measurement option for any of our existing assets and liabilities and accordingly SFAS No. 159 did not have any impact on our consolidated financial statements. We could elect this option for new or substantially modified assets and liabilities in the future.

On April 1, 2008, we adopted SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* an amendment of FASB Statement No. 133. This statement requires enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* and its related interpretations and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. As this standard impacts disclosures only, the adoption of this standard did not have a material impact on our consolidated financial statements.

Newly Issued Accounting Pronouncements: In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*. SFAS No. 141(R) amends SFAS No. 141 and provides revised guidance for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed and any noncontrolling interest in the acquiree. It also provides disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of the business combination. We are currently evaluating the impact of this standard on our consolidated financial statements which will become effective for us on April 1, 2009.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* an amendment of ARB No. 51. This statement requires reporting entities to present noncontrolling interests as equity (as opposed to as a liability or mezzanine equity) and provides guidance on the accounting for transactions between an entity and noncontrolling interests. We are currently evaluating the impact of this standard on our consolidated financial statements which will become effective for us on April 1, 2009.

In April 2008, the FASB issued FSP No. FAS 142-3, *Determination of the Useful Life of Intangible Assets*, FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. We are currently evaluating the impact of this standard on our consolidated financial statements which will become

effective for us on April 1, 2009.

McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. This statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP. While this statement formalizes the sources and hierarchy of GAAP within the authoritative accounting literature, it does not change the accounting principles that are already in place. This statement will be effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. SFAS No. 162 is not expected to have a material impact on our consolidated financial statements.

In June 2008, the FASB issued FSP No. Emerging Issue Task Force (EITF) 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. FSP No. EITF 03-6-1 concluded that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of basic earnings per share (EPS) pursuant to the two-class method. This FSP becomes effective for us on April 1, 2009. Early adoption of the FSP is not permitted; however, it will apply retrospectively to our EPS as previously reported. We do not currently anticipate that this FSP will have a material impact upon adoption.

In September 2008, the FASB issued FSP No. FAS 133-1 and FASB Interpretation (FIN) No. 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FAS No. 133 and FIN No. 45; and Clarification of the Effective Date of FAS No. 161*. This FSP becomes effective for us during the third quarter of 2009. As this standard impacts disclosures only, the adoption of this standard will not have an impact on our consolidated financial statements.

2. Acquisitions and Investments

In 2009, we made the following acquisition:

- On May 21, 2008, we acquired McQueary Brothers Drug Company (McQueary Brothers), of Springfield, Missouri for approximately \$191 million. McQueary Brothers is a regional distributor of pharmaceutical, health, and beauty products to independent and regional chain pharmacies in the Midwestern U.S. This acquisition expanded our existing U.S. pharmaceutical distribution business. The acquisition was funded with cash on hand. Approximately \$125 million of the preliminary purchase price allocation has been assigned to goodwill, which primarily reflects the expected future benefits from synergies to be realized upon integrating the business. Financial results for McQueary Brothers are included within our Distribution Solutions segment since the date of acquisition.

In 2008, we made the following acquisition:

- On October 29, 2007, we acquired all of the outstanding shares of Oncology Therapeutics Network (OTN) of San Francisco, California for approximately \$532 million, including the assumption of debt and net of \$31 million of cash acquired from OTN. OTN is a U.S. distributor of specialty pharmaceuticals. The acquisition of OTN expanded our existing specialty pharmaceutical distribution business. The acquisition was funded with cash on hand. Approximately \$257 million of the preliminary purchase price allocation has been assigned to goodwill, which primarily reflects the expected future benefits from synergies to be realized upon integrating the business. Financial results of OTN are included within our Distribution Solutions segment since the date of acquisition.

McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

During the first six months of 2009 and over the last two years, we also completed a number of other smaller acquisitions and investments within both of our operating segments. Financial results for our business acquisitions have been included in our 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 and, for certain recent acquisitions, may be subject to change as we continue to evaluate and implement various restructuring initiatives. Goodwill recognized for our business acquisitions is generally not expected to be deductible for tax purposes. Pro forma results of operations for our business acquisitions have not been presented because the effects were not material to the consolidated financial statements on either an individual or an aggregate basis.

3. Gain on Sale of Equity Investment

In July 2008, our Distribution Solutions segment sold its 42% equity interest in Verispan, L.L.C. (Verispan), a data analytics company, for a pre-tax gain of approximately \$24 million or \$14 million after income taxes. The pre-tax gain is included in other income on our condensed consolidated statements of operations.

4. Share-Based Payment

We provide share-based compensation for our employees, officers and non-employee directors, including stock options, the employee stock purchase plan, restricted stock (RS), restricted stock units (RSUs) and performance-based restricted stock units (PeRSUs) (collectively, share-based awards). PeRSUs are RSUs for which the number of RSUs awarded may be conditional upon the attainment of one or more performance objectives over a specified period. At the end of the performance period, if the goals are attained, the award is classified as a RSU and is accounted for on that basis.

Share-based compensation expense is measured based on the grant-date fair value of the share-based awards. We recognize compensation expense on a straight-line basis over the requisite service period for those awards with graded vesting and service conditions. For awards with performance conditions and multiple vest dates, we recognize the expense on an accelerated basis. For awards with performance conditions and a single vest date, we recognize the expense on a straight-line basis. Vesting of PeRSUs ranges from one to three-year periods following the end of the performance period and may follow graded or cliff vesting. Compensation expense is recognized for the portion of the awards that are ultimately expected to vest. We develop an estimate of the number of share-based awards that will ultimately vest primarily based on historical experience. The estimated forfeiture rate is adjusted throughout the requisite service period. As required, forfeiture estimates are adjusted to reflect actual forfeiture and vesting activity as they occur.

Compensation expense recognized for share-based compensation has been classified in the condensed consolidated statements of operations or capitalized on the condensed consolidated balance sheets in the same manner as cash compensation paid to our employees. There was no material share-based compensation expense capitalized in the condensed consolidated balance sheets for the quarters and six months ended September 30, 2008 and 2007.

McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

Most of the Company's share-based awards are granted in the first quarter of each fiscal year. The components of share-based compensation expense and the related tax benefit for the quarters and six months ended September 30, 2008 and 2007 are shown in the following table:

| <i>(In millions, except per share amounts)</i> | Quarter Ended | | Six Months Ended | |
|------------------------------------------------------------|----------------------|-------------|-------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| RSUs and RS ⁽¹⁾ | \$ 15 | \$ 14 | \$ 34 | \$ 27 |
| PeRSUs ⁽²⁾ | 5 | 8 | 7 | 10 |
| Stock options | 4 | 4 | 8 | 6 |
| Employee stock purchase plan | 1 | 2 | 4 | 4 |
| Share-based compensation expense | 25 | 28 | 53 | 47 |
| Tax benefit for share-based compensation expense | (8) | (10) | (18) | (17) |
| Share-base compensation expense, net of tax ⁽³⁾ | \$ 17 | \$ 18 | \$ 35 | \$ 30 |
| Impact of share-based compensation: | | | | |
| Earnings per share | | | | |
| Diluted | \$0.06 | \$0.06 | \$0.12 | \$0.10 |
| Basic | \$0.06 | \$0.06 | \$0.13 | \$0.10 |

(1) Substantially all of this expense was the result of PeRSUs awarded in prior years which converted to RSUs due to the attainment of goals during the prior years performance period.

(2) Represents estimated compensation expense for PeRSUs that are conditional upon attaining performance objectives

during the applicable year's performance period.

- (3) No material share-based compensation expense was included in Discontinued Operations.

Share-based compensation charges are affected by our stock price, changes in our vesting methodologies, as well as assumptions regarding a number of complex and subjective variables and the related tax impact. These variables include, but are not limited to, the volatility of our stock price, employee stock option exercise behavior, timing, level and types of our grants of annual share-based awards, the attainment of performance goals and actual forfeiture rates. As a result, the actual future share-based compensation expense may differ from historical levels of expense.

5. Restructuring Activities

The following table summarizes the activity related to our restructuring liabilities:

| <i>(In millions)</i> | Distribution Solutions | | Technology Solutions | | Corporate | Total |
|-------------------------------------|-------------------------------|---------------------|-----------------------------|---------------------|------------------|--------------|
| | Severance | Exit-Related | Severance | Exit-Related | Severance | |
| Balance, March 31, 2008 | \$ 7 | \$ 7 | \$ 6 | \$ 6 | \$ 2 | \$ 28 |
| Expenses | 1 | | | | (1) | |
| Liabilities related to acquisitions | 2 | 1 | | | | 3 |
| Cash expenditures | (5) | (3) | (3) | (2) | | (13) |
| Balance, September 30, 2008 | \$ 5 | \$ 5 | \$ 3 | \$ 4 | \$ 1 | \$ 18 |

McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

As a result of our recent acquisitions, we have a number of restructuring activities pertaining to the consolidation of business functions and facilities from newly acquired businesses. In connection with our OTN acquisition within our Distribution Solutions segment, to date we recorded \$6 million of employee severance costs and \$4 million of facility exit costs. In connection with our Per-Se acquisition within our Technology Solutions segment, to date we recorded a total of \$19 million of employee severance costs and \$5 million of facility exit and contract termination costs. As of September 30, 2008, substantially all of the \$18 million restructuring accrual is expected to be disbursed in 2009. Accrued restructuring liabilities are included in other accrued and other noncurrent liabilities in the condensed consolidated balance sheets.

Based on our current initiatives, we expect to substantially complete all of these activities by the end of 2009. Expenses associated with these initiatives are not anticipated to be material. We are, however, continuing to evaluate other restructuring initiatives pertaining to our newly acquired businesses, which may have an impact on future net income. Approximately 690 employees, consisting primarily of distribution, general and administrative staff were planned to be terminated as part of our restructuring plans, of which 540 employees had been terminated as of September 30, 2008. Restructuring expenses were recorded as operating expenses in our condensed consolidated statements of operations.

6. Income Taxes

During the second quarter and first six months of 2009, income tax expense included \$76 million of net income tax benefits for discrete items primarily relating to previously unrecognized tax benefits and related accrued interest. The recognition of these discrete items is primarily due to the lapsing of the statutes of limitations. Of the \$76 million of net tax benefits, \$65 million represents a non-cash benefit to McKesson. In accordance with SFAS No. 109,

Accounting for Income Taxes, the net tax benefit is included in our income tax expense from continuing operations.

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (The Act), which included a retroactive reinstatement of the federal research and development credit, was signed into law. The Act extends the federal research and development credit to December 31, 2009 and we are in the process of assessing the tax impact of this extension.

As of September 30, 2008, we had \$518 million of unrecognized tax benefits, of which \$304 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 expiration of statutes of limitations could potentially reduce our unrecognized tax benefits by up to \$65 million. However, this amount may change because we continue to have ongoing negotiations with various taxing authorities throughout the year. In June 2008, the Internal Revenue Service began its examination of fiscal years 2003 through 2006.

We continue to report interest and penalties on tax deficiencies as income tax expense. At September 30, 2008, before any tax benefits, our accrued interest on unrecognized tax benefits amounted to \$117 million. We recognized income tax benefits of \$35 million and \$13 million, before any tax effect, related to interest in our condensed consolidated statements of operations for the quarter and six months ended September 30, 2008. We have no material amounts accrued for penalties.

7. Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the reporting period. Diluted earnings per share is computed similarly 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.

McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

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

| <i>(In millions, except per share data)</i> | Quarter Ended | | Six Months Ended | |
|---------------------------------------------|----------------------|-------------|-------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Income from continuing operations | \$ 327 | \$ 247 | \$ 562 | \$ 483 |
| Discontinued operations, net | | | | (1) |
| Net income | \$ 327 | \$ 247 | \$ 562 | \$ 482 |
| Weighted average common shares outstanding: | | | | |
| Basic | 275 | 293 | 276 | 295 |
| Effect of dilutive securities: | | | | |
| Options to purchase common stock | 4 | 5 | 4 | 6 |
| Restricted stock units | 1 | 1 | 1 | 1 |
| Diluted | 280 | 299 | 281 | 302 |
| Earnings Per Common Share: ⁽¹⁾ | | | | |
| Diluted | \$1.17 | \$0.83 | \$2.00 | \$1.60 |
| Basic | \$1.19 | \$0.85 | \$2.04 | \$1.64 |

(1) Certain computations may reflect rounding adjustments.

Approximately 9 million and 10 million stock options were excluded from the computations of diluted net earnings per share for the quarters ended September 30, 2008 and 2007 as their exercise price was higher than the Company's average stock price for the quarter. For the six months ended September 30, 2008 and 2007, the number of stock options excluded was approximately 12 million and 11 million.

8. Goodwill and Intangible Assets, Net

Changes in the carrying amount of goodwill for the six months ended September 30, 2008 are as follows:

| <i>(In millions)</i> | Distribution Solutions | Technology Solutions | Total |
|------------------------------------|-------------------------------|-----------------------------|--------------|
| Balance, March 31, 2008 | \$1,672 | \$1,673 | \$3,345 |
| Goodwill acquired | 158 | 31 | 189 |
| Foreign currency adjustments | (2) | (8) | (10) |
| Balance, September 30, 2008 | \$1,828 | \$1,696 | \$3,524 |

Information regarding intangible assets is as follows:

| <i>(In millions)</i> | September 30, 2008 | March 31, 2008 |
|--------------------------|-----------------------------------|---------------------------|
| Customer lists | \$ 819 | \$ 725 |
| Technology | 187 | 176 |
| Trademarks and other | 74 | 61 |
| Gross intangibles | 1,080 | 962 |
| Accumulated amortization | (364) | (301) |
| Intangible assets, net | \$ 716 | \$ 661 |

McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

Amortization expense of intangible assets was \$34 million and \$64 million for the quarter and six months ended September 30, 2008 and \$26 million and \$52 million for the quarter and six months ended September 30, 2007. The weighted average remaining amortization periods for customer lists, technology and trademarks and other intangible assets at September 30, 2008 were: 8 years, 3 years and 7 years. Estimated annual amortization expense of these assets is as follows: \$127 million, \$117 million, \$109 million, \$102 million and \$84 million for 2009 through 2013, and \$241 million thereafter. As of March 31, 2008, there were \$4 million of intangible assets not subject to amortization which included trade names and trademarks. All intangible assets were subject to amortization as of September 30, 2008.

9. Financing Activities

In June 2008, we renewed our accounts receivable sales facility under substantially similar terms to those previously in place, except that we increased the committed balance from \$700 million to \$1.0 billion. The renewed facility expires in June 2009. Through this facility, we receive cash proceeds from selling undivided ownership interests in our trade receivables to special purpose entities owned and operated by banks. These transactions are accounted for as a sale in accordance with SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, because we have relinquished control of the receivables. Accordingly, accounts receivable sold under these transactions are excluded from receivables, net in the accompanying condensed consolidated balance sheets. Total receivables sold for the quarter and six months ended September 30, 2008 were \$3.2 billion and \$4.4 billion for which we received fair value of the same amount and \$497 million of the facility was utilized at September 30, 2008. There were no receivables sold for the quarter and six months ended September 30, 2007. Discounts are recorded within administrative expenses in the condensed consolidated statements of operations. Although we continue servicing the sold receivables, no servicing liabilities are recorded because costs regarding collection of the sold receivables are insignificant.

We have a \$1.3 billion five-year, senior unsecured revolving credit facility which expires in June 2012. Total borrowings under this facility were \$189 million during the six months ended September 30, 2008. As of September 30, 2008, there were no amounts outstanding under this facility. There were no borrowings for the six months ended September 30, 2007.

We issued and repaid approximately \$3.3 billion in commercial paper during the six months ended September 30, 2008. There were no commercial paper issuances outstanding at September 30, 2008. There were no issuances during the six months ended September 30, 2007.

10. Pension and Other Postretirement Benefit Plans

Net periodic expense for the Company's defined pension and other postretirement benefit plans was \$2 million and \$5 million for the second quarter and first six months of 2009 compared to \$5 million and \$16 million for the comparable prior year periods. The decline in net periodic expense in 2009 compared to 2008 was due primarily to favorable claims experience and higher assumed discount rates. Cash contributions to these plans for the first six months of 2009 were \$14 million.

McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

11. Financial Guarantees and Warranties

Financial Guarantees

We have agreements with certain of our customers' financial institutions under which we have guaranteed the repurchase of inventory (primarily for our Canadian business) at a discount in the event these customers are unable to meet certain obligations to those financial institutions. Among other requirements, these inventories must be in resalable condition. Customer guarantees range from one to seven years and were primarily provided to facilitate financing for certain strategic customers. We also have an agreement with one software customer that, under limited circumstances, might 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 September 30, 2008, the maximum amounts of inventory repurchase guarantees and other customer guarantees were approximately \$116 million and \$8 million, of which a nominal amount has been accrued.

In addition, our banks and insurance companies have issued \$106 million of standby letters of credit and surety bonds on our behalf 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 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. Revenue from these maintenance agreements is 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.

McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

12. Other 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. In accordance with SFAS No. 5, Accounting for Contingencies, we record a provision for a liability when management believes that it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We believe we have adequate provisions for any such matters. Management reviews these provisions at least quarterly and adjusts these provisions to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Because litigation outcomes are inherently unpredictable, these decisions often involve a series of complex assessments by management about future events and can rely heavily on estimates and assumptions.

Based on our experience, we believe that any damage amounts claimed in the specific matters referenced in our Annual Report on Form 10-K for the fiscal year ended March 31, 2008 (2008 Annual Report), Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2008 (First Quarter 2009 Form 10-Q) and those matters discussed below are not meaningful indicators of our potential liability. We believe that we have valid defenses to these legal proceedings and are defending the matters vigorously. Nevertheless, the outcome of any litigation is inherently uncertain. We are currently unable to estimate the remaining possible losses in these unresolved legal proceedings. Should any one or a combination of more than one of these proceedings against us be successful, or should we determine to settle any or a combination of these matters on unfavorable terms, 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.

As more fully described in our previous public reports filed with the SEC, we are involved in numerous legal proceedings. For a discussion of these proceedings, please refer to the financial statement footnote entitled Other Commitments and Contingent Liabilities included in our 2008 Annual Report and First Quarter 2009 Form 10-Q. Significant developments in previously reported proceedings and in other litigation and claims since the referenced filings are set out below.

I. Average Wholesale Price Litigation

On August 7, 2008, in the previously described civil action pending against the Company in the United States District Court, District of Massachusetts, *New England Carpenters Health Benefits Fund et al., v. First DataBank, Inc. and McKesson Corporation*, (Civil Action No. 1:05-CV-11148-PBS) (*New England Carpenters I*), the court issued its order denying plaintiffs motion to certify a class made up of uninsured consumers who paid usual and customary prices for prescription drugs from August 1, 2001 through the present, although the court did so without prejudice to the plaintiffs renewing their motion at a future date based on new facts developed in ongoing discovery. The previously certified third party payor and percentage co-pay consumer class claims in *New England Carpenters I* based on alleged violations of the Racketeer Influenced and Corrupt Organizations Act (RICO) remain set for trial commencing December 1, 2008. Expert discovery is ongoing, and in connection with those proceedings plaintiffs have produced a report which claims total damages through March 15, 2005, for the third party payor class and the consumer percentage co-pay class of \$5.6 billion, inclusive of prejudgment interest. As a subset of this total, the plaintiffs report claims damages for the respective certified class periods scheduled for trial of \$3.7 billion for the third party payor class, and \$150 million for the consumer percentage co-pay class, both amounts inclusive of prejudgment interest. Under RICO, any damages awarded at trial would be trebled and prejudgment interest would be discretionary.

McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

As previously reported, on December 10, 2007, the same plaintiffs named in the *New England Carpenters I* civil action filed a civil class action complaint under federal and state antitrust laws against the Company in the United States District Court, District of Massachusetts, *New England Carpenters Health Benefits Fund et al., v. McKesson Corporation*, (Civil Action No. 1:07-CV-12277-PBS) (*New England Carpenters II*). On August 27, 2008, the trial court entered an order granting the Company's motion to dismiss *New England Carpenters II* without leave to amend. On September 2, 2008, the trial court entered an order staying the previously reported actions, *San Francisco Health Plan et al v. McKesson Corporation*, (Civil Action No. 1:08-CA-10843-PBS) (*San Francisco action*") and *State of Connecticut v. McKesson Corporation*, (Civil Action No. 1:08-CV-10900-PBS) (*Connecticut action*").

On August 7, 2008, an action was filed in the United States District Court for the District of Massachusetts by the Board of County Commissioners of Douglas County, Kansas on behalf of itself and a purported national class of state, local and territorial governmental entities against the Company and First DataBank, Inc. (*FDB*), alleging violations of civil RICO and federal antitrust laws and seeking damages and treble damages, as well as injunctive relief, interest, attorneys' fees and costs of suit, all in unspecified amounts, *Board of County Commissioners of Douglas County, Kansas v. McKesson Corporation et al.*, (Civil Action No. 1:08-CV-11349-PBS) (*Kansas action*").

On August 18, 2008, a class action was filed by the City of Panama City, Florida on behalf of itself and a class of Florida state and local governmental entities, alleging violations of civil RICO, federal and state antitrust laws and the Florida Deceptive and Unfair Trade Practices Act, and seeking damages and treble damages, as well as injunctive relief, interest, attorneys' fees and costs of suit, all in unspecified amounts, *City of Panama City, Florida v. McKesson Corporation, et al.*, (Civil Action No. 1:08-CV-11423-PBS) (*Florida action*"). On October 15, 2008, an action was filed in the United States District Court for the District of Massachusetts by the State of Oklahoma on behalf of itself and a class of Oklahoma state and local governmental entities, agencies and subdivisions against the Company and *FDB*, alleging violations of civil RICO, the Oklahoma Consumer Protection Act (*OCPA*) and civil conspiracy to violate the *OCPA*, and seeking damages, treble damages and civil penalties, as well as injunctive relief, interest, attorneys' fees and costs of suit, all in unspecified amounts, *State of Oklahoma v. McKesson Corporation et al.*, (Civil Action No. 1:08-CV-11745-PBS) (*Oklahoma action*"). The *Kansas action*, *Florida action* and *Oklahoma action* are each based on factual allegations substantially identical to those previously reported for *New England Carpenters I*, the *San Francisco action* and the *Connecticut action* already pending in the U.S. District Court for the District of Massachusetts.

II. Other Litigation and Claims

As previously reported, the Company has been cooperating in an investigation by the United States Attorney's Office for the Northern District of Mississippi into whether it would intervene in a civil *qui tam* action purportedly filed on December 29, 2004, against the Company and other defendants by a relator now known to be Thomas F. Jamison. On October 3, 2008, the United States filed a Complaint in Intervention in the United States District Court for the Northern District of Mississippi, naming as defendants, among others, the Company and its former indirect subsidiary, Medical-Surgical MediNet Inc., now merged into and doing business as McKesson Medical-Surgical MediMart Inc., *United States v. McKesson Corporation, et al.*, (Civil Action No. 2:08-CV-00214-SA-SAA). The government's complaint alleges violations of the False Claims Act, 31 U.S.C. Sections 3729-33, as well as a common law claim for unjust enrichment, and seeks monetary damages, treble damages, injunctive relief, civil penalties and costs of suit, all in unspecified amounts. The Company has not yet responded to the complaint.

McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

13. Stockholders' Equity

Comprehensive income is as follows:

| <i>(In millions)</i> | Quarter Ended | | Six Months Ended | |
|----------------------------------------------------|----------------------|-------------|-------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Net income | \$327 | \$247 | \$562 | \$482 |
| Foreign currency translation adjustments and other | (59) | 68 | (49) | 119 |
| Comprehensive income | \$268 | \$315 | \$513 | \$601 |

In April and September 2007, the Company's Board of Directors (the Board) approved two plans to repurchase up to \$2.0 billion of the Company's common stock (\$1.0 billion per plan). In 2008, we repurchased a total of 28 million shares for \$1,686 million, fully utilizing the April 2007 plan and leaving \$314 million remaining on the September 2007 plan. In April 2008, the Board approved a new plan to repurchase an additional \$1.0 billion of the Company's common stock. During the second quarter and first six months of 2009, we repurchased 4 million and 6 million shares for \$204 million and \$334 million, fully utilizing the September 2007 plan and leaving \$980 million available for future repurchase as of September 30, 2008. Stock repurchases may be made from time to time in open market or private transactions.

In July 2008, the Board authorized the retirement of shares of the Company's common stock that may be repurchased from time to time pursuant to its stock repurchase program. During the second quarter of 2009, all repurchased shares were formally retired by the Company. The retired shares constitute authorized but unissued shares. We elected to allocate any excess of share repurchase price over par value between additional paid-in capital and retained earnings. At September 30, 2008, \$165 million was recorded as a decrease to retained earnings. Shares repurchased prior to the second quarter of 2009 were designated as treasury shares.

In April 2008, the Board approved a change in the Company's dividend policy by increasing the amount of the Company's quarterly dividend from six cents to twelve cents per share which will apply to ensuing quarterly dividend declarations until further action by the Board. 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.

McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

14. Segment Information

We report our operations in two operating segments: Distribution Solutions and Technology Solutions. We evaluate the performance of our operating segments based on 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 September 30, | | Six Months Ended September 30, | |
|-------------------------------------------------------|----------------------------------------|-------------|-------------------------------------------|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| Revenues | | | | |
| Distribution Solutions ⁽¹⁾ | | | | |
| U.S. pharmaceutical direct distribution & services | \$ 16,611 | \$ 14,372 | \$ 33,039 | \$ 28,570 |
| U.S. pharmaceutical sales to customers warehouses | 6,319 | 6,826 | 12,983 | 14,068 |
| Subtotal | 22,930 | 21,198 | 46,022 | 42,638 |
| Canada pharmaceutical distribution & services | 2,182 | 1,898 | 4,423 | 3,662 |
| Medical-Surgical distribution and services | 700 | 642 | 1,327 | 1,236 |
| Total Distribution Solutions | 25,812 | 23,738 | 51,772 | 47,536 |
| Technology Solutions | | | | |
| Services ⁽²⁾ | 582 | 538 | 1,146 | 1,091 |
| Software and software systems | 140 | 139 | 278 | 277 |
| Hardware | 40 | 35 | 82 | 74 |
| Total Technology Solutions | 762 | 712 | 1,506 | 1,442 |
| Total | \$ 26,574 | \$ 24,450 | \$ 53,278 | \$ 48,978 |
| Operating profit | | | | |
| Distribution Solutions ^{(3) (4)} | \$ 406 | \$ 366 | \$ 790 | \$ 706 |
| Technology Solutions ⁽²⁾ | 71 | 66 | 137 | 166 |
| Total | 477 | 432 | 927 | 872 |
| Corporate | (63) | (42) | (121) | (89) |
| Securities Litigation credit, net | | 5 | | 5 |
| Interest Expense | (35) | (36) | (69) | (72) |
| Income from Continuing Operations Before Income Taxes | \$ 379 | \$ 359 | \$ 737 | \$ 716 |

(1)

Revenues derived from services represent less than 1% of this segment's total revenues for the quarters and six months ended September 30, 2008 and 2007.

(2) Revenues and operating profit for the first six months of 2008 reflect the recognition of \$21 million of disease management deferred revenues for which expenses associated with these revenues were previously recognized as incurred.

(3) Includes net losses of \$3 million and net earnings of \$5 million from equity investments for the second quarter and first six months of 2009 and \$4 million and \$12 million of net earnings for the comparable prior year periods. Results for 2009 also include a \$24 million pre-tax gain on

the sale of our
42% equity
interest in
Verispan.

- (4) Operating profit for the first six months of 2008 includes \$14 million representing our share of antitrust class action lawsuit settlements brought against certain drug manufacturers. These settlements were recorded as reductions to cost of sales within our condensed consolidated statements of operations.

15. Subsequent Event

In October 2008, we entered into an agreement to sell our Distribution Solutions specialty pharmacy business (a business within McKesson's Specialty Care Solutions division). The sale is subject to various customary closing conditions including regulatory review and is expected to close during the third quarter of 2009. The financial impact of this sale is not expected to be material to our condensed consolidated financial statements.

McKESSON CORPORATION
FINANCIAL REVIEW
(UNAUDITED)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Financial Overview

| <i>(In millions, except per share data)</i> | Quarter Ended September 30, | | | Six Months Ended September 30, | | |
|----------------------------------------------------------|----------------------------------------|-------------|---------------|-------------------------------------------|-------------|---------------|
| | 2008 | 2007 | Change | 2008 | 2007 | Change |
| Revenues | \$ 26,574 | \$ 24,450 | 9% | \$ 53,278 | \$ 48,978 | 9% |
| Income from Continuing Operations Before Income Taxes | 379 | 359 | 6 | 737 | 716 | 3 |
| Income Tax Expense | (52) | (112) | (54) | (175) | (233) | (25) |
| Discontinued Operations, Net | | | | | (1) | NM |
| Net Income | \$ 327 | \$ 247 | 32 | \$ 562 | \$ 482 | 17 |
| Diluted Earnings Per Share: | \$ 1.17 | \$ 0.83 | 41% | \$ 2.00 | \$ 1.60 | 25% |
| Weighted Average Diluted Shares | 280 | 299 | (6) | 281 | 302 | (7) |

NM not meaningful

Revenues for the quarter ended September 30, 2008 grew 9% to \$26.6 billion, net income increased 32% to \$327 million and diluted earnings per share increased 41% to \$1.17 compared to the same period a year ago. For the first six months of 2009, revenue increased 9% to \$53.3 billion, net income increased 17% to \$562 million and diluted earnings per share increased 25% to \$2.00 compared to the same period a year ago. Increases in net income and diluted earnings per share primarily reflect the recognition of \$76 million of previously unrecognized tax benefits and related interest expense as a result of the effective settlement of uncertain tax positions and improvement in our Distribution Solutions segment, which includes a \$24 million pre-tax gain on the sale of our 42% equity interest in Verispan, L.L.C. (Verispan). Diluted earnings per share also benefited from the impact of share repurchases made in 2008 and the first half of 2009.

Results of Operations

Revenues:

| <i>(In millions)</i> | Quarter Ended September 30, | | | Six Months Ended September 30, | | |
|-------------------------------------------------------|----------------------------------------|-------------|---------------|-------------------------------------------|-------------|---------------|
| | 2008 | 2007 | Change | 2008 | 2007 | Change |
| Distribution Solutions | | | | | | |
| U.S. pharmaceutical direct distribution & services | \$ 16,611 | \$ 14,372 | 16% | \$ 33,039 | \$ 28,570 | 16% |
| U.S. pharmaceutical sales to customers warehouses | 6,319 | 6,826 | (7) | 12,983 | 14,068 | (8) |
| Subtotal | 22,930 | 21,198 | 8 | 46,022 | 42,638 | 8 |
| Canada pharmaceutical distribution & services | 2,182 | 1,898 | 15 | 4,423 | 3,662 | 21 |
| Medical-Surgical distribution & services | 700 | 642 | 9 | 1,327 | 1,236 | 7 |

Edgar Filing: MCKESSON CORP - Form 10-Q

| | | | | | | |
|-------------------------------|-----------|-----------|----|-----------|-----------|----|
| Total Distribution Solutions | 25,812 | 23,738 | 9 | 51,772 | 47,536 | 9 |
| Technology Solutions Services | 582 | 538 | 8 | 1,146 | 1,091 | 5 |
| Software and software systems | 140 | 139 | 1 | 278 | 277 | |
| Hardware | 40 | 35 | 14 | 82 | 74 | 11 |
| Total Technology Solutions | 762 | 712 | 7 | 1,506 | 1,442 | 4 |
| Total Revenues | \$ 26,574 | \$ 24,450 | 9 | \$ 53,278 | \$ 48,978 | 9 |

McKESSON CORPORATION
FINANCIAL REVIEW (CONTINUED)
(UNAUDITED)

Revenues increased by 9% to \$26.6 billion and 9% to \$53.3 billion during the quarter and six months ended September 30, 2008 compared to the same periods a year ago. The increase primarily reflects growth in our Distribution Solutions segment which accounted for over 97% of consolidated revenues.

U.S. pharmaceutical direct distribution and services revenues increased primarily reflecting market growth rates (which include growing drug utilization and price increases, offset in part by the increased use of lower priced generics), our acquisition of Oncology Therapeutics Network (OTN) in October 2007 and expanded business with existing customers. U.S. pharmaceutical sales to customers' warehouses decreased primarily reflecting a decrease in volume from a large customer, the loss of a large customer and reduced revenues associated with the consolidation of certain customers. These decreases were partially offset by expanded business with existing customers. In addition, U.S. pharmaceutical revenues benefited from one additional day of sales in 2009 compared with the same prior year periods.

Canadian pharmaceutical distribution revenues increased primarily reflecting new and expanded business and market growth rates. For the first half of 2009, revenues also benefited from a 5% favorable foreign exchange rate impact. In addition, revenues benefited from one additional day of sales during the second quarter of 2009 and three additional days of sales during the first six months of 2009 compared to the same periods a year ago.

Medical-Surgical distribution and services revenues increased primarily reflecting market growth rates and earlier sales of flu vaccines.

Technology Solutions segment revenues increased in the second quarter of 2009 compared to the same period a year ago primarily due to increased services revenues reflecting the segment's expanded customer base and higher disease management and outsourcing revenues. Additionally, during the second quarter of 2009, the segment saw some hospital customers delay their purchasing decisions, particularly in the last two weeks of the quarter. For the first six months of 2009, Technology Solutions segment revenues increased primarily due to increased services revenues reflecting the segment's expanded customer base, partially offset by lower disease management revenues. During the first six months of 2008, the segment recognized \$21 million of disease management deferred revenues for which expenses associated with these revenues were previously recognized as incurred.

Gross Profit:

| <i>(Dollars in millions)</i> | 2008 | Quarter Ended September 30, 2007 | Change | 2008 | Six Months Ended September 30, 2007 | Change |
|------------------------------|-------------|-------------------------------------------------|---------------|-------------|----------------------------------------------------|---------------|
| Gross Profit | | | | | | |
| Distribution Solutions | \$ 951 | \$ 848 | 12% | \$1,885 | \$1,670 | 13% |
| Technology Solutions | 351 | 333 | 5 | 685 | 688 | |
| Total | \$1,302 | \$1,181 | 10 | \$2,570 | \$2,358 | 9 |
| Gross Profit Margin | | | | | | |
| Distribution Solutions | 3.68% | 3.57% | 11 bp | 3.64% | 3.51% | 13 bp |
| Technology Solutions | 46.06 | 46.77 | (71) | 45.48 | 47.71 | (223) |
| Total | 4.90 | 4.83 | 7 | 4.82 | 4.81 | 1 |

Gross profit increased 10% and 9% in the second quarter and first six months of 2009 compared to the same periods a year ago. As a percentage of revenues, gross profit margin increased in the second quarter of 2009 and was relatively unchanged for the first six months of 2009 compared to the same periods a year ago. Gross profit margin for 2009 benefited from improvements in our Distribution Solutions segment. Gross profit margin for the first half of

2008 was impacted by our Technology Solutions segment's recognition of \$21 million of disease management deferred revenues for which expenses associated with these revenues were previously recognized as incurred.

20

McKESSON CORPORATION
FINANCIAL REVIEW (CONTINUED)
(UNAUDITED)

Distribution Solutions segment's gross profit margin increased by 11 basis points to 3.68% in the second quarter of 2009 and by 13 basis points to 3.64% in the first six months of 2009 compared to the same periods a year ago. In the second quarter and the first six months of 2009, gross profit margin was impacted by the benefit of increased sales of generic drugs with higher margins and a benefit associated with a lower proportion of revenues within the segment attributed to sales to customers' warehouses, which have lower gross profit margins relative to other revenues within the segment. In the second quarter, these benefits were partially offset by lower buy side margin primarily reflecting the timing of compensation from branded pharmaceutical manufacturers. For the first six months of 2009, these positive gross profit margin benefits were partially reduced by a \$14 million decrease in antitrust settlements. During the first six months of 2008, we received \$14 million of antitrust settlements representing our share of cash proceeds from two antitrust class action lawsuits.

Technology Solutions segment's gross profit margin decreased in the second quarter and first six months of 2009 compared to the same periods a year ago. Gross profit margin was impacted primarily by a change in product mix and, for the first half of 2009, due to the recognition in 2008 of \$21 million of disease management deferred revenues for which expenses associated with these revenues were previously recognized as incurred.

Operating Expenses and Other Income:

| <i>(Dollars in millions)</i> | Quarter Ended September 30, | | | Six Months Ended September 30, | | |
|---------------------------------------------------|----------------------------------------|-------------|---------------|-------------------------------------------|-------------|---------------|
| | 2008 | 2007 | Change | 2008 | 2007 | Change |
| Operating Expenses | | | | | | |
| Distribution Solutions | \$ 570 | \$ 491 | 16% | \$1,132 | \$ 987 | 15% |
| Technology Solutions | 282 | 270 | 4 | 552 | 527 | 5 |
| Corporate | 69 | 66 | 5 | 134 | 134 | |
| Securities Litigation credit, net | | (5) | NM | | (5) | NM |
| Total | \$ 921 | \$ 822 | 12 | \$1,818 | \$1,643 | 11 |
| Operating Expenses as a Percentage of Revenues | | | | | | |
| Distribution Solutions | 2.21% | 2.07% | 14 bp | 2.19% | 2.08% | 11 bp |
| Technology Solutions | 37.01 | 37.92 | (91) | 36.65 | 36.55 | 10 |
| Total | 3.47 | 3.36 | 11 | 3.41 | 3.35 | 6 |
| Other Income, Net | | | | | | |
| Distribution Solutions ⁽¹⁾ | \$ 25 | \$ 9 | 178% | \$ 37 | \$ 23 | 61% |
| Technology Solutions | 2 | 3 | (33) | 4 | 5 | (20) |
| Corporate | 6 | 24 | (75) | 13 | 45 | (71) |
| Total | \$ 33 | \$ 36 | (8) | \$ 54 | \$ 73 | (26) |

(1) Includes the second quarter of 2009

Distribution
Solutions
segment's sale of
its 42% equity
interest in
Verispan.

Operating expenses for the second quarter of 2009 increased 12% to \$921 million and for the first half of 2009 increased 11% to \$1.8 billion. As a percentage of revenues, operating expenses for the second quarter and first half of 2009 increased 11 basis points to 3.47% and 6 basis points to 3.41%. Operating expense dollars increased primarily due to our business acquisitions and additional costs incurred to support our sales volume growth.

Distribution Solutions segment's operating expenses increased primarily due to business acquisitions and additional costs incurred to support our sales volume growth. Operating expenses as a percentage of revenues increased primarily due to our business acquisitions, higher distribution and information technology costs, as well as a change in business mix.

McKESSON CORPORATION
FINANCIAL REVIEW (CONTINUED)
(UNAUDITED)

Technology Solutions segment's operating expenses increased during the second quarter primarily due to additional costs incurred to support our sales growth and business acquisitions. For the first six months of 2009, operating expenses were also impacted by an increase in net research and development expenses, which was partially offset by a decrease in bad debt expense. Operating expenses as a percentage of revenues decreased in the second quarter of 2009 primarily reflecting the segment's business mix. Operating expenses as a percentage of revenues for the first six months of 2009 increased primarily reflecting the impact of the \$21 million of disease management deferred revenues recognized for which expenses associated with these revenues were previously recognized as incurred, partially offset by a favorable business mix.

Corporate expenses remained relatively unchanged compared to prior year periods.

Other income, net decreased primarily reflecting a decrease in interest income due to lower cash balances and lower interest rates and a net increase in losses from our equity investments. These decreases were partially offset by a \$24 million pre-tax gain from the sale of our 42% equity interest in Verispan. Interest income is primarily recorded at Corporate and financial results for Verispan are recorded within our Distribution Solutions segment.

Segment Operating Profit and Corporate Expenses:

| <i>(Dollars in millions)</i> | Quarter Ended September 30, | | | Six Months Ended September 30, | | |
|--------------------------------------------------------------|----------------------------------------|-------------|---------------|-------------------------------------------|-------------|---------------|
| | 2008 | 2007 | Change | 2008 | 2007 | Change |
| Segment Operating Profit ⁽¹⁾ | | | | | | |
| Distribution Solutions | \$ 406 | \$ 366 | 11% | \$ 790 | \$ 706 | 12% |
| Technology Solutions | 71 | 66 | 8 | 137 | 166 | (17) |
| Subtotal | 477 | 432 | 10 | 927 | 872 | 6 |
| Corporate Expenses, net | (63) | (42) | 50 | (121) | (89) | 36 |
| Securities Litigation credit, net | | 5 | NM | | 5 | NM |
| Interest Expense | (35) | (36) | (3) | (69) | (72) | (4) |
| Income from Continuing Operations, Before Income Taxes | \$ 379 | \$ 359 | 6 | \$ 737 | \$ 716 | 3 |
| Segment Operating Profit Margin | | | | | | |
| Distribution Solutions | 1.57% | 1.54% | 3 bp | 1.53% | 1.49% | 4 bp |
| Technology Solutions | 9.32 | 9.27 | 5 | 9.10 | 11.51 | (241) |

(1) Segment operating profit includes gross profit, net of operating expenses plus other income for our two

business
segments.

Operating profit as a percentage of revenues in our Distribution Solutions segment increased slightly primarily reflecting higher gross profit margin and the gain on the sale of our equity interest in Verispan, partially offset by higher operating expenses as a percentage of revenues.

In October 2008, we entered into an agreement to sell our Distribution Solutions specialty pharmacy business (a business within McKesson's Specialty Care Solutions division). The sale is subject to various customary closing conditions including regulatory review and is expected to close during the third quarter of 2009. The financial impact of this sale is not expected to be material to our condensed consolidated financial statements.

McKESSON CORPORATION
FINANCIAL REVIEW (CONTINUED)
(UNAUDITED)

Operating profit as a percentage of revenues in our Technology Solutions segment increased during the second quarter of 2009 primarily reflecting favorable operating expenses as a percentage of revenues, partially offset by a decrease in gross profit margin. Operating profit as a percentage of revenues decreased during the first half of 2009 primarily reflecting a decrease in gross profit margin, including the \$21 million of deferred revenue recognized during the first half of 2008 for which expenses had been recognized in prior years and by an increase in operating expenses as a percentage of revenues.

Corporate expenses, net increased primarily due to lower interest income.

Securities Litigation: During the second quarter of 2008, we recorded net credits of \$5 million relating to certain settlements for our Securities Litigation.

Interest Expense: Interest expense decreased primarily reflecting the repayment of \$150 million of term debt during the fourth quarter of 2008.

Income Taxes: The Company's reported income tax rates for the second quarters of 2009 and 2008 were 13.7% and 31.2% and for the first six months of 2009 and 2008, were 23.7% and 32.5%. In addition to the items noted below, fluctuations in our reported tax rate are primarily due to changes within state and foreign tax rates resulting from our business mix, including varying proportions of income attributable to foreign countries that have lower income tax rates. During the second quarter of 2009, income tax expense included \$76 million of net income tax benefits for discrete items primarily relating to previously unrecognized tax benefits and related accrued interest. The recognition of these discrete items is primarily due to the lapsing of the statutes of limitations. Of the \$76 million of net tax benefits, \$65 million represents a non-cash benefit to McKesson. During the first six months of 2009, income tax expense included \$71 million of net income tax benefits for discrete items.

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (The Act), which included a retroactive reinstatement of the federal research and development credit, was signed into law. The Act extends the federal research and development credit to December 31, 2009 and we are in the process of assessing the tax impact of this extension.

During the second quarter of 2008, our estimated annual effective tax rate decreased from a range of 34% - 35% to 33.0% primarily due to an estimated higher proportion of income attributed to foreign countries. This decrease required a \$3 million cumulative catch-up benefit to income taxes associated with the first quarter of 2008.

Net Income: Net income was \$327 million and \$247 million for the second quarters of 2009 and 2008, or \$1.17 and \$0.83 per diluted share. Net income was \$562 million and \$482 million for the first six months of 2009 and 2008, or \$2.00 and \$1.60 per diluted share.

McKESSON CORPORATION
FINANCIAL REVIEW (CONTINUED)
(UNAUDITED)

Weighted Average Diluted Shares Outstanding: Diluted earnings per share were calculated based on an average number of diluted shares outstanding of 280 million and 299 million for the second quarters of 2009 and 2008 and 281 million and 302 million for the six months ended September 30, 2008 and 2007. The decrease in the number of weighted average diluted shares outstanding primarily reflects a decrease in the number of common shares outstanding as a result of repurchased stock, partially offset by exercised stock options.

Business Acquisitions

In 2009, we made the following acquisition:

- On May 21, 2008, we acquired McQueary Brothers Drug Company (McQueary Brothers), of Springfield, Missouri for approximately \$191 million. McQueary Brothers is a regional distributor of pharmaceutical, health, and beauty products to independent and regional chain pharmacies in the Midwestern U.S. This acquisition expanded our existing U.S. pharmaceutical distribution business. The acquisition was funded with cash on hand. Approximately \$125 million of the preliminary purchase price allocation has been assigned to goodwill, which primarily reflects the expected future benefits from synergies to be realized upon integrating the business. Financial results for McQueary Brothers are included within our Distribution Solutions segment since the date of acquisition.

In 2008, we made the following acquisition:

- On October 29, 2007, we acquired all of the outstanding shares of OTN of San Francisco, California for approximately \$532 million, including the assumption of debt and net of \$31 million of cash acquired from OTN. OTN is a U.S. distributor of specialty pharmaceuticals. The acquisition of OTN expanded our existing specialty pharmaceutical distribution business. The acquisition was funded with cash on hand. Approximately \$257 million of the preliminary purchase price allocation has been assigned to goodwill, which primarily reflects the expected future benefits from synergies to be realized upon integrating the business. Financial results of OTN are included within our Distribution Solutions segment since the date of acquisition.

During the first six months of 2009 and over the last two years, we also completed a number of other smaller acquisitions and investments within both of our operating segments. Financial results for our business acquisitions have been included in our 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 and, for certain recent acquisitions, may be subject to change as we continue to evaluate and implement various restructuring initiatives. Goodwill recognized for our business acquisitions is generally not expected to be deductible for tax purposes. Pro forma results of operations for our business acquisitions have not been presented because the effects were not material to the consolidated financial statements on either an individual or an aggregate basis. Refer to Financial Note 2, Acquisitions and Investments, to the accompanying condensed consolidated financial statements for further discussions regarding our acquisitions and investing activities.

New Accounting Developments

New accounting pronouncements that we have recently adopted as well as those that have been recently issued but not yet adopted by us are included in Financial Note 1, Significant Accounting Policies to the accompanying condensed consolidated financial statements.

McKESSON CORPORATION
FINANCIAL REVIEW (CONTINUED)
(UNAUDITED)

Financial Condition, Liquidity and Capital Resources

Operating activities provided cash of \$548 million and \$1,272 million during the first six months of 2009 and 2008. Operating activities for 2009 reflect a decrease in accounts payable, as well as increases in our accounts receivable and inventory balances primarily associated with the timing of payments and receipts, as well as inventory purchases. Operating activities for 2008 reflect an increase in accounts payable associated with longer payment terms, partially offset by an increase in receivables associated with longer payment terms. Cash flows from operations can be significantly impacted by factors such as the timing of receipts from customers and payments to vendors.

Investing activities utilized cash of \$453 million and \$228 million during the first six months of 2009 and 2008. Investing activities include \$320 million and \$51 million in 2009 and 2008 of payments for business acquisitions. Activity for 2009 includes the McQueary Brothers acquisition for approximately \$191 million. Investing activities for 2009 and 2008 include \$80 million and \$83 million of property acquisitions.

Financing activities utilized cash of \$329 million and \$498 million in the first six months of 2009 and 2008. Financing activities for 2009 were favorably impacted by a \$344 million reduction in the use of cash for share repurchases partially offset by a \$118 million decrease in cash receipts from employees' exercises of stock options compared to the first six months of 2008.

In April and September 2007, the Company's Board of Directors (the Board) approved two plans to repurchase up to \$2.0 billion of the Company's common stock (\$1.0 billion per plan). In 2008, we repurchased a total of 28 million shares for \$1,686 million, fully utilizing the April 2007 plan and leaving \$314 million remaining on the September 2007 plan. In April 2008, the Board approved a new plan to repurchase an additional \$1.0 billion of the Company's common stock. During the second quarter and first six months of 2009, we repurchased 4 million and 6 million shares for \$204 million and \$334 million, fully utilizing the September 2007 plan and leaving \$980 million available for future repurchase as of September 30, 2008. Stock repurchases may be made from time to time in open market or private transactions.

In July 2008, the Board authorized the retirement of shares of the Company's common stock that may be repurchased from time to time pursuant to its stock repurchase program. During the second quarter of 2009, all repurchased shares were formally retired by the Company. The retired shares constitute authorized but unissued shares. Shares repurchased prior to the second quarter of 2009 were designated as treasury shares.

Selected Measures of Liquidity and Capital Resources

| <i>(Dollars in millions)</i> | September 30, 2008 | March 31, 2008 |
|-------------------------------------------------|-----------------------------------|---------------------------|
| Cash and cash equivalents | \$ 1,123 | \$ 1,362 |
| Working capital | 2,390 | 2,438 |
| Debt, net of cash and cash equivalents | 676 | 435 |
| Debt to capital ratio ⁽¹⁾ | 22.1% | 22.7% |
| Net debt to net capital employed ⁽²⁾ | 9.6 | 6.6 |
| Return on stockholders' equity ⁽³⁾ | 16.9 | 15.6 |

(1) Ratio is computed as total debt divided by total debt and stockholders

equity.

(2) Ratio is computed as total debt, net of cash and cash equivalents (net debt), divided by net debt and stockholders equity (net capital employed).

(3) Ratio is computed as net income for the last four quarters, divided by a five-quarter average of stockholders equity.

McKESSON CORPORATION
FINANCIAL REVIEW (CONTINUED)
(UNAUDITED)

Working capital primarily includes cash and cash equivalents, receivables, inventories, drafts and accounts payable, deferred revenue and other current liabilities. Our Distribution Solutions segment requires a substantial investment in working capital that is susceptible to large variations during the year as a result of inventory purchase patterns and seasonal demands. Inventory purchase activity is a function of sales activity and new customer build-up requirements. Consolidated working capital decreased primarily due to the sale of \$497 million of our accounts receivable as well as a decrease in cash and cash equivalents.

Our ratio of net debt to net capital employed increased in 2009 primarily due to a decrease in our cash and cash equivalent balances.

In April 2008, the Board approved a change in the Company's dividend policy by increasing the amount of the Company's quarterly dividend from six cents to twelve cents per share which will apply to ensuing quarterly dividend declarations until further action by the Board. 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.

Credit Resources

We fund our working capital requirements primarily with cash and cash equivalents, short-term borrowings and our receivables sales facility.

In June 2008, we renewed our accounts receivable sales facility under substantially similar terms to those previously in place, except that we increased the committed balance from \$700 million to \$1.0 billion. The renewed facility expires in June 2009. Through this facility, we receive cash proceeds from selling undivided ownership interests in our trade receivables to special purpose entities owned and operated by banks. These transactions are accounted for as a sale in accordance with Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," because we have relinquished control of the receivables. Accordingly, accounts receivable sold under these transactions are excluded from receivables, net in the accompanying condensed consolidated balance sheets. Total receivables sold for the quarter and six months ended September 30, 2008 were \$3.2 billion and \$4.4 billion for which we received fair value of the same amount and \$497 million of the facility was utilized at September 30, 2008. There were no receivables sold for the quarter and six months ended September 30, 2007. Discounts are recorded within administrative expenses in the condensed consolidated statements of operations. Although we continue servicing the sold receivables, no servicing liabilities are recorded because costs regarding collection of the sold receivables are insignificant.

We have a \$1.3 billion five-year, senior unsecured revolving credit facility which expires in June 2012. Total borrowings under this facility were \$189 million during the six months ended September 30, 2008. As of September 30, 2008, there were no amounts outstanding under this facility. There were no borrowings for the six months ended September 30, 2007.

We issued and repaid approximately \$3.3 billion in commercial paper during the six months ended September 30, 2008. There were no commercial paper issuances outstanding at September 30, 2008. There were no issuances during the six months ended September 30, 2007.

Our various borrowing facilities and long-term debt are subject to certain covenants. Our principal debt covenant is our debt to capital ratio, which cannot exceed 56.5%. If we exceed this ratio, repayment of debt outstanding under the revolving credit facility and \$215 million of term debt could be accelerated. As of September 30, 2008, this ratio was 22.1% and we were in compliance with our other financial covenants. A reduction in our credit ratings or the lack of compliance with our covenants could negatively impact our ability to finance operations through our credit facilities, or issue additional debt at the interest rates then currently available.

Funds necessary for future debt maturities and our other cash requirements are expected to be met by existing cash balances, cash flows from operations, existing credit sources and other capital market transactions.

McKESSON CORPORATION
FINANCIAL REVIEW (CONCLUDED)
(UNAUDITED)

FACTORS AFFECTING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2 of Part I of this report, contains forward-looking statements within the meaning of section 27A of the Securities Act of 1933, as amended and section 21E of the Securities Exchange Act of 1934, as amended. Some of the forward-looking statements can be identified by use of forward-looking words such as believes, expects, anticipates, may, will, should, seeks, approximates, intends, plans, or estimates, or the words, or other comparable terminology. The discussion of financial trends, strategy, plans or intentions may also include forward-looking statements. Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected, anticipated or implied. Although it is not possible to predict or identify all such risks and uncertainties, they may include, but are not limited to, the following factors. The reader should not consider this list to be a complete statement of all potential risks and uncertainties:

- § material adverse resolution of pending legal proceedings;
- § changes in the U.S. healthcare industry and regulatory environment;
- § competition;
- § the frequency or rate of branded drug price inflation and generic drug price deflation;
- § substantial defaults or material reduction in purchases by large customers;
- § implementation delay, malfunction or failure of internal information systems;
- § the adequacy of insurance to cover property loss or liability claims;
- § the company's failure to attract and retain customers for its software products and solutions due to integration and implementation challenges, or due to an inability to keep pace with technological advances;
- § loss of third party licenses for technology incorporated into the company's products and solutions;
- § the company's proprietary products and services may not be adequately protected, and its products and solutions may infringe on the rights of others;
- § failure of our technology products and solutions to conform to specifications;
- § disaster or other event causing interruption of customer access to the data residing in our service centers;
- § increased costs or product delays required to comply with existing and changing regulations applicable to our businesses and products;
- § changes in government regulations relating to patient confidentiality and to format and data content standards;
- § the delay or extension of our sales or implementation cycles for external software products;
- § changes in circumstances that could impair our goodwill or intangible assets;

- § foreign currency fluctuations or disruptions to our foreign operations;
- § new or revised tax legislation or challenges to our tax positions;
- § the company's ability to successfully identify, consummate and integrate strategic acquisitions;
- § changes in generally accepted accounting principles (GAAP); and
- § general economic conditions.

These and other risks and uncertainties are described herein or in our Forms 10-K, 10-Q, 8-K and other public documents filed with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to publicly release the result of any revisions to these forward-looking statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events.

McKESSON CORPORATION

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We believe there has been no material change in our exposure to risks associated with fluctuations in interest and foreign currency exchange rates as disclosed in our 2008 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Our Chief Executive Officer and our Chief Financial Officer, with the participation of other members of the Company's management, have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities and Exchange Act of 1934, as amended (Exchange Act)) as of the end of the period covered by this quarterly report, and our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective based on their evaluation of these controls and procedures required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15.

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See Financial Note 12, Other Commitments and Contingent Liabilities, of our unaudited condensed consolidated financial statements contained in Part I of this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors

There have been no material changes from the risk factors disclosed in Part 1, Item 1A, of our 2008 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information on the Company's share repurchases during the second quarter of 2009.

| | Share Repurchases | | | Approximate |
|----------------------------------------------|------------------------------------------------------------------------|---------------------------------------------|---------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------|
| | Total Number of Shares Purchased As Part of Publicly | Average Price Paid | Total Number of Shares Purchased As Part of Publicly Announced Program | Dollar Value of Shares that May Yet Be Purchased Under the Programs ⁽¹⁾ |
| <i>(In millions, except price per share)</i> | Total Number of Shares Purchased | Average Price Paid Per Share | | |
| July 1, 2008 - July 31, 2008 | | \$ | | \$ 1,184 |
| August 1, 2008 - August 31, 2008 | 4 | 56.56 | 4 | 990 |
| September 1, 2008 - September 30, 2008 | | 58.09 | | 980 |
| Total | 4 | 56.63 | 4 | 980 |

(1) In April and September 2007, the Board

approved two plans to repurchase up to \$2.0 billion of the Company's common stock (\$1.0 billion per plan). In 2008, repurchases fully utilized the April 2007 plan and \$314 million remained available on the September 2007 plan. In April 2008, the Board approved a new plan to repurchase an additional \$1.0 billion of the Company's common stock. In the second quarter of 2009, repurchases fully utilized the September 2007 plan.

McKESSON CORPORATION**Item 3. Defaults Upon Senior Securities**

None

Item 4. Submission of Matters to a Vote of Security Holders

The Company's Annual Meeting of Stockholders was held on July 23, 2008. The following matters were voted upon at the meeting and the stockholder votes on each such matter are briefly described below.

The Board of Directors' nominees for directors as listed in the proxy statement were each elected to serve a one-year term. The votes were as follows:

| | Votes For | Votes Against | Votes Abstained |
|------------------------|------------------|----------------------|------------------------|
| Andy D. Bryant | 245,791,369 | 892,610 | 2,441,250 |
| Wayne A. Budd | 245,703,651 | 1,003,994 | 2,417,584 |
| John H. Hammergren | 244,539,006 | 2,326,119 | 2,260,104 |
| Alton F. Irby III | 220,649,759 | 25,892,589 | 2,582,881 |
| M. Christine Jacobs | 226,067,843 | 20,649,281 | 2,408,105 |
| Marie L. Knowles | 245,758,068 | 966,356 | 2,400,805 |
| David M. Lawrence M.D. | 225,953,237 | 20,781,579 | 2,390,413 |
| Edward A. Mueller | 243,748,696 | 2,913,827 | 2,462,706 |
| James V. Napier | 226,441,541 | 20,246,484 | 2,437,204 |
| Jane E. Shaw | 244,086,669 | 2,639,470 | 2,399,090 |

The proposal to ratify the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the year ending March 31, 2009 received the following votes:

| Votes For | Votes Against | Votes Abstained |
|------------------|----------------------|------------------------|
| 246,003,775 | 721,494 | 2,399,960 |

There were no broker non-votes with respect to either of the matters described above.

Item 5. Other Information

On October 24, 2008, the Compensation Committee of the Board of Directors (the "Compensation Committee") of McKesson Corporation approved amendments to certain of the Company's compensation and benefit arrangements and individual employment agreements to comply with the final regulations promulgated under section 409A of the Internal Revenue Code of 1986, as amended (the "Code"), and guidance issued under Code section 162(m). The following arrangements and individual agreements were so amended (collectively, the "Agreements"):

- § McKesson Corporation Deferred Compensation Administration Plan III, as amended and restated on October 24, 2008;
- § McKesson Corporation Long-Term Incentive Plan, as amended and restated on October 24, 2008;
- § McKesson Corporation Supplemental Profit Sharing Investment Plan II, as amended and restated on October 24, 2008;
- § McKesson Corporation Executive Benefit Retirement Plan, as amended and restated on October 24, 2008;
- § McKesson Corporation 2005 Management Incentive Plan, as amended and restated on October 24, 2008;
- § McKesson Corporation Severance Policy for Executive Employees, as amended and restated on October 24, 2008;

§

McKesson Corporation Change in Control Policy for Selected Executive Employees, as amended and restated on October 24, 2008;

- § Amended and Restated Employment Agreement, effective November 1, 2008, by and between the Company and its Chairman, President and Chief Executive Officer;
- § Amended and Restated Employment Agreement, effective November 1, 2008, by and between the Company and its Executive Vice President and Group President; and
- § Amended and Restated Employment Agreement, effective November 1, 2008, by and between the Company and its Executive Vice President and President, McKesson Technology Solutions.

McKESSON CORPORATION

Code section 409A governs the administration of non-qualified deferred compensation, which includes certain payments under the Agreements. If the terms of the Agreements are not operated in compliance with Code section 409A currently or in written compliance beginning on January 1, 2009, such non-compliance may result in significant tax penalties for the recipients of payments that are subject to Code section 409A. Code section 162(m) limits the tax deductibility of compensation of a public company's chief executive officer and top three highest compensated officers; however, if the compensation is performance-based within the meaning of Code section 162(m), then the deduction limits will not apply. Therefore, the employment agreements of John H. Hammergren, Chairman, President and Chief Executive Officer, Paul C. Julian, Executive Vice President, Group President, and Pamela J. Pure, Executive Vice President, President, McKesson Technology Solutions, were each amended by the Compensation Committee to accord with recently published Internal Revenue Service guidance clarifying the definition of performance-based compensation under Code section 162(m).

Mr. Hammergren's employment agreement (the Hammergren Agreement) was further amended by the Compensation Committee to provide for additional retention and succession planning incentives. If Mr. Hammergren voluntarily terminates employment after the close of the fiscal year in which he has attained at least age fifty-five (55) and has completed fifteen (15) years of continuous service in one or more of the following positions: Executive Chairman of the Board, Chief Executive Officer and/or co-Chief Executive Officer, upon retirement he will receive continued vesting of his equity compensation, have the full term to exercise his outstanding stock option awards, and continue participation in the Long-Term Incentive Plan, Management Incentive Plan and performance-based restricted stock units granted under the Company's 2005 Stock Plan (or successor plans) for the performance periods that begin prior to, but end after, his retirement. Receipt of these added benefits is conditioned on Mr. Hammergren providing advance notice of his intent to retire and the Board either electing or approving by resolution his successor as Chief Executive Officer or approving a plan of succession. Mr. Hammergren will forfeit the aforementioned benefits if he breaches his obligations to the Company after his retirement, as set forth in Section 6 of the Hammergren Agreement, which includes a non-compete and non-solicitation obligation.

Item 6. Exhibits

Exhibits identified in parentheses below are on file with the SEC and are incorporated by reference as exhibits hereto.

| Exhibit Number | Description |
|----------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3 | Amended and Restated By-Laws of the Company, as amended and restated through July 23, 2008 (Exhibit 99.1 to the Company's Current Report on Form 8-K, Date of Report, July 23, 2008, File No. 1-13252). |
| 10.1 | McKesson Corporation Supplemental Profit Sharing Investment Plan II, as amended and restated on October 24, 2008. |
| 10.2 | McKesson Corporation Deferred Compensation Administration Plan III, as amended and restated on October 24, 2008. |
| 10.3 | McKesson Corporation Executive Benefit Retirement Plan, as amended and restated on October 24, 2008. |
| 10.4 | McKesson Corporation Severance Policy for Executive Employees, as amended and restated on October 24, 2008. |
| 10.5 | McKesson Corporation 2005 Management Incentive Plan, as amended and restated on October 24, 2008. |
| 10.6 | McKesson Corporation Long-Term Incentive Plan, as amended and restated on October 24, 2008. |

- 10.7 McKesson Corporation 2005 Stock Plan, as amended and restated through July 23, 2008.
- 10.8 Statement of Terms and Conditions Applicable to Restricted Stock Units Granted to Outside Directors Pursuant to the 2005 Stock Plan, effective July 23, 2008.
- 10.9 McKesson Corporation Change in Control Policy for Selected Executive Employees, as amended and restated on October 24, 2008.
- 10.10 Amended and Restated Employment Agreement, effective as of November 1, 2008, by and between the Company and its Chairman, President and Chief Executive Officer.

McKESSON CORPORATION

**Exhibit
Number**

Description

- | | |
|-------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.11 | Amended and Restated Employment Agreement, effective as of November 1, 2008, by and between the Company and its Executive Vice President and President, Mckesson Technology Solutions. |
| 10.12 | Amended and Restated Employment Agreement, effective as of November 1, 2008, by and between the Company and its Executive Vice President and Group President. |
| 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

McKesson Corporation

Dated: October 29, 2008

/s/ Jeffrey C. Campbell

Jeffrey C. Campbell

Executive Vice President and Chief Financial
Officer

/s/ Nigel A. Rees

Nigel A. Rees

Vice President and Controller