

PharMerica CORP  
Form 10-K  
February 09, 2012  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
Washington, DC 20549

**FORM 10-K**

(Mark One)

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

For the year ended December 31, 2011

or

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

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

**Commission File Number: 001-33380**

**PHARMERICA CORPORATION**

(Exact name of registrant as specified in its charter)

Delaware

87-0792558

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(State or Other Jurisdiction of

(I.R.S. Employer

Incorporation or Organization)

Identification No.)

1901 Campus Place

Louisville, KY

(Address of Principal Executive Offices)

40299

(Zip Code)

(502) 627-7000

(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

<b>Title of each class</b>	<b>Name of exchange on which registered</b>
Common stock \$0.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

N/A

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer   
Non-accelerated filer

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

The aggregate market value of the voting and non-voting common equity of the registrant held by non-affiliates as of June 30, 2011 was \$ .

**Class of Common Stock**  
Common stock, \$0.01 par value

**Outstanding at January 27, 2012**  
29,443,872 shares

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**DOCUMENTS INCORPORATED BY REFERENCE**

Part III of this Form 10-K incorporates certain information by reference from registrant's definitive proxy statement for the 2012 annual meeting of stockholders, which proxy statement will be filed no later than 120 days after the close of the registrant's fiscal year ended December 31, 2011.

**Table of Contents**

**PHARMERICA CORPORATION**

**FORM 10-K**

**INDEX**

	<b>Page</b>
<b>Part I</b>	
Item 1. <u>Business</u>	3
Item 1A. <u>Risk Factors</u>	20
Item 1B. <u>Unresolved Staff Comments</u>	34
Item 2. <u>Properties</u>	35
Item 3. <u>Legal Proceedings</u>	35
Item 4. <u>Mine Safety Disclosures</u>	37
<b>Part II</b>	
Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	38
Item 6. <u>Selected Financial Data</u>	42
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	45
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	89
Item 8. <u>Financial Statements and Supplementary Data</u>	F-1
Item 9. <u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	90
Item 9A. <u>Controls and Procedures</u>	90
Item 9B. <u>Other Information</u>	91
<b>Part III</b>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	92
Item 11. <u>Executive Compensation</u>	92
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	92
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	92
Item 14. <u>Principal Accounting Fees and Services</u>	92
<b>Part IV</b>	
Item 15. <u>Exhibits, Financial Statement Schedules</u>	93

---

**Table of Contents****Part I****Item 1. Business****Overview**

PharMerica Corporation ( the Corporation ) was formed on October 23, 2006, by Kindred Healthcare, Inc. ( Kindred or Former Parent ) and AmerisourceBergen Corporation ( AmerisourceBergen ) for the purpose of consummating the transactions contemplated by the Master Transaction Agreement dated October 25, 2006, as amended (the Master Agreement ). Pursuant to the Master Agreement, Kindred and AmerisourceBergen, through a series of transactions (collectively, the Pharmacy Transaction ), spun-off and combined their respective institutional pharmacy businesses, Kindred Pharmacy Services ( KPS ) and PharMerica Long-Term Care ( PharMerica LTC ), into a new, stand-alone, publicly traded company. The Pharmacy Transaction was consummated on July 31, 2007 (the Closing Date ).

***Unsolicited Tender Offer by Omnicare***

On August 23, 2011, Omnicare, Inc. ( Omnicare ) made public an unsolicited proposal to acquire all of the outstanding shares of the Corporation s common stock for \$15.00 per share in cash. After careful consideration with our financial and legal advisors, our Board of Directors determined unanimously that Omnicare s proposal undervalues the Corporation and was not in the best interests of our stockholders. On September 7, 2011, Omnicare, through its wholly-owned subsidiary, Philadelphia Acquisition Sub, Inc., commenced an unsolicited tender offer to purchase all of the outstanding shares of our common stock at \$15.00 per share. On September 18, 2011, the Board again met with its financial and legal advisors, and after careful consideration our Board of Directors again unanimously recommended that our stockholders reject the offer and not tender their shares of our common stock because it believes that Omnicare s tender offer (i) undervalues the Corporation and its prospects, (ii) is illusory because it is subject to significant regulatory and other uncertainty, and (iii) is opportunistic based on the Corporation s then traded market value. On September 20, 2011, we filed with the Securities and Exchange Commission ( SEC ) a Recommendation/Solicitation Statement on Schedule 14D-9 detailing the recommendation of our Board of Directors in response to Omnicare s tender offer and the reasons it rejected the offer. Please refer to Part I, Item 3 Legal Proceedings and Note 6 to our consolidated financial statements included elsewhere in this report for a discussion of certain litigation commenced in respect of Omnicare s tender offer and related actions. On October 5, 2011, Omnicare extended the expiration date of its tender offer until 5:00 p.m., New York City time, on Friday, December 2, 2011, unless further extended. On December 5, 2011, Omnicare extended the expiration date of its tender offer until 5:00 p.m., New York City time, on Friday, January 20, 2012, unless further extended. On January 19, 2012, Omnicare extended the expiration date of its tender offer until 5:00p.m., New York City time, on Friday, January 27, 2012, unless further extended. On January 27, 2012, Omnicare extended the expiration of its tender offer until 5:00 p.m., New York City time, on Friday, February 17, 2012, unless further extended.

On August 25, 2011, after careful consideration and consultation with our financial and legal advisors, our Board of Directors adopted a rights plan and authorized the execution of the Rights Agreement, dated August 25, 2011 (the Rights Agreement ), between the Corporation and Mellon Investor Services LLC, as Rights Agent. On August 25, 2011, the Board of Directors of the Corporation declared a dividend of one preferred share purchase right (a Right ) for each outstanding share of common stock, par value \$0.01 per share. The dividend was payable on September 6, 2011 to the stockholders of record on September 6, 2011. The Rights will expire on the earlier of August 25, 2021, or redemption by the Corporation. However, the rights will expire immediately at the final adjournment of the Corporation s 2012 annual meeting of stockholders if stockholder approval of the Rights Agreement has not been received prior to that time. The Rights Agreement is designed to prevent third parties from opportunistically acquiring the Corporation in a transaction that the Corporation s Board of Directors believes is not in the best interests of the Corporation s stockholders. In general terms, it works by imposing a significant penalty upon any person or group that acquires beneficial ownership of 15 percent or more of our outstanding common stock without the prior approval of our Board of Directors. The Corporation s Board of Directors believes the Rights Agreement has helped the Corporation s stockholders at this time by effectively

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**Table of Contents**

preventing Omnicare from opportunistically acquiring the Corporation at a price that the Corporation's Board of Directors believes is inadequate for the reasons discussed above. The Rights Agreement has been narrowly tailored in a manner that our Board of Directors believes appropriately balances the interests of our stockholders in connection with what our Board of Directors considers an opportunistic, illusory and disadvantageous proposal, against the need to avoid excessive anti-takeover protections that ultimately may adversely impact stockholder value. The Rights Agreement should not interfere with any merger or other business combination approved by the Board of Directors.

Pursuant to the requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the regulations thereunder (the HSR Act), Omnicare filed a Notification and Report Form with the Antitrust Division of the U.S. Department of Justice (the Antitrust Division) and the Federal Trade Commission (the FTC) relating to its proposed acquisition of the Corporation on September 7, 2011. On or about September 19, 2011, the Corporation submitted a responsive Notification and Report Form with the Antitrust Division and the FTC. On September 22, 2011, the Corporation received a request for additional information from the FTC relating to the tender offer. On September 22, 2011, Omnicare also received a request for additional information from the FTC relating to the tender offer (the Second Request). The Second Request extended the waiting period under the HSR Act for 10 calendar days after the date Omnicare certified substantial compliance with the Second Request issued to Omnicare. On September 30, 2011, the FTC also issued a subpoena and civil investigative demand to the Corporation covering the same subject matter as the Second Request. The Corporation has produced a considerable amount of material in response to the FTC requests.

On November 18, 2011 Omnicare certified to the FTC that it had substantially complied with the Second Request. On November 18, 2011, Omnicare also executed a timing agreement with the FTC pursuant to which Omnicare agreed (i) to provide 14 days notice to the FTC prior to consummating its proposed acquisition and (ii) not to consummate its proposed acquisition prior to December 19, 2011 without the consent of the FTC. On December 2, 2011, Omnicare agreed with the FTC to extend the date prior to which Omnicare will not consummate its proposed acquisition to January 19, 2012, unless the FTC notifies Omnicare that it has closed its investigation relating to its proposed acquisition. On January 10, 2012, Omnicare agreed with the FTC that it will not consummate its proposed acquisition prior to January 26, 2012, unless the FTC notifies Omnicare that it has closed its investigation relating to its proposed acquisition. On January 27, 2012, the FTC issued an administrative complaint to block Omnicare's proposed acquisition of the Corporation. The complaint alleges that the proposed acquisition would be illegal and in violation of Section 15 of the FTC Act and Section 7 of the Clayton Act because it would harm competition and enable Omnicare to raise the price of drugs for Medicare Part D consumers and others. The case is scheduled to be heard before an administrative law judge at the FTC in June 2012.

The financial and outside legal advisors to the Corporation and Omnicare have met from time-to-time in an effort to agree upon an acceptable information sharing process relating to antitrust issues. On October 26, 2011, the Corporation and Omnicare and their respective outside legal advisors entered into a Confidentiality and Joint Defense Agreement (the Confidentiality and Joint Defense Agreement), which provides, among other things, for the parties to exchange on a confidential and privileged basis information in order to facilitate their respective assessment of the antitrust risk associated with a potential combination of the two companies. Although the Corporation's Board of Directors continues to believe that Omnicare's \$15.00 per share offer undervalues the Corporation, the Corporation is engaging in this analytical process in order to further its understanding of Omnicare's assessment of the antitrust risk related to a business combination. The Confidentiality and Joint Defense Agreement does not obligate the Corporation to enter a transaction with Omnicare and there can be no assurance that this review will lead to a definitive merger agreement or any transaction between the two companies.

In connection with these matters, for the year ended December 31, 2011, we expensed \$2.8 million of legal and advisory fees, which are included in integration, merger and acquisition related costs and other charges in the consolidated financial statements. We expect to incur significant additional costs in the future in connection with Omnicare's unsolicited tender offer.

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**Table of Contents**

***Institutional Pharmacy Business***

The Corporation is the second largest institutional pharmacy services company in the United States based on revenues. We service healthcare facilities and also provide management pharmacy services to hospitals. The Corporation operates 95 institutional pharmacies in 44 states. The Corporation's customers are typically institutional healthcare providers, such as skilled nursing facilities, nursing centers, assisted living facilities, hospitals, and other long-term alternative care settings. The Corporation is generally the primary source of supply of pharmaceuticals to its customers. The Corporation also provides pharmacy management services to 91 hospitals in the United States.

Our core business provides pharmacy products and services to residents and patients in skilled nursing facilities, nursing centers, assisted living facilities, hospitals, and other long-term alternative care settings. We purchase, repackage, and dispense prescription and non-prescription pharmaceuticals in accordance with physician orders and deliver such medication to healthcare facilities for administration to individual patients and residents. Depending on the specific location, we service healthcare facilities typically within a radius of 120 miles or less of our pharmacy locations at least once each day. Each pharmacy provides 24-hour, seven-day per week on-call pharmacist services for emergency dispensing, delivery, and/or consultation with the facility's staff or the resident's attending physician. We also provide various supplemental healthcare services that complement our institutional pharmacy services.

We offer prescription and non-prescription pharmaceuticals to our customers through unit dose or modified unit dose packaging, dispensing, and delivery systems, typically in a 15 to 30 day supply. Unit dose medications are packaged for dispensing in individual doses as compared to bulk packaging used by most retail pharmacies. The customers we serve prefer the unit dose delivery system over the bulk delivery system employed by retail pharmacies because it improves control over the storage and ordering of drugs and reduces errors in drug administration in healthcare facilities. Nursing staff in our customers' facilities administer the pharmaceuticals to individual patients and residents.

Our computerized dispensing and delivery systems are designed to improve efficiency and control over distribution of medications to patients and residents. We provide computerized physician orders and medication administration records for patients or residents on a monthly basis as requested. Data from these records are formulated into monthly management reports on patient and resident care and quality assurance. This system improves efficiencies in nursing time, reduces drug waste, and helps to improve patient outcomes.

***Consultant Pharmacist Services***

Federal and state regulations mandate that long-term care facilities, in addition to providing a source of pharmaceuticals, retain consultant pharmacist services to monitor and report on prescription drug therapy in order to maintain and improve the quality of resident care. On September 30, 2008, the United States Department of Health and Human Services Office of Inspector General (OIG) published OIG Supplemental Compliance Program Guidance for Nursing Homes. With quality of care being the first risk area identified, the supplemental guidance is part of a series of recent government efforts focused on improving quality of care at skilled nursing and long-term care facilities. The guidance contains compliance recommendations and an expanded discussion of risk areas. The guidance stressed that facilities must provide pharmaceutical services to meet the needs of each resident and should be mindful of potential quality of care problems when implementing policies and procedures on proper medication management. It further stated that facilities can reduce risk by educating staff on medication management and improper pharmacy kickbacks for consultant pharmacists and that facilities should review the total compensation paid to consultant pharmacists to ensure it is not structured in a way that reflects the volume or value of particular drugs prescribed or administered to residents.

In October 2011, Centers for Medicare and Medicaid Services (CMS) issued a proposed rule entitled Medicare Program; Proposed Changes to the Medicare Advantage and the Medicare Prescription Drug Benefit Programs for Contract Year 2013 and Other Proposed Changes; Considering Changes to the Conditions of

## **Table of Contents**

Participation for Long Term Care Facilities. In the proposed rule, CMS outlined its concerns, and requested comments, regarding certain contractual arrangements between Long Term Care ( LTC ) facilities, LTC pharmacies, consultant pharmacies, and pharmaceutical manufacturers. Specifically, CMS explained its perception that the provision of consulting services by pharmacy providers that supply medication to the facility leads to lack of independence of consultant pharmacists. CMS proposed requiring the independence of consultant pharmacists from LTC pharmacies. The Corporation believes that the proposed rule, which could require the independence of consultant pharmacists, may increase overall costs for payers and customers and reduce the quality of care and service to long-term care patients and residents. However, until CMS provides additional guidance, the Corporation is unable to fully evaluate the impact of the proposed changes in consultant pharmacist services.

We provide consultant pharmacist services that help our customers comply with the federal and state regulations applicable to nursing homes. Currently, we provide consultant services to approximately 73.4% of our patients serviced. The services offered by our consultant pharmacists include:

Monthly reviews of each resident s drug regimen to assess the appropriateness and efficacy of drug therapies, including the review of medical records, monitoring drug interactions with other drugs or food, monitoring laboratory test results, and recommending alternative therapies;

Participation on quality assurance and other committees of our customers, as required or requested by such customers;

Monitoring and reporting on facility-wide drug utilization;

Development and maintenance of pharmaceutical policy and procedure manuals; and

Assistance with federal and state regulatory compliance pertaining to resident care.

### ***Medical Records***

The Corporation provides medical records services, which includes the completion and maintenance of medical record information for patients in the Corporation s customer s facilities. The medical records services include:

Real-time access to medication and treatment administration records, physician order sheets and psychotropic drug monitoring sheets;

Online ordering to save time and resources;

A customized database with the medication profiles of each resident s medication safety, efficiency and regulatory compliance;

Web-based individual patient records detailing each prescribed medicine; and

Electronic medical records to improve information to make it more legible and instantaneous.

### ***Ancillary Services***



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The Corporation provides intravenous drug therapy products and services to its customers. We provide intravenous ( IV or infusion therapy) products and services to client facilities as well as hospice and home care patients. Infusion therapy consists of the product (a nutrient, antibiotic, chemotherapy, or other drugs in solution) and the intravenous administration of the product.

We prepare the product to be administered using proper equipment in an aseptic environment and then deliver the product to the facilities for administration by the nursing staff. Proper administration of IV drug therapy requires a highly trained nursing staff. Upon request, our nurse consultants provide an education and certification program on IV therapy to assure proper staff training and compliance with regulatory requirements in client facilities offering an IV therapy program.

## **Table of Contents**

### ***Hospital Pharmacy Management Services***

We also provide hospital pharmacy management services. These services generally entail the overall management of the hospital pharmacy operations, including the ordering, receipt, storage, and dispensing of pharmaceuticals to the hospital's patients pursuant to the clinical guidelines established by the hospital. We offer the hospitals a wide range of regulatory and financial management services, including inventory control, budgetary analysis, staffing optimization, and assistance with obtaining and maintaining applicable regulatory licenses, certifications, and accreditations. We work with the hospitals to develop and implement pharmacy policies and procedures, including drug formulary development and utilization management. We also offer clinical pharmacy programs that encompass a wide range of drug therapy and disease management protocols, including protocols for anemia treatment, infectious diseases, wound care, nutritional support, renal dosing, and therapeutic substitution. The hospital pharmacy management services segment is comprised of a few customers, of which, our largest service is to the majority of the Kindred hospitals.

Additional business segment information is set forth in Part II, Item 8 "Financial Statements" and Note 12 "Business Segment Data" to the Consolidated Financial Statements of this annual report on Form 10-K.

### ***Our Business Focus***

*Drive Scale Economies.* We will focus on consistently providing quality pharmaceutical services to our customers at competitive prices and delivery of prescriptions in a timely and effective manner. Our business seeks to implement innovative and cost-effective solutions to improve the provision of medication to our customers and the residents and patients that they serve.

*Focus on Organic Growth through New Sales and Client Retention.* We aim to grow our business through expansion in our existing markets and by servicing new customers. We intend to grow organically. We believe our industry has underlying market growth potential attributable to both an increase in drug utilization as well as the general aging population of the United States.

*Acquire Competitors.* We also intend to expand our market share through selected geographic expansion in markets not currently served by us and through strategic acquisitions in existing and underserved markets. The Corporation currently operates in 44 states. We believe that there are growth opportunities in several other markets. There are numerous businesses in our markets, mostly small or regional companies, that lack the scale that we believe will be necessary to ultimately compete in a market that is national in scope. We intend to actively seek opportunities to acquire these companies. Since its formation, the Corporation has acquired seven institutional pharmacy businesses.

### ***Sales and Marketing***

We sell our products and services through a national sales force. Our sales force is organized along geographic lines to maximize coverage, manage costs, and align more effectively with our operating regions. Our sales representatives specialize in the products and services we offer and the markets in which we operate. Their knowledge permits us to meet the unique needs of our customers while maintaining profitable relationships.

### ***Customers***

*Institutional Care Settings.* Our customers are typically institutional healthcare providers, such as skilled nursing facilities, nursing centers, assisted living facilities, hospitals and other long-term alternative care settings. We are generally the primary source of supply of pharmaceuticals for our customers.

Our customers depend on institutional pharmacies like us to provide the necessary pharmacy products and services and to play an integral role in monitoring patient medication regimens and safety. We dispense pharmaceuticals in patient specific packaging in accordance with physician instructions.

**Table of Contents**

At December 31, 2011, we had contracts to provide pharmacy services to 339,498 licensed beds for patients in healthcare facilities throughout the country. We also have significant customer concentrations with facilities operated by Kindred. For the year ended December 31, 2011, Kindred institutional pharmacy contracts represented approximately 10.7% of the Corporation's total revenues.

*Hospital Pharmacy Management Services.* At December 31, 2011, the Corporation provided hospital pharmacy management services to Kindred and other customers at 91 locations. For the year ended December 31, 2011, revenues under the Kindred hospital pharmacy management service contracts represented approximately 3.0% of the Corporation's total revenues.

***Suppliers/Inventory***

On January 4, 2011, the Corporation entered into an Amended and Restated Prime Vendor Agreement for Long-Term Care Pharmacies by and between AmerisourceBergen Drug Corporation ( ABDC ), a wholly owned subsidiary of AmerisourceBergen Corporation, the Corporation, Pharmacy Corporation of America and Chem Rx Pharmacy Services, LLC ( Chem Rx ) (the Amended Prime Vendor Agreement ). The Amended Prime Vendor Agreement became effective on January 1, 2011 and, upon its effectiveness, superseded in its entirety the Prime Vendor Agreement for Long-Term Care Pharmacies entered into as of August 1, 2007 between the Corporation and ABDC.

The Amended Prime Vendor Agreement incorporates Chem Rx and is otherwise substantially the same in scope except for modifications to select sourcing and rebate terms. The term of the Amended Prime Vendor Agreement was extended until September 30, 2013, with one-year automatic renewal periods unless either party provides prior notice of its intent not to renew.

We also obtain pharmaceutical and other products from contracts negotiated directly with pharmaceutical manufacturers for discounted prices. While the loss of a supplier could adversely affect our business if alternate sources of supply are unavailable, numerous sources of supply are generally available to us and we have not experienced any difficulty in obtaining pharmaceuticals or other products and supplies to conduct our business.

We seek to maintain an on-site inventory of pharmaceuticals and supplies to ensure prompt delivery to our customers. ABDC maintains local distribution facilities in most major geographic markets in which we operate.

***Brand versus Generic***

The pharmaceutical industry has been experiencing a higher level of brand-to-generic drug conversions. We believe the generic dispensing rate will continue to increase over time as the result of a large number of patent expirations in the near future.

The following table summarizes the generic drug dispensing rate:

<b>2009</b>	<b>2010</b>	<b>2011</b>
74.2%	75.5%	77.9%

**Table of Contents**

The following table summarizes the material brand-to-generic conversions expected to occur in 2012 through 2016:

2012	2013	2014	2015	2016
Lexapro (1Q)	Oxycontin (2Q)	Celebrex (2Q)	Namenda (1Q)	Crestor (3Q)
Seroquel IR (1Q)	Advair Diskus (3Q)	Humalog (2Q)	Abilify (2Q)	
Plavix (2Q)	Cymbalta (4Q)	Nexium (2Q)	Zyvox (2Q)	
Provigil (2Q)		Renvela (3Q)	Aggrenox (3Q)	
Actos (3Q)		Copaxone (4Q)	Lidoderm (4Q)	
Detrol (3Q)				
Detrol LA (3Q)				
Diovan (3Q)				
Diovan HCT (3Q)				
Geodon (3Q)				
Singulair (3Q)				
Xopenex (3Q)				

(Number in parentheses equals the quarter of conversion)

When a branded drug shifts to a generic, initial pricing of the generic drug in the market will vary depending on the number of manufacturers launching their generic version of the drug. Historically a shift from brand-to-generic decreased our revenue and improved our gross margin from sales of these classes of drugs during the initial time period a brand drug has a generic alternative. However, recent experience has indicated that the third-party payers may reduce their reimbursements to the Corporation faster than previously experienced. This acceleration in the reimbursement reduction has resulted in margin compression much earlier than we have historically experienced. Due to the unique nature of the brand-to-generic conversion, management cannot estimate the future financial impact of the brand-to-generic conversions on its results of operations.

**Supplier and Manufacturer Rebates**

We currently receive rebates from certain manufacturers and distributors of pharmaceutical products for achieving targets of market share or purchase volumes. Rebates are designed to prefer, protect, or maintain a manufacturer's products that are dispensed by the pharmacy under its formulary. Rebates for brand name products are generally based upon achieving a defined market share tier within a therapeutic class and can be based on either purchasing volumes or actual prescriptions dispensed. Rebates for generic products are more likely to be based on achieving purchasing volume requirements. For the years ended December 31, 2009, 2010 and 2011, rebates recorded as a reduction in cost of goods sold were \$34.1 million, \$37.2 million, and \$75.5 million, respectively. The Corporation had \$3.0 million, \$3.3 million, and \$6.1 million of rebates allocated as a reduction in inventory as of December 31, 2009, 2010, and 2011, respectively.

**Information Technology**

Computerized medical records and documentation are an integral part of our distribution system. We primarily utilize a proprietary information technology infrastructure that automates order entry of medications, dispensing of medications, invoicing, and payment processing. These systems provide consulting drug review, electronic medication management, medical records, and regulatory compliance information to help ensure patient safety. These systems also support verification of eligibility and electronic billing capabilities for the Corporation's pharmacies. They also provide order entry, shipment, billing, reimbursement and collection of service fees for medications, specialty services and other services rendered.

Based upon our electronic records, we are able to provide reports to our customers and management on patient care and quality assurance. These reports help to improve efficiency in patient care, reduce drug waste, and improve patient outcomes. We expect to continue to invest in technologies that help critical information access and system availability.

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**Table of Contents**

On July 31, 2007, the Corporation entered into an Information Technology Services Agreement with Kindred Healthcare Operating, Inc. ( KHOI ), a wholly owned subsidiary of Kindred (the IT Services Agreement ). Pursuant to the IT Services Agreement, KHOI is the Corporation's exclusive provider of certain information services and support related to information technology infrastructure and financial systems for a period of five years, ending on July 31, 2012. The services provided by KHOI include business services necessary to operate, manage, and support certain financial applications the Corporation uses, including enabling or supporting technology infrastructure and technology procurement services to support certain business functions. Such services include, among other matters, functions for financial management systems and payroll. The Corporation supports internally all other operating systems, including functions for order entry, pharmacy dispensing, clinical consulting, billing and collections, electronic medication management, sales and marketing, medical records management, human resources, internal and external customer call center support, and general business systems.

Except for certain services that will be provided at cost, KHOI will provide such services to the Corporation at its cost plus 10%, which will be the actual costs and expenses incurred in providing these services, including certain overhead costs and per hour costs of the KHOI employees providing the services. The initial term of the IT Services Agreement is five years. The IT Services Agreement will automatically renew for successive one-year periods after the expiration of the initial five year term, absent 120 days prior written notice of termination as provided for in the IT Services Agreement. The IT Services Agreement may be terminated by either party for cause and, in certain circumstances, by the Corporation in the event that KHOI undergoes a change of control to one of the Corporation's competitors. Following termination of the IT Services Agreement, KHOI must provide termination and expiration assistance for up to 180 days. The Corporation incurred \$11.5 million, \$11.1 million, and \$10.8 million in fees to Kindred under the terms of the IT Services Agreement for the years ended December 31, 2009, 2010, and 2011, respectively.

***Sources of Pharmacy Revenues***

We receive payment for our services from third party payers, including Medicare Part D Plans, government reimbursement programs under Medicare and Medicaid, and non-government sources such as institutional healthcare providers, commercial insurance companies, health maintenance organizations, preferred provider organizations, and contracted providers. The sources and amounts of our revenues will be determined by a number of factors, including the mix of our customers' patients, brand to generic conversions and the rates and charges of reimbursement among payers. Changes in our customers' censuses, the case mix of the patients, brand and generic dispensing rates, and the payer mix among private pay, Medicare Part D and Medicaid, will affect our profitability.

In December 2003, Congress enacted the Medicare Prescription Drug, Improvement and Modernization Act of 2003 ( MMA ) which included a major expansion of the Medicare program through the introduction of a prescription drug benefit (titled Medicare Part D) which is administered by commercial market insurers contracted with CMS. Under Medicare Part D, Medicare beneficiaries who are also entitled to benefits under a state Medicaid program (so called dual eligibles ) now have their outpatient prescription drug costs covered by Medicare Part D, subject to certain limitations. Since January 1, 2006, most of the nursing center residents we serve whose drug costs were previously covered by state Medicaid programs are dual eligibles who qualify for Medicare Part D. Accordingly, Medicaid is no longer a primary payer for the pharmacy services provided to these residents. See Overview of Reimbursement.

**Table of Contents**

A summary of revenue by payer type for the years ended December 31, are as follows (dollars in millions):

	2009		2010		2011	
	Amount	% of Revenues	Amount	% of Revenues	Amount	% of Revenues
Medicare Part D	\$ 852.6	46.3%	\$ 859.2	46.5%	\$ 998.5	48.0%
Institutional healthcare providers	545.6	29.6	556.2	30.1	615.6	29.6
Medicaid	165.8	9.0	169.5	9.2	217.4	10.4
Private and other	122.4	6.6	107.3	5.8	92.7	4.5
Insured	91.5	5.0	89.8	4.9	90.0	4.3
Medicare	6.8	0.4	7.4	0.4	4.4	0.2
Hospital management fees	56.5	3.1	57.9	3.1	62.5	3.0
Total	\$ 1,841.2	100.0%	\$ 1,847.3	100.0%	\$ 2,081.1	100.0%

**Competition**

We face a highly competitive environment in the institutional pharmacy market. In each geographic market, there are national, regional and local institutional pharmacies that provide services comparable to those offered by our pharmacies which may have greater financial and other resources than we do and may be more established in the markets they serve than we are. In addition, owners of skilled nursing facilities are also entering the institutional pharmacy market, particularly in areas of their geographic concentration. On a nationwide basis, there is one large competitor in the institutional pharmacy industry, Omnicare.

We believe that the competitive factors most important to our business are pricing, quality and the range of services offered, clinical expertise, ease of doing business with the provider and the ability to develop and maintain relationships with customers. Because relatively few barriers to entry exist in the local markets we serve, we have encountered and will continue to encounter substantial competition from local market entrants.

**Patents, Trademarks and Licenses**

We use a number of trademarks and service marks. All of the principal trademarks and service marks used in the course of our business have been registered in the United States or are the subject of pending applications for registration.

We have various proprietary products, processes, software and other intellectual property that are used either to facilitate the conduct of our business or that are made available as products or services to customers. We generally seek to protect such intellectual property through a combination of trade secret, patent and copyright laws and through confidentiality and other contractually imposed protections.

Although we believe that our products and processes do not infringe upon the intellectual property rights of any third parties, third parties may assert infringement claims against us from time to time.

**Seasonality**

Our largest customers in our institutional pharmacy segment are skilled nursing facilities. Both prescription and non-prescription drug sales at skilled nursing facilities are affected by the timing and severity of the cold/flu season and other seasonality of the long-term care facilities industry.

**Working Capital**

For information about the Corporation's practices relating to working capital items, see Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources .

## **Table of Contents**

### ***Employees***

As of December 31, 2011, we had approximately 5,900 employees which included approximately 1,100 part-time employees. As a result of the acquisition of Chem Rx, the Corporation had approximately 500 employees that were covered by collective bargaining agreements as of December 31, 2011. As of December 31, 2011, we employed approximately 1,700 licensed pharmacists. We believe that our relationships with our employees are good.

### **Government Regulation**

#### ***General***

Extensive federal, state and local regulations govern institutional pharmacies and the healthcare facilities that they serve. These regulations cover licenses, staffing qualifications, conduct of operations, reimbursement, recordkeeping and documentation requirements and the confidentiality and security of health-related information. Our institutional pharmacies are also subject to federal and state laws that regulate financial arrangements between healthcare providers, including the federal anti-kickback statutes and the federal physician self-referral statutes.

#### ***Licensure, Certification and Regulation***

States generally require that the state board of pharmacy license a pharmacy operating within the state. Many states also regulate out-of-state pharmacies that deliver prescription products to patients or residents in their states. We have the necessary pharmacy state licenses, or pending applications, for each pharmacy we operate. Our pharmacies are also registered with the appropriate federal and state authorities pursuant to statutes governing the regulation of controlled substances. In addition, pharmacists, nurses and other healthcare professionals who provide services on our behalf are in most cases required to obtain and maintain professional licenses and are subject to state regulation regarding professional standards of conduct.

The Drug Enforcement Agency (the DEA), the U.S. Food and Drug Administration (the FDA) and various state regulatory authorities regulate the distribution of pharmaceutical products and controlled substances. These laws impose a host of requirements on the pharmaceutical supply channel, including providers of institutional pharmacy services. Under the Comprehensive Drug Abuse Prevention and Control Act of 1970, as a dispenser of controlled substances, we must register with the DEA, file reports of inventories and transactions and provide adequate security measures. In addition, we are required to comply with all the relevant requirements of the Controlled Substances Act for the transfer and shipment of pharmaceuticals. The FDA, DEA and state regulatory authorities have broad enforcement powers, including the ability to seize or recall products and impose significant criminal, civil and administrative sanctions for violations of these laws and regulations. We have received all necessary regulatory approvals and believe that our pharmacy operations are in substantial compliance with applicable federal and state good manufacturing practice requirements.

Client long-term care facilities are separately required to be licensed in the states in which they operate and, if serving Medicaid or Medicare patients, must be certified to be in compliance with applicable program participation requirements. Client facilities are also subject to the nursing home reforms of the Omnibus Budget Reconciliation Act of 1987, as amended, which imposed strict compliance standards relating to quality of care for facility operations, including vastly increased documentation and reporting requirements.

On September 20, 2006, CMS issued revised guidance to surveyors of long term care facilities regarding the survey protocol for review of pharmacy services provided in long-term care facilities participating in the Medicare and Medicaid programs. The new guidelines, which became effective December 18, 2006, expanded the areas and detail in which surveyors are to assess pharmacy services at the facility, including ordering, acquiring, receiving, storing, labeling, dispensing and disposing of all medications at the facility; the provision of medication-related information to health care professionals and residents; the process of identifying and

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**Table of Contents**

addressing medication-related issues through medication regimen reviews and collaboration between the licensed consultant pharmacist, the facility and other healthcare professionals; and the provision, monitoring and use of medication-related devices. The guidelines also emphasize the important role of consultative services of pharmacists in promoting safe and effective medication use through the coordination of all aspects of pharmacy services provided to all residents within a facility. In addition, on September 30, 2008, the OIG published OIG Supplemental Compliance Program Guidance for Nursing Facilities. With quality of care being the first risk area identified, the supplemental guidance is part of a series of government efforts focused on improving quality of care at skilled nursing and long-term care facilities. The guidance contained new compliance recommendations and an expanded discussion of risk areas. The guidance stressed that facilities must provide pharmaceutical services to meet the needs of each resident and should be mindful of potential quality of care problems when implementing policies and procedures on proper medication management. It further stated that facilities can reduce risk by educating staff on medication management and improper pharmacy kickbacks for consultant pharmacists and that facilities should review the total compensation paid to consultant pharmacists to ensure it is not structured in a way that reflects the volume or value of particular drugs prescribed or administered to residents.

***Laws Affecting Referrals and Business Practices***

We are subject to federal and state laws that govern financial and other arrangements between healthcare providers. These laws prohibit certain direct and indirect payments or fee-splitting arrangements between healthcare providers that are designed to induce or encourage the referral of patients to, or the recommendation of, a particular provider for medical products and services. These laws include:

the federal anti-kickback statute, which prohibits, among other things, knowingly or willfully soliciting, receiving, offering or paying remuneration including any kickback, bribe or rebate directly or indirectly in return for or to induce the referral of an individual to a person for the furnishing or arranging for the furnishing of any item or service for which payment may be made in whole or in part under Medicare, Medicaid or other federal healthcare programs; and

the federal Stark laws which prohibit, with limited exceptions, the referral of patients by physicians for certain designated health services, to an entity with which the physician has a financial relationship.

These laws impact the relationships that we may have with potential referral sources. We have a variety of relationships with potential referral sources, including hospitals and skilled nursing facilities with which we have contracted to provide pharmacy services. With respect to the anti-kickback statute, the OIG has enacted safe harbor regulations that outline practices that are deemed protected from prosecution. While we endeavor to comply with the applicable safe harbors, certain of our current arrangements, none of which is material to us, may not qualify for safe harbor protection. Failure to meet a safe harbor does not mean that the arrangement necessarily violates the anti-kickback statute, but may subject the arrangement to greater scrutiny. In addition, as a means of providing guidance to healthcare providers, the OIG issues a variety of sub-regulatory guidance including Special Fraud Alerts, Special Advisory Bulletins, Advisory Opinions, and other compliance guidance documents. This guidance does not have the force of law, but identifies features of arrangements or transactions that may indicate that the arrangements or transactions violate the anti kickback statute or other federal health care laws. While we believe our practices comply with the anti-kickback statute, we cannot assure our practices that are outside of a safe harbor will not be found to violate the anti-kickback statute.

In addition to federal law, many states have enacted similar statutes which are not necessarily limited to items or services for which payment is made by federal healthcare programs. Violations of these laws may result in fines, imprisonment, denial of payment for services and exclusion from the Medicare and Medicaid programs and other state-funded programs.

Other provisions in the Social Security Act and in other federal and state laws authorize the imposition of penalties, including criminal and civil fines and exclusions from participation in Medicare, Medicaid and other



## **Table of Contents**

federal healthcare programs for false claims, improper billing and other offenses. These laws include the federal False Claims Act, under which private parties have the right to bring *qui tam* whistleblower lawsuits against companies that submit false claims for payments to the government. Recent changes to the False Claims Act, expanding liability to certain additional parties and circumstances, may make these *qui tam* law lawsuits more prevalent. Some states have adopted similar state whistleblower and false claims laws.

In addition, a number of states have undertaken enforcement actions against pharmaceutical manufacturers involving pharmaceutical marketing programs, including looking at relationships with pharmacies and programs containing incentives for pharmacists to dispense one particular product rather than another. These enforcement actions arose under various state laws including fraud and abuse laws and consumer protection laws which generally prohibit false advertising, deceptive trade practices and the like.

In the ordinary course of business, we are regularly subject to inquiries, investigations and audits by federal and state agencies that oversee applicable healthcare program participation and payment regulations. We believe that the regulatory environment surrounding most segments of the healthcare industry remains intense. Federal and state governments continue to impose intensive enforcement policies resulting in a significant number of inspections, citations for regulatory deficiencies and other regulatory sanctions including demands for refund of overpayments, terminations from the Medicare and Medicaid programs, bars on Medicare and Medicaid payments and fines. Such sanctions could have a material adverse effect on our financial position, results of operation and liquidity.

We believe our contract arrangements with other healthcare providers and our pharmaceutical suppliers and our pharmacy practices are in substantial compliance with applicable federal and state laws. These laws may, however, be interpreted in the future in a manner inconsistent with our interpretation and application.

### ***State Laws Affecting Access to Services***

Some states have enacted *freedom of choice* or *any willing provider* requirements as part of their state Medicaid programs or in separate legislation. These laws may preclude a nursing center from requiring their patients and residents to purchase pharmacy or other ancillary medical services or supplies from particular providers that have a supplier relationship with the nursing center. Limitations such as these may increase the competition which we face in providing services to nursing center residents.

### ***HIPAA***

The federal Health Insurance Portability and Accountability Act of 1996, commonly known as *HIPAA*, mandates the adoption of regulations aimed at standardizing transaction formats and billing codes for documenting medical services, dealing with claims submissions and protecting the privacy and security of individually identifiable health information. *HIPAA* regulations that standardize transactions and code sets require standard formatting for healthcare providers, like us, that submit claims electronically.

The *HIPAA* privacy regulations apply to *protected health information*, or *PHI* which is defined generally as individually identifiable health information transmitted or maintained in any form or medium, excluding certain education records and student medical records. The privacy regulations seek to limit the use and disclosure of most paper and oral communications, as well as those in electronic form, regarding an individual's past, present or future physical or mental health or condition, or relating to the provision of healthcare to the individual or payment for that healthcare, if the individual can or may be identified by such information. *HIPAA* provides for the imposition of civil or criminal penalties if *PHI* is improperly disclosed.

*HIPAA*'s security regulations require us to ensure the confidentiality, integrity and availability of all electronic protected health information that we create, receive, maintain or transmit. We must protect against reasonably anticipated threats or hazards to the security of such information and the unauthorized use or disclosure of such information.

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## **Table of Contents**

In addition to HIPAA, we are subject to state privacy laws and other state privacy or health information requirements not preempted by HIPAA, including those which may furnish greater privacy protection for individuals than HIPAA.

The scope of our operations involving health information is broad and the nature of those operations is complex. Although we believe that our contract arrangements with healthcare payers and providers and our business practices are in material compliance with applicable federal and state electronic transmissions, privacy and security of health information laws, the requirements of these laws, including HIPAA, are complicated and are subject to interpretation. In addition, state regulation of matters also covered by HIPAA, especially the privacy standards, is increasing, and determining which state laws are preempted by HIPAA is a matter of interpretation. Failure to comply with HIPAA or similar state laws could subject us to loss of customers, denial of the right to conduct business, civil damages, fines, criminal penalties and other enforcement actions.

The American Recovery and Reinvestment Act of 2009, commonly known as the Stimulus Package, changed several aspects of HIPAA including, without limitation, the following: (i) applies HIPAA security provisions and penalties directly to business associates of covered entities; (ii) requires certain notifications in the event of a security breach involving PHI; (iii) restricts certain unauthorized disclosures; (iv) changes the treatment of certain marketing activities; and (v) strengthens enforcement activities. In addition, the Secretary issued an interim final rule on August 24, 2009 that requires notifications for certain breaches of PHI. A final rule was submitted by the Secretary in 2010, but later withdrawn. The interim final rule will remain in effect until a final rule is issued.

### ***2010 Health Care Legislation***

On March 23, 2010, President Obama signed into law the Patient Protection and Affordable Care Act and on March 30, 2010, President Obama signed into law the reconciliation law known as Health Care and Education Affordability Reconciliation Act (the Reconciliation Act), combined both Acts will hereinafter be referred to as 2010 Health Care Legislation. Four key provisions of the 2010 Health Care Legislation that are relevant to the Corporation are: (i) the gradual modification to the calculation of the Federal Upper Limit (FUL) for drug prices and the definition of Average Manufacturer's Price (AMP), (ii) the closure, over time, of the Part D coverage gap, which is otherwise known as the Donut Hole, (iii) short cycle dispensing requirements, and (iv) Biosimilar Biological Products. The constitutionality of the 2010 Health Care Legislation has been challenged in several Federal courts. At this time, the courts have split on the constitutionality of the 2010 Health Care Legislation. The appeal of these decisions has been accepted by the United States Supreme Court, which is expected to consider the case in 2012. Pending a final decision on the constitutionality of the legislation and the promulgation of regulations there under, the Corporation is unable to fully evaluate the impact of the 2010 Health Care Legislation.

### ***FUL and AMP Changes***

The 2010 Health Care Legislation amended the Deficit Reduction Act of 2005 (the DRA) to change the definition of the Federal Upper Limit or FUL by requiring the calculation of the FUL as no less than 175% of the weighted average, based on utilization, of the most recently reported monthly Average Manufacturer's Price or AMP for pharmaceutically and therapeutically equivalent multi-source drugs available through retail community pharmacies nationally.

In addition, the definition of AMP changed to reflect net sales only to drug wholesalers that distribute to retail community pharmacies and to retail community pharmacies that directly purchase from drug manufacturers. Further, the 2010 Health Care Legislation continues the current statutory exclusion of prompt pay discounts offered to wholesalers and adds three other exclusions to the AMP definition: i) bona fide services fees; ii) reimbursement for unsalable returned goods (recalled, expired, damaged, etc.); and iii) payments from and rebates/discounts to certain entities not conducting business as a wholesaler or retail community pharmacy.

## **Table of Contents**

In addition to reporting monthly, the manufacturers are required to report the total number of units used to calculate each monthly AMP. CMS will use this information when it establishes FULs as a result of the new volume-weighted requirements pursuant to the 2010 Health Care Legislation.

In September 2011, CMS issued the first draft FUL reimbursement files for multiple source drugs, including the draft methodology used to calculate the FULs in accordance with the Health Care Legislation. These draft FUL prices are based on the manufacturer reported and certified July 2011 monthly AMP and AMP unit data. CMS continues to release this data monthly and is expected to do so going forward. CMS has not posted monthly AMPs for individual drugs, but only posted the weighted average of monthly AMPs in a FUL group and the calculation methodology.

On February 2, 2012, CMS issued proposed regulations further clarifying the AMP and FUL changes described above and indicated that the final rule would be issued sometime in 2013.

Until CMS provides final guidance and the industry adapts to this now public available pricing information, the Corporation is unable to fully evaluate the impact of the changes in FUL and AMP to its business.

### ***Part D Coverage Gap***

Starting on January 1, 2011, the Medicare Coverage Gap Discount Program (the Program) requires drug manufacturers to provide a 50% discount on the negotiated ingredient cost to certain Part D beneficiaries for certain drugs and biologics purchased during the coverage gap (this is exclusive of the pharmacy dispensing fee). In addition, the 2010 Health Care Legislation includes a requirement that closes or eliminates the coverage gap entirely by fiscal year 2020. The coverage gap will be eliminated by gradually reducing the coinsurance percentage for both drugs covered and not covered by the Program for each applicable beneficiary.

At this time, the Corporation is unable to fully evaluate the impact of the changes to the coverage gap to its business.

### ***Short Cycle Dispensing***

Pursuant to the 2010 Health Care Legislation, Prescription Drug Plans (PDPs) will be required, under Medicare Part D and Medicare Advantage prescription drug plans (Medicare Advantage or MAPDs) to utilize specific, uniform dispensing techniques, such as weekly, daily, or automated dose dispensing, when dispensing covered Part D drugs to beneficiaries who reside in a long-term care facility to reduce waste associated with 30 to 90 day prescriptions for such beneficiaries. This short cycle dispensing provision will take effect on January 1, 2013. On April 15, 2011, CMS issued final regulations pursuant to the 2010 Health Care Legislation requiring, beginning January 1, 2013, pharmacies dispensing to long-term care facilities to dispense no more than 14-day supplies of brand-name medications covered by Part D except in limited circumstances (i.e. solid oral doses of antibiotics and solid oral doses dispensed in original containers as indicated by the FDA or otherwise customarily dispensed in their original packaging to assist patients with compliance). The final regulations also provided clarity around what pharmacy costs should be included in the determination of the dispensing fee.

The Corporation is unable to fully evaluate the impact of the short cycle dispensing requirements on the Corporation's operating costs.

### ***Biosimilar Biological Products***

The 2010 Health Care Legislation creates a regulatory approval pathway for biosimilars (alternatively known as generics) for biological products. An innovator biological product will be granted 12 years of exclusivity. At this time, the Corporation is unable to fully evaluate the impact of the changes to biosimilars to its business.

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## **Table of Contents**

### ***Overview of Reimbursement***

Medicare is a federal program that provides certain hospital and medical insurance benefits to persons age 65 and over and to certain disabled persons. Medicaid is a medical assistance program administered by each state that provides healthcare benefits to certain indigent patients. Within the Medicare and Medicaid statutory framework, there are substantial areas subject to administrative rulings, interpretations, and discretion that may affect payments made under Medicare and Medicaid.

We receive payment for our services from institutional healthcare providers, commercial Medicare Part D Plans, third party payer government reimbursement programs such as Medicare and Medicaid, and other non-government sources such as commercial insurance companies, health maintenance organizations, preferred provider organizations, and contracted providers. With respect to our skilled nursing facilities customers, their residents are covered by Medicare Part A, Part B and Part D Plans, Medicaid, insurance, and other private payers (including managed care).

### ***Medicare***

The Medicare program consists of four parts: (i) Medicare Part A, which covers, among other things, in-patient hospital, skilled nursing facilities, home healthcare, and certain other types of healthcare services; (ii) Medicare Part B, which covers physicians' services, outpatient services, and certain items and services provided by medical suppliers such as intravenous therapy; (iii) a managed care option for beneficiaries who are entitled to Medicare Part A and enrolled in Medicare Part B, known as Medicare Part C or Medicare Advantage; and (iv) Medicare Part D, which provides coverage for prescription drugs that are not otherwise covered under Medicare Part A or Part B for those beneficiaries that enroll.

### ***Part A***

The Balanced Budget Act of 1997 (the "BBA") mandated the Prospective Payment System ("PPS") for Medicare-eligible enrolled residents in skilled nursing facilities. Under PPS, Medicare pays skilled nursing facilities a fixed fee per patient per day for extended care services to patients, covering substantially all items and services furnished during such enrollee's stay. Such services and items include pharmacy services and prescription drugs. We bill skilled nursing facilities based upon a negotiated fee schedule and are paid based on those contractual relationships. We do not receive direct payment from Medicare for patients covered under the Medicare Part A benefit. We classify the revenues recognized from these payers as Institutional Healthcare Providers.

Federal legislation continues to focus on reducing Medicare and Medicaid program expenditures. Such decreases may directly impact the Corporation's customers and their Medicare reimbursement. Given the changing nature of these rules, we are unable at this time to fully evaluate the impact on our business. Any evaluation of budgeting, cost-cutting, and financing of health care must also consider the new federal administration and the impact its proposed health care policies could have on any future cost considerations.

### ***Part B***

The MMA also changed the Medicare payment methodology and conditions for coverage of certain items of durable medical equipment, prosthetics, orthotics, and supplies ("DMEPOS") under Medicare Part B. The Corporation provides some of these products to its customers. The changes include, among other things, a new competitive bidding program. Beginning on January 1, 2011 in selected areas and for selected supplies, only suppliers that were winning bidders are eligible to provide services, at prices established as a result of the competitive bids, to Medicare beneficiaries. Enteral nutrients, equipment and supplies, and oxygen equipment and supplies are among the 10 categories of DMEPOS included in the first round of the competitive bidding process. The Corporation did not participate in the bidding process. The Corporation will continue to evaluate whether it will participate in additional rounds of the bidding, which CMS has not yet scheduled. Medicare Part B is not material to the Corporation, representing less than 0.5% of revenues.

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**Table of Contents**

***Part D***

Medicare Part D provides coverage for prescription drugs that are not otherwise covered under Medicare Part A or Part B for those beneficiaries that enroll. Under Medicare Part D, beneficiaries may enroll in prescription drug plans offered by private commercial insurers who contract with CMS (or in a fallback plan offered on behalf of the government through a contractor, to the extent private entities fail to offer a plan in a given area), which provide coverage of outpatient prescription drugs (collectively, Part D Plans). Part D Plans include both plans providing the drug benefit on a standalone basis and Medicare Advantage plans providing drug coverage as a supplement to an existing medical benefit under that Medicare Advantage plan. Medicare beneficiaries generally have to pay a premium to enroll in a Part D Plan, with the premium amount varying from one Part D Plan to another, although CMS provides various federal subsidies to Part D Plans to reduce the cost to beneficiaries.

Part D Plans are required to make available certain drugs on their formularies. Dually-eligible residents in nursing centers generally are entitled to have their prescription drug costs covered by a Part D Plan, provided that the prescription drugs which they are taking are either on the Part D Plan's formulary or an exception to the Part D Plan's formulary is granted. CMS reviews the formularies of Part D Plans and requires these formularies to include the types of drugs most commonly used by Medicare beneficiaries. CMS also reviews the formulary exceptions criteria of the Part D Plans that provide for coverage of drugs determined by the Part D Plan to be medically appropriate for the enrollee; however there currently is not a separate formulary for long-term care residents.

We obtain reimbursement for drugs we provide to enrollees of the given Part D Plan in accordance with the terms of agreements negotiated between us and the Part D Plan. The Medicare Part D final rule prohibits Part D plans from paying for drugs and services not specifically called for by the BBA. Beginning in 2010, CMS required Part D sponsors to use pass-through pricing, based on the price actually received by the pharmacy for drugs, in order to determine beneficiary cost sharing and drug reporting. This change, and similar changes by CMS aimed at ensuring administrative costs are absorbed by the Pharmacy Benefit Manager (PBM) and not the government, may alter the way certain PBMs negotiate prices with pharmacies. Currently, we are unable to fully evaluate the impact of this change in pricing definition on the Corporation.

In addition, beginning January 2010, MIPPA required that all PDPs are required to provide prompt payment to pharmacies. PDP and MAPDs must pay clean claims to retail pharmacies within 14 days if submitted electronically or within 30 days otherwise.

Medicare Part D does not alter federal reimbursement for residents of nursing centers whose stay at the nursing center is covered under Medicare Part A. Accordingly, Medicare's fixed per diem payments to nursing centers under PPS will continue to include a portion attributable to the expected cost of drugs provided to such residents. We will, therefore, continue to receive reimbursement for drugs provided to such residents from the nursing center in accordance with the terms of our agreements with each nursing center.

In June 2009, CMS released a report indicating that approximately \$41.0 million in Medicare Part D payments for prescription drugs, some dispensed by LTC pharmacies, were likely made incorrectly. CMS concluded many of the drugs, which were dispensed during Part A skilled nursing facility stays, should have been included in per diem payments under Medicare Part A. CMS stated it will focus on ensuring such improper payments do not occur in the future. We are unable to fully evaluate the impact of current and future federal initiatives aimed at eliminating these discrepancies.

In addition, we receive rebates from pharmaceutical manufacturers for undertaking certain activities that the manufacturers believe may increase the likelihood that we will dispense their products. CMS continues to question whether institutional pharmacies should be permitted to receive these access/performance rebates from manufacturers with respect to prescriptions covered under Medicare Part D, but has not prohibited the receipt of

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## **Table of Contents**

such rebates. CMS defines these as rebates a manufacturer provides to long-term care pharmacies that are designed to prefer, protect, or maintain that manufacturer's product selection by the long-term care pharmacy or to increase the volume of that manufacturer's products that are dispensed by the pharmacy under its formulary. CMS, in 2007, required PDPs to have policies and systems in place as part of their drug utilization management programs to protect beneficiaries and reduce costs when long-term care pharmacies receive incentives to move market share through access/performance rebates. The elimination or substantial reduction of manufacturer rebates, if not offset by other reimbursement, would have an adverse effect on our business.

### ***Medicaid***

The reimbursement rate for pharmacy services under Medicaid is determined on a state-by-state basis subject to review by CMS and applicable federal law. Although Medicaid programs vary from state to state, they generally provide for the payment of certain pharmacy services, up to established limits, at rates determined in accordance with each state's regulations. The federal Medicaid statute specifies a variety of requirements that a state plan must meet, including the requirements related to eligibility, coverage for services, payment, and admissions. For residents that are eligible for Medicaid only, and are not dual eligibles covered under Medicare Part D, we bill the individual state Medicaid program or in certain circumstances the state's designated managed care or other similar organizations. Federal regulations and the regulations of certain states establish upper limits for reimbursement of certain prescription drugs under Medicaid. In most states, pharmacy services are priced at the lower of usual and customary charges or cost, which generally is defined as a function of average wholesale price and may include a profit percentage plus a dispensing fee. Most states establish a fixed dispensing fee per prescription that is adjusted to reflect associated cost. Over the last several years, state Medicaid programs have lowered reimbursement through a variety of mechanisms, principally higher discounts off average wholesale price levels, expansion of the number of medications subject to federal upper limit pricing, and general reductions in contract payment methodology to pharmacies.

### ***Environmental Matters***

In operating our facilities, historically we have not encountered any material difficulties effecting compliance with applicable pollution control laws. No material capital expenditures for environmental control facilities are expected. While we cannot predict the effect which any future legislation, regulations or interpretations may have upon our operations, we do not anticipate any changes regarding pollution control laws that would have a material adverse impact on the Corporation.

### ***Available Information***

We make available free of charge on or through our web site, at [www.pharmerica.com](http://www.pharmerica.com), our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with the SEC. Additionally, the public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, D.C., 20549. Information regarding operation of the Public Reference Room is available by calling the SEC at 1-800-SEC-0330. Information that we file with the SEC is also available at the SEC's web site at [www.sec.gov](http://www.sec.gov).

Our SEC filings are available to the public through the New York Stock Exchange ( NYSE ), 20 Broad Street, New York, New York, 10005. Our Common Stock is listed on the NYSE and trades under the symbol **PMC** .

The certifications of our Chief Executive Officer and Chief Financial Officer required under Section 302 of the Sarbanes-Oxley Act have been filed as Exhibits 31.1 and 31.2 to this Annual Report on Form 10-K.

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**Table of Contents**

**Item 1A. Risk Factors**

*You should consider carefully the risks described below, together with all of the other information, in evaluating our company and our common stock. If any of the risks described below actually occur, it could have a material adverse effect on our business, results of operations, financial position and stock price.*

**Risk Factors Relating to Unsolicited Tender Offer**

*The unsolicited takeover attempt by Omnicare will likely require us to incur significant additional costs.*

On August 23, 2011, Omnicare made public an unsolicited proposal to acquire all of the outstanding shares of the Corporation's common stock for \$15.00 per share in cash. After careful consideration and consultation with our financial and legal advisors, our Board of Directors determined unanimously that Omnicare's proposal undervalues the Corporation and was not in the best interests of our stockholders. On September 7, 2011, Omnicare, through its wholly-owned subsidiary, Philadelphia Acquisition Sub, Inc., commenced an unsolicited tender offer to purchase all of the outstanding shares of our common stock at \$15.00 per share, net to seller in cash without interest thereon and less any required withholding tax. On September 18, 2011, the Board again met with its financial and legal advisors, and after careful consideration, our Board of Directors again unanimously recommended that our stockholders reject the offer and not tender their shares of our common stock because it believes that Omnicare's tender offer (i) undervalues the Corporation and its prospects, (ii) is illusory because it is subject to significant regulatory and other uncertainty, and (iii) is opportunistic based on the Corporation's then traded market value.

On October 26, 2011, the Corporation and Omnicare and their respective outside legal advisors entered into a Confidentiality and Joint Defense Agreement (the "Confidentiality and Joint Defense Agreement") which provides, among other things, for the parties to exchange on a confidential and privileged basis information in order to facilitate their respective assessment of the antitrust risk associated with a potential combination of the two companies. Although the Corporation's Board of Directors continues to believe that Omnicare's \$15.00 per share offer undervalues the Corporation, the Corporation is engaging in this analytical process in order to further its understanding of Omnicare's assessment of the antitrust risk related to a combination. The Confidentiality and Joint Defense Agreement does not obligate the Corporation to enter a transaction with Omnicare and there can be no assurance that this review will lead to a definitive merger agreement or any transaction between the two companies.

During the year ended December 31, 2011, the Corporation incurred \$2.8 million in legal and advisory fees related to the evaluation of Omnicare's unsolicited tender offer and related actions. Responding to Omnicare's unsolicited tender offer and related actions is expected to result in the incurrence of significant additional expenses in the future, which may be material to the Corporation's financial position and results of operations.

*Litigation relating to Omnicare's unsolicited tender offer may adversely impact our business.*

On September 7, 2011, Omnicare filed a lawsuit in the Court of Chancery of the State of Delaware against the Corporation and the members of the Board of Directors, alleging that the members of the Board of Directors breached their fiduciary duties by refusing to negotiate with Omnicare, failing to inform themselves of the merits of the tender offer, and failing to consider and negotiate the tender offer.

On September 9, 2011, the Louisiana Municipal Police Employee's Retirement System (LMPERS) filed a lawsuit in the Court of Chancery of the State of Delaware, purportedly on behalf of a class of the Corporation stockholders against the Corporation and the members of the Board of Directors, alleging the members of the Board of Directors breached their fiduciary duties to the Corporation and its stockholders by adopting the Rights Agreement and failing to respond appropriately to the tender offer. LMPERS is seeking declaratory and injunctive relief, including an order certifying the case as a class action and an order enjoining application of the Rights Agreement.

## **Table of Contents**

On September 22, 2011, Hugh F. Drummond as Trustee of the FBO Hugh F. Drummond Trust ( Drummond ) filed a lawsuit in the Court of Chancery of the State of Delaware, purportedly on behalf of a class of the Corporation's stockholders, against the Corporation and the members of the Board of Directors, alleging that the members of the Board of Directors breached their fiduciary duties to the Corporation and its stockholders by adopting the Rights Agreement and failing to respond appropriately to the tender offer. Drummond seeks declaratory and injunctive relief, including an order certifying the case as a class action and an order enjoining the directors and the Corporation from excluding strategic bidders, including Omnicare, imposing unreasonable preconditions on such strategic bidders, refusing to provide due diligence to strategic bidders, and conducting a limited sale process not designed to produce the best transaction for PharMerica's stockholders.

On October 3, 2011, the Court of Chancery of the State of Delaware entered an order consolidating the LMPERS and Drummond actions under the caption *In re PharMerica Corporation Shareholders Litigation*, Consolidated Civil Action No. 6851-CS. Plaintiffs in the consolidated action designated the complaint filed in the *Drummond* action as operative.

Other lawsuits may continue to be filed against us and our directors with similar or additional allegations. Such claims and any resultant litigation could subject us and our directors to liability, could be time consuming and expensive to defend, and could result in the diversion of the time and attention of our management and employees, any of which could have a material adverse impact on our business. See Legal Proceedings in Item 3 of Part I of this Annual Report for additional information regarding certain litigation relating to Omnicare's tender offer.

### ***Omnicare's unsolicited tender offer is disruptive to our business.***

The review and consideration of Omnicare's unsolicited tender offer and related actions by Omnicare and other stockholders, have been, and may continue to be, a significant distraction for our management and employees and have required, and may continue to require, the expenditure of significant time and resources by the Corporation. Omnicare's tender offer and related actions have also created uncertainty for the Corporation's employees, and this uncertainty may adversely affect our ability to retain key employees and hire new talent. Further, Omnicare's tender offer and related actions may create uncertainty for the Corporation's current and potential business partners. This uncertainty may cause our current and potential business partners to change or terminate their business relationship with us.

Uncertainty and speculation regarding Omnicare's tender offer and related actions may cause increased volatility in our stock price. In addition, if a transaction does not occur, or the market perceives that a transaction is unlikely to occur, our stock price may decline.

Omnicare's tender offer and related actions have created and may continue to create uncertainty for the Corporation's current and potential customers. This uncertainty may cause our current customers to change or terminate their business relationship with us and our potential customers not to commence a business relationship with us.



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## **Table of Contents**

Pursuant to the requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the regulations thereunder (the HSR Act ), Omnicare filed a Notification and Report Form with the Antitrust Division of the U.S. Department of Justice (the Antitrust Division ) and the Federal Trade Commission (the FTC ) relating to its proposed acquisition of the Corporation on September 7, 2011. On or about September 19, 2011, the Corporation submitted a responsive Notification and Report Form with the Antitrust Division and the FTC. On September 22, 2011, the Corporation received a request for additional information from the FTC relating to the tender offer. On September 22, 2011, Omnicare also received a request for additional information from the FTC relating to the tender offer (the Second Request ). The Second Request extended the waiting period under the HSR Act for 10 calendar days after the date Omnicare certified substantial compliance with the Second Request issued to Omnicare. On September 30, 2011 the FTC also issued a subpoena and civil investigative demand to the Corporation covering the same subject matter as the Second Request. The Corporation has produced a considerable amount of material in response to the FTC requests. Responding to the FTC s requests has required the expenditure of significant time and resources by the Corporation.

On November 18, 2011 Omnicare certified to the FTC that it had substantially complied with the Second Request. On November 18, 2011, Omnicare also executed a timing agreement with the FTC pursuant to which Omnicare agreed (i) to provide 14 days notice to the FTC prior to consummating its proposed acquisition and (ii) not to consummate its proposed acquisition prior to December 19, 2011 without the consent of the FTC. On December 2, 2011, Omnicare agreed with the FTC to extend the date prior to which Omnicare will not consummate its proposed acquisition to January 19, 2012, unless the FTC notifies Omnicare that it has closed its investigation relating to its proposed acquisition. On January 10, 2012, Omnicare agreed with the FTC that it will not consummate its proposed acquisition prior to January 26, 2012, unless the FTC notifies Omnicare that it has closed its investigation relating to its proposed acquisition. On January 27, 2012, the FTC issued an administrative complaint to block Omnicare s proposed acquisition of the Corporation. The complaint alleges that the proposed acquisition would be illegal and in violation of Section 15 of the FTC Act and Section 7 of the Clayton Act because it would harm competition and enable Omnicare to raise the price of drugs for Medicare Part D consumers and others. The case is scheduled to be heard before an administrative law judge at the FTC in June 2012.

The impact of Omnicare s tender offer due to these and other factors may undermine our business and have a material adverse affect on our results of operations.

***Omnicare may undertake a proxy solicitation to elect its own slate of nominees for the Board of Directors at the Corporation s 2012 annual meeting of stockholders.***

Omnicare has publicly stated that it may nominate and solicit proxies for the election of a slate of director nominees at the 2012 annual meeting of the Corporation s stockholders. If the Omnicare nominees are elected to our Board of Directors, the ability of management to work effectively and efficiently with our Board of Directors with respect to the day to day operations and development of the Corporation may be restricted, and as a result, the Corporation s business may be adversely impacted.

### **Risk Factors Relating to the Pharmacy Transaction**

***We may be charged for services and products from one of our former parents at amounts greater than those charged prior to the Pharmacy Transaction and those charged by third-parties.***

Before the Pharmacy Transaction, our business was part of two separate public companies. Our former parent companies performed many corporate functions at costs that are less than those that are presently being charged. Kindred provides information technology services under the Information Technology Services Agreement. During the term of the Information Technology Services Agreement, we are not able to negotiate potentially better terms and thus this existing agreement could negatively impact our results of operations, financial position and competitive position.

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## **Table of Contents**

### **Risk Factors Relating to Our Business**

#### ***Financial soundness of our customers and suppliers may adversely affect our results of operations.***

If our customers' operating and financial performance deteriorates, or if they are unable to make scheduled payments or obtain credit, our customers may not be able to pay, or may delay payment of, accounts receivable owed to us. Any inability of customers to pay us for our products and services may adversely affect our earnings and cash flow. Additionally, both state and federal government sponsored payers, as a result of budget deficits or reductions, may seek to reduce their health care expenditures resulting in the long-term care customers renegotiating their contracts with us. Any reduction in payments by such government sponsored payers may adversely affect our earnings and cash flow. Also some of our customers' real estate is owned by Real Estate Investment Trusts limiting their ability to renegotiate rental costs furthering their desire to reduce other controllable costs, such as pharmacy costs.

#### ***Intense competition may erode our profit margins.***

The distribution of pharmaceuticals to healthcare facilities is highly competitive. In each geographic market, there are national, regional and local institutional pharmacies and numerous local retail pharmacies, which provide services comparable to those offered by our pharmacies and which may have greater financial and other resources than we do and may be more established in the markets they serve than we are. We also compete against regional and local pharmacies that specialize in long-term care. Many of our competitors have equal or greater resources and access to capital than the Corporation. In addition, local pharmacies have strong personal relationships with their customers. Because relatively few barriers to entry exist in the local markets we serve, we may encounter substantial competition from local market entrants. In addition, owners of skilled nursing facilities are also entering the institutional pharmacy market, particularly in areas of their geographic concentration. Consolidation within the institutional pharmacy industry may also lead to increased competition. Competitive pricing pressures may adversely affect our earnings and cash flow.

We compete based on innovation and service as well as price. To attract new clients and retain existing clients, we must continually meet service expectations of our clients and customers. We cannot be sure that we will continue to remain competitive with the service to our clients at our current levels of profitability.

#### ***If we lose relationships with one or more key pharmaceutical manufacturers or if the payments made or discounts provided by pharmaceutical manufacturers decline, our business and financial results could be adversely affected.***

We maintain contractual relationships with numerous pharmaceutical manufacturers that may provide us with, among other things:

discounts for drugs we purchase to be dispensed from our institutional pharmacies;

rebates based upon distributions of drugs from our institutional pharmacies; and

administrative fees for managing rebate programs.

If several of these contractual relationships are terminated or materially altered by the pharmaceutical manufacturers, our business and financial results could be materially adversely affected. In addition, formulary fee programs have been the subject of debate in federal and state legislatures and various other public and

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**Table of Contents**

governmental forums. Changes in existing laws or regulations or in interpretations of existing laws or regulations or the adoption of new laws or regulations relating to any of these programs may materially adversely affect our business.

***Our operating revenue and profitability may suffer upon the occurrence of the loss of certain customers.***

We have a number of customers that own or operate numerous facilities in our institutional pharmacy segment. In addition, our hospital segment revenues are primarily derived from one large multi-facility customer. If we are not able to continue these relationships or are only able to continue these relationships on less favorable terms than the ones currently in place, our operating revenues and results of operations would be materially impacted. There can be no assurance that these customers will not terminate all or a portion of their contracts with the Corporation.

***Our operating revenue and profitability may suffer because of an increase in our generic dispensing rate.***

A shift in prescriptions dispensed from brand-to-generic and a decline in generic reimbursement rates from the PDP/PBMs may affect our operating revenue. When a branded drug shifts to a generic, initial pricing of the generic drug in the market will vary depending on the number of manufacturers launching their generic version of the drug. Historically a shift from brand-to-generic decreased our revenue and improved our gross margin from sales of these classes of drugs during the initial time period a brand drug has a generic alternative. However, recent experience has indicated that the third-party payers may reduce their reimbursements to the Corporation faster than previously experienced. This acceleration in the reimbursement reduction has resulted in margin compression as multi-source alternatives have become available much earlier than we have historically experienced. Due to the unique nature of the brand-to-generic conversion, management cannot estimate the future financial impact of the brand-to-generic conversions on its results of operations.

***If we fail to comply with complex and rapidly evolving laws and regulations, we could suffer penalties, be required to pay substantial damages or make significant changes to our operations.***

We are subject to numerous federal and state regulations. If we fail to comply with existing or future applicable laws and regulations, we could suffer civil or criminal penalties, including the loss of our licenses to operate our institutional pharmacies and our ability to participate in federal and state healthcare programs. As a consequence of the severe penalties we could face, we must devote significant operational and managerial resources to complying with these laws and regulations. Although we believe that we are substantially compliant with all existing statutes and regulations applicable to our business, different interpretations and enforcement policies of these laws and regulations could subject our current practices to allegations of impropriety or illegality, or could require us to make significant changes to our operations. In addition, we cannot predict the impact of future legislation and regulatory changes on our business or assure that we will be able to obtain or maintain the regulatory approvals required to operate our business.

As a result of political, economic, and regulatory influences, the healthcare delivery industry in the United States is under intense scrutiny and subject to fundamental changes. We cannot predict which reform proposals will be adopted, when they may be adopted, or what impact they may have on us.

The costs associated with complying with federal and state regulations could be significant and the failure to comply with any such legal requirements could have a material adverse effect on our financial condition, results of operations, and liquidity.

***Pharmaceutical products can develop unexpected safety or efficacy concerns.***

Unexpected safety or efficacy concerns can arise with respect to marketed products, whether or not scientifically justified, leading to product recalls, withdrawals or declining sales. If we fail to or do not promptly withdraw pharmaceutical products upon a recall by a drug manufacturer, our business and results of operations could be negatively impacted.

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**Table of Contents**

***Legal and regulatory changes reducing reimbursement rates for pharmaceuticals and/or medical treatments or services may reduce our profitability.***

Both our own profit margins and the profit margins of our customers may be adversely affected by laws and regulations reducing reimbursement rates and charges. The sources and amounts of our revenues are determined by a number of factors, including licensed bed capacity and occupancy rates of our customers, the number of drugs administered to patients, the mix of pharmaceuticals dispensed, whether the drugs are brand or generic, and the rates of reimbursement among payers. Changes in the number of drugs administered to patients, as well as payer mix among private pay, Medicare and Medicaid, in our customers' facilities will significantly affect our earnings and cash flow.

***Further Modifications to the Medicare Part D Program May Reduce Revenue and Impose Additional Costs to the Industry.***

The Medicare Prescription Drug Improvement and Modernization Act of 2003 or MMA included a major expansion of the Medicare program with the addition of a prescription drug benefit under the new Medicare Part D program. The continued impact of these regulations depends upon a variety of factors, including our ongoing relationships with the Part D Plans and the patient mix of our customers. Future modifications to the Medicare Part D program may reduce revenue and impose additional costs to the industry. In addition, we cannot assure you that Medicare Part D and the regulations promulgated under Medicare Part D will not have a material adverse effect on our institutional pharmacy business.

***Reductions in manufacturer rebates may reduce our profitability.***

Our pharmacies receive rebates from pharmaceutical manufacturers for undertaking certain activities that the manufacturers believe may increase the likelihood that their respective products will be dispensed. CMS has questioned whether long-term care pharmacies should be permitted to receive discounts, rebates and other price concessions from pharmaceutical manufacturers with respect to prescriptions covered under the Medicare Part D benefit. Our business would be adversely affected if CMS should take any action that has the effect of eliminating or significantly reducing the rebates that we receive from pharmaceutical manufacturers.

***Changes in Medicaid Reimbursement may reduce our revenue.***

The 2010 Health Care Legislation amended the Deficit Reduction Act of 2005 (the "DRA") to change the definition of the FUL by requiring the calculation of the FUL as no less than 175% of the weighted average, based on utilization, of the most recently reported monthly AMP for pharmaceutically and therapeutically equivalent multi-source drugs available through retail community pharmacies nationally.

In addition, the definition of AMP changed to reflect net sales only to drug wholesalers that distribute to retail community pharmacies and to retail community pharmacies that directly purchase from drug manufacturers. Further, the 2010 Health Care Legislation continues the current statutory exclusion of prompt pay discounts offered to wholesalers and adds three other exclusions to the AMP definition; i) bona fide services fees; ii) reimbursement for unsalable returned goods (recalled, expired, damaged, etc.); and iii) payments from and rebates/discounts to certain entities not conducting business as a wholesaler or retail community pharmacy. In addition to reporting monthly, the manufacturers are required to report the total number of units used to calculate each monthly AMP. CMS will use this information when it establishes the FUL as a result of the new volume-weighted requirements pursuant to the 2010 Health Care Legislation.

In September 2011, CMS issued the first draft FUL reimbursement files for multiple source drugs, including the draft methodology used to calculate the FULs in accordance with the Health Care Legislation. These draft FUL prices are based on the manufacturer reported and certified July 2011 monthly AMP and AMP unit data. CMS continues to release this data monthly and is expected to do so going forward. CMS has not posted monthly AMPs for individual drugs, but only posted the weighted average of monthly AMPs in a FUL group and the calculation methodology.

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**Table of Contents**

On February 2, 2012, CMS issued a proposed regulation further clarifying the AMP and FUL changes described above and indicated that the final rule will be issued sometime in 2013.

Until CMS provides final guidance and the industry adapts to this now public available pricing information, the Corporation is unable to fully evaluate the impact of the changes in FUL and AMP to its business.

***Adverse results in material litigation matters or governmental inquiries could have a material adverse effect upon the Corporation's business.***

The Corporation may from time to time become subject in the ordinary course of business to material legal action related to, among other things, intellectual property disputes, professional liability and employee-related matters, as well as inquiries from governmental agencies and Medicare or Medicaid carriers requesting comment and information on allegations of billing irregularities and other matters that are brought to their attention through billing audits, third parties or other sources. The health care industry is subject to substantial federal and state government regulation and audit. Legal actions could result in substantial monetary damages as well as damage to the Corporation's reputation with customers, which could have a material adverse effect upon our financial condition, results of operations, and liquidity.

***If we or our customers fail to comply with Medicare and Medicaid regulations, we may be subjected to penalties or loss of eligibility to participate in these programs.***

The Medicare and Medicaid programs are highly regulated. These programs are also subject to frequent and substantial changes. If we or our customers' facilities fail to comply with applicable reimbursement laws and regulations, whether purposely or inadvertently, our reimbursement under these programs could be curtailed or reduced and our eligibility to continue to participate in these programs could be adversely affected. Federal or state governments may also impose other penalties on us for failure to comply with the applicable reimbursement regulations. Failure by our customers to comply with these or future laws and regulations could result in our inability to provide pharmacy services to these customers and their residents. We do not believe that we have taken any actions that could subject us to material penalties under these rules and regulations.

Among these laws is the federal anti-kickback statute. This statute prohibits anyone from knowingly and willfully soliciting, receiving, offering or paying any remuneration with the intent to refer, or to arrange for the referral or order of, services or items payable under a federal healthcare program. Courts have interpreted this statute broadly. Violations of the anti-kickback statute may be punished by a criminal fine of up to \$25,000 for each violation or imprisonment, civil money penalties of up to \$50,000 per violation and damages of up to three times the total amount of the remuneration and/or exclusion from participation in federal health care programs, including Medicare and Medicaid. This law impacts the relationships that we may have with potential referral sources. We have a variety of relationships with potential referral sources, including hospitals and skilled nursing facilities with which we have contracted to provide pharmacy services. The Office of Inspector General at HHS, or OIG, among other regulatory agencies, is responsible for identifying and eliminating fraud, abuse or waste. The OIG carries out this responsibility through a nationwide program of audits, investigations and inspections. The OIG has promulgated safe harbor regulations that outline practices that are deemed protected from prosecution under the anti-kickback statute. While we endeavor to comply with the applicable safe harbors, certain of our current arrangements may not qualify for safe harbor protection. Failure to meet a safe harbor does not mean that the arrangement necessarily violates the anti-kickback statute, but may subject the arrangement to greater scrutiny. It cannot be assured that practices outside of a safe harbor will not be found to violate the anti-kickback statute.

The anti-kickback statute and similar state laws and regulations are expansive. We do not always have the benefit of significant regulatory or judicial interpretation of these laws and regulations. In the future, different interpretations or enforcement of these laws and regulations could subject our current or past practices to allegations of impropriety or illegality, or could require us to make changes in our facilities, equipment,

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**Table of Contents**

personnel, services, capital expenditure programs and operating expenses. A determination that we have violated these laws, or the public announcement that we are being investigated for possible violations of these laws, could have a material adverse effect on our business, financial position, results of operations or prospects and our business reputation could suffer significantly. If we fail to comply with the anti-kickback statute or other applicable laws and regulations, we could be subjected to liabilities, including criminal penalties, civil penalties (including the loss of our licenses to operate one or more facilities), and exclusion of one or more facilities from participation in the Medicare, Medicaid and other federal and state health care programs. In addition, we are unable to predict whether other legislation or regulations at the federal or state level will be adopted, what form such legislation or regulations may take or their impact.

***Continuing government and private efforts to contain healthcare costs may reduce our future revenue.***

We could be adversely affected by the continuing efforts of government and private payers to contain healthcare costs. To reduce healthcare costs, payers seek to lower reimbursement rates, limit the scope of covered services and negotiate reduced or capped pricing arrangements. While many of the proposed policy changes would require congressional approval to implement, we cannot assure you that reimbursement payments under governmental and private third party payer programs will remain at levels comparable to present levels or will be sufficient to cover the costs allocable to patients eligible for reimbursement under these programs. Any changes that lower reimbursement rates under Medicare, Medicaid or private pay programs could result in a substantial reduction in our net operating revenues. Our operating margins may continue to be under pressure because of deterioration in reimbursement, changes in payer mix and growth in operating expenses in excess of increases, if any, in payments by third party payers. For instance, the short cycle dispensing requirements set forth in the Patient Protection and Affordable Care Act, which would become effective January 2013, could impact our revenues and our profitability if the costs associated therewith are not fully reimbursed by the appropriate payers.

***Healthcare reform could adversely affect the liquidity of our customers which would have an adverse effect on their ability to make timely payments to us for our products and services.***

Healthcare reform and legislation may have an adverse effect on our business through decreasing funds available to our customers. Limitations or restrictions on Medicare and Medicaid payments to our customers could adversely impact the liquidity of our customers, resulting in their inability to pay us, or to timely pay us, for our products and services. This inability could have a material adverse effect on our financial position, results of operations, and liquidity.

***The changing U.S. healthcare industry and increasing enforcement environment may negatively impact our business.***

Our products and services are part of the structure of the healthcare financing and reimbursement system currently existing in the United States. In recent years, the healthcare industry has undergone significant changes in an effort to reduce costs and government spending. These changes include an increased reliance on managed care, cuts in Medicare funding affecting our healthcare provider customer base and consolidation of competitors, suppliers and customers.

We expect the healthcare industry to continue to change significantly in the future. Some of these potential changes, such as a reduction in governmental support of healthcare services or adverse changes in legislation or regulations governing prescription drug pricing, healthcare services or mandated benefits, may cause healthcare providers to reduce the amount of our products and services they purchase or the price they are willing to pay for our products and services. If we are unable to adjust to changes in the healthcare environment, it could have a material adverse effect on our financial position, results of operations and liquidity.

Further, both federal and state government agencies have increased their focus on and coordination of civil and criminal enforcement efforts in the healthcare area. The OIG and the U.S. Department of Justice have, from

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**Table of Contents**

time to time, established national enforcement initiatives, targeting all providers of a particular type, that focus on specific billing practices or other suspected areas of abuse. In addition, under the federal False Claims Act, private parties have the right to bring qui tam whistleblower lawsuits against companies that submit false claims for payments to the government. A number of states have adopted similar state whistleblower and false claims provisions. We do not believe that we have taken any actions that could subject us to material penalties under these provisions.

***Further consolidation of managed care organizations and other third-party payers may adversely affect our profits.***

Managed care organizations and other third-party payers have continued to consolidate in order to enhance their ability to influence the delivery of healthcare services. Consequently, the healthcare needs of a large percentage of the U.S. population are increasingly served by a small number of managed care organizations. These organizations generally enter into service agreements with a limited number of providers for needed services. In addition, private payers, including managed care payers, increasingly are demanding discounted fee structures. To the extent that these organizations terminate us as a preferred provider, engage our competitors as a preferred or exclusive provider or demand discounted fee structures, our liquidity and results of operations could be materially and adversely affected.

***Possible changes in, or our failure to satisfy our manufacturers' rebate programs could adversely affect our results of operations.***

We currently earn rebates from certain manufacturers of pharmaceutical products for meeting tiered market share and purchase volumes. There can be no assurance that pharmaceutical manufacturers will continue to offer these rebates or that they will not change the terms upon which rebates are offered. A decrease in prescription volumes dispensed or a decrease in the number of brand or generic drugs which participate in rebate programs and are used by the geriatric population could affect our ability to satisfy our manufacturers' rebate programs. The termination of such programs or our failure to satisfy the criterion for earning rebates may have an adverse affect on our cost of goods sold, financial position, results of operations and liquidity.

***If we or our customers fail to comply with licensure requirements, laws and regulations in respect of healthcare fraud or other applicable laws and regulations, we could suffer penalties or be required to make significant changes to our operations.***

Our pharmacies must be licensed by the state board of pharmacy in the state in which they operate. Many states also regulate out-of-state pharmacies that are delivering prescription products to patients or residents in their states. The failure to obtain or renew any required regulatory approvals or licenses could adversely impact the operation of our business. In addition, the healthcare facilities we service are also subject to extensive federal, state and local regulations and are required to be licensed in the states in which they are located. The failure by these healthcare facilities to comply with these or future regulations or to obtain or renew any required licenses could result in our inability to provide pharmacy services to these facilities and their residents and could have a material adverse effect on our financial position, results of operations and liquidity.

While we believe that we are in substantial compliance with all applicable laws, many of the regulations applicable to us, including those relating to marketing incentives offered by pharmaceutical suppliers, and rebates paid by pharmaceutical manufacturers are vague or indefinite and have not been interpreted by the courts. They may be interpreted or applied by a prosecutorial, regulatory or judicial authority in a manner that could require us to make changes in our operations. These changes may be material and may require the expenditure of material funds to implement. We believe that the regulatory environment surrounding most segments of the healthcare industry remains intense. Federal and state governments continue to impose intensive enforcement policies resulting in a significant number of inspections, citations of regulatory deficiencies and other regulatory sanctions including demands for refund of overpayments, terminations from the Medicare and Medicaid

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## **Table of Contents**

programs, bans on Medicare and Medicaid payments and fines. If we or our customers fail to comply with the extensive applicable laws and regulations, we could become ineligible to receive government program reimbursement, suffer civil or criminal penalties or be required to make significant changes to our operations. In addition, we could be forced to expend considerable resources responding to an investigation or other enforcement action under these laws or regulations regardless of whether we have actually been involved in any violations or wrong-doing.

***Federal and state medical privacy regulations may increase the costs of operations and expose us to civil and criminal sanctions.***

We must comply with extensive federal and state requirements regarding the transmission and retention of health information. The Health Insurance Portability and Accountability Act of 1996 and its implementing regulations, referred to as HIPAA, was enacted to ensure that employees can retain and at times transfer their health insurance when they change jobs, to enhance the privacy and security of personal health information and to simplify healthcare administrative processes. HIPAA requires the adoption of standards for the exchange of electronic health information. Failure to comply with HIPAA could result in fines and penalties that could have a material adverse effect on our results of operations, financial condition, and liquidity.

***Acquisitions, investments and strategic alliances that we have made or may make in the future may use significant resources, may be unsuccessful and could expose us to unforeseen liabilities.***

We have made and anticipate that we may continue to make acquisitions of, investments in and strategic alliances with complementary businesses to enable us to capitalize on our position in the geographic markets in which we operate and to expand our businesses in new geographic markets. At any particular time, we may be in various stages of assessment, discussion and negotiation with regard to one or more potential acquisitions, investments or strategic alliances, not all of which, if any, will be consummated. Our acquisition program and strategy has and may lead us to contemplate acquisitions of companies in bankruptcy or financial distress, all of which entail additional risks and uncertainties. Such risks and uncertainties include, without limitation, that, before assets may be acquired, customers may leave in search of more stable providers and vendors may terminate key relationships. Also, assets are generally acquired on an as is basis, with no recourse to the seller if the assets are not as valuable as may be represented. Finally, while bankrupt companies may be acquired for comparatively little money, the cost of continuing the operations may significantly exceed expectations. Our growth plans rely, in part, on the successful completion of future acquisitions. If we are unsuccessful, our business would suffer.

We intend to make public disclosure of pending and completed acquisitions when appropriate or required by applicable securities laws and regulations. Acquisitions may involve significant cash expenditures, debt incurrence, additional operating losses, amortization of certain intangible assets of acquired companies, and expenses that could have a material adverse effect on our financial position, results of operations and liquidity. Acquisitions involve numerous risks and uncertainties, including, without limitation:

difficulties integrating acquired operations, personnel and information systems, or in realizing projected efficiencies and cost savings;

diversion of management's time from existing operations;

potential loss of key employees or customers of acquired companies;

inaccurate assessment of assets and liabilities and exposure to undisclosed or unforeseen liabilities of acquired companies, including liabilities for failure to comply with healthcare laws;

increases in our indebtedness and a limitation on our ability to access additional capital when needed; and

failure to operate acquired facilities profitably or to achieve improvements in their financial performance.





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**Table of Contents**

***Risks generally associated with our sophisticated information systems may adversely affect our results of operations.***

We rely on sophisticated information systems in our business to obtain, rapidly process, analyze, and manage data to facilitate the dispensing of prescription and non-prescription pharmaceuticals in accordance with physician orders and deliver those medications to patients and long-term care residents on a timely basis; to manage the accurate billing and collections for thousands of customers; and to process payments to suppliers. Our business and results of operations may be materially adversely affected if these systems are interrupted or damaged or if they fail for an extended period of time.

***We purchase a significant portion of our pharmaceutical products from one supplier AmerisourceBergen.***

We are required to purchase a substantial amount of our pharmaceutical products from AmerisourceBergen, pursuant to the Amended Prime Vendor Agreement. If AmerisourceBergen fails to deliver products in accordance with the Amended Prime Vendor Agreement, there can be no assurance that our operations would not be disrupted or that we could obtain the products at similar cost or at all. In this event, failure to satisfy our customers' requirements would result in defaults under these customer contracts subjecting us to damages and the potential termination of those contracts. Such events could have a material adverse effect on our financial position, results of operations and liquidity. In addition, under the terms of the Amended Prime Vendor Agreement, we are unable to negotiate potentially better pricing and other terms with other drug distributors which could negatively impact our competitive position.

***Prescription volumes may decline, and our net revenues and profitability may be negatively impacted, if products are withdrawn from the market or if increased safety risk profiles of specific drugs result in utilization decreases.***

We dispense significant volumes of drugs from our pharmacies. These volumes are the basis for our net revenues and profitability. When increased safety risk profiles of specific drugs or classes of drugs result in utilization decreases, physicians may cease writing or reduce the numbers of prescriptions written for these drugs. Additionally, negative press regarding drugs with higher safety risk profiles may result in reduced consumer demand for such drugs. On occasion, products are withdrawn by their manufacturers. In cases where there are no acceptable prescription drug equivalents or alternatives for these prescription drugs, our volumes, net revenues, profitability and cash flows may decline.

***We could be required to record a material non-cash charge to income if our recorded goodwill or intangible assets are impaired, or if we shorten intangible asset useful lives.***

We have \$214.2 million of goodwill and \$100.2 million of recorded intangible assets, net, on our consolidated balance sheet as of December 31, 2011. Our intangible assets primarily represent the value of client relationships that were recorded from past acquisitions. Under current accounting rules, intangible assets are amortized over their useful lives. These assets may become impaired with the loss of significant clients. If the carrying amount of the assets exceeds the undiscounted pre-tax expected future cash flows from the lowest appropriate asset grouping, we would be required to record a non-cash impairment charge to our consolidated income statements in the amount the carrying value of these assets exceeds its fair value. In addition, while the intangible assets may not be impaired, the useful lives are subject to continual assessment, taking into account historical and expected losses of relationships that were in the base at time of acquisition. This assessment may result in a reduction of the remaining weighted average useful life of these assets, resulting in potentially significant increases to non-cash amortization expense that is charged to our consolidated income statements. A goodwill or intangible asset impairment charge, or a reduction of useful lives, could have a material effect on our results of operations. For the year ended December 31, 2011, we incurred a pre-tax impairment charge of \$5.1 million or \$0.11 per diluted common share as a result of non-renewal of certain customer contracts related to a pre-Pharmacy Transaction acquisition.

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## **Table of Contents**

*We primarily obtain our information services from one provider. Failure to provide information services in a timely manner could cause delays in the delivery of our services, which could damage our reputation, cause us to lose customers and negatively impact our growth.*

We obtain substantially all of our information services from Kindred, one of our former parent companies, pursuant to the IT Services Agreement. Kindred is not in the business of providing comprehensive information technology outsourcing services to third parties and does not have any significant prior experience providing comprehensive outsourcing information technology services for any third party. If Kindred or other third parties upon whom we are dependent fail to devote sufficient time and resources to us or if their performance is substandard, our business may be harmed. Any delays, malfunctions, inefficiencies or interruptions in these products or services could adversely affect the reliability or operation of our business, which could cause us to experience difficulty retaining current customers and attracting new customers. This could result in our failure to satisfy our customers' requirements or comply with certain of our financial or regulatory reporting requirements, which could have a material adverse effect on our financial position, results of operations and liquidity.

*We are highly dependent on our senior management team and our pharmacy professionals.*

We are highly dependent upon the members of our senior management and our pharmacists and other pharmacy professionals. Our business is managed by a small number of senior management personnel. If we were unable to retain these persons, we might be materially adversely affected due to the limited pool of senior management personnel with significant experience in our industry. Accordingly, we believe we could experience significant difficulty in replacing key management personnel. We expect that any employment contracts we enter into with our key management personnel will be subject to termination without cause by either party. Moreover, although the majority of the members of our senior management team have significant experience in the industry, they will need time to fully assess and understand our business and operations. We can offer no assurance how long these members of senior management will choose to remain with us.

In addition, our continued success depends on our ability to attract and retain pharmacists and other pharmacy professionals. Competition for qualified pharmacists and other pharmacy professionals is intense. The loss of pharmacy personnel or the inability to attract or retain sufficient numbers of qualified pharmacy professionals could adversely affect our business. Although we generally have been able to meet our staffing requirements for pharmacists and other pharmacy professionals, our inability to do so in the future could have a material adverse effect on our financial position, results of operations and liquidity.

### **Risk Factors Relating to Ownership of Our Common Stock and Our Senior Secured Credit Facility**

*Certain provisions of our certificate of incorporation and bylaws and provisions of Delaware law could delay or prevent a change of control that stockholders favor.*

Provisions of our certificate of incorporation and bylaws may discourage, delay or prevent a merger or other change of control that stockholders may consider favorable or may impede the ability of the holders of our common stock to change our management and Board of Directors. The provisions of our certificate of incorporation and bylaws, among other things:

prohibit stockholder action except at an annual or special meeting. Specifically, this means our stockholders are unable to act by written consent;

regulate how stockholders may present proposals or nominate directors for election at annual meetings of stockholders. Advance notice of such proposals or nominations is required;

regulate how special meetings of stockholders may be called. Our stockholders do not have the right to call special meetings;

authorize our board of directors to issue preferred stock in one or more series, without stockholder approval. Under this authority, our Board of Directors adopted the Rights Agreement which could

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**Table of Contents**

ensure continuity of management by rendering it more difficult for a potential acquirer to obtain control of us; and

require an affirmative vote of the holders of three-quarters or more of the combined voting power of our common stock entitled to vote in the election of our directors in order for the stockholders to amend our bylaws.

In addition, because we have not chosen to be exempt from Section 203 of the Delaware General Corporation Law ( DGCL ), this provision could also delay or prevent a change of control that some stockholders may view as favorable. Section 203 provides that unless board and/or stockholder approval is obtained pursuant to the requirements of the statute, persons that acquire, or are affiliated with a person that acquires, more than 15% of the outstanding voting stock of a Delaware corporation shall not engage in any business combination with that corporation, including by merger, consolidation or acquisitions of additional shares, for a three-year period following the date on which that person or its affiliate becomes the holder of more than 15% of the corporation s outstanding voting stock.

On August 25, 2011, the Board of Directors adopted the Rights Agreement, providing for the distribution of one right for each share of common stock outstanding. Each right entitles the holder to purchase one one-thousandth (1/1000th) of a share of Series A Junior Preferred Stock, par value \$0.01 per share, of the Corporation at a price of \$45.00 per one one-thousandth (1/1000th) of a share, subject to adjustment. The Rights generally become exercisable at the discretion of the Board of Directors following a public announcement that 15% or more of the Corporation s common stock has been acquired or an intent to acquire has become apparent. The Rights will expire on the earlier of August 25, 2021 or redemption or exchange by the Corporation. However, the Rights will expire immediately at the final adjournment of the Corporation s 2012 annual meeting of stockholders if stockholder approval of the Rights Agreement has not been received prior to that time. Certain terms of the rights are subject to adjustment to prevent dilution. Further description and terms of the rights are set forth in the Rights Agreement dated August 25, 2011 between the Corporation and Mellon Investors Services LLC, as Rights Agent.

On August 25, 2011, the Board of Directors declared a dividend of one preferred share purchase right for each outstanding share of common stock. The dividend was paid on September 6, 2011 to the stockholders of record on September 6, 2011.

***The market price and trading volume of our common stock may be volatile.***

The market price of our common stock could fluctuate significantly for many reasons, including, without limitation the following:

as a result of the risk factors listed in this document;

actual or anticipated fluctuations in our results of operations;

for reasons unrelated to our specific performance, such as reports by industry analysts, investor perceptions, or negative announcements by our customers or competitors regarding their own performance;

changes in the outlook for a potential business combination transaction with Omnicare;

regulatory changes that could impact our business or that of our customers; and

general economic and industry conditions.

In addition, when the market price of a company s common stock drops significantly, stockholders often institute securities class action lawsuits against the company. A lawsuit against us could cause us to incur substantial costs and could divert the time and attention of our management and other resources.



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**Table of Contents**

***Acquisitions, investments and strategic alliances we may make in the future may need to be financed by borrowings from the senior secured credit facility for which funds may not be made available by certain participants.***

We have made and anticipate that we may continue to make acquisitions of, investments in and strategic alliances with complementary businesses to enable us to capitalize on our position in the geographic markets in which we operate and to expand our business in new geographic markets. Our growth plans rely, in part, on the successful completion of future acquisitions. At any particular time, we may need to finance such acquisitions and strategic alliances with borrowings from our senior secured credit facility. The financial markets are very volatile and certain participants in our senior secured credit facility may not be able to participate in funding their commitments under the revolving line of credit. If we are unsuccessful in obtaining the financing, our business would be impacted.

***We are exposed to interest rate changes.***

We are exposed to market risk related to changes in interest rates. As of December 31, 2011, we had outstanding debt of \$300.0 million, all of which was subject to variable rates of interest. See Item 7A., Quantitative and Qualitative Disclosures about Market Risk.

***We have indebtedness, which restricts our ability to pay cash dividends and has a negative impact on our financing options and liquidity.***

We have \$300.0 million in indebtednesses outstanding as of December 31, 2011 under our senior secured credit facility and revolver.

The credit agreement contains customary restrictions, requirements and other limitations on our ability to incur indebtedness. The senior secured credit facility also contains financial covenants that require us to satisfy certain financial tests and maintain certain financial ratios, including a maximum of debt to EBITDA ratio. The senior secured credit facility limits our ability to declare and pay dividends or other distributions on our shares of common stock. If our lenders permit us to declare dividends, the dividend amounts, if any, will be determined by our Board of Directors, which will consider a number of factors, including our financial condition, capital requirements, funds generated from operations, future business prospects, applicable contractual restrictions and any other factors our Board of Directors may deem relevant. The amount of this outstanding indebtedness could limit our ability to pay cash dividends and to obtain additional financing in the future for working capital, capital expenditure and acquisition purposes. A significant portion of our cash flows will be dedicated to debt service and will be unavailable for investment, capital expenditures or other operating expenses.

As a result of these and other factors, we cannot assure you that our business will generate sufficient cash flows from operations or that future borrowings will be available to us in amounts sufficient to enable us to pay our indebtedness or to fund our other liquidity needs. If we do not generate or are unable to borrow sufficient amounts of cash on satisfactory terms to meet these needs, we may need to seek to refinance all or a portion of our indebtedness on or before maturity, sell assets, curtail discretionary capital expenditures or seek additional capital. There can be no assurance that additional capital will be available to us on acceptable terms, or at all, which could adversely impact our business, results of operations, liquidity, capital resources, and financial position.

***Our ability to pay dividends is limited by our financial results and we do not anticipate paying any distributions in the foreseeable future.***

We anticipate that future earnings will be used principally to support operations and finance the growth of our business. Thus, we do not intend to pay dividends or other cash distributions on our common stock in the foreseeable future. See Part II, Item 5 Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

**Table of Contents**

We entered into a senior secured credit facility providing for both term and revolving credit borrowings. Our ability to make payments on our existing and future debt and to fund working capital needs and planned capital expenditures will depend on our ability to generate cash in the future, which is largely subject to general economic, financial, competitive, regulatory, legislative and other factors that are beyond our control. Cost containment and lower reimbursement levels relative to increases in cost by third party payers, including federal and state governments, could have a significant negative impact on our business and on our cash flows. Our operating margins continue to be under pressure because of continuing reimbursement and regulatory changes and growth in our operating expenses, such as product and labor costs.

See Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

**Item 1B. Unresolved Staff Comments**

None.

**Table of Contents****Item 2. Properties**

We have facilities including offices and key operating facilities (e.g. institutional pharmacies) in various locations throughout the United States. The Corporation's corporate headquarters are located in Louisville, Kentucky. In addition to the institutional pharmacies listed below, the Corporation also has four facilities throughout the nation with several overhead and administrative functions. As of December 31, 2011, all facilities were leased. We consider all of these facilities to be suitable, adequate, and are utilized at full capacity by the institutional pharmacy business segment.

The following table presents certain information with respect to operating leases of our institutional pharmacies identified by the Corporation as properties as of December 31, 2011:

State	# of Facilities	Square Footage	State	# of Facilities	Square Footage
Alabama	2	20,330	Mississippi	1	11,600
Arizona	2	21,436	Missouri	1	4,090
Arkansas	1	6,850	Montana	1	2,440
California	10	100,451	Nebraska	1	5,120
Colorado	2	14,067	Nevada	1	7,000
Connecticut	1	15,600	New Hampshire	1	7,500
Delaware	1	5,739	New Jersey	1	14,309
Florida	6	67,112	New Mexico	1	4,798
Georgia	2	33,202	New York	2	56,738
Hawaii	5	15,506	North Carolina	4	26,950
Idaho	1	4,031	Ohio	4	41,582
Illinois	1	15,495	Pennsylvania	7	62,380
Indiana	1	20,386	Rhode Island	1	9,415
Iowa	1	6,250	South Carolina	1	15,550
Kansas	1	9,977	South Dakota	2	12,050
Kentucky	2	43,500	Tennessee	3	28,862
Louisiana	1	4,914	Texas	9	69,179
Maine	1	10,200	Utah	1	8,002
Maryland	1	10,744	Virginia	3	23,647
Massachusetts	1	53,111	Washington	2	14,792
Michigan	2	13,185	West Virginia	1	1,419
Minnesota	1	13,871	Wisconsin	1	11,068

**Item 3. Legal Proceedings**

On September 7, 2011 Omnicare filed a lawsuit in the Court of Chancery of the State of Delaware against the Corporation and the members of the Corporation's Board of Directors, styled Omnicare, Inc. v. PharMerica Corporation, et al., Civil Action No. 6841-CS. In the action, Omnicare alleges that the members of the Board of Directors breached their fiduciary duties to the Corporation and its stockholders by, among other things, refusing to negotiate with Omnicare, failing to inform themselves of the merits of the tender offer, and failing to consider and negotiate the tender offer. Omnicare seeks declaratory and injunctive relief, including an order requiring the Board of Directors to render the Rights Agreement, dated August 25, 2011 (the "Rights Agreement"), between the Corporation and Mellon Investor Services LLC, as Rights Agent, and Section 203 of the Delaware General Corporation Law ( "DGCL") inapplicable to Omnicare's tender offer and proposed merger. The Corporation and its directors believe that the claims made by Omnicare are without merit and intend to defend them vigorously.

On September 9, 2011, the Louisiana Municipal Police Employees' Retirement System ( "LMPERS") filed a lawsuit in the Court of Chancery of the State of Delaware, purportedly on behalf of a class of the Corporation's stockholders, against the Corporation and the members of the Corporation's Board of Directors, styled Louisiana



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**Table of Contents**

Municipal Police Employees Retirement System v. Frank Collins, et al., Civil Action No. 6851-CS. In the action, LMPERS alleges that the members of the Board of Directors breached their fiduciary duties to the Corporation and its stockholders by, among other things, adopting the Rights Agreement and failing to respond appropriately to the tender offer. LMPERS seeks declaratory and injunctive relief, including an order certifying the case as a class action and an order enjoining application of the Rights Agreement and Section 203 of the DGCL to the tender offer and proposed merger.

On September 22, 2011, Hugh F. Drummond as Trustee of the FBO Hugh F. Drummond Trust ( Drummond ) filed a lawsuit in the Court of Chancery of the State of Delaware, purportedly on behalf of a class of the Corporation s stockholders, against the Corporation and the members of the Corporation s Board of Directors, styled Hugh F. Drummond as Trustee of the FBO Hugh F. Drummond Trust v. PharMerica Corp., et al., Civil Action No. 6882. In the action, Drummond alleges that the members of the Board of Directors breached their fiduciary duties to the Corporation and its stockholders by, among other things, adopting the Rights Agreement and failing to respond appropriately to the tender offer. Drummond seeks declaratory and injunctive relief, including an order certifying the case as a class action and an order enjoining the directors and the Corporation from excluding strategic bidders, including Omnicare, imposing unreasonable preconditions on such strategic bidders, refusing to provide due diligence to strategic bidders, and conducting a limited sale process not designed to produce the best transaction for PharMerica s stockholders.

On October 3, 2011, the Court of Chancery of the State of Delaware entered an order consolidating the LMPERS and Drummond actions under the caption *In re PharMerica Corporation Shareholders Litigation*, Consolidated Civil Action No. 6851-CS. Plaintiffs in the consolidated action designated the complaint filed in the *Drummond* action as operative. The Corporation and its directors believe that the claims made by LMPERS and Drummond are without merit and intend to defend the consolidated action vigorously.

Pursuant to the requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the regulations thereunder (the HSR Act ), Omnicare filed a Notification and Report Form with the Antitrust Division of the U.S. Department of Justice (the Antitrust Division ) and the Federal Trade Commission (the FTC ) relating to its proposed acquisition of the Corporation on September 7, 2011. On or about September 19, 2011, the Corporation submitted a responsive Notification and Report Form with the Antitrust Division and the FTC. On September 22, 2011, the Corporation received a request for additional information from the FTC relating to the tender offer. On September 22, 2011, Omnicare also received a request for additional information from the FTC relating to the tender offer (the Second Request ). The Second Request extended the waiting period under the HSR Act for 10 calendar days after the date Omnicare certified substantial compliance with the Second Request issued to Omnicare. On September 30, 2011, the FTC also issued a subpoena and civil investigative demand to the Corporation covering the same subject matter as the Second Request. The Corporation has produced a considerable amount of material in response to the FTC requests.

On November 18, 2011 Omnicare certified to the FTC that it had substantially complied with the Second Request. On November 18, 2011, Omnicare also executed a timing agreement with the FTC pursuant to which

**Table of Contents**

Omnicare agreed (i) to provide 14 days notice to the FTC prior to consummating its proposed acquisition and (ii) not to consummate its proposed acquisition prior to December 19, 2011 without the consent of the FTC. On December 2, 2011, Omnicare agreed with the FTC to extend the date prior to which Omnicare will not consummate its proposed acquisition to January 19, 2012, unless the FTC notifies Omnicare that it has closed its investigation relating to its proposed acquisition. On January 10, 2012, Omnicare agreed with the FTC that it will not consummate its proposed acquisition prior to January 26, 2012, unless the FTC notifies Omnicare that it has closed its investigation relating to its proposed acquisition. On January 27, 2012, the FTC issued an administrative complaint to block Omnicare's proposed acquisition of the Corporation. The complaint alleges that the proposed acquisition would be illegal and in violation of Section 15 of the FTC Act and Section 7 of the Clayton Act because it would harm competition and enable Omnicare to raise the price of drugs for Medicare Part D consumers and others. The case is scheduled to be heard before an administrative law judge at the FTC in June 2012.

The Corporation is responding to an investigation by the U.S. Attorney for the Eastern District of Wisconsin and by the Drug Enforcement Agency into the Corporation's alleged failure to comply with various laws and regulations relating to the control and dispensing of certain controlled substances as well as the potential filing of false claims for payments of certain controlled substances that the Corporation dispensed to nursing home residents. The Corporation has been informed that the government believes that the claims at issue were not eligible for payment due to the alleged non-compliance with various Medicare, Medicaid and other laws and regulations relating to the dispensing, control, sale, billing and reimbursement for such controlled substances. The Corporation denies the allegations made by the government and will defend itself in the event any actions are brought by the government. At this time, we are unable to estimate the outcome of the investigation. If the government brings claims and the Corporation is not successful in defending them, it could result in fines and recoupment of government claims.

In addition, the Corporation is involved in certain legal actions and regulatory investigations arising in the ordinary course of business. At this time, the Corporation is unable to determine the impact of these investigations on its consolidated financial position, results of operations, or liquidity.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**  
**Market Information**

Our only class of common equity is our \$0.01 par value common stock, which trades on the NYSE under the symbol PMC. Trading in our common stock commenced on the NYSE on August 1, 2007. Prior to that time, there was no public trading market for our common stock.

The following table sets forth the high and low closing prices per share during the period and the closing price of our common stock as reported by the NYSE for the fiscal periods indicated.

	High	Low	Close
<b>Fiscal 2010</b>			
First Quarter	\$ 18.94	\$ 16.23	\$ 18.22
Second Quarter	\$ 20.71	\$ 14.49	\$ 14.66
Third Quarter	\$ 14.36	\$ 6.93	\$ 9.53
Fourth Quarter	\$ 11.83	\$ 9.40	\$ 11.45
<b>Fiscal 2011</b>			
First Quarter	\$ 12.89	\$ 10.71	\$ 11.44
Second Quarter	\$ 13.61	\$ 10.61	\$ 12.76
Third Quarter	\$ 14.73	\$ 10.69	\$ 14.27
Fourth Quarter	\$ 16.40	\$ 11.91	\$ 15.18

**Stockholders**

As of January 24, 2012, we had approximately 2,644 stockholders of record of the Corporation's common stock. Because many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

**Cash Dividends**

The Corporation has never paid a cash dividend on its common stock and does not expect to pay cash dividends on its common stock in the foreseeable future. Our Senior Secured Credit Facility also limits our ability to declare and pay dividends or other distributions on our shares of common stock. Management believes the stockholders are better served if all of the Corporation's earnings are retained for expansion of the business.

**Stock Dividends**

On August 25, 2011, the Board of Directors adopted a Rights Plan, providing for the distribution of one right for each share of common stock outstanding. Each right entitles the holder to purchase one one-thousandth (1/1000<sup>th</sup>) of a share of Series A Junior Preferred Stock, par value \$0.01 per share, of the Corporation at a price of \$45.00 per one one-thousandth (1/1000<sup>th</sup>) of a share, subject to adjustment. The rights generally become exercisable at the discretion of the Board of Directors following a public announcement that 15% or more of the Corporation's common stock has been acquired or an intent to acquire has become apparent. The rights will expire on the earlier of August 25, 2021 or redemption by the Corporation. However, the rights will expire immediately at the final adjournment of the Corporation's 2012 annual meeting of stockholders if stockholder approval of the Rights Agreement has not been received prior to that time. Certain terms of the rights are subject to adjustment to prevent dilution. Further description and terms of the rights are set forth in the Rights Agreement.

On August 25, 2011, the Board of Directors declared a dividend of one Right for each outstanding share of common stock. The dividend was paid on September 6, 2011 to the stockholders of record on September 6, 2011.



**Table of Contents****Securities authorized for issuance under equity compensation plans**

The Corporation has adopted the Amended and Restated PharMerica Corporation 2007 Omnibus Incentive Plan (as amended and restated, Omnibus Plan ) under which the Corporation is authorized to grant equity-based and other awards to its employees, officers, directors and consultants. In connection with the Corporation's 2010 Annual Meeting of Stockholders, the stockholders of the Corporation approved and adopted the amended and restated Omnibus Plan to, among other things, implement a fungible share pool effective as of January 1, 2010, and preserve preferential tax treatment as qualified performance-based compensation under Section 162(m) of the Internal Revenue Code.

The Corporation has reserved 7,237,000 shares of its common stock for awards to be granted under the Omnibus Plan plus 534,642 shares issued for substitute equity awards for employees of KPS and PharMerica LTC. Under the fungible share pool, one share of stock will be subtracted from the share limit for each share of stock covered by a stock option or stock appreciation right award and 1.65 shares of stock will be subtracted from the share limit for each share of stock covered by any full-value award, including restricted stock awards, restricted stock units and performance share awards at target. The following shares are not available for re-grant under the Omnibus Plan: (i) shares tendered by a participant or withheld by the Corporation to pay the purchase price of a stock option award or to satisfy taxes owed with respect to an award, (ii) shares subject to a stock appreciation right that are not issued in connection with such award's settlement upon the exercise thereof, and (iii) shares reacquired by the Corporation using cash proceeds received by the Corporation from the exercise of stock options. Effective January 1, 2010, shares subject to an award that is forfeited, expired or settled for cash, are available for re-grant under the Omnibus Plan as one share of stock for each share of stock covered by a stock option or appreciation right and 1.65 shares of stock for each share of stock covered by any other type of award.

The following table sets forth equity compensation plan information as of December 31, 2011:

Plan Category	Number of securities to be issued upon exercise of outstanding options and rights (a)	Weighted-average exercise price of outstanding options and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by stockholders	3,560,500(1)	\$ 15.07(2)	3,168,057(3)

(1) Includes the following:

*2,744,011 shares of common stock to be issued upon exercise of outstanding stock options granted under the Omnibus Plan;*

*334,206 shares of common stock to be issued upon vesting of performance share units under the Omnibus Plan;*

*16,808 shares of common stock to be issued upon vesting of restricted stock awards under the Omnibus Plan; and*

*465,475 shares of common stock to be issued upon vesting of restricted stock units under the Omnibus Plan.*

(2) The weighted average exercise price in column (b) does not take into account the 949,745 shares of common stock potentially to be issued under restricted stock awards, performance share units and restricted stock units.

(3) The 3,168,057 shares does not take into consideration the dilution of 1.65 shares of stock for any full-value award, including restricted stock awards, restricted stock units and performance share units at target. The number of shares remaining available for future issuance calculated under the fungible share pool would be 2,747,573.



**Table of Contents**

See Note 9 to the Consolidated Financial Statements included in this Report for information regarding the material features of the Omnibus Plan.

On January 18, 2012, a long-term incentive award was granted which was comprised of 299,729 restricted stock units and 199,814 performance share units. The 2012 award reduced the amount of shares available for future issuance calculated under the fungible share pool to 1,923,327.

**Stock Performance Graph**

The following graph compares the cumulative total return on a \$100 investment in each of the Common Stock of the Corporation, the Standard & Poor's 500 Stock Index and the Standard & Poor's Healthcare Index for the period from August 1, 2007 to December 31, 2011. This graph assumes an investment in the Corporation's common stock and the indices of \$100 on August 1, 2007 and that all dividends were reinvested:

	<b>PharMerica Corporation</b>	<b>S&amp;P 500</b>	<b>S&amp;P Healthcare</b>
August 1, 2007	\$ 100	\$ 100	\$ 100
September 30, 2007	86	104	104
December 31, 2007	80	100	104
March 31, 2008	96	90	92
June 30, 2008	131	87	90
September 30, 2008	130	79	90
December 31, 2008	91	62	79
March 31, 2009	96	54	72
June 30, 2009	114	63	78
September 30, 2009	108	72	85
December 31, 2009	92	76	92
March 31, 2010	136	80	91
June 30, 2010	106	70	80
September 30, 2010	63	80	87
December 31, 2010	66	86	91
March 31, 2011	66	90	96
June 30, 2011	74	90	103
September 30, 2011	83	77	92
December 31, 2011	88	86	100

**Table of Contents**

*Recent Sales of Unregistered Securities*

None.

**Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

In August 2010, the Board of Directors authorized a share repurchase of up to \$25.0 million of the Corporation's common stock.

Share repurchases under this authorization may be made in the open market through unsolicited or solicited privately negotiated transactions, or in such other appropriate manner, and will be funded from available cash. The amount and timing of the repurchases will be determined by the Corporation's management and will depend on a variety of factors including price, corporate and regulatory requirements, capital availability and other market conditions. Common stock acquired through the share repurchase program will be held as treasury shares and may be used for general corporate purposes, including reissuances in connection with acquisitions, employee stock option exercises or other employee stock plans. During the year ended December 31, 2011, the Corporation did not repurchase any shares of its common stock under this program.

Additionally, the Corporation may redeem shares from employees upon vesting of the Corporation's stock awards for minimum statutory tax withholding purposes. The Corporation redeemed 13,311 shares of certain vested awards for an aggregate price of \$0.2 million, during the year ended December 31, 2011. These shares have been designated by the Corporation as treasury stock.

The following table summarizes our share repurchase activity by month for the three months ended December 31, 2011:

Period	Total Number of Shares Purchased	Weighted Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program	Approximate Dollar Value of Shares that may yet be Purchased under the Program (in millions)
October 1, 2011 - October 31, 2011		\$		\$ 14.5
November 1, 2011 - November 30, 2011	5,189(1)	15.33		14.5
December 1, 2011 - December 31, 2011				14.5

(1) The Corporation repurchased 5,189 shares of common stock in connection with the vesting of certain stock awards to cover minimum statutory withholding taxes.



**Table of Contents****Item 6. Selected Financial Data**

The following table presents our selected historical consolidated financial and operating data. The selected historical financial and operating data should be read in conjunction with, and is qualified in its entirety by reference to, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and notes thereto included elsewhere in this Annual Report on Form 10-K (in millions, except where indicated):

	Years Ended December 31,				
	2007 (1)	2008	2009	2010	2011
<b>Statement of operations data:</b>					
Revenues	\$ 1,217.8	\$ 1,947.3	\$ 1,841.2	\$ 1,847.3	\$ 2,081.1
Cost of goods sold	1,044.0	1,660.0	1,565.7	1,607.0	1,787.8
Gross profit	173.8	287.3	275.5	240.3	293.3
Selling, general and administrative	169.3	216.8	190.8	180.6	214.9
Amortization expense	5.0	6.5	9.0	9.3	11.0
Impairment of intangible assets		14.8			5.1
Integration, merger and acquisition related costs and other charges	29.8	26.7	5.2	14.6	15.3
Operating income (loss) (2)	\$ (30.3)	\$ 22.5	\$ 70.5	\$ 35.8	\$ 47.0
Net income (loss)	\$ (24.1)	\$ 5.0	\$ 42.2	\$ 19.2	\$ 23.4
<b>Earnings (loss) per common share: (3)</b>					
Basic	\$ (1.13)	\$ 0.17	\$ 1.39	\$ 0.64	\$ 0.80
Diluted	\$ (1.13)	\$ 0.17	\$ 1.39	\$ 0.64	\$ 0.79
Adjusted earnings per diluted common share (4)	\$ 0.52	\$ 1.00	\$ 1.30	\$ 0.93	\$ 1.20
<b>Shares used in computing earnings (loss) per common share:</b>					
Basic	21.3	30.1	30.3	30.0	29.3
Diluted	21.3	30.2	30.4	30.1	29.5
<b>Balance sheet data:</b>					
Cash and cash equivalents	\$ 32.0	\$ 41.3	\$ 51.2	\$ 10.8	\$ 17.4
Working capital (5)	\$ 268.6	\$ 272.3	\$ 312.8	\$ 280.9	\$ 349.1
Goodwill (5)	\$ 111.3	\$ 113.7	\$ 140.1	\$ 179.4	\$ 214.2
Intangible assets, net	\$ 77.5	\$ 73.4	\$ 90.8	\$ 102.2	\$ 100.2
Total assets	\$ 680.1	\$ 679.2	\$ 724.3	\$ 759.7	\$ 833.4
Long-term debt	\$ 250.0	\$ 240.0	\$ 240.0	\$ 245.6	\$ 300.0
Total stockholder's equity	\$ 309.2	\$ 319.8	\$ 370.9	\$ 384.4	\$ 413.8
<b>Supplemental information:</b>					
Adjusted EBITDA (4)	\$ 44.5	\$ 92.5	\$ 102.7	\$ 78.5	\$ 98.5
Adjusted EBITDA Margin (4)	3.7%	4.8%	5.6%	4.2%	4.7%
Adjusted EBITDA per prescription dispensed (4)	\$ 1.80	\$ 2.29	\$ 2.63	\$ 2.08	\$ 2.36
Net cash provided by operating activities	\$ 36.3	\$ 65.7	\$ 85.0	\$ 98.2	\$ 26.8
Net cash used by investing activities	\$ (22.0)	\$ (47.4)	\$ (76.1)	\$ (133.2)	\$ (64.0)
Net cash provided by (used in) financing activities	\$ 14.0	\$ (9.0)	\$ 1.0	\$ (5.4)	\$ 43.8
<b>Statistical information (in whole numbers except where indicated)</b>					
<b>Institutional Pharmacy</b>					
<b>Volume information:</b>					
Prescriptions dispensed (in thousands)	24,751	40,319	39,037	37,826	41,677
Revenue per prescription dispensed	\$ 46.99	\$ 46.85	\$ 45.72	\$ 47.31	\$ 48.43
Gross profit per prescription dispensed	\$ 6.57	\$ 6.85	\$ 6.84	\$ 6.15	\$ 6.85
Institutional pharmacy gross margin	14.0%	14.6%	15.0%	13.0%	14.1%
Generic drug dispensing rate	67.4%	70.7%	74.2%	75.5%	77.9%
<b>Customer licensed beds under contract:</b>					
Beginning of period	102,347	336,759	321,062	313,867	362,901
Additions - PharMerica Corporation	260,085	21,398	35,921	34,176	27,218
Additions - Chem Rx				61,773	3,242
Losses - PharMerica Corporation	(25,673)	(37,095)	(43,116)	(46,915)	(44,904)
Losses - Chem Rx					(8,959)

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End of period	336,759	321,062	313,867	362,901	339,498
<b>Hospital management contracts serviced</b>	86	84	86	90	91

- (1) For the year ended December 31, 2007, PharMerica LTC is included beginning August 1, 2007.
- (2) Includes depreciation expense of \$15.6 million, \$22.0 million, \$18.0 million, \$18.8 million and \$20.1 million for the years ended December 31, 2007, 2008, 2009, 2010 and 2011, respectively.
- (3) The Corporation has never declared a cash dividend. Earnings (loss) per share in whole dollars and cents.
- (4) See Use of Non GAAP Measures for Measuring Annual Results for a definition and Reconciliation of Adjusted Earnings per Diluted Common Share to Earnings Per Diluted Common Share and for Reconciliation of Net Income (loss) to Adjusted EBITDA and Margin.
- (5) As adjusted, see Note 2 Acquisitions in the Consolidated Financial Statements

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**Table of Contents*****Use of Non-GAAP Measures For Measuring Annual Results***

The Corporation calculates Adjusted EBITDA as provided in the reconciliation below and calculates Adjusted EBITDA Margin by taking Adjusted EBITDA and dividing it by revenues. The Corporation calculates and uses Adjusted EBITDA as an indicator of its ability to generate cash from reported operating results. The measurement is used in concert with net income and cash flows from operating activities, which measure actual cash generated in the period. In addition, the Corporation believes that Adjusted EBITDA and Adjusted EBITDA Margin are supplemental measurement tools used by analysts and investors to help evaluate overall operating performance and the ability to incur and service debt and make capital expenditures. In addition, Adjusted EBITDA, as defined in the Credit Agreement, is used in conjunction with the Corporation's debt leverage ratio and this calculation sets the applicable margin for the quarterly interest charge. Adjusted EBITDA, as defined in the Credit Agreement, is not the same calculation as this Adjusted EBITDA table. Adjusted EBITDA does not represent funds available for the Corporation's discretionary use and is not intended to represent or to be used as a substitute for net income or cash flows from operating activities data as measured under U.S. generally accepted accounting principles ( GAAP ). The items excluded from Adjusted EBITDA but included in the calculation of the Corporation's reported net income and cash flows from operating activities are significant components of the accompanying consolidated income statements and cash flows, and must be considered in performing a comprehensive assessment of overall financial performance. The Corporation's calculation of Adjusted EBITDA may not be consistent with calculations of EBITDA used by other companies. The following is a reconciliation of the Corporation's net income, net operating cash flows and earnings per diluted share for the periods presented.

The Corporation calculates and uses adjusted earnings per diluted common share, which is exclusive of the impact of impairment of intangible assets, integration, merger and acquisition related costs and other charges, change in estimate on cost of goods sold, change in estimate on allowance for doubtful accounts and tax accounting matters as an indicator of its core operating results. The measurement is used in concert with net income and earnings per diluted share, which measure actual earnings per share generated in the period. The Corporation believes the exclusion of these charges in expressing earnings per share provides management with a useful measure to assess period to period comparability and is useful to investors in evaluating the Corporation's operating results from period to period. Adjusted earnings per diluted common share, which is exclusive of the impact of impairment of intangible assets, integration, merger and acquisition related costs and other charges, change in estimate on cost of goods sold, change in estimate on allowance for doubtful accounts and tax accounting matters does not represent the amount that effectively accrues directly to stockholders (i.e., such costs are a reduction in earnings and stockholders' equity) and is not intended to represent or to be used as a substitute for earnings per diluted share as measured under GAAP. The integration, merger and acquisition related costs and other charges, impairment on intangible assets, change in estimate on cost of goods sold, change in estimate on allowance for doubtful accounts and tax accounting matters excluded from the earnings per diluted share are significant components of the accompanying consolidated income statements, and must be considered in performing a comprehensive assessment of overall financial performance.

**Table of Contents**

**Reconciliation of Net Income (Loss) to Adjusted EBITDA**

	Years Ended December 31,				
	\$44.5	\$44.5	\$44.5	\$44.5	\$44.5
	2007	2008	2009	2010	2011
Net income (loss)	\$ (24.1)	\$ 5.0	\$ 42.2	\$ 19.2	\$ 23.4
Add:					
Interest expense, net	7.2	14.2	9.4	3.6	8.8
Integration, merger and acquisition related costs and other charges	29.8	26.7	5.2	14.6	15.3
Provision (benefit) for income taxes	(13.4)	3.3	18.9	13.0	14.8
Effect of change in estimate on cost of goods sold	(3.1)				
Effect of change in estimate on allowance for doubtful accounts	27.9				
Impairment of intangible assets		14.8			5.1
Depreciation and amortization expense	20.2	28.5	27.0	28.1	31.1
Adjusted EBITDA	\$ 44.5	\$ 92.5	\$ 102.7	\$ 78.5	\$ 98.5
Adjusted EBITDA Margin	3.7%	4.8%	5.6%	4.2%	4.7%

**Reconciliation of Adjusted EBITDA to Net Operating Cash Flows**

	Years Ended December 31,				
	2007	2008	2009	2010	2011
Adjusted EBITDA	\$ 44.5	\$ 92.5	\$ 102.7	\$ 78.5	\$ 98.5
Interest expense, net	(7.2)	(14.2)	(9.4)	(3.6)	(8.8)
(Provision) benefit for income taxes	13.4	(3.3)	(18.9)	(13.0)	(14.8)
Effect of change in estimate on cost of goods sold	3.1				
Effect of change in estimate on allowance for doubtful accounts	(27.9)				
Integration, merger and acquisition related costs and other charges	(22.6)	(22.2)	(4.8)	(14.0)	(13.8)
Provision for bad debt	44.1	24.7	16.6	18.5	24.8
Stock-based compensation	1.5	4.9	4.6	4.8	5.9
Amortization of deferred financing fees	0.2	0.4	0.4	0.6	0.8
Loss on disposition of equipment	0.1	0.2	0.3	0.3	0.1
Deferred income taxes	(13.4)	2.8	19.7	12.3	13.9
Other	(0.9)	(0.5)	(0.3)		0.2
Changes in assets and liabilities	1.4	(19.6)	(25.9)	13.8	(80.0)
Net Cash Flows from Operating Activities	\$ 36.3	\$ 65.7	\$ 85.0	\$ 98.2	\$ 26.8

**Reconciliation of Earnings Per Diluted Common Share to Adjusted Earnings Per Diluted Common Share**

	Years Ended December 31,				
	2007	2008	2009	2010	2011
Earnings (loss) per diluted common share	\$ (1.13)	\$ 0.17	\$ 1.39	\$ 0.64	\$ 0.79
Add:					
Diluted earnings per share impact of:					
Impairment of intangible assets		0.30			0.11
Integration, merger, and acquisition related costs and other charges	0.90	0.53	0.10	0.29	0.32

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Effect of change in estimate on cost of goods sold	(0.09)				
Effect of change in estimate on allowance for doubtful accounts	0.84				
Tax accounting matters			(0.19)		(0.02)
Adjusted earnings per diluted common share after impact of above items	\$ 0.52	\$ 1.00	\$ 1.30	\$ 0.93	\$ 1.20

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**Table of Contents**

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K 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, which reflect the Corporation's current estimates, expectations and projections about the Corporation's future results, performance, prospects and opportunities. Forward looking statements include, among other things, the information concerning the Corporation's possible future results of operations including revenue, costs of goods sold, and gross margin, business and growth strategies, financing plans, the Corporation's competitive position and the effects of competition, the projected growth of the industries in which we operate, and the Corporation's ability to consummate strategic acquisitions. Forward-looking statements include statements that are not historical facts and can be identified by forward-looking words such as anticipate, believe, could, estimate, expect, intend, plan, may, should, will, would, project, and similar expressions. These forward-looking statements are based upon information currently available to the Corporation and are subject to a number of risks, uncertainties and other factors that could cause the Corporation's actual results, performance, prospects or opportunities to differ materially from those expressed in, or implied by, these forward-looking statements. Important factors that could cause the Corporation's actual results to differ materially from the results referred to in the forward-looking statements the Corporation makes in this report include:

the impact of Omnicare's unsolicited tender offer to acquire all of our outstanding common stock, including distracting attention of employees, requiring expenditure of substantial time and resources, disrupting our business activities, and increasing the volatility of our stock price;

the impact of the litigation by Omnicare and other stockholders relating to Omnicare's unsolicited tender offer;

the Corporation's access to capital, credit ratings, indebtedness, and ability to raise additional financings and operate under the terms of the Corporation's debt obligations;

anti-takeover provisions of the Delaware General Corporation Law, which in concert with our certificate of incorporation and our by-laws could delay or deter a change in control;

certain restrictions resulting from continuing relationships with the Corporation's former parent company;

the effects of adverse economic trends or intense competition in the markets in which we operate;

the demand for the Corporation's products and services;

the effects of retaining existing customers and service contracts and the Corporation's ability to attract new customers for growth of the Corporation's business;

the effects of renegotiating contract pricing relating to significant customers and suppliers, including the hospital pharmacy segment which is substantially dependent on service provided to one customer;

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the effects of an increase in credit risk, loss or bankruptcy of or default by any significant customer, supplier, or other entity relevant to the Corporation's operations;

the Corporation's ability to successfully pursue the Corporation's development and acquisition activities and successfully integrate new operations and systems, including the realization of anticipated revenues, economies of scale, cost savings, and productivity gains associated with such operations;

the Corporation's ability to control costs, particularly labor and employee benefit costs, rising pharmaceutical costs, and regulatory compliance costs;

the effects of healthcare reform and government regulations, including, interpretation of regulations and changes in the nature and enforcement of regulations governing the healthcare and institutional pharmacy services industries;

**Table of Contents**

changes in the reimbursement rates or methods of payment from Medicare and Medicaid and other third party payers to both us and our customers;

the potential impact of state government budget shortfalls and their ability to pay the Corporation and its customers for services provided;

the Corporation's ability, and the ability of the Corporation's customers, to comply with Medicare or Medicaid reimbursement regulations or other applicable laws;

the effects of changes in the interest rate on the Corporation's outstanding floating rate debt instrument and the increases in interest expense, including increases in interest rate terms on any new debt financing;

the Corporation's ability to implement the short cycle dispensing requirements of the 2010 Health Care Legislation without incurring significant additional operating costs;

further consolidation of managed care organizations and other third party payers;

political and economic conditions nationally, regionally, and in the markets in which the Corporation operates;

natural disasters, war, civil unrest, terrorism, fire, floods, tornadoes, earthquakes, hurricanes, epidemic, pandemic, catastrophic event or other matters beyond the Corporation's control;

increases in energy costs, including state and federal taxes, and the impact on the costs of delivery expenses and utility expenses;

elimination of, changes in, or the Corporation's failure to satisfy pharmaceutical manufacturers' rebate programs;

the Corporation's ability to attract and retain key executives, pharmacists, and other healthcare personnel;

the Corporation's risk of loss not covered by insurance;

the outcome of litigation to which the Corporation is a party from time to time, including adverse results in material litigation or governmental inquiries;

changes in accounting rules and standards, audits, compliance with the Sarbanes-Oxley Act, and regulatory investigations;

changes in market conditions that would result in the impairment of goodwill or other assets of the Corporation;



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changes in market conditions in which we operate that would influence the value of the Corporation's stock;

changes in volatility of the Corporation's stock price and the risk of litigation following a decline in the price of the Corporation's stock price;

the Corporation's ability to anticipate a shift in demand for generic drug equivalents and the impact on the financial results including the negative impact on brand drug rebates;

prescription volumes may decline, and our net revenues and profitability may be negatively impacted, if the safety risk profiles of drugs increase or if drugs are withdrawn from the market, including as a result of manufacturing issues, or if prescription drugs transition to over-the-counter products;

the effects on the Corporation's results of operations related to interpretations of accounting principles by the SEC staff that may differ from those of management;

changes in tax laws and regulations;

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**Table of Contents**

the effects of changes to critical accounting estimates; and

other factors, risks and uncertainties referenced in the Corporation's filings with the Commission, including the Risk Factors set forth in this Report on Form 10-K for the year ended December 31, 2011.

**YOU ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON ANY FORWARD-LOOKING STATEMENTS, ALL OF WHICH SPEAK ONLY AS OF THE DATE OF THIS ANNUAL REPORT. EXCEPT AS REQUIRED BY LAW, WE UNDERTAKE NO OBLIGATION TO PUBLICLY UPDATE OR RELEASE ANY REVISIONS TO THESE FORWARD-LOOKING STATEMENTS TO REFLECT ANY EVENTS OR CIRCUMSTANCES AFTER THE DATE OF THIS ANNUAL REPORT OR TO REFLECT THE OCCURRENCE OF UNANTICIPATED EVENTS. ALL SUBSEQUENT WRITTEN AND ORAL FORWARD-LOOKING STATEMENTS ATTRIBUTABLE TO US OR ANY PERSON ACTING ON THE CORPORATION'S BEHALF ARE EXPRESSLY QUALIFIED IN THEIR ENTIRETY BY THE CAUTIONARY STATEMENTS CONTAINED OR REFERRED TO IN THIS SECTION AND IN OUR RISK FACTORS SET FORTH IN PART I, ITEM 1A OF THIS REPORT ON FORM 10-K AND IN OTHER REPORTS FILED WITH THE SEC BY THE CORPORATION.**

**The Corporation's Business and Industry Trends**

The Corporation is an institutional pharmacy services company, which services healthcare facilities and provides management pharmacy services to hospitals. The Corporation is the second largest institutional pharmacy services company in the United States. The Corporation operates 95 institutional pharmacies in 44 states. The Corporation's customers are typically institutional healthcare providers, such as nursing centers, assisted living facilities, hospitals and other long-term alternative care settings. The Corporation is generally the primary source of supply of pharmaceuticals to its customers. The Corporation also provides pharmacy management services to 91 hospitals in the United States.

The institutional pharmacy services business is highly competitive. Competition is a significant factor that can impact the Corporation's overall financial results, pricing to customers, and bed retention. In each geographic market, there are national, regional and local institutional pharmacies that provide services comparable to those offered by the Corporation's pharmacies. These pharmacies may have greater financial and other resources than we do and may be more established in the markets they serve than we are. The Corporation also competes against regional and local pharmacies that specialize in the highly-fragmented long-term care markets. In the future some of the Corporation's customers may seek to in-source the provision of pharmaceuticals to patients in their facilities by establishing an internal pharmacy.

A variety of factors are affecting the institutional pharmacy industry. With an aging population and the extension of drug coverage to a greater number of individuals through Medicare Part D, the consumption of pharmaceuticals by residents of long-term care facilities is likely to increase in the future. In addition, individuals are expected to enter assisted living facilities, independent living facilities and continuing care retirement communities at increasing rates. Under Medicare Part D, eligible individuals may choose to enroll in various Medicare Part D Plans to receive prescription drug coverage. Each Medicare Part D Plan determines a distinct formulary for the long-term care residents enrolled in its plan. Accordingly, institutional pharmacies have incurred increased administrative costs to manage each Part D Plan's formulary, reimbursement and administrative processes for their long-term care enrollees. Institutional pharmacies may continue to experience increased administrative burdens and costs due to the greater complexity of the requirements for drug reimbursement, including costs associated with the short cycle dispensing requirements which take effect January 1, 2013. Medicare Part D also requires increased choices for patients with respect to complex drug categories and therapeutic interchange opportunities. Institutional pharmacies may realize increased revenue by providing long-term care residents with specialized services in these areas. Continued industry consolidation may also impact the dynamics of the institutional pharmacy market.

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**Table of Contents**

In addition, our continued success depends on our ability to attract and retain pharmacists and other pharmacy professionals. Competition for qualified pharmacists and other pharmacy professionals is strong. The loss of pharmacy personnel or the inability to attract, retain or motivate sufficient numbers of qualified pharmacy professionals could adversely affect our business. Although we generally have been able to meet our staffing requirements for pharmacists and other pharmacy professionals in the past, our inability to do so in the future could have a material adverse impact on us.

***Unsolicited Tender Offer by Omnicare***

On August 23, 2011, Omnicare, Inc. ( Omnicare ) made public an unsolicited proposal to acquire all of the outstanding shares of the Corporation's common stock for \$15.00 per share in cash. After careful consideration with our financial and legal advisors, our Board of Directors determined unanimously that Omnicare's proposal undervalues the Corporation and was not in the best interests of our stockholders. On September 7, 2011, Omnicare, through its wholly-owned subsidiary, Philadelphia Acquisition Sub, Inc., commenced an unsolicited tender offer to purchase all of the outstanding shares of our common stock at \$15.00 per share. On September 18, 2011, the Board again met with its financial and legal advisors, and after careful consideration our Board of Directors again unanimously recommended that our stockholders reject the offer and not tender their shares of our common stock because it believes that Omnicare's tender offer (i) undervalues the Corporation and its prospects, (ii) is illusory because it is subject to significant regulatory and other uncertainty, and (iii) is opportunistic based on the Corporation's then traded market value. On September 20, 2011, we filed with the Securities and Exchange Commission ( SEC ) a Recommendation/Solicitation Statement on Schedule 14D-9 detailing the recommendation of our Board of Directors in response to Omnicare's tender offer and the reasons it rejected the offer. See Note 6 Commitments and Contingencies for a discussion of certain litigation commenced in respect of Omnicare's tender offer and related actions. On October 5, 2011, Omnicare extended the expiration date of its tender offer until 5:00 p.m., New York City time, on Friday, December 2, 2011, unless further extended. On December 5, 2011, Omnicare extended the expiration date of its tender offer until 5:00 p.m., New York City time, on Friday, January 20, 2012, unless further extended. On January 19, 2012, Omnicare extended the expiration date of its tender offer until 5:00 p.m., New York time, on Friday, January 27, 2012, unless further extended. On January 27, 2012, Omnicare extended the expiration of its tender offer until 5:00 p.m., New York City time, on Friday, February 17, 2012, unless further extended.

On August 25, 2011, after careful consideration and consultation with our financial and legal advisors, our Board of Directors adopted a rights plan and authorized the execution of the Rights Agreement, dated August 25, 2011 (the Rights Agreement ), between the Corporation and Mellon Investor Services LLC, as Rights Agent. On August 25, 2011, the Board of Directors of the Corporation declared a dividend of one preferred share purchase right (a Right ) for each outstanding share of common stock, par value \$0.01 per share. The dividend was payable on September 6, 2011 to the stockholders of record on September 6, 2011. The Rights will expire on the earlier of August 25, 2021, or redemption by the Corporation. However, the rights will expire immediately at the final adjournment of the Corporation's 2012 annual meeting of stockholders if stockholder approval of the Rights Agreement has not been received prior to that time. The Rights Agreement is designed to prevent third parties from opportunistically acquiring the Corporation in a transaction that the Corporation's Board of Directors believes is not in the best interests of the Corporation's stockholders. In general terms, it works by imposing a significant penalty upon any person or group that acquires beneficial ownership of 15 percent or more of our outstanding common stock without the prior approval of our Board of Directors. The Corporation's Board of Directors believes the Rights Agreement has helped the Corporation's stockholders at this time by effectively preventing Omnicare from opportunistically acquiring the Corporation at a price that the Corporation's Board of Directors believes is inadequate for the reasons discussed above. The Rights Agreement has been narrowly tailored in a manner that our Board of Directors believes appropriately balances the interests of our stockholders in connection with what our Board of Directors considers an opportunistic, illusory and disadvantageous proposal, against the need to avoid excessive anti-takeover protections that ultimately may adversely impact stockholder value. The Rights Agreement should not interfere with any merger or other business combination approved by the Board of Directors.

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**Table of Contents**

Pursuant to the requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the regulations thereunder (the HSR Act ), Omnicare filed a Notification and Report Form with the Antitrust Division of the U.S. Department of Justice (the Antitrust Division ) and the Federal Trade Commission (the FTC ) relating to its proposed acquisition of the Corporation on September 7, 2011. On or about September 19, 2011, the Corporation submitted a responsive Notification and Report Form with the Antitrust Division and the FTC. On September 22, 2011, the Corporation received a request for additional information from the FTC relating to the tender offer. On September 22, 2011, Omnicare also received a request for additional information from the FTC relating to the tender offer (the Second Request ). The Second Request extended the waiting period under the HSR Act for 10 calendar days after the date Omnicare certified substantial compliance with the Second Request issued to Omnicare. On September 30, 2011, the FTC also issued a subpoena and civil investigative demand to the Corporation covering the same subject matter as the Second Request. The Corporation has produced a considerable amount of material in response to the FTC requests.

On November 18, 2011 Omnicare certified to the FTC that it had substantially complied with the Second Request. On November 18, 2011, Omnicare also executed a timing agreement with the FTC pursuant to which Omnicare agreed (i) to provide 14 days notice to the FTC prior to consummating its proposed acquisition and (ii) not to consummate its proposed acquisition prior to December 19, 2011 without the consent of the FTC. On December 2, 2011, Omnicare agreed with the FTC to extend the date prior to which Omnicare will not consummate its proposed acquisition to January 19, 2012, unless the FTC notifies Omnicare that it has closed its investigation relating to its proposed acquisition. On January 10, 2012, Omnicare agreed with the FTC that it will not consummate its proposed acquisition prior to January 26, 2012, unless the FTC notifies Omnicare that it has closed its investigation relating to its proposed acquisition. On January 27, 2012, the FTC issued an administrative complaint to block Omnicare s proposed acquisition of the Corporation. The complaint alleges that the proposed acquisition would be illegal and in violation of Section 15 of the FTC Act and Section 7 of the Clayton Act because it would harm competition and enable Omnicare to raise the price of drugs for Medicare Part D consumers and others. The case is scheduled to be heard before an administrative law judge at the FTC in June 2012.

The financial and outside legal advisors to the Corporation and Omnicare have continued to meet from time to time in an effort to agree upon an acceptable information sharing process relating to antitrust issues. On October 26, 2011, the Corporation and Omnicare and their respective outside legal advisors entered into a Confidentiality and Joint Defense Agreement (the Confidentiality and Joint Defense Agreement ), which provides, among other things, for the parties to exchange on a confidential and privileged basis information in order to facilitate their respective assessment of the antitrust risk associated with a potential combination of the two companies. Although the Corporation s Board of Directors continues to believe that Omnicare s \$15.00 per share offer undervalues the Corporation, the Corporation is engaging in this analytical process in order to further its understanding of Omnicare s assessment of the antitrust risk related to a business combination. The Confidentiality and Joint Defense Agreement does not obligate the Corporation to enter a transaction with Omnicare and there can be no assurance that this review will lead to a definitive merger agreement or any transaction between the two companies.

In connection with these matters, for the year ended December 31, 2011, we expensed \$2.8 million of legal and advisory fees, which are included in integration, merger and acquisition related costs and other charges in the consolidated financial statements. We expect to incur significant additional costs in the future in connection with Omnicare s unsolicited tender offer.

***Acquisitions During the Periods Presented***

For a discussion of Acquisitions by the Corporation during the periods presented see Note 2 Acquisitions to our Consolidated Financial Statements included elsewhere in this Report.

## **Table of Contents**

### **Critical Accounting Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the U.S. requires us to make estimates and assumptions that affect reported amounts and related disclosures. Management considers an accounting estimate to be critical if:

It requires assumptions to be made that were uncertain at the time the estimate was made; and

Changes in the estimate or different estimates could have a material impact on our consolidated results of operations or financial condition.

The Corporation's management has discussed the development and selection of these critical accounting estimates with the audit committee of the Board of Directors and with the Corporation's independent registered public accounting firm, and they both have reviewed the disclosure presented below relating to critical accounting estimates.

The table of critical accounting estimates is not intended to be a comprehensive list of all of the Corporation's accounting policies that require estimates. Management believes that of the significant accounting policies, as discussed in Note 1 of the consolidated financial statements included elsewhere in this report, the estimates discussed below involve a higher degree of judgment and complexity. Management believes the current assumptions and other considerations used to estimate amounts reflected in the consolidated financial statements are appropriate. However, if actual experience differs from the assumptions and other considerations used in estimating amounts reflected in the consolidated financial statements, the resulting changes could have a material adverse effect on the consolidated results of operations and financial condition of the Corporation.

The table that follows presents information about our critical accounting estimates, as well as the effects of hypothetical changes in the material assumptions used to develop each estimate. Our sensitivity analysis was performed assuming the assumptions listed, based upon the actual results of the Corporation for the year ended December 31, 2011, and the actual diluted shares.

**Table of Contents****Balance Sheet or****Income Statement Caption/****Nature of Critical Estimate Item*****Allowance for doubtful accounts and provision for doubtful accounts***

Accounts receivable primarily consist of amounts due from Prescription Drug Plans ( PDP s ) under Medicaid Part D, long-term care institutions, the respective state Medicaid programs, private payers and third party insurance companies. Our ability to collect outstanding receivables is critical to our results of operations and cash flows. We establish an allowance for doubtful accounts to reduce the carrying value of our receivables to their estimated net realizable value. In addition, certain drugs dispensed are subject to being returned and the responsible paying party is due a credit for such returns.

Our allowance for doubtful accounts, included in our balance sheets at December 31, 2010 and 2011, were \$36.8 million and \$48.6 million, respectively.

Our quarterly provision for doubtful accounts included in our income statements was as follows (dollars in millions):

	<b>Amount</b>	<b>% of Revenues</b>
<b>2009</b>		
March 31	\$ 7.1	1.5%
June 30	3.6	0.8
September 30	2.5	0.5
December 31	3.4	0.8
<b>2010</b>		
March 31	\$ 3.8	0.8%
June 30	4.6	1.0
September 30	4.5	1.0
December 31	5.6	1.1
<b>2011</b>		
March 31	\$ 5.4	1.0%
June 30	5.8	1.1
September 30	6.4	1.2
December 31	7.2	1.5

**Assumptions/Approach Used**

The largest components of bad debts in our accounts receivable relate to the accounts for which private payers are responsible (which we refer to as private and other), accounts for which our customers from long-term care institutions are responsible for under Medicare Part A and owe us for the drug component of their patients stay at their respective institution and third party, Medicare Part D, and Medicaid accounts that have been denied.

We attempt to collect the private and other accounts through various efforts for which the patient is the responsible party. We attempt to collect payments due from long-term care institutions through billing and collecting in accordance with the terms of the contracts. We attempt to collect from third party, Medicare Part D and Medicaid accounts by obtaining the appropriate documentation and direct discussions with the payors. In all cases, the drugs have been dispensed.

In general, we perform the following steps in collecting accounts receivable:

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if possible, perform up front adjudication prior to dispensing the product;

billing and follow-up with third party payers;

billing and follow-up with long-term care institutions;

utilization of collection agencies; and

other legal processes.

The Corporation has an established process to determine the adequacy of the allowance for doubtful accounts, which relies on analytical tools, specific identification, and benchmarks to arrive at a reasonable allowance. No single statistic or measurement alone determines the allowance for doubtful accounts.

We monitor and review trends by payer classification along with the composition of our aging accounts receivable. This review is focused primarily on trends in private and other payer, PDP s, dual eligible co-payments, historic payment patterns of long-term care institutions, and monitoring respective credit risks.

In addition, we analyze other factors such as revenue days in accounts receivables, denial trends by payer types, payment patterns by payer types, subsequent cash collections, and current events that may impact payment patterns of our long-term care institution customers.

The following table shows our institutional pharmacy revenue days outstanding reflected in our institutional pharmacy net accounts receivable as of the dates indicated:

	2009	2010	2011
March 31	42.4	40.5	39.0
June 30	42.0	40.4	41.6
September 30	42.1	40.3	42.5
December 31	42.9	39.7	42.8

In the first quarter of 2010, the Corporation benefited from improved collections from the Part D payors due to the requirements of the MIPPA. MIPPA required Part D payors to pay claims within 30 days, or within 14 days if submitted electronically, beginning with the 2010 plan years. As a result of the MIPPA requirements, the Corporation collected a larger amount of receivables in the first quarter of 2010 than normal.

### Sensitivity Analysis

If our provision as a percent of institutional revenue increases 0.10%, our after tax income would decrease by approximately \$1.2 million or \$0.04 per diluted share.

This is only one example of reasonably possible sensitivity scenarios. The process of determining the allowance requires us to estimate uncollectible accounts that are highly uncertain and requires a high degree of judgment. Our estimates may be impacted by economic conditions, success in collections, payer mix and trends in federal and state regulations.





**Table of Contents**

**Balance Sheet or  
Income Statement Caption/  
Nature of Critical Estimate Item**

***Allowance for doubtful accounts and provision for doubtful accounts -(continued)***

The following table shows our allowance for doubtful accounts as a percent of gross accounts receivable:

	Allowance	Gross Accounts Receivable	% of Gross Accounts Receivable
<b>2009</b>			
March 31	\$ 49.1	\$ 267.8	18.3%
June 30	50.4	260.6	19.3
September 30	46.3	261.6	17.7
December 31	40.2	255.5	15.7
<b>2010</b>			
March 31	\$ 37.6	\$ 241.8	15.6%
June 30	37.1	237.6	15.6
September 30	38.1	231.9	16.4
December 31	36.8	263.3	14.0
<b>2011</b>			
March 31	\$ 38.1	\$ 273.9	13.9%
June 30	39.6	282.4	14.0
September 30	42.9	282.8	15.2
December 31	48.6	281.0	17.3

Please refer to Note 1 to our consolidated financial statements included elsewhere in this report for a detailed rollforward of our allowance for doubtful accounts.

The allowance for doubtful accounts for 2009 included a transfer of reserves on contractual adjustments into the allowance for doubtful accounts during the period. The reclassification did not impact the provision for bad debt.

**Assumptions/Approach Used**

The following table shows our summarized aging categories by quarter:

	0 to 60 days	61 to 120 days	Over 120 Days
<b>2009</b>			
March 31	63.1%	17.4%	19.5%
June 30	64.3%	17.0%	18.7%
September 30	63.6%	17.1%	19.3%
December 31	64.9%	17.1%	18.0%

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<b>2010</b>			
March 31	66.2%	17.8%	16.0%
June 30	65.7%	18.0%	16.3%
September 30	62.9%	19.2%	17.9%
December 31	61.8%	22.0%	16.2%
<b>2011</b>			
March 31	63.4%	19.3%	17.3%
June 30	63.9%	18.0%	18.1%
September 30	63.1%	18.9%	18.0%
December 31	61.2%	19.5%	19.3%

On a monthly basis, the Corporation performs a comprehensive assessment of its reserve levels in light of its expectations around the ultimate collection of its accounts receivable balances. The Corporation considers recent industry trends, changes in reimbursement sources and procedures, age of receivables and recent collection history.

### Sensitivity Analysis

**Table of Contents**

**Balance Sheet or  
Income Statement Caption/  
Nature of Critical Estimate Item**

**Revenue recognition/Allowance for contractual discounts**

We recognize revenues at the time services are provided or products are delivered.

Our sources of revenues for the years ended December 31, 2009, 2010, and 2011 are as follows:

	<b>2009 % of Revenues</b>	<b>2010 % of Revenues</b>	<b>2011 % of Revenues</b>
Medicare Part D	46.3%	46.5%	48.0%
Institutional healthcare providers	29.6	30.1	29.6
Medicaid	9.0	9.2	10.4
Private and other	6.6	5.8	4.5
Insured	5.0	4.9	4.3
Medicare	0.4	0.4	0.2
Hospital management fees	3.1	3.1	3.0
Total	100.0%	100.0%	100.0%

Our sources of revenues for the quarters ended March 31, June 30, September 30, and December 31, 2009, 2010, and 2011 are as follows:

	<b>Three Months Ended March 31,</b>			<b>Three Months Ended June 30,</b>		
	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Medicare Part D	45.9%	46.8%	47.7%	45.5%	45.8%	47.6%
Institutional healthcare providers	30.1	30.4	30.6	30.1	30.5	29.5
Medicaid	9.3	8.7	10.5	9.2	8.9	10.7
Private and other	6.2	5.7	4.0	6.8	6.1	4.6
Insured	5.0	4.9	4.1	4.9	5.1	4.4
Medicare	0.3	0.5	0.2	0.4	0.4	0.2
Hospital management fees	3.2	3.0	2.9	3.1	3.2	3.0
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

	<b>Three Months Ended September 30,</b>			<b>Three Months Ended December 31,</b>		
	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Medicare Part D	45.9%	46.2%	48.4%	48.0%	47.1%	48.0%

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Institutional healthcare providers	29.2	30.0	29.7	29.0	29.7	29.6
Medicaid	9.1	8.9	10.4	8.4	10.1	10.4
Private and other	7.5	6.0	4.5	6.2	5.5	4.5
Insured	5.0	5.0	3.8	5.0	4.5	4.3
Medicare	0.3	0.4	0.2	0.4	0.3	0.2
Hospital management fees	3.0	3.5	3.0	3.0	2.8	3.0
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Please refer to Note 7 to our consolidated financial statements included elsewhere in this report for a detailed discussion of our revenue recognition policies.

### Assumptions/Approach Used

We recognize revenues at the time services are provided or products are delivered. A significant portion of our revenues are billed to PDPs under Medicare Part D, the state Medicaid programs, long-term care institutions, third party insurance companies, and private payers. Some claims are electronically adjudicated through online processing at the point the prescription is dispensed such that our operating system is automatically updated with the actual amount to be reimbursed. As a result, our revenues and the associated receivables are based upon the actual reimbursement to be received. For claims that are adjudicated on-line and are rejected or otherwise denied upon submission, the Corporation provides contractual allowances based upon historical trends, contractual reimbursement terms and other factors which may impact ultimate reimbursement. Amounts are adjusted to actual reimbursed amounts based upon cash receipts.

Co-payments for our services can be applicable under Medicare Part D, the state Medicaid programs, and certain third party payers and are typically not collected at the time products are delivered or services are provided. Co-payments under the Medicaid programs and third party plans are generally billed to the responsible party as part of our normal billing procedures which are subject to normal collection procedures.

Under Medicare Part D, institutional residents who are dual eligible have co-payments due from the responsible party for up to the first thirty days of a beneficiary's stay in a skilled nursing facility subsequent to which the PDP's are responsible for reimbursement.

Under certain circumstances, including state-mandated return policies under various Medicaid programs, we accept returns of medications and issue credit memorandums to the applicable payer. Product returns are processed in the period returned. We estimate an amount for expected returns based on historical trends.

Our hospital pharmacy management revenues represent contractually defined management fees and the reimbursement of costs associated with the direct operations of hospital pharmacies, and are primarily comprised of personnel costs.

### Sensitivity Analysis

If our reimbursement declined or was negatively impacted 0.25% of revenues, the negative impact on net income would be \$3.1 million or \$0.11 per diluted common share.



**Table of Contents****Balance Sheet or****Income Statement Caption/****Nature of Critical Estimate Item*****Inventory and cost of drugs dispensed***

We have inventory located at each of our institutional pharmacy locations. Our inventory is maintained on a first-in, first-out lower of cost or market basis. The inventory consists of prescription drugs, over the counter products and intravenous solutions. Our inventory relating to controlled substances is maintained on a manually prepared perpetual system to the extent required by the Drug Enforcement Agency. All other inventory is maintained on a periodic system, through the performance of quarterly physical inventories at the end of each quarter. All inventory counts are reconciled to the balance sheet account and differences are adjusted through cost of goods sold. In addition, we record an amount of potential returns of prescription drugs based on historical rates of returns.

At December 31, 2010 and 2011, our inventory on our consolidated balance sheets was as follows (dollars in millions):

2010 \$ 88.4

2011 \$130.5

Our annualized inventory turns were as follows:

	2009	2010	2011
March 31	16.7	15.7	15.0
June 30	16.8	15.5	12.0
September 30	16.7	15.3	11.0
December 31	15.8	15.6	10.3

We receive rebates on purchases from various vendors and suppliers.

Rebates included in our income statements were as follows (dollars in millions):

	2009	2010	2011
March 31	\$ 6.2	\$ 9.5	\$ 14.3
June 30	7.8	9.1	20.7
September 30	9.0	8.7	18.2
December 31	11.1	9.9	22.3
	\$ 34.1	\$ 37.2	\$ 75.5

Please refer to Note 1 to our consolidated financial statements included elsewhere in this report for a detailed discussion of our inventory.

**Assumptions/Approach Used**

Our inventory is maintained on a first-in, first-out lower of cost or market basis. Our controlled prescription drugs are maintained on a perpetual inventory basis to the extent required by the Drug Enforcement Agency. All other inventory is maintained on a periodic basis. We perform quarterly inventory counts at all locations with the use of our personnel and the use of third party inventory count teams under our supervision. We perform quarterly inventory counts in the third month of each quarter.

All inventory counts are reconciled to the balance sheet account and differences are adjusted through cost of goods sold. In addition, we record an amount of potential returns of prescription drugs based on historical rates of returns.

We account for rebates and other incentives received from vendors and suppliers, relating to the purchase or distribution of inventory, as a reduction to cost of goods sold and inventory. We consider these rebates to represent product discounts, and as a result, the rebates are allocated as a reduction of product cost and relieved through cost of goods sold upon the sale of the related inventory.

#### Sensitivity Analysis

Actual inventory counts may include estimates based on amounts that may be dispensed from an open container. In addition, items are reviewed for potential obsolescence.

A 1.0% error rate in the count of prescription drugs in inventory would negatively impact net income \$0.8 million, or \$0.03 per diluted common share.

If our rebates received were to be reduced by 1.0%, the effect on net income for the year ended December 31, 2011 would have been a decrease of \$0.4 million, or \$0.02 per diluted common share.

**Table of Contents****Balance Sheet or****Income Statement Caption/****Nature of Critical Estimate Item*****Goodwill, other intangible assets and accounting for business combinations***

Goodwill represents the excess of the purchase price over the fair value of the net assets of acquired companies. Our intangible assets are comprised primarily of trade names, customer relationship assets, and non-compete agreements.

Our goodwill included in our consolidated balance sheets as of December 31, 2010 and 2011 was as follows (dollars in millions):

2010 \$179.4

2011 \$214.2

Our net intangible assets, included in our consolidated balance sheets as of December 31, 2010 and 2011 were as follows (dollars in millions):

	<b>2010</b>	<b>2011</b>
Customer relationships	\$ 95.1	\$ 96.0
Tradenames	29.5	30.0
Non-competition agreements	5.9	8.4
	130.5	134.4
Accumulated Amortization	(28.3)	(34.2)
	\$ 102.2	\$ 100.2

Please refer to Note 4 to our consolidated financial statements included elsewhere in this report for a detailed roll forward of our goodwill and intangible assets.

**Assumptions/Approach Used**

In September 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2011-08 intended to simplify goodwill impairment testing. Entities will be allowed to perform a qualitative assessment on goodwill impairment to determine whether it is more likely than not (defined as having a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The amendments in this ASU are effective for goodwill impairment tests performed in interim and annual periods for fiscal years beginning after December 15, 2011, with early adoption permitted. The Corporation adopted the guidance for the fiscal year ended December 31, 2011. The Corporation performed a qualitative assessment of its reporting unit, and did not find it necessary to perform the first step of the two step impairment test based on that analysis.

The Corporation performs an annual qualitative assessment of its goodwill reporting unit to determine if it is necessary to proceed to the first step of the two-step impairment test. The Corporation is not required to do so unless, based on the qualitative assessment, it is determined that it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If the Corporation must continue to step one, then we determine fair value using widely accepted valuation techniques, including discounted cash flow and market multiple analyses. These types of analyses require us to make assumptions and estimates



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regarding future cash flows, industry economic factors and the profitability of future business strategies.

The purchase price of acquisitions are allocated to the assets acquired and liabilities assumed based upon their respective fair values. We engage independent third-party resources to assist us in determining the fair values of assets acquired and liabilities assumed. Such valuations require us to make significant estimates and assumptions, including projections of future events and operating performance.

Fair value estimates are determined by management based upon established market values of comparable assets, or internal calculations of estimated future net cash flows. Our estimate of future cash flows is based on assumptions and projections we believe to be currently reasonable and supportable. The ultimate decision of allocations are that of management.

We assess for the potential impairment of intangible assets and long-lived assets recorded on the Corporation's balance sheet whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

During the third quarter of 2011, the Corporation recorded a pre-tax impairment charge of \$5.1 million related to finite-lived customer relationships. The impairment, which related to the Institutional Pharmacy Segment, was incurred as the result of non-renewal of certain customer contracts. The impairment was related to intangible assets acquired in an acquisition during the year ended December 31, 2005. These asset groups were assessed for recoverability and management determined the finite-lived customer relationship assets to be impaired. No other assets within the asset groups were deemed impaired. Using a discounted cash flow analysis, the Corporation determined that the pre-tax impairment charge of \$5.1 million was required to write the carrying value down to fair value, resulting in a per diluted common share impact of \$0.11. The Corporation recognized the impairment as a permanent write-down of the cost basis and accumulated amortization of the affected assets.

### Sensitivity Analysis

We performed our annual testing for goodwill impairment as of December 31, 2009, 2010, and 2011 and determined that no goodwill impairment existed. If actual future results are not consistent with our assumptions and estimates, we may be required to record goodwill impairment charges in the future. Our estimate of fair value of acquired assets and assumed liabilities are based upon assumptions believed to be reasonable based upon current facts and circumstances.

**Table of Contents**

**Balance Sheet or**

**Income Statement Caption/**

**Nature of Critical Estimate Item**

*Accounting for income taxes*

The provision for income taxes is based upon the Corporation's annual income or loss before income taxes for each respective accounting period. The Corporation recognizes an asset or liability for the deferred tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets generally represent items that will result in a tax deduction in future years for which we have already recorded the tax benefit in our income statement. The Corporation also recognizes as deferred tax assets the future tax benefits from net operating and capital loss carryforwards.

We assess the likelihood that deferred tax assets will be realized from future taxable income. A valuation allowance is provided for deferred tax assets if it is more-likely-than-not that some portion or all of the net deferred tax assets will not be realized. Our deferred tax asset balances in our consolidated balance sheets as of December 31, 2010 and 2011 were as follows (dollars in millions), including the impact of valuation allowances:

2010 \$ 52.2

2011 \$ 37.1

Our valuation allowances for deferred tax assets in our consolidated balance sheets as of December 31, 2010 and 2011 were as follows (dollars in millions):

2010 \$ 1.6

2011 \$ 1.0

Significant judgment is required in determining and assessing the impact of uncertain tax positions. For an identified uncertain tax position to qualify for benefit recognition, the position must have at least a more-likely-than-not chance of being sustained on its technical merits if challenged by relevant taxing authorities and taken by management to the court of last resort. If an uncertain position does not meet this recognition threshold based on our analysis of applicable tax law, we establish a liability for the realized, but unrecognized tax benefit. As of December 31, 2011, the Corporation has no liability recorded for unrecognized tax benefits for U.S. federal and state tax jurisdictions. The Corporation records accrued interest and penalties associated with uncertain tax positions as income tax expense in the consolidated income statements. We recognize the benefit for an uncertain tax position we have taken upon any one of the following conditions: 1) the recognition threshold is met due to changes in facts, circumstances and information available at the reporting date; 2) the tax position is effectively settled through examination, negotiation or litigation; or 3) the statute of limitations for the relevant taxing authority to examine and challenge the tax position has expired.

Please refer to Note 10 to our consolidated financial statements included elsewhere in this report for a detailed discussion of our accounting for income taxes.

#### Assumptions/Approach Used

The first step in determining the deferred tax asset valuation allowance is identifying reporting jurisdictions where we have a history of tax and operating losses or are projected to have losses in future periods as a result of changes in operational performance. We then determine if a valuation allowance should be established against the deferred tax assets for that reporting jurisdiction. The second step is to determine the amount of valuation allowance. We will generally establish a valuation allowance equal to the net deferred tax asset (deferred tax assets less deferred tax liabilities) related to the jurisdiction identified in step one of the analysis. In certain cases, we may not reduce the valuation allowance by the amount of the deferred tax liabilities depending on the nature and timing of future taxable income attributable to deferred tax liabilities.

Tax benefits from uncertain tax positions are recognized in the Corporation's financial statements if it is more-likely-than-not that the position is sustainable based on the technical merits of the position. In evaluating whether the position has met this recognition threshold, the Corporation assumes that the appropriate taxing authority has full knowledge of all relevant information. The amount of benefit recognized in the Corporation's financial statements for a tax position meeting the recognition threshold is determined by a measurement of the largest amount of benefit that is more than 50% likely to be realized upon ultimate settlement.

Subsequent recognition, derecognition and measurement of uncertain tax positions is based on management's best judgment given the facts, circumstances, and information available at the reporting date.

With respect to the net operating loss carryforwards, the Corporation considers all available positive and negative evidence to determine whether a valuation allowance is needed. This includes an analysis of the statutory carryforward available under law, anticipated future income or loss, as well as tax planning strategies. If the cumulative weight of evidence suggests that it is more-likely-than-not that all or some portion of the net operating losses will not be realized, a full or partial valuation allowance will be recognized based upon the qualitative and quantitative evidence examined.

#### Sensitivity Analysis

Our deferred tax assets exceeded our deferred tax liabilities by \$37.1 million as of December 31, 2011, including the impact of valuation allowances. Historically, we have produced taxable income and we expect to generate taxable income in future years. Therefore, we believe that the likelihood of our not realizing the tax benefit of our deferred tax assets is remote.

While we have generated taxable income in recent years and expect to continue to do so in the future, we have tax loss carryovers in selected states that we expect to expire before we are able to fully use them to offset taxable income. We have recorded a valuation allowance against these state losses. If our conclusion about our ability to use these losses is incorrect, then our deferred tax assets would be understated or overstated at December 31, 2011.

The IRS may propose adjustments for items we have failed to identify as tax contingencies. If the IRS were to propose and sustain assessments we would incur additional tax payments for 2010 and 2011 plus the applicable penalties and interest.

**Table of Contents**

**Balance Sheet or**

**Income Statement Caption/**

**Nature of Critical Estimate Item**

***Accounting for stock-based compensation***

The Corporation has reserved 7,237,000 shares of its common stock for awards to be granted under the Omnibus Plan plus 534,642 shares issued for substitute equity awards for employees of KPS and PharMerica LTC whose awards were cancelled or forfeited upon the consummation of the Pharmacy Transaction. The Corporation has adopted the Amended and Restated PharMerica Corporation 2007 Omnibus Incentive Plan (as amended and restated, "Omnibus Plan") under which the Corporation is authorized to grant equity-based and other awards to its employees, officers, directors and consultants. In connection with the Corporation's 2010 Annual Meeting of Stockholders, the stockholders of the Corporation approved and adopted the amended and restated Omnibus Plan to, among other things, implement a fungible share pool effective as of January 1, 2010, and preserve preferential tax treatment as qualified performance-based compensation under Section 162(m) of the Internal Revenue Code. Under the fungible share pool, one share of stock will be subtracted from the share limit for each share of stock covered by a stock option or stock appreciation right award and 1.65 shares of stock will be subtracted from the share limit for each share of stock covered by any full-value award, including restricted stock awards, restricted stock units and performance share awards at target. The following shares are not available for re-grant under the Omnibus Plan: (i) shares tendered by a participant or withheld by the Corporation to pay the purchase price of a stock option award or to satisfy taxes owed with respect to an award, (ii) shares subject to a stock appreciation right that are not issued in connection with such award's settlement upon the exercise thereof, and (iii) shares reacquired by the Corporation using cash proceeds received by the Corporation from the exercise of stock options. Effective January 1, 2010, shares subject to an award that is forfeited, expired or settled for cash, are available for re-grant under the Omnibus Plan as one share of stock for each share of stock covered by a stock option or appreciation right and 1.65 shares of stock for each share of stock covered by any other type of award.

The Compensation Committee has granted stock based compensation awards with respect to 5,415,276 common shares under the Omnibus Plan. After consideration of forfeitures, 3,168,057 shares remain available for grant at December 31, 2011.

The 3,168,057 shares does not take into consideration the dilution of 1.65 shares of stock for any full-value award, including restructured stock awards, restricted stock units, and performance awards at target. The number of shares remaining available for future issuance calculated under the fungible share would be 2,747,573.

On January 18, 2012, a long-term incentive award was granted which was comprised of 299,729 restricted stock units and 199,814 performance share units. The 2012 award reduced the amount of shares available for future issuance calculated under the fungible

share pool to 1,923,327

**Assumptions/Approach Used**

Stock options granted under the Omnibus Plan generally vest in three to four equal annual installments and have a term of seven years. The restricted stock granted to officers and employees generally vests in full upon the three-year anniversary of the date of grant. The restricted stock units granted to officers generally vest in three equal annual installments. The restricted stock grant to members of the Board of Directors vests in three equal annual installments. The restricted stock units granted to members of the Board of Directors vest in one annual installment. The performance share units granted under the Omnibus Plan vest based upon the achievement of a target amount of the Corporation's earnings before interest, income taxes, depreciation and amortization, integration, merger and acquisition related costs and other charges, impairment of intangible assets, and any changes in accounting principles, which reinforces the importance of achieving the Corporation's profitability objectives. The performance is generally measured over a three-year period.

We estimated the fair value of stock options granted during 2009, 2010, and 2011 using the Black-Scholes-Merton option valuation model ("BSM"). We are amortizing the fair value on a straight-line basis over the requisite service periods of the awards, which are the vesting periods of three to four years.

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The weighted average fair value per share of stock options granted by us during 2009, 2010, and 2011 were \$4.40, \$5.79, and \$3.61, respectively. The following table shows the weighted average assumptions we used to develop the fair value estimates under our stock options valuation model for 2009, 2010, and 2011 and the paragraphs below this table summarizes each assumption:

	2009	2010	2011
Expected volatility (range)	36.36 - 41.07%	38.53 - 45.54%	42.23 - 46.34%
Risk free interest rate (range)	0.75 - 2.09%	0.49 - 2.47%	0.19 - 2.20%
Expected dividends			
Average expected term (years)	2.0-5.0	2.0-5.0	2.0-5.0
Average fair value per share of stock options granted based on the Black-Scholes-Merton model (dollars)	\$4.40	\$5.79	\$3.61
Weighted average fair value of options granted during the year (in millions)	\$2.5	\$3.3	\$2.4

The Corporation aggregates individual awards into relatively homogeneous groups with respect to exercise and post-vesting employment behaviors for the purpose of refining the expected term assumption, regardless of the valuation technique used to estimate the fair value. We have stratified our employee population into two groups: (i) insiders, who are the Section 16 filers under SEC rules; and (ii) non-insiders, who are the rest of the employee population.

### Sensitivity Analysis

The fair value calculations of our stock option grants are affected by assumptions that are believed to be reasonable based upon the facts and circumstances at the time of grant. Changes in our volatility estimates can materially affect the fair values of our stock option grants. If our stock based compensation expense during 2011 was 10% higher, our 2011 after-tax income would decrease by approximately \$0.4 million, or \$0.01 per diluted common share.

**Table of Contents**

**Balance Sheet or**

**Income Statement Caption/**

**Nature of Critical Estimate Item**

***Accounting for stock-based compensation- (continued)***

Our stock-based compensation for the years ended December 31, 2009, 2010, and 2011 included in our results of operations was as follows (dollars in millions):

2009: \$4.6

2010: \$4.8

2011: \$5.9

Please refer to Note 9 to our consolidated financial statements included elsewhere in this report for a detailed discussion of our accounting for stock-based compensation.

**Assumptions/Approach Used**

Volatility is a measure of the tendency of investment returns to vary around a long-term average rate. Historical volatility is an appropriate starting point for setting this assumption. The Corporation also considers how future experience may differ from the past. This may require using other factors to adjust historical volatility, such as implied volatility, peer-group volatility and the range and mean-reversion of volatility estimates over various historical periods. The peer-group utilized consisted of fourteen companies in 2009 and 2010 and twelve companies in 2011, in the same or similar industries as the Corporation. In addition, if a best estimate cannot be made, management uses the mid-point in the range of reasonable estimates for volatility. The Corporation estimates the volatility of its common stock in conjunction with the Corporation's annual grant and volatility is calculated utilizing the historical volatility of the Corporation and its peer-group. To the extent material grants are made subsequent to the Corporation's annual grant, the volatility calculation is updated through the most recent grant date of the awards.

The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option.

We have never paid cash dividends on our common stock and do not anticipate paying cash dividends on our common stock in the foreseeable future. Consequently, we use an expected dividend yield of zero.

Pre-vesting forfeitures do not affect the fair value calculation, but they affect the expense calculation. The Corporation estimates pre-vesting forfeitures at the time of grant and revises those estimates in subsequent periods if actual forfeitures differ from those estimates. We have estimated pre-vesting option forfeitures and recorded share-based compensation expense only for those awards that are expected to vest.

Post-vesting cancellations include vested options that are cancelled, exercised or expire unexercised.

The Corporation calculated an expected term using management's estimate and expectation of option exercises. The majority of the Corporation's stock options are on a graded-vesting schedule. The Corporation estimates the value of awards with graded vesting by treating each vesting tranche as a separate award. Management has determined to value each tranche of the awards separately utilizing a multiple fair value method.

**Sensitivity Analysis**

## **Table of Contents**

### **Key Financial Statement Components**

#### ***Consolidated Income Statements***

Our revenues are comprised primarily of product revenues and are derived from the sale of prescription drugs through our institutional pharmacies. The majority of our product revenues are derived on a fee-for-service basis. Our revenues are recorded net of certain discounts and estimates for returns. Hospital pharmacy revenues represent management fees and pass through costs associated with managing the clients hospital pharmacy.

Cost of goods sold is comprised primarily of the cost of product and is principally attributable to the dispensing of prescription drugs. Our cost of product relating to drugs dispensed by our institutional pharmacies consists primarily of the cost of inventory dispensed and our costs incurred to process and dispense the prescriptions. Cost of goods also includes direct labor, delivery costs, rent, utilities, depreciation, travel costs, professional fees and other costs attributable to the dispensing of medications. In addition, cost of product includes a credit for rebates earned from pharmaceutical manufacturers whose drugs are included in our formularies. These rebates generally take the form of formulary rebates, which are earned based on the volume of a specific drug dispensed, or market share rebates, which are earned based on the achievement of contractually specified market share levels. The Corporation receives rebates on brand and generic drugs dispensed and other administrative rebates.

Selling, general and administrative expenses reflect the costs of operations dedicated to executive management, the generation of new sales, maintenance of existing client relationships, management of clinical programs, enhancement of technology capabilities, direction of pharmacy operations, human resources and performance of reimbursement and collection activities, in addition to finance, legal and other staff activities.

Integration, merger and acquisition related costs and other charges represent the costs associated with integrating our operations, as well as costs related to acquisitions. Also included in this category are costs related to the unsolicited Tender Offer by Omnicare.

Interest expense, net, primarily includes interest expense relating to our senior secured credit facility, partially offset by interest income generated by cash and cash equivalents.

#### ***Consolidated Balance Sheets***

Our assets include cash and cash equivalent investments, accounts receivable, inventory, fixed assets, deferred tax assets, goodwill and intangibles.

Cash reflects the accumulation of positive cash flows from our operations and financing activities, and primarily includes deposits with banks or other financial institutions. Our cash balances are at the highest on Thursday nights and at the lowest on Friday nights. Friday is usually our largest cash disbursement day as a result of payments for our drug costs and our payrolls.

Accounts receivable primarily consist of amounts due from PDPs under Medicare Part D, the respective state Medicaid programs, long-term care institutions, third party insurance companies, and private payers, net of allowances for doubtful accounts, as well as contractual allowances.

Inventory reflects the cost of prescription products held for dispensing by our institutional pharmacies, net of allocated rebates, and is recorded on a first-in, first-out basis. We perform quarterly inventory counts and record our inventory and cost of goods sold based on such quarterly inventories. We also include an estimate for returns on inventory.

Deferred tax assets primarily represent temporary differences between the financial statement basis and the tax basis of certain accrued expenses, net operating loss carryforwards, and stock-based compensation.



## **Table of Contents**

Fixed assets include investments in our institutional pharmacies and information technology, including capitalized software development. Goodwill and intangible assets are comprised primarily of goodwill and intangibles related to our previous acquisitions.

Our primary liabilities include accounts payable, accrued salaries and wages, other current liabilities, debt, and deferred tax liabilities. Accounts payable primarily consist of amounts payable for prescription inventory purchases under our Amended Prime Vendor Agreement and other purchases made in the normal course of business. The balances in accounts payable and accrued salaries and wages are at the highest on Thursday nights and at the lowest on Friday nights, as a result of payments for drug costs and payroll being funded on Friday. Accrued expenses and other current liabilities primarily consist of employee and facility-related cost accruals incurred in the normal course of business, as well as income taxes payable. Our debt is primarily comprised of loans under our senior secured credit facility as well as our revolver. Deferred tax liabilities primarily represent temporary differences between the financial statement basis and tax basis of fixed assets and tax deductible goodwill. We do not have any off-balance sheet arrangements, other than purchase commitments and lease obligations.

### ***Consolidated Statements of Cash Flows***

An important element of our operating cash flows is the timing of billing cycles, subsequent cash collections and payments for drug costs and labor. Due to the nature of the Corporation's cash cycle, cash flows from operations can fluctuate significantly depending on the day of the week of the respective close process. We pay for our prescription drug inventory in accordance with payment terms offered under our Amended Prime Vendor Agreement. The Corporation receives rebates from its prime vendor and suppliers each period. Rebates are allocated as reduction in inventory and also recorded as a reduction to cost of goods sold in the period earned. Outgoing cash flows include inventory purchases, employee payroll and benefits, facility operating expenses, capital expenditures including technology investments, interest and principal payments on our outstanding debt, and income taxes. The cost of acquisitions will also result in cash outflows.

### **Definitions**

Listed below are definitions of terms used by the Corporation in managing the business. The definitions are necessary to the understanding of the Management's Discussion and Analysis section of this document.

*Assisted Living Facilities (ALF)*: Represents assisted living facility. Its units or beds will represent the number of apartment type units within the facility.

*Bps*: Represents basis points. Basis points are based on percentages. For example, 100 bps represents a change of 1.0%.

*Gross profit per prescription dispensed*: Represents the gross profit from the institutional pharmacy segment divided by the total prescriptions dispensed.

*Gross profit percentage*: Represents the gross profit per prescription dispensed divided by the revenue per prescription dispensed.

*NM*: Represents not meaningful.

*Prescriptions dispensed*: Represents a prescription filled for an individual patient. A prescription will usually be for a 15 or 30 day period and will include only one drug type.

*Revenues per prescription dispensed*: Represents the revenues from the institutional pharmacy segment divided by the total prescriptions dispensed.

**Table of Contents**

*Skilled Nursing Facilities (SNF)*: Represents skilled nursing facilities. Its licensed beds will represent the customer licensed beds and this may not be indicative of its census.

**Results of Operations**

The following table presents selected consolidated comparative results of operations and statistical information for the periods presented (dollars in millions, except per prescription and per patient amounts, and prescriptions in thousands):

	Years Ended December 31,									
	2009		Increase (Decrease)		2010		Increase (Decrease)		2011	
	Amount	% of Total Revenues			Amount	% of Total Revenues			Amount	% of Total Revenues
<b>Net revenues:</b>										
Institutional Pharmacy	\$ 1,784.7	96.9%	\$ 4.7	0.3%	\$ 1,789.4	96.9%	\$ 229.2	12.8%	\$ 2,018.6	97.0%
Hospital Management	56.5	3.1	1.4	2.5	57.9	3.1	4.6	7.9	62.5	3.0
Total net revenues	1,841.2	100.0	6.1	0.3	1,847.3	100.0	233.8	12.7	2,081.1	100.0
<b>Cost of goods sold:</b>										
Institutional Pharmacy	1,517.7	82.4	38.9	2.6	1,556.6	84.3	176.4	11.3	1,733.0	83.3
Hospital Management	48.0	2.6	2.4	5.0	50.4	2.7	4.4	8.7	54.8	2.6
Total cost of goods sold	1,565.7	85.0	41.3	2.6	1,607.0	87.0	180.8	11.3	1,787.8	85.9
<b>Gross profit:</b>										
Institutional Pharmacy	267.0	14.5	(34.2)	(12.8)	232.8	12.6	52.8	22.7	285.6	13.7
Hospital Management	8.5	0.5	(1.0)	(11.8)	7.5	0.4	0.2	2.7	7.7	0.4
Total gross profit	\$ 275.5	15.0%	\$ (35.2)	(12.8)%	\$ 240.3	13.0%	\$ 53.0	22.1%	\$ 293.3	14.1%
<b>Institutional Pharmacy (in whole numbers except where indicated)</b>										
<b>Volume information</b>										
Prescriptions dispensed (in thousands)	39,037		(1,211)	(3.1)%	37,826		3,851	10.2%	41,677	
Revenue per prescription dispensed	\$ 45.72		\$ 1.59	3.5%	\$ 47.31		\$ 1.12	2.4%	\$ 48.43	
Gross profit per prescription dispensed	\$ 6.84		\$ (0.69)	(10.1)%	\$ 6.15		\$ 0.70	11.4%	\$ 6.85	
Institutional pharmacy gross margin	15.0%		(2.0)	(13.3)%	13.0%		1.1	8.5%	14.1%	
Generic dispensing rate	74.2%		1.3	1.8%	75.5%		2.4	3.2%	77.9%	
<b>Customer licensed beds under contract</b>										
Beginning of period	321,062		(7,195)	(2.2)%	313,867		49,034	15.6%	362,901	
Additions PharMerica Corporation	35,921		(1,745)	(4.9)	34,176		(6,958)	(20.4)	27,218	
Additions Chem Rx			61,773	100.0	61,773		(58,531)	(94.8)	3,242	
Losses PharMerica Corporation	(43,116)		(3,799)	8.8	(46,915)		2,011	(4.3)	(44,904)	
Losses Chem Rx							(8,959)	(100.0)	(8,959)	
End of period	313,867		49,034	15.6%	362,901		(23,403)	(6.4)%	339,498	

*Hospital Management (in whole numbers except where indicated)*

**Volume information**

Hospital management contracts serviced	86	4	4.7%	90	1	1.1%	91
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**Revenues**

Institutional pharmacy revenues increased \$229.2 million for the year ended December 31, 2011 compared to the year ended December 31, 2010, due primarily to the Chem Rx and other pharmacy acquisitions. The increase of \$229.2 million resulted from a favorable volume variance of approximately \$182.2 million or 3,851,000 additional

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**Table of Contents**

prescriptions dispensed and a favorable rate variance of approximately \$47.0 million or \$1.12 increase per prescription dispensed. The rate variance was comprised of approximately \$172.5 million due to inflation on drugs dispensed between periods offset by \$125.5 million due to the increase in the generic dispensing rate from 75.5% to 77.9% and certain pricing concessions. The favorable volume variance of approximately \$182.2 million was due to the increase in customer licensed beds under contract as a result of the acquisitions.

The increase in hospital management revenues of \$4.6 million for the year ended December 31, 2011 compared to the year ended December 31, 2010 was primarily due to an increase in the number of hospital management contracts serviced.

Institutional pharmacy revenues increased \$4.7 million for the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase in revenues was due primarily to the acquisition of Chem Rx on November 4, 2010, which resulted in additional revenues of \$59.1 million or 1,096,000 prescriptions dispensed, offset by a decline in the existing institutional pharmacy revenues of \$54.4 million. The acquisition of Chem Rx had an impact of a positive rate increase on revenue of \$0.20 per prescription dispensed in the year. The existing institutional pharmacy revenues decline of \$54.4 million resulted from an unfavorable volume variance of approximately \$105.5 million or 2,307,000 fewer prescriptions dispensed, offset by a favorable rate variance of approximately \$51.1 million or a \$1.39 increase per prescription dispensed. The rate variance was comprised of approximately \$101.0 million due to inflation on drugs dispensed between periods offset by \$49.9 million due to the increase in the generic drug dispensing rate during the period from 74.2% to 75.5% and the September 2009 change in the AWP for which state Medicaid reimbursement has not been upwardly adjusted, continued Medicare Part D pricing pressures and other concessions. The unfavorable volume variance of approximately \$105.5 million was due to the decline in customer licensed beds under contract prior to the acquisition of Chem Rx and Lone Star. The Lone Star acquisition closed on December 31, 2010; and accordingly no revenues from this acquisition are included in the results of operations for the year ended December 31, 2010.

The increase in hospital management revenues for the year ended December 31, 2010 compared to the year ended December 31, 2009 of \$1.4 million was primarily due to an increase in the number of hospital management contracts serviced, partially offset by concessions with certain hospital management contracts serviced in the period.

**Cost of Goods Sold**

Institutional pharmacy cost of goods sold increased \$176.4 million for the year ended December 31, 2011 compared to the year ended December 31, 2010 primarily due to the Chem Rx and other pharmacy acquisitions. Overall total drug costs decreased as a percent of revenues 114 bps due primarily to higher rebates on generic drugs as a result of the Amended Prime Vendor Agreement and implementation of changes in branded pharmaceutical purchasing practices. Other costs included in cost of goods sold increased as a percentage of revenues 4 bps.

Hospital management cost of goods sold increased \$4.4 million for the year ended December 31, 2011 as compared to the year ended December 31, 2010 due to the additional hospital management contract serviced during the period.

Institutional pharmacy cost of goods sold increased \$38.9 million for the year ended December 31, 2010 as compared to the year ended December 31, 2009 primarily due to the acquisition of Chem Rx offset by lower costs as a result of fewer prescriptions dispensed from the existing institutional pharmacy business and other factors. The Chem Rx acquisition increased cost of goods sold approximately \$52.6 million or 1,096,000 prescriptions dispensed. The decline of \$13.7 million in the existing institutional pharmacy business is due to 2,307,000 fewer prescriptions dispensed. Excluding the Chem Rx acquisition overall total drug costs as a percent

**Table of Contents**

of revenues increased 138 bps and other costs included in cost of goods sold as a percent of revenues increased 52 bps, of which the increase primarily related to higher delivery expense as a result of the DEA's new interpretation of the Controlled Substances Act regarding the ability of nurses in skilled nursing facilities to order controlled substances for the residents of these facilities. The Lone Star acquisition closed on December 31, 2010 and accordingly, no costs of goods sold from this acquisition are included in the results of operations for the year ended December 31, 2010.

Hospital management cost of goods sold increased \$2.4 million for the year ended December 31, 2010 as compared to the year ended December 31, 2009 due to four additional hospital management contracts serviced during the period.

**Gross Profit and Operating Expenses**

Gross profit and other operating expenses were the following for the periods presented (dollars in millions):

	Years Ended December 31,									
	2009		Increase (Decrease)		2010		Increase (Decrease)		2011	
	Amount	% of Total Revenues			Amount	% of Total Revenues			Amount	% of Total Revenues
<b>Gross profit and operating expenses:</b>										
Total gross profit	\$ 275.5	15.0%	\$ (35.2)	(12.8)%	\$ 240.3	13.0%	\$ 53.0	22.1%	\$ 293.3	14.1%
Selling, general and administrative expenses	190.8	10.4	(10.2)	(5.3)	180.6	9.8	34.3	19.0	214.9	10.3
Amortization expense	9.0	0.5	0.3	3.3	9.3	0.5	1.7	18.3	11.0	0.5
Impairment of intangible assets							5.1		5.1	0.3
Integration, merger related costs and other charges	5.2	0.3	9.4	180.8	14.6	0.8	0.7	4.8	15.3	0.8
Interest expense, net	9.4	0.5	(5.8)	(61.7)	3.6	0.2	5.2	144.4	8.8	0.4
Income before provision for income taxes	61.1	3.3	(28.9)	(47.3)	32.2	1.7	6.0	18.6	38.2	1.8
Provision for income taxes	18.9	1.0	(5.9)	(31.2)	13.0	0.7	1.8	13.8	14.8	0.7
Net income	\$ 42.2	2.3%	\$ (23.0)	(54.5)%	\$ 19.2	1.0%	\$ 4.2	21.9%	\$ 23.4	1.1%

Institutional pharmacy gross profit for the year ended December 31, 2011 was \$285.6 million or \$6.85 per prescription dispensed compared to \$232.8 million or \$6.15 per prescription dispensed for the year ended December 31, 2010. Institutional pharmacy gross profit margin for the year ended December 31, 2011 was 14.1% compared to 13.0% for the year ended December 31, 2010. Gross profit margin was positively impacted by higher margins on drugs which recently became available as generics, better pricing terms as a result of the Amended Prime Vendor Agreement, and implementation of changes in branded pharmaceutical purchasing practices. The increase in gross profit dollars was as a result of these factors as well as the Chem Rx and other pharmacy acquisitions.

The increase in hospital management gross profit for the year ended December 31, 2011 of \$0.2 million as compared to the year ended December 31, 2010 was due to the additional hospital management contract serviced during the period.

Institutional pharmacy gross profit for the year ended December 31, 2010 was \$232.8 million or \$6.15 per prescription dispensed, compared to \$267.0 million or \$6.84 per prescription dispensed for the year ended December 31, 2009. The Chem Rx acquisition resulted in \$6.5 million of gross profit, or \$5.93 per prescription dispensed. The gross margin for the Chem Rx business during the year was approximately 11.0%, which is lower



**Table of Contents**

than the Corporation's existing institutional pharmacy business primarily because of the nature of the customers they service and markets in which they operate. The institutional pharmacy gross profit margin for the year ended December 31, 2010 was 13.0% compared to 15.0% for the year ended December 31, 2009. Gross profit was impacted by a continuation of reimbursement pressure under the Medicare Part D and Medicaid programs, other pricing concessions, a decline in licensed beds under contract prior to the acquisition of Chem Rx and Lone Star and higher delivery expenses. Delivery expense increased as a result of the DEA's new interpretation of the Controlled Substances Act regarding the ability of nurses in skilled nursing facilities to order controlled substances for the residents of these facilities. The Lone Star acquisition closed on December 31, 2010 and accordingly, no gross profit from this acquisition is included in the results of operations for the year ended December 31, 2010.

The decrease in hospital management gross profit for the year ended December 31, 2010 of \$1.0 million as compared to the year ended December 31, 2009 was due primarily to the June 30, 2009 pricing concessions related to the renegotiated Kindred contract, partially offset by the four additional hospital contracts serviced in 2010.

**Selling, General and Administrative Expenses (Dollars in millions)**

	Years Ended December 31,									
	2009		Increase (Decrease)		2010		Increase (Decrease)		2011	
	Amount	% of Total Revenues			Amount	% of Total Revenues			Amount	% of Total Revenues
<b>Selling, general and administrative expenses</b>										
Total wages, benefits and contract labor	\$ 104.9	5.7%	\$ (12.6)	(12.0)%	\$ 92.3	5.0%	\$ 18.0	19.5%	\$ 110.3	5.3%
Contracted services	13.2	0.7	1.7	12.9	14.9	0.8			14.9	0.7
Provision for doubtful accounts	16.6	0.9	1.9	11.4	18.5	1.0	6.3	34.1	24.8	1.2
Supplies	7.5	0.4	(0.8)	(10.7)	6.7	0.4	0.1	1.5	6.8	0.3
Travel expenses	4.5	0.2	0.2	4.4	4.7	0.3	0.3	6.4	5.0	0.2
Professional fees	9.3	0.5	(0.7)	(7.5)	8.6	0.5	4.7	54.7	13.3	0.6
Stock-based compensation	4.6	0.3	0.2	4.3	4.8	0.3	1.1	22.9	5.9	0.3
Depreciation	8.6	0.5	0.8	9.3	9.4	0.5	0.1	1.1	9.5	0.5
Rent	4.1	0.2	(0.1)	(2.4)	4.0	0.2	0.4	10.0	4.4	0.2
Maintenance	2.6	0.2	(0.1)	(3.8)	2.5	0.1	0.3	12.0	2.8	0.1
Other costs	14.9	0.8	(0.7)	(4.7)	14.2	0.7	3.0	21.1	17.2	0.9
<b>Total selling, general and administrative expenses</b>	<b>\$ 190.8</b>	<b>10.4%</b>	<b>\$ (10.2)</b>	<b>(5.3)%</b>	<b>\$ 180.6</b>	<b>9.8%</b>	<b>\$ 34.3</b>	<b>19.0%</b>	<b>\$ 214.9</b>	<b>10.3%</b>

Selling, general and administrative expenses increased \$34.3 million for the year ended December 31, 2011, compared to the year ended December 31, 2010. The increase of \$34.3 million is primarily due to higher labor costs of \$18.0 million. The labor increase of \$18.0 million included \$10.9 million of performance based compensation. Bad debt expense increased \$6.3 million primarily as a result of the Chem Rx and other pharmacy acquisitions and professional fees increased \$4.7 million. All other costs included in selling, general and administrative expenses increased approximately \$5.3 million as a result of the acquisitions.

Selling, general and administrative expenses, excluding the \$4.8 million of Chem Rx expenses, decreased \$15.0 million for the year ended December 31, 2010 compared to the year ended December 31, 2009. Total labor

**Table of Contents**

costs decreased \$12.6 million for the year ended December 31, 2010 over the comparable period in the prior year, which included \$2.5 million of additional labor costs related to the Chem Rx acquisition. The decrease of \$15.1 million in labor costs excluding Chem Rx is due to a reduction in staffing and employee performance based compensation of approximately \$8.8 million. Other costs in selling, general and administrative expenses increased \$2.4 million during the year ended December 31, 2010 due primarily to the Chem Rx acquisition. The Lone Star acquisition closed on December 31, 2010 and accordingly, no selling, general and administrative expenses from this acquisition are included in the results of operations for the year ended December 31, 2010.

**Depreciation and Amortization**

Depreciation expense for the periods presented is as follows (dollars in millions):

	2009		Years Ended December 31, 2010		2011	
	Amount	% of Total Revenues	Amount	% of Total Revenues	Amount	% of Total Revenues
Leasehold improvements	\$ 1.5	0.1%	\$ 1.7	0.1%	\$ 1.9	0.1%
Equipment and software	15.9	0.9	16.4	0.9	17.4	0.9
Leased equipment	0.6	NM	0.7	NM	0.8	NM
Total depreciation expense	\$ 18.0	1.0%	\$ 18.8	1.0%	\$ 20.1	1.0%
Depreciation expense recorded in cost of goods sold	\$ 9.4	0.5%	\$ 9.4	0.5%	\$ 10.6	0.5%
Depreciation expense recorded in selling, general & administrative expenses	8.6	0.5	9.4	0.5	9.5	0.5
Total depreciation expense	\$ 18.0	1.0%	\$ 18.8	1.0%	\$ 20.1	1.0%
Total capital expenditures	\$ 21.6	1.2%	\$ 12.6	0.7%	\$ 13.2	0.6%

Depreciation expense increased \$1.3 million for the year ended December 31, 2011 compared to the year ended December 31, 2010, primarily as a result of a full year of depreciation for the Chem Rx and the Lone Star acquisitions.

Depreciation expense increased \$0.8 million for the year ended December 31, 2010, as compared to the year ended December 31, 2009. The Corporation acquired Integrity Pharmacy Services on December 31, 2009, therefore, the year ended December 31, 2010 included a full year of depreciation expense for assets acquired as a result of this acquisition. In addition, the Corporation also recognized additional depreciation expense for the year ended December 31, 2010 due to the acquisition of Chem Rx on November 4, 2010. The Lone Star acquisition closed on December 31, 2010 and accordingly, no depreciation from this acquisition is included in the results of operations for the year ended December 31, 2010.

Amortization expense related to certain identifiable intangibles for the periods presented is as follows (dollars in millions):

	2009		Years Ended December 31, 2010		2011	
	Amount	% of Total Revenues	Amount	% of Total Revenues	Amount	% of Total Revenues
Trade names	\$ 1.4	0.1%	\$ 1.5	0.1%	\$ 1.6	0.1%
Non-compete agreements	1.1	NM	1.8	0.1	1.9	0.1
Customer relationships	6.5	0.4	6.0	0.3	7.5	0.3
Total amortization expense	\$ 9.0	0.5%	\$ 9.3	0.5%	\$ 11.0	0.5%





**Table of Contents**

Amortization expense increased \$1.7 million for the year ended December 31, 2011 compared to the year ended December 31, 2010, primarily as a result of a full year of amortization associated with intangibles acquired in the Chem Rx and Lone Star acquisitions.

Amortization expense for the year ended December 31, 2010 increased \$0.3 million, compared to the year ended December 31, 2009. The Corporation acquired Integrity Pharmacy Services on December 31, 2009, therefore, the year ended December 31, 2010 included a full year of amortization expense for assets acquired as a result of this acquisition. In addition, the Corporation also recognized additional amortization expense for the year ended December 31, 2010 due to the acquisition of Chem Rx on November 4, 2010. The Lone Star acquisition closed on December 31, 2010 and accordingly, no amortization from this acquisition is included in the results of operations for the year ended December 31, 2010.

Total amortization expense of \$9.3 million was reduced for the year ended December 31, 2010, due to certain customer relationships being fully amortized in the period that related to acquisitions that occurred prior to the Pharmacy Transaction.

**Impairment of intangible assets**

During the third quarter of 2011, the Corporation recorded a pre-tax impairment charge of \$5.1 million related to finite-lived customer relationships. The impairment, which related to the Institutional Pharmacy Segment, was incurred as the result of non-renewal of certain customer contracts. The impairment was related to intangible assets acquired in an acquisition during the year ended December 31, 2005. These asset groups were assessed for recoverability and management determined the finite-lived customer relationship assets to be impaired. No other assets within the asset groups were deemed impaired. Using a discounted cash flow analysis, the Corporation determined that the pre-tax impairment charge of \$5.1 million was required to write the carrying value down to fair value, resulting in a loss per diluted share impact of \$0.11. The Corporation recognized the impairment as a permanent write-down of the cost basis and accumulated amortization of the affected assets.

**Integration, Merger, and Acquisition Related Costs and Other Charges (Dollars in millions, except per share amounts)**

	Years Ended December 31,		
	2009	2010	2011
<b>Integration costs and other charges:</b>			
Pre-Pharmacy Transaction litigation matters	\$	\$ 5.0	\$ (2.0)
Tender offer costs			2.8
Professional and advisory fees	0.2	2.3	0.9
General and administrative	0.8	0.7	0.1
Employee costs	1.5	0.5	0.2
Severance costs	0.9	0.6	0.2
Facility costs	0.8	0.3	0.2
	4.2	9.4	2.4
<b>Acquisition related costs:</b>			
Professional and advisory fees	1.0	3.5	4.9
General and administrative		1.5	0.8
Employee costs		0.4	2.9
Severance costs			1.7
Facility costs		1.3	1.7
Contingent consideration		(1.7)	
Other		0.2	0.9
	1.0	5.2	12.9
<b>Total integration, merger and acquisition related costs and other charges</b>	<b>\$ 5.2</b>	<b>\$ 14.6</b>	<b>\$ 15.3</b>
Negative effect on earnings per diluted common share	\$ (0.10)	\$ (0.29)	\$ (0.32)



**Table of Contents**

The Corporation incurred integration costs and other charges during the years ended December 31, 2009, 2010 and 2011 related to costs to convert data and integrate systems. Integration costs and other charges decreased \$7.0 million for the year ended December 31, 2011 compared to the year ended December 31, 2010. During the second quarter of 2010, the Corporation recorded an estimated liability of \$5.0 million related to certain claims arising from time periods prior to July 31, 2007. During the third quarter of 2011, the Corporation was informed that one claim would not be pursued. Therefore, the Corporation reversed \$2.0 million of the estimated liability recorded in 2010.

The Corporation has incurred various expenses as a result of Omnicare's unsolicited tender offer including legal, investment banking and other fees. During the year ended December 31, 2011, \$2.8 million of tender offer costs were incurred. The Corporation anticipates that significant additional tender offer costs will continue to be incurred through the duration of the tender offer; however, the amount of these expenses cannot be reasonably estimated.

Acquisition related costs were higher for the year ended December 31, 2011 compared to the year ended December 31, 2010 due to the continuing costs associated with the Chem Rx acquisition. In addition, professional and advisory fees were higher as a result of the 2011 acquisitions and other pipeline acquisition opportunities.

For the year ended December 31, 2010, the Corporation incurred costs of \$5.2 million compared to \$1.0 million for acquisition related costs for the year ended December 31, 2009. Acquisition related costs were higher in 2010 due to costs incurred related to the Integrity Pharmacy Services acquisition and integration along with costs incurred related to the acquisitions of Chem Rx and Lone Star. Acquisition related costs were reduced in the period by \$1.7 million due to the Corporation concluding it is not probable the amount related to the previously recognized contingent consideration will be paid under the terms of the agreement.

**Interest Expense (Dollars in millions)**

	Years Ended December 31,		
	2009	2010	2011
<b>Interest expense:</b>			
Term Debt	\$ 8.7	\$ 2.8	\$ 6.0
Revolving Credit Facility	0.4	0.4	2.0
<b>Subtotal (including commitment fees and letters of credit fees)</b>	9.1	3.2	8.0
<b>Other:</b>			
Interest income	(0.2)	(0.2)	
Amortization of deferred financing fees	0.5	0.6	0.8
<b>Total interest expense, net</b>	<b>\$ 9.4</b>	<b>\$ 3.6</b>	<b>\$ 8.8</b>

Interest rate (excluding applicable margin):			
Average interest rate on variable term debt	0.65%	0.28%	0.52%
LIBOR 1 month, at beginning of period	0.44	0.23	0.26
LIBOR 1 month, at end of period	0.23	0.26	0.30
LIBOR 3 months, at beginning of period	1.43	0.25	0.30
LIBOR 3 months, at end of period	0.25	0.30	0.58

Interest expense increased \$5.2 million for the year ended December 31, 2011, compared to the year ended December 31, 2010, due to the increase in long-term debt and the revolving credit facility, along with higher interest rates during the period. The Corporation's interest rate on its borrowings increased from London Interbank Offered Rate (LIBOR) plus 1.0% at December 31, 2010 to LIBOR plus 2.75% at December 31, 2011 due to the Corporation's refinancing activities in the second quarter 2011, which paid off the 2007 credit agreement and replaced it with the Credit Agreement dated as of May 2, 2011. Long-term debt, including the current portion, was \$245.6 million and \$300.0 million as of December 31, 2010 and December 31, 2011, respectively.

**Table of Contents**

The decrease in interest expense during the year ended December 31, 2010, as compared to the year ended December 31, 2009, was due to the lower LIBOR and the expiration of the interest rate swap on July 31, 2009. The margin over LIBOR was 0.75% 1.00% during the year ended December 31, 2010. Total long-term debt outstanding, including capital lease obligations, as of December 31, 2009 and 2010, was \$241.5 million and \$245.6 million, respectively.

**Tax Provision (Dollars in millions)**

	Years Ended December 31,		
	2009	2010	2011
Tax provision	\$ 18.9	\$ 13.0	\$ 14.8
Total provision as a percentage of income	30.9%	40.2%	38.7%

The effective tax rate for the year ended December 31, 2011 was 38.7%, which was comprised of the 35.0% federal rate, 4.5% for the state rate, and a net benefit of 0.8% related to reserve releases for unrecognized tax benefits, permanent differences and other discrete items. Our effective tax rate for the year ended December 31, 2010 was 40.2%, which was comprised of the 35.0% federal rate, 4.7% for the state rate, and 0.5% for the permanent differences and other discrete items. Our effective tax rate for the year ended December 31, 2009 was 30.9%, which was comprised of the 35.0% federal rate, 4.5% for the state rate, and a net benefit of 8.6% on the valuation allowance releases, permanent differences and other discrete items. Excluding the impact of the reserve releases and discrete items in 2011, the discrete items in 2010 and the valuation allowances and discrete items in 2009, our effective tax rates would have been 40.5%, 40.5% and 40.2%, respectively.

**Liquidity and Capital Resources**

The primary sources of liquidity for the Corporation are cash flows from operations and the availability under the Credit Agreement. Based upon our existing cash levels, expected operating cash flows, capital spending, potential future acquisitions, and the availability of funds under our revolving credit facility, we believe that we have the necessary financial resources to satisfy our expected short-term and long-term liquidity needs.

**Cash Flows** The following table presents selected data from our consolidated statements of cash flows for the periods presented (dollars in millions):

	Years Ended December 31,		
	2009	2010	2011
Net cash provided by operating activities	\$ 85.0	\$ 98.2	\$ 26.8
Net cash used in investing activities	(76.1)	(133.2)	(64.0)
Net cash provided by (used in) financing activities	1.0	(5.4)	43.8
Net increase (decrease) in cash and cash equivalents	9.9	(40.4)	6.6
Cash and cash equivalents at beginning of period	41.3	51.2	10.8
Cash and cash equivalents at end of period	\$ 51.2	\$ 10.8	\$ 17.4

**Operating Activities** Cash provided by operating activities aggregated \$26.8 million for the year ended December 31, 2011 compared to \$98.2 million for the year ended December 31, 2010. The decrease in cash provided by operating activities compared to prior periods is a result of the increase in inventory purchases as a result of the Corporation implementing changes in its branded pharmaceutical purchasing practices and an increase in rebate receivables from AmerisourceBergen under the Amended Prime Vendor Agreement. The change in purchasing provides the Corporation with the opportunity to maximize its gross margin on certain pharmaceuticals. Also, for the year ended December 31, 2011 compared to the prior period there was an additional payment of \$29.6 million to AmerisourceBergen as a result of 2011 containing an additional Friday. Cash provided by operating activities for the period also



**Table of Contents**

decreased due to an adjustment of Chem Rx's payment terms, relating to the Amended Prime Vendor Agreement. As shown in the table below, cash from operating activities adjusted for these items would have aggregated \$126.5 million as compared to \$98.2 million for the years ended December 31, 2011 and December 31, 2010, respectively.

	<b>Years Ended December 31,</b>	
	<b>2010</b>	<b>2011</b>
Net cash provided by operating activities	\$ 98.2	\$ 26.8
Additional payment to AmerisourceBergen due to additional Friday		29.6
Increase in inventory due to branded pharmaceutical purchasing practices and rebate receivables due from AmerisourceBergen		57.4
Adjustment of ChemRx's payment terms with AmerisourceBergen to existing contract		12.7
<b>Adjusted cash provided by operating activities</b>	<b>\$ 98.2</b>	<b>\$ 126.5</b>

Cash provided by operations aggregated \$98.2 million for the year ended December 31, 2010, compared to \$85.0 million for the year ended December 31, 2009. The increase is due to the Chem Rx acquisition and the improvement in cash collections from the Part D payers due to the requirements of MIPPA. As a result of the MIPPA requirements, the Corporation collected a larger amount of receivables in the first quarter of 2010 than normal. The Corporation does not expect MIPPA to have an incremental benefit in future periods.

**Investing Activities** Cash used in investing activities aggregated \$64.0 million for the year ended December 31, 2011 as compared to \$133.2 million for the year ended December 31, 2010. The decrease in investing activities compared to prior period is due primarily to the decrease in pharmacy acquisitions of \$69.7 million for the year ended December 31, 2011 as compared to the prior period. The decrease in cost of acquisitions was partially offset by increased capital expenditures.

Cash used in investing activities aggregated \$133.2 million for the year ended December 31, 2010, compared to \$76.1 million for the year ended December 31, 2009. The increase in cash used in investing activities is due primarily to \$70.6 million paid for Chem Rx and approximately \$50.0 million paid for Lone Star compared to the \$54.7 million used for 2009 acquisitions.

**Financing Activities** Cash provided by financing activities aggregated \$43.8 million for the year ended December 31, 2011. Cash used in financing activities aggregated \$5.4 million for the year ended December 31, 2010. The increase is primarily due to additional borrowings and financing costs associated with the Credit Agreement entered into on May 2, 2011 and revolver borrowings to fund the aforementioned inventory purchases and acquisition.

Cash used in financing activities aggregated \$5.4 million for the year ended December 31, 2010, as compared to cash provided by financing activities of \$1.0 million for the year ended December 31, 2009. The decrease of \$6.4 million is due to the common stock purchased by the Corporation of \$10.6 million along with a revolving credit facility payment of \$7.6 million for the year ended December 31, 2010. These uses of cash were partially offset by a borrowing on the revolving credit facility of \$13.2 million.

**Credit Agreement**

On May 2, 2011, the Corporation entered into a long-term credit agreement (the "Credit Agreement") among the Corporation, the Lenders named therein, and Citibank, N.A. ("Citibank"), as Administrative Agent. The Credit Agreement replaced the \$425.0 million five-year credit agreement dated as of July 31, 2007, among the Corporation, JPMorgan Chase Bank, N.A., individually and as administrative agent, and certain lenders. The

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## **Table of Contents**

Credit Agreement consists of a \$250.0 million term loan facility and a \$200.0 million revolving credit facility. The terms and conditions of the Credit Agreement are customary to facilities of this nature. Indebtedness under the Credit Agreement matures on June 30, 2016, at which time the commitments of the Lenders to make revolving loans also expire.

The Credit Agreement requires term loan principal payments by the Corporation in an amount of \$3.1 million on the last business day of each quarter beginning September 2012 through June 2015 and \$53.1 million on the last business day of each quarter beginning September 2015 through June 2016. The final principal repayment installment of term loans shall be repaid on the term maturity date, June 30, 2016. In addition, the term loan is subject to certain prepayment obligations relating to certain asset sales, certain casualty losses and the incurrence by the Corporation of certain indebtedness.

Borrowings under the Credit Agreement bear interest at a floating rate equal to, at the Corporation's option, a base rate plus a margin between 1.25% and 2.00% per annum, or an adjusted LIBO Rate plus a margin between 2.25% and 3.00% per annum, in each case depending on the leverage ratio of the Corporation as defined by the Credit Agreement. The base rate is the greater of the prime lending rate in effect on such day, the federal funds effective rate published by the Federal Reserve Bank of New York on such day plus 0.5%, or the adjusted LIBO Rate for deposits for a period equal to one month plus 1.0%. Any changes in the base rate, federal funds rate or adjusted LIBO Rate shall be effective from and including the effective date of such change in the rate, as applicable. The Credit Agreement also provides for letter of credit fees between 2.25% and 3.00% and a commitment fee payable on the unused portion of the revolving credit facility, which shall accrue at a rate per annum ranging from 0.375% to 0.500%, in each case depending on the leverage ratio of the Corporation.

The Corporation's obligations under the Credit Agreement are secured by substantially all of the Corporation's assets. Those obligations are guaranteed by many of the Corporation's wholly-owned subsidiaries and the obligations of the guarantors are secured by substantially all of their assets. The foregoing includes a pledge of all of the equity interests of substantially all of the Corporation's direct and indirect domestic subsidiaries and a portion of the equity interests of any future foreign subsidiaries.

The Corporation had a total of \$250.0 million outstanding of term debt under the Credit Agreement and \$50.0 million outstanding under the revolving portion of the Credit Agreement as of December 31, 2011. The Credit Agreement provides for the issuance of letters of credit which, when issued, constitute usage and reduce availability on the revolving portion of the Credit Agreement. The amount of letters of credit outstanding as of December 31, 2011 was \$2.0 million. After giving effect to the letters of credit and amounts outstanding under the revolving credit agreement, total availability under the revolving credit facility was \$148.0 million as of December 31, 2011.

### ***Covenants***

The Credit Agreement requires the Corporation to satisfy an interest coverage ratio and a leverage ratio. The interest coverage ratio, which is tested as of the last day of any fiscal quarter on a trailing four quarter basis, can be no less than: 3.00:1.00. The leverage ratio, which also is tested quarterly, cannot exceed 4.00:1.00 from the end of the first full fiscal quarter ending after the effective date, through the quarter ending December 31, 2012; cannot exceed 3.75:1.00 for each of the four quarters in the year ending December 31, 2013; and cannot exceed 3.50:1.00 for all remaining quarters through the expiration of the agreement. In addition, capital expenditures (other than those funded with proceeds of asset sales or insurance proceeds) are restricted in any fiscal year to 3.0% of revenues.

In addition, the Credit Agreement contains customary affirmative and negative covenants, which among other things, limit the Corporation's ability to incur additional debt, create liens, pay dividends, effect transactions with the Corporation's affiliates, sell assets, pay subordinated debt, merge, consolidate, enter into acquisitions, and effect sale leaseback transactions.



**Table of Contents**

The financial covenant ratio and requirements as defined by the Corporation's Credit Agreements are as follows:

	<b>Interest Coverage Ratio</b>	<b>Leverage Ratio</b>	<b>Capital Expenditures</b>
Requirement	>=3.00 to 1.00	<=4.00 to 1.00	<=3.00%
December 31, 2011	11.99	2.44	0.63%

*Deferred Financing Fees*

The Corporation capitalized a total of \$9.8 million in deferred financing fees associated with the Credit Agreement and recorded them as other assets in the accompanying consolidated balance sheets. As of December 31, 2011, the Corporation had \$9.2 million of unamortized deferred financing fees. The Corporation amortizes these deferred financing fees using the effective interest method.

**Prime Vendor Agreement**

On January 4, 2011, the Corporation entered into an Amended and Restated Prime Vendor Agreement for Long-Term Care Pharmacies by and between AmerisourceBergen Drug Corporation ( ABDC ), a wholly owned subsidiary of AmerisourceBergen Corporation, the Corporation, Pharmacy Corporation of America and Chem Rx Pharmacy Services, LLC (the Amended Prime Vendor Agreement ). The Amended Prime Vendor Agreement became effective on January 1, 2011 and, upon its effectiveness, superseded in its entirety the Prime Vendor Agreement for Long-Term Care Pharmacies entered into as of August 1, 2007 between the Corporation and ABDC.

The Amended Prime Vendor Agreement incorporates Chem Rx and is otherwise substantially the same in scope excepting modifications to select sourcing and rebate terms. The term of the Amended Prime Vendor Agreement was extended until September 30, 2013, with one-year automatic renewal periods unless either party provides prior notice of its intent not to renew.

We also obtain pharmaceutical and other products from contracts negotiated directly with pharmaceutical manufacturers for discounted prices. While the loss of a supplier could adversely affect our business if alternate sources of supply are unavailable, numerous sources of supply are generally available to us and we have not experienced any difficulty in obtaining pharmaceuticals or other products and supplies to conduct our business.

We seek to maintain an on-site inventory of pharmaceuticals and supplies to ensure prompt delivery to our customers. ABDC maintains local distribution facilities in most major geographic markets in which we operate.

**Information Technology Services Agreement**

On July 31, 2007, the Corporation entered into an Information Technology Services Agreement with KHOI, a wholly owned subsidiary of Kindred. Pursuant to this IT Services Agreement, KHOI is the Corporation's exclusive provider of certain information services and support related to information technology infrastructure and financial systems for a period of five years. The services provided by KHOI includes business services necessary to operate, manage and support certain financial applications the Corporation uses, including enabling and/or supporting technology infrastructure and technology procurement services to support certain business functions. Such services include, among other matters, functions for financial management systems and payroll. The Corporation internally supports all other operating systems, including functions for order entry, pharmacy dispensing, clinical consulting, billing and collections, electronic medication management, sales and marketing, medical records management, human resources, internal and external customer call center support and general business systems.

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## **Table of Contents**

Except for certain services that will be provided at cost, KHOI will provide such services to the Corporation at its cost plus 10%, which will be the actual costs and expenses incurred in providing these services, including certain overhead costs and per hour costs of the KHOI employees providing the services. The initial term of the IT Services Agreement is five years. The IT Services Agreement will automatically renew for successive one-year periods after the expiration of the initial five year term, absent 120 days prior written notice of termination as provided for in the agreement. The IT Services Agreement may be terminated by either party for cause and, in certain circumstances, by the Corporation in the event that KHOI undergoes a change of control to one of the Corporation's competitors. Following termination of the IT Services Agreement, KHOI must provide termination and expiration assistance for up to 180 days. The Corporation incurred \$11.5 million, \$11.1 million, and \$10.8 million in fees to Kindred under the terms of the IT Services Agreement for the years ended December 31, 2009, 2010, and 2011, respectively.

### **Treasury Stock**

In August 2010, the Board of Directors authorized a share repurchase of up to \$25.0 million of the Corporation's common stock. Share repurchases under this authorization may be made in the open market through unsolicited or solicited privately negotiated transactions, or in such other appropriate manner, and will be funded from available cash. The amount and timing of the repurchases will be determined by the Corporation's management and will depend on a variety of factors including price, corporate and regulatory requirements, capital availability and other market conditions. Common stock acquired through the share repurchase program will be held as treasury shares and may be used for general corporate purposes, including reissuances in connection with acquisitions, employee stock option exercises or other employee stock plans. The share repurchase program does not have an expiration date and may be limited, terminated or extended at any time without prior notice.

The Corporation did not repurchase shares under this program during the year ended December 31, 2011. Additionally, the Corporation has approximately \$14.5 million of shares that may yet be purchased under the share repurchase program. The Corporation may redeem shares from employees upon the vesting of the Corporation's stock awards for minimum statutory tax withholding purposes. The Corporation redeemed 13,311 shares of certain vested awards for an aggregate price of approximately \$0.2 million during the year ended December 31, 2011. These shares have also been designated by the Corporation as treasury stock.

As of December 31, 2011, the Corporation had a total of 1,350,128 shares held as treasury stock.

### **Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements, other than purchase commitments and lease obligations. See Contractual Obligations below.

### **Contractual Obligations**

The Corporation is obligated to make future payments under various contracts such as long-term purchase obligations, debt agreements, and lease agreements, and has certain commitments. The Corporation has grouped these contractual obligations and off-balance sheet arrangements into operating activities, financing activities, and investing activities in the same manner as they are classified in the Consolidated Statements of Cash Flows in order to provide a better understanding of the nature of the obligations and arrangements and to provide a basis for comparison to historical information.

**Table of Contents**

The table below provides a summary of contractual obligations and off-balance sheet arrangements as of December 31, 2011 (dollars in millions):

	2012	2013	2014	2015	2016	Thereafter
<b>Operating activities:</b>						
Amended Prime Vendor Agreement (1)	\$	\$	\$	\$	\$	\$
Non-cancelable operating leases	14.4	11.9	7.5	5.8	4.4	13.6
Information Technology Services Agreement (2)	6.3					
<b>Financing activities:</b>						
Total debt and estimated interest (3) (4)	9.5	15.6	15.4	115.1	156.8	
<b>Totals</b>	<b>\$ 30.2</b>	<b>\$ 27.5</b>	<b>\$ 22.9</b>	<b>\$ 120.9</b>	<b>\$ 161.2</b>	<b>\$ 13.6</b>

- (1) Under the Amended Prime Vendor Agreement the Corporation is required to purchase a certain percentage of its drug purchases through AmerisourceBergen through September 30, 2013.
- (2) The Information Technology Services Agreement expires on July 31, 2012 but will be automatically renewed for successive one-year periods after the expiration of the initial five year term, absent 120 days prior written notice of termination by the Corporation or KHOI.
- (3) At December 31, 2011, the Corporation had \$50.0 million outstanding on the revolving credit facility and the balance is included in the 2016 column as a long-term obligation.
- (4) Estimated interest amounts do not include interest on the revolving credit facility.

**Table of Contents****Supplemental Quarterly Information**

The following tables represent the results of the Corporation's quarterly operations for the years ended December 31, 2010 and 2011 (in millions, except where indicated):

	2010 Quarters				2011 Quarters			
	First	Second	Third	Fourth	First	Second	Third	Fourth
<b>Net revenues:</b>								
Institutional pharmacy revenues	\$ 448.3	\$ 435.9	\$ 427.7	\$ 477.5	\$ 519.6	\$ 516.0	\$ 503.0	\$ 480.0
Hospital management revenues	13.9	14.6	15.4	14.0	15.5	15.7	15.7	15.6
<b>Total revenues</b>	<b>462.2</b>	<b>450.5</b>	<b>443.1</b>	<b>491.5</b>	<b>535.1</b>	<b>531.7</b>	<b>518.7</b>	<b>495.6</b>
<b>Cost of goods sold:</b>								
Institutional pharmacy	386.8	380.1	372.8	416.9	455.9	441.6	429.6	405.9
Hospital management	12.1	12.8	13.5	12.0	13.5	13.7	13.8	13.8
<b>Total cost of goods sold</b>	<b>398.9</b>	<b>392.9</b>	<b>386.3</b>	<b>428.9</b>	<b>469.4</b>	<b>455.3</b>	<b>443.4</b>	<b>419.7</b>
<b>Gross profit:</b>								
Institutional pharmacy	61.5	55.8	54.9	60.6	63.7	74.4	73.4	74.1
Hospital management	1.8	1.8	1.9	2.0	2.0	2.0	1.9	1.8
<b>Total gross profit</b>	<b>63.3</b>	<b>57.6</b>	<b>56.8</b>	<b>62.6</b>	<b>65.7</b>	<b>76.4</b>	<b>75.3</b>	<b>75.9</b>
Selling, general and administrative	44.8	43.0	43.3	49.5	51.6	55.1	54.7	53.5
Amortization expense	2.3	2.4	2.2	2.4	2.7	2.7	3.0	2.6
Impairment of intangible assets							5.1	
Integration, merger and acquisition related costs and other charges	1.2	9.2	2.4	1.8	4.7	5.1	1.8	3.7
<b>Operating income</b>	<b>15.0</b>	<b>3.0</b>	<b>8.9</b>	<b>8.9</b>	<b>6.7</b>	<b>13.5</b>	<b>10.7</b>	<b>16.1</b>
Interest expense, net	0.9	0.8	0.9	1.0	1.1	2.6	2.6	2.5
<b>Income before income taxes</b>	<b>14.1</b>	<b>2.2</b>	<b>8.0</b>	<b>7.9</b>	<b>5.6</b>	<b>10.9</b>	<b>8.1</b>	<b>13.6</b>
Provision for income taxes	5.7	0.9	3.2	3.2	2.3	3.5	3.3	5.7
<b>Net income</b>	<b>\$ 8.4</b>	<b>\$ 1.3</b>	<b>\$ 4.8</b>	<b>\$ 4.7</b>	<b>\$ 3.3</b>	<b>\$ 7.4</b>	<b>\$ 4.8</b>	<b>\$ 7.9</b>
<b>Earnings per common share (1):</b>								
Basic	\$ 0.28	\$ 0.04	\$ 0.16	\$ 0.16	\$ 0.11	\$ 0.25	\$ 0.16	\$ 0.27
Diluted	\$ 0.27	\$ 0.04	\$ 0.16	\$ 0.16	\$ 0.11	\$ 0.25	\$ 0.16	\$ 0.27
<b>Adjusted earnings per diluted common share (1)(2):</b>	<b>\$ 0.29</b>	<b>\$ 0.22</b>	<b>\$ 0.21</b>	<b>\$ 0.20</b>	<b>\$ 0.21</b>	<b>\$ 0.32</b>	<b>\$ 0.31</b>	<b>\$ 0.35</b>
<b>Shares used in computing earnings per common share:</b>								
Basic	30.4	30.4	30.0	29.2	29.3	29.3	29.4	29.4
Diluted	30.6	30.6	30.1	29.3	29.4	29.4	29.5	29.6
<b>Balance sheet data:</b>								
Cash and cash equivalents	\$ 73.5	\$ 91.2	\$ 96.7	\$ 10.8	\$ 12.3	\$ 14.6	\$ 10.3	\$ 17.4
Working capital (3)	\$ 331.3	\$ 344.6	\$ 341.9	\$ 280.9	\$ 295.5	\$ 334.6	\$ 336.7	\$ 349.1
Goodwill (3)	\$ 140.6	\$ 140.4	\$ 140.4	\$ 179.4	\$ 193.9	\$ 186.8	\$ 183.4	\$ 214.2
Intangible assets, net	\$ 88.8	\$ 86.6	\$ 84.8	\$ 102.2	\$ 100.3	\$ 100.8	\$ 93.1	\$ 100.2
Total assets (3)	\$ 720.3	\$ 731.2	\$ 721.5	\$ 759.7	\$ 784.7	\$ 823.4	\$ 787.6	\$ 833.4
Long-term debt	\$ 240.0	\$ 240.0	\$ 240.0	\$ 245.6	\$ 244.3	\$ 274.0	\$ 257.9	\$ 300.0
Total stockholders' equity	\$ 380.2	\$ 383.4	\$ 378.2	\$ 384.4	\$ 389.2	\$ 398.3	\$ 404.5	\$ 413.8
<b>Supplemental information:</b>								
Adjusted EBITDA(2)	\$ 23.1	\$ 19.3	\$ 18.3	\$ 17.8	\$ 19.2	\$ 26.3	\$ 25.4	\$ 27.6
Adjusted EBITDA Margin (2)	5.0%	4.3%	4.1%	3.6%	3.6%	4.9%	4.9%	5.6%

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Adjusted EBTIDA per prescription dispensed	\$ 2.39	\$ 2.07	\$ 2.04	\$ 1.80	\$ 1.78	\$ 2.48	\$ 2.45	\$ 2.78
Net cash provided by (used in) operating activities	\$ 24.7	\$ 20.6	\$ 23.5	\$ 29.4	\$ 5.4	\$ (5.1)	\$ 12.0	\$ 14.5
Net cash used in investing activities	\$ (2.3)	\$ (2.9)	\$ (7.2)	\$ (120.8)	\$ (2.4)	\$ (12.3)	\$ (3.1)	\$ (46.2)
Net cash provided by (used in) financing activities	\$ (0.1)	\$	\$ (10.8)	\$ 5.5	\$ (1.5)	\$ 19.7	\$ (13.2)	\$ 38.8
<b>Statistical information (in whole numbers except where indicated)</b>								
<b>Institutional Pharmacy</b>								
<b>Volume information</b>								
Prescriptions dispensed (in thousands)	9,664	9,316	8,949	9,897	10,769	10,607	10,357	9,944
Revenue per prescription dispensed	\$ 46.39	\$ 46.79	\$ 47.79	\$ 48.25	\$ 48.25	\$ 48.65	\$ 48.57	\$ 48.27
Gross profit per prescription dispensed	\$ 6.36	\$ 5.99	\$ 6.13	\$ 6.12	\$ 5.92	\$ 7.01	\$ 7.09	\$ 7.45
Gross profit percentage	13.7%	12.8%	12.8%	12.7%	12.3%	14.4%	14.6%	15.4%
Generic drug dispensing rate	74.5%	75.7%	75.9%	75.8%	77.1%	77.9%	78.3%	78.4%
<b>Customer licensed beds under contract</b>								
Beginning of period	313,867	307,508	298,584	289,748	362,901	357,669	353,024	342,099
Additions PharMerica Corporation	4,111	2,586	4,867	22,612	4,481	6,160	3,229	13,348
Additions Chem Rx				61,773	998	392	905	947
Losses PharMerica Corporation	(10,470)	(11,510)	(13,703)	(11,232)	(7,173)	(9,553)	(13,561)	(14,617)
Losses Chem Rx					(3,538)	(1,644)	(1,498)	(2,279)
End of period	307,508	298,584	289,748	362,901	357,669	353,024	342,099	339,498
<b>Hospital management contracts serviced</b>	<b>86</b>	<b>89</b>	<b>89</b>	<b>90</b>	<b>90</b>	<b>90</b>	<b>90</b>	<b>91</b>

- (1) The Corporation has never declared a cash dividend. Earnings per common share in actual cents.
- (2) See Use of Non-GAAP Measures For Measuring Quarterly Results for a definition and Reconciliation of Adjusted Earnings Per Diluted Common Share to Earnings Per Diluted Common Share, and for Reconciliation of Net Income to Adjusted EBITDA and Margin.
- (3) As adjusted, see Note 2 Acquisitions in the Consolidated Financial Statements.

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**Table of Contents*****Use of Non-GAAP Measures for Measuring Quarterly Results***

The Corporation calculates Adjusted EBITDA as provided in the reconciliation below and calculates Adjusted EBITDA Margin by taking Adjusted EBITDA and dividing it by revenues. The Corporation calculates and uses Adjusted EBITDA as an indicator of its ability to generate cash from reported operating results. The measurement is used in concert with net income and cash flows from operating activities, which measure actual cash generated in the period. In addition, the Corporation believes that Adjusted EBITDA and Adjusted EBITDA Margin are supplemental measurement tools used by analysts and investors to help evaluate overall operating performance and the ability to incur and service debt and make capital expenditures. In addition, Adjusted EBITDA, as defined in the Credit Agreement, is used in conjunction with the Corporation's debt leverage ratio and this calculation sets the applicable margin for the quarterly interest charge. Adjusted EBITDA, as defined in the Credit Agreement, is not the same calculation as this Adjusted EBITDA table. Adjusted EBITDA does not represent funds available for the Corporation's discretionary use and is not intended to represent or to be used as a substitute for net income or cash flows from operating activities data as measured under U.S. generally accepted accounting principles (GAAP). The items excluded from Adjusted EBITDA but included in the calculation of the Corporation's reported net income and cash flows from operating activities are significant components of the accompanying consolidated income statements and cash flows, and must be considered in performing a comprehensive assessment of overall financial performance. The Corporation's calculation of Adjusted EBITDA may not be consistent with calculations of EBITDA used by other companies. The following are reconciliations of Adjusted EBITDA to the Corporation's net income and net operating cash flows for the periods presented.

The Corporation calculates and uses adjusted earnings per diluted common share, which is exclusive of the impact of integration, merger and acquisition related costs and other charges, impairment of intangible assets, and tax accounting matters as an indicator of its core operating results. The measurement is used in concert with net income and earnings per diluted share, which measure actual earnings per share generated in the period. The Corporation believes the exclusion of these charges in expressing earnings per share provides management with a useful measure to assess period to period comparability and is useful to investors in evaluating the Corporation's operating results from period to period. Adjusted earnings per diluted common share, which is exclusive of the impact of integration, merger and acquisition related costs and other charges, impairment of intangible assets, and tax accounting matters does not represent the amount that effectively accrues directly to stockholders (i.e., such costs are a reduction in earnings and stockholders' equity) and is not intended to represent or to be used as a substitute for earnings per diluted common share as measured under GAAP. The impact of integration, merger and acquisition related costs and other charges, impairment of intangible assets, and tax accounting matters excluded from the earnings per diluted share are significant components of the accompanying consolidated income statements, and must be considered in performing a comprehensive assessment of overall financial performance. The following is a reconciliation of adjusted earnings per diluted common share to the Corporation's GAAP earnings per diluted common share for the periods presented.

**Table of Contents****Unaudited Reconciliation of Net Income to Adjusted EBITDA**

	2010 Quarters				2011 Quarters			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Net income	\$ 8.4	\$ 1.3	\$ 4.8	\$ 4.7	\$ 3.3	\$ 7.4	\$ 4.8	\$ 7.9
Add:								
Interest expense, net	0.9	0.8	0.9	1.0	1.1	2.6	2.6	2.5
Integration, merger and acquisition related costs and other charges	1.2	9.2	2.4	1.8	4.7	5.1	1.8	3.7
Provision for income taxes	5.7	0.9	3.2	3.2	2.3	3.5	3.3	5.7
Impairment of intangible assets							5.1	
Depreciation and amortization expense	6.9	7.1	7.0	7.1	7.8	7.7	7.8	7.8
Adjusted EBITDA	\$ 23.1	\$ 19.3	\$ 18.3	\$ 17.8	\$ 19.2	\$ 26.3	\$ 25.4	\$ 27.6
Adjusted EBITDA Margin	5.0%	4.3%	4.1%	3.6%	3.6%	4.9%	4.9%	5.6%

**Unaudited Reconciliation of Adjusted EBITDA to Net Operating Cash Flows**

	2010 Quarters				2011 Quarters			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Adjusted EBITDA	\$ 23.1	\$ 19.3	\$ 18.3	\$ 17.8	\$ 19.2	\$ 26.3	\$ 25.4	\$ 27.6
Interest expense, net	(0.9)	(0.8)	(0.9)	(1.0)	(1.1)	(2.6)	(2.6)	(2.5)
Provision for income taxes	(5.7)	(0.9)	(3.2)	(3.2)	(2.3)	(3.5)	(3.3)	(5.7)
Integration, merger and acquisition related costs and other charges	(1.1)	(8.8)	(2.3)	(1.8)	(4.4)	(4.7)	(1.3)	(3.4)
Provision for bad debt	3.8	4.6	4.5	5.6	5.4	5.8	6.4	7.2
Stock-based compensation	0.8	1.7	0.8	1.5	1.4	1.8	1.3	1.4
Amortization of deferred financing fees	0.2	0.1	0.1	0.2	0.2	0.3	0.2	0.1
Deferred income taxes	4.8	0.9	3.4	3.2	2.3	4.6	2.9	4.1
Loss on disposition of equipment		0.1	0.1	0.1	0.1	0.1	0.1	(0.2)
Other	0.1	(0.1)					(0.2)	0.4
Changes in assets and liabilities	(0.4)	4.5	2.7	7.0	(15.4)	(33.2)	(16.9)	(14.5)
Net Cash Flows provided by (used in) Operating Activities	\$ 24.7	\$ 20.6	\$ 23.5	\$ 29.4	\$ 5.4	\$ (5.1)	\$ 12.0	\$ 14.5

**Unaudited Reconciliation of Earnings Per Diluted Common Share to Adjusted Earnings Per Diluted Common Share**

	2010 Quarters				2011 Quarters			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Earnings per diluted common share	\$ 0.27	\$ 0.04	\$ 0.16	\$ 0.16	\$ 0.11	\$ 0.25	\$ 0.16	\$ 0.27
Add:								
Diluted earnings per common share impact of:								
Impairment of intangible assets							0.11	
Integration, merger and acquisition related costs and other charges	0.02	0.18	0.05	0.04	0.09	0.12	0.04	0.07
Tax accounting matters						(0.04)		0.01
	\$ 0.29	\$ 0.22	\$ 0.21	\$ 0.20	\$ 0.20	\$ 0.33	\$ 0.31	\$ 0.35

Adjusted earnings per diluted common share after impact  
of above items



**Table of Contents**

Following Represent the Fourth Quarter 2011 Results compared to the Fourth Quarter 2010

**Results of Operations**

The following table presents selected consolidated comparative results of operations and statistical information for the periods presented (dollars in millions):

	December 31, 2010		Quarter Ended Increase (Decrease)		December 31, 2011	
	Amount	% of Total Revenues			Amount	% of Total Revenues
<b>Net revenues:</b>						
Institutional Pharmacy	\$ 477.5	97.2%	\$ 2.5	0.5%	\$ 480.0	96.9%
Hospital Management	14.0	2.8	1.6	11.4	15.6	3.1
Total net revenues	491.5	100.0	4.1	0.8	495.6	100.0
<b>Cost of goods sold:</b>						
Institutional Pharmacy	416.9	84.9	(11.0)	(2.6)	405.9	81.9
Hospital Management	12.0	2.4	1.8	15.0	13.8	2.8
Total cost of goods sold	428.9	87.3	(9.2)	(2.1)	419.7	84.7
<b>Gross profit:</b>						
Institutional Pharmacy	60.6	12.3	13.5	22.3	74.1	15.0
Hospital Management	2.0	0.4	(0.2)	(10.0)	1.8	0.3
Total gross profit	\$ 62.6	12.7%	\$ 13.3	21.2%	\$ 75.9	15.3%
<b><i>Institutional Pharmacy (in whole numbers except where indicated)</i></b>						
<b>Volume information</b>						
Prescriptions dispensed (in thousands)	9,897		47	0.5%	9,944	
Revenue per prescription dispensed	\$ 48.25		\$ 0.02	NM%	\$ 48.27	
Gross profit per prescription dispensed	\$ 6.12		\$ 1.33	21.7%	\$ 7.45	
Institutional pharmacy gross margin	12.7%		2.7	21.3%	15.4%	
Generic dispensing rate	75.8%		2.6	3.4%	78.4%	
<b>Customer licensed beds under contract</b>						
Beginning of period	289,748		52,351	18.1%	342,099	
Additions PharMerica Corporation	22,612		(9,264)	(41.0)	13,348	
Additions Chem Rx	61,773		(60,826)	(98.5)	947	
Losses PharMerica Corporation	(11,232)		(3,385)	(30.1)	(14,617)	
Losses Chem Rx			(2,279)	(100.0)	(2,279)	
End of period	362,901		(23,403)	(6.4)%	339,498	

***Hospital Management (in whole numbers except where indicated)*****Volume information**

Hospital management contracts serviced	90		1.0	1.1%	91	
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**Revenues**

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Institutional pharmacy revenues increased \$2.5 million for the three months ended December 31, 2011 compared to the three months ended December 31, 2010, due primarily to the Chem Rx and other pharmacy acquisitions having a full quarter impact in 2011 and only partial quarter in 2010. The increase of \$2.5 million resulted from a favorable volume variance of approximately \$2.3 million or 47,000 additional prescriptions

**Table of Contents**

dispensed and a favorable rate variance of approximately \$0.2 million or \$0.02 increase per prescription dispensed. The rate variance was comprised of approximately \$34.0 million due to inflation on drugs dispensed between periods offset by \$33.8 million due to the increase in the generic dispensing rate from 75.8% to 78.4% and certain pricing concessions. The favorable volume variance of approximately \$2.3 million was due to the increase in customer licensed beds under contract as a result of the acquisitions.

The increase in hospital management revenues of \$1.6 million for the three months ended December 31, 2011 compared to the three months ended December 31, 2010 was primarily due to an increase in the number of hospital management contacts serviced.

**Cost of Goods Sold**

Institutional pharmacy cost of goods sold decreased \$11.0 million for the three months ended December 31, 2011 compared to the three months ended December 31, 2010 primarily due to a decrease in overall total drug costs as a percent of revenues of 317 bps due primarily to the increased generic dispensing rate, which has improved margins, and higher generic rebates as a result of the Amended Prime Vendor Agreement. Other costs included in cost of goods sold increased as a percentage of revenues 47 bps, of which the increase primarily related to increased salaries and wages expenses of 24 bps and contracted services of 12 bps.

The increase in hospital management cost of goods sold of \$1.8 million was due to the additional hospital management contract serviced during the period.

**Gross Profit and Operating Expenses**

Gross profit and other operating expenses were the following for the periods presented (dollars in millions):

	December 31, 2010		Quarter Ended		December 31, 2011	
	Amount	% of Total Revenues	Increase (Decrease)		Amount	% of Total Revenues
<b>Gross profit and operating expenses:</b>						
Total gross profit	\$ 62.6	12.7%	\$ 13.3	21.2%	\$ 75.9	15.3%
Selling, general and administrative expenses	49.5	10.1	4.0	8.1	53.5	10.8
Amortization expense	2.4	0.5	0.2	8.3	2.6	0.5
Integration, merger related costs and other charges	1.8	0.3	1.9	105.6	3.7	0.7
Interest expense, net	1.0	0.2	1.5	150.0	2.5	0.5
Income before provision for income taxes	7.9	1.6	5.7	72.2	13.6	2.8
Provision for income taxes	3.2	0.6	2.5	78.1	5.7	1.2
Net income	\$ 4.7	1.0%	\$ 3.2	68.1%	\$ 7.9	1.6%

Institutional pharmacy gross profit for the three months ended December 31, 2011 was \$74.1 million or \$7.45 per prescription dispensed compared to \$60.6 million or \$6.12 per prescription dispensed for the three months ended December 31, 2010. Institutional pharmacy gross profit margin for the three months ended December 31, 2011 was 15.4% compared to 12.7% for the three months ended December 31, 2010. Gross profit margin was positively impacted by higher margins on certain brand-name drugs which recently went generic and better pricing terms as a result of the Amended Prime Vendor Agreement partially offset by certain pricing concessions. The increase in gross profit dollars was a result of these factors as well as the Chem Rx and other pharmacy acquisitions having a full quarter impact in 2011 and only partial quarter in 2010.

The decrease in hospital management gross profit of \$0.2 million for the three months ended December 31, 2011 as compared to December 31, 2010 was due to higher costs associated with the additional contract served in 2011.



**Table of Contents****Selling, General and Administrative Expenses (Dollars in millions)**

	December 31, 2010		Quarter Ended Increase (Decrease)		December 31, 2011	
	Amount	% of Total Revenues			Amount	% of Total Revenues
<b>Selling, general and administrative expenses:</b>						
Total wages, benefits and contract labor	\$ 24.7	5.0%	\$ 0.6	2.4%	\$ 25.3	5.1%
Contracted services	3.7	0.8			3.7	0.7
Provision for doubtful accounts	5.6	1.1	1.6	28.6	7.2	1.5
Supplies	1.8	0.4	(0.1)	(5.6)	1.7	0.3
Travel expenses	1.3	0.3	0.1	7.7	1.4	0.3
Professional fees	2.6	0.5	1.6	61.5	4.2	0.9
Stock-based compensation	1.5	0.3	(0.1)	(6.7)	1.4	0.3
Depreciation	2.3	0.5	0.2	8.7	2.5	0.5
Rent	1.0	0.2			1.0	0.2
Maintenance	0.8	0.2	(0.2)	(25.0)	0.6	0.1
Other costs	4.2	0.8	0.3	7.1	4.5	0.9
<b>Total selling general and administrative expenses</b>	<b>\$ 49.5</b>	<b>10.1%</b>	<b>\$ 4.0</b>	<b>8.1%</b>	<b>\$ 53.5</b>	<b>10.8%</b>

Selling, general and administrative expenses increased \$4.0 million for the three months ended December 31, 2011, compared to the three months ended December 31, 2010. The increase of \$4.0 million is due to an increase in bad debt expense of \$1.6 million and higher labor costs of \$0.6 million primarily as a result of the Chem Rx and other pharmacy acquisitions having a full quarter impact in 2011 and only partial quarter in 2010. Professional fees increased \$1.6 million due to the increase in legal related fees. All other costs included in selling, general and administrative expenses increased approximately \$0.2 million as a result of the acquisitions.

**Depreciation and Amortization (Dollars in millions)**

Depreciation expense for the periods presented is as follows (dollars in millions):

	December 31, 2010		Quarter Ended December 31, 2011	
	Amount	% of Total Revenues	Amount	% of Total Revenues
Leasehold improvements	\$ 0.4	0.1%	\$ 0.5	0.1%
Equipment and software	4.1	0.9	4.4	0.9
Leased equipment	0.2	NM	0.3	NM
<b>Total depreciation expense</b>	<b>\$ 4.7</b>	<b>1.0%</b>	<b>\$ 5.2</b>	<b>1.0%</b>
Depreciation expense recorded in cost of goods sold	\$ 2.4	0.5%	\$ 2.7	0.5%
Depreciation expense recorded in selling, general & administrative expenses	2.3	0.5	2.5	0.5
<b>Total depreciation expense</b>	<b>\$ 4.7</b>	<b>1.0%</b>	<b>\$ 5.2</b>	<b>1.0%</b>
<b>Total capital expenditures</b>	<b>\$ 3.8</b>	<b>0.8%</b>	<b>\$ 3.8</b>	<b>0.8%</b>

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Depreciation expense increased \$0.5 million for the three months ended December 31, 2011, compared to the three months ended December 31, 2010 as a result of the Chem Rx and other pharmacy acquisitions having a full quarter impact in 2011 and only partial quarter in 2010.

**Table of Contents**

Amortization expense related to certain identifiable intangibles for the periods presented is as follows (dollars in millions):

	Quarter Ended			
	December 31, 2010		December 31, 2011	
	Amount	% of Total Revenues	Amount	% of Total Revenues
Trade names	\$ 0.4	0.1%	\$ 0.4	0.1%
Non-compete agreements	0.4	0.1	0.5	0.1
Customer relationships	1.6	0.3	1.7	0.3
Total amortization expense	\$ 2.4	0.5%	\$ 2.6	0.5%

Amortization expense increased \$0.2 million for the three months ended December 31, 2011, compared to the three months ended December 31, 2010 as a result of the Chem Rx and other pharmacy acquisitions having a full quarter impact in 2011 and only partial quarter in 2010.

**Integration, Merger and Acquisition Related Costs and Other Charges (Dollars in millions, except per share amounts)**

	Quarter Ended	
	December 31, 2010	December 31, 2011
<b>Integration costs and other charges:</b>		
Tender offer costs	\$	\$ 1.7
Professional and advisory fees	0.1	0.3
General and administrative	0.2	
Employee costs	0.1	
Facility costs	0.2	
Other costs	(0.1)	
	0.5	2.0
<b>Acquisition related costs:</b>		
Professional and advisory fees	2.4	0.8
General and administrative	0.4	0.1
Employee costs	0.2	0.4
Severance costs		0.1
Facility costs		0.2
Contingent Consideration	(1.7)	
Other		0.1
	1.3	1.7
Total integration, merger related costs and other charges	\$ 1.8	\$ 3.7
Negative effect on earnings per diluted common share	\$ (0.04)	\$ (0.07)

The Corporation incurred integration, costs and other charges during the three months ended December 31, 2010 and 2011 related to costs to convert data and integrate systems. Integration costs and other charges increased \$1.5 million for the three months ended December 30, 2011 compared to the three months ended December 31, 2010.

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The Corporation has incurred various expenses as a result of Omnicare's unsolicited tender offer including legal, investment banking and other fees. During the three months ended December 31, 2011, \$1.7 million of



**Table of Contents**

tender offer costs were incurred. The Corporation anticipates that significant additional tender offer costs will continue to be incurred through the duration of the tender offer; however, the amount of these expenses cannot be reasonably estimated.

Acquisition costs were higher in the three months ended December 31, 2011 compared to three months ended December 31, 2010 due to the continuing costs associated with the Chem Rx and other pharmacy acquisitions, along with the \$1.7 million reversal for the contingent consideration in 2010.

**Interest Expense (Dollars in millions)**

	Quarter Ended	
	December 31, 2010 Amount	December 31, 2011 Amount
<b>Interest expense, net:</b>		
Term Debt	\$ 0.7	\$ 2.0
Revolving credit facility	0.1	0.4
<b>Subtotal (including commitment fees and letters of credit fees)</b>	0.8	2.4
<b>Other:</b>		
Interest expense (income)		
Amortization of deferred financing fees	0.2	0.1
<b>Total interest expense, net</b>	\$ 1.0	\$ 2.5
<b>Interest rate (excluding applicable margin):</b>		
Average interest rate on variable term debt	0.26%	0.29%
LIBOR 1 month, at beginning of period	0.26%	0.24%
LIBOR 1 month, at end of period	0.26%	0.30%
LIBOR 3 months, at beginning of period	0.29%	0.37%
LIBOR 3 months, at end of period	0.30%	0.58%

Interest expense increased \$1.5 million for the three months ended December 31, 2011, compared to the three months ended December 31, 2010, due to the increase in long-term debt and the revolving credit facility, along with higher interest rates during the period. The Corporation's interest rate on its borrowings increased from LIBOR plus 1.0% at December 31, 2010 to LIBOR plus 2.75% at December 31, 2011 due to the Corporation's refinancing activities in the second quarter of 2011, which paid off the 2007 credit agreement and replaced it with the new Credit Agreement dated as of May 2, 2011. Long-term debt, including current portion, was \$245.6 million and \$300.0 million as of December 31, 2010 and December 31, 2011, respectively.

**Tax Provision (Dollars in millions)**

	Quarter Ended	
	December 31, 2010 Amount	December 31, 2011 Amount
Tax provision	\$ 3.2	\$ 5.7
Total provision as a percentage of pre-tax income	39.6%	41.8%

Our effective tax rate for the three months ended December 31, 2011 was 41.8%, comprised of the 35.0% federal rate, 4.5% for the state rate, and 2.3% for the permanent differences and other discrete items. Our effective tax rate for the three months ended December 31, 2010 was 39.6%, comprised of the 35.0% federal rate, 4.6% for the state rate, and no net impact for the permanent differences and other discrete items. Excluding the impact of the discrete items, our effective tax rates would have been 40.5% and 40.4% for the three months ended December 31, 2011 and December 31, 2010, respectively.



**Table of Contents****Liquidity and Capital Resources**

The following compares the Corporation's Statement of Cash Flows for the quarters ended December 31, 2010 and 2011 (dollars in millions):

	Quarter Ended	
	December 31, 2010	December 31, 2011
Cash flows provided by (used in) operating activities:		
Net income	\$ 4.7	\$ 7.9
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	4.7	5.2
Amortization	2.4	2.6
Integration, merger and acquisition related costs and other charges		0.3
Stock-based compensation	1.5	1.4
Amortization of deferred financing fees	0.2	0.1
Deferred income taxes	3.2	4.1
Loss on disposition of equipment	0.1	(0.2)
Other		0.4
Change in operating assets and liabilities:		
Accounts receivable, net	7.1	11.3
Inventory	3.6	(9.2)
Prepays and other assets	(0.2)	(2.8)
Accounts payable	10.8	(3.7)
Salaries, wages and other compensation	(5.9)	(0.5)
Other accrued and long-term liabilities	(2.8)	(2.4)
<b>Net cash provided by operating activities</b>	<b>29.4</b>	<b>14.5</b>
Cash flows provided by (used in) investing activities:		
Purchase of equipment and leasehold improvements	(3.8)	(3.8)
Acquisitions, net of cash acquired	(117.1)	(42.5)
Cash proceeds from sale of assets	0.1	0.1
<b>Net cash used in investing activities</b>	<b>(120.8)</b>	<b>(46.2)</b>
Cash flows provided by (used in) financing activities:		
Net Activity of long-term revolving credit facility	5.6	39.0
Repayments of capital lease obligations	(0.2)	(0.1)
Issuance of common stock		
Treasury stock at cost	(0.1)	(0.1)
Tax benefit from stock-based compensation	0.2	
<b>Net cash provided by financing activities</b>	<b>5.5</b>	<b>38.8</b>
Change in cash and cash equivalents	(85.9)	7.1
Cash and cash equivalents at beginning of period	96.7	10.3
<b>Cash and cash equivalents at end of period</b>	<b>\$ 10.8</b>	<b>\$ 17.4</b>
Supplemental information:		
Cash paid for interest	\$ 0.9	\$ 2.5
Cash paid for taxes	\$	\$ 0.4



**Table of Contents**

Cash provided by operating activities would have been \$31.8 million for the three months ended December 31, 2011, as adjusted for the items shown in the table below. Cash provided by operating activities decreased as a result of an increase in inventory purchases and an increase in rebate receivable. The increase in inventory is a result of the Corporation implementing changes in its branded pharmaceutical purchasing practices and the increase in rebates receivable relates to the AmerisourceBergen Amended Prime Vendor Agreement.

	Quarter Ended	
	December 31, 2010	December 31, 2011
Net cash provided by operating activities	\$ 29.4	\$ 14.5
Increase in inventory due to branded pharmaceutical purchasing practices and rebate receivables due from AmerisourceBergen		17.3
Adjusted cash provided by operating activities	\$ 29.4	\$ 31.8

**Following Represents the Fourth Quarter 2011 Results compared to the Third Quarter 2011**

**Results of Operations**

The following table presents selected consolidated comparative results of operations and statistical information for the periods presented (dollars in millions, except where indicated):

	September 30, 2011		Quarter Ended Increase (Decrease)		December 31, 2011	
	Amount	% of Total Revenues			Amount	% of Total Revenues
<b>Net revenues:</b>						
Institutional Pharmacy	\$ 503.0	97.0%	\$ (23.0)	(4.6)%	\$ 480.0	96.9%
Hospital Management	15.7	3.0	(0.1)	(0.6)	15.6	3.1
Total net revenues	518.7	100.0	(23.1)	(4.5)	495.6	100.0
<b>Cost of goods sold:</b>						
Institutional Pharmacy	429.6	82.8	(23.7)	(5.5)	405.9	81.9
Hospital Management	13.8	2.7			13.8	2.8
Total cost of goods sold	443.4	85.5	(23.7)	(5.3)	419.7	84.7
<b>Gross profit:</b>						
Institutional Pharmacy	73.4	14.2	0.7	1.0	74.1	15.0
Hospital Management	1.9	0.3	(0.1)	(5.3)	1.8	0.3
Total gross profit	\$ 75.3	14.5%	\$ 0.6	0.8%	\$ 75.9	15.3%
<b><i>Institutional Pharmacy (in whole numbers except where indicated)</i></b>						
<b>Volume information</b>						
Prescriptions dispensed (in thousands)	10,357		(413)	(4.0)%	9,944	
Revenue per prescription dispensed	\$ 48.57		\$ (0.30)	(0.6)%	\$ 48.27	
Gross profit per prescription dispensed	\$ 7.09		\$ 0.36	5.1%	\$ 7.45	

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Institutional pharmacy gross margin	14.6%	0.80	5.5%	15.4%
Generic dispensing rate	78.3%	0.1	0.1%	78.4%
<b>Customer licensed beds under contract</b>				
Beginning of period	353,024	(10,925)	(3.1)%	342,099
Additions PharMerica Corporation	3,229	10,119	313.4	13,348
Additions Chem Rx	905	42	4.6	947
Losses PharMerica Corporation	(13,561)	(1,056)	(7.8)	(14,617)
Losses Chem Rx	(1,498)	(781)	(52.1)	(2,279)
End of period	342,099	(2,601)	(0.8)%	339,498
<b><i>Hospital Management (in whole numbers except where indicated)</i></b>				
<b>Volume information</b>				
Hospital management contracts serviced	90	1.0	1.1%	91

**Table of Contents****Revenues**

Institutional pharmacy revenues decreased \$23.0 million for the three months ended December 31, 2011 compared to the three months ended September 30, 2011, due primarily to the decline in customer licensed beds of 2,601. The decrease of \$23.0 million resulted from an unfavorable volume variance of approximately \$20.0 million or 413,000 less prescriptions dispensed and an unfavorable rate variance of approximately \$3.0 million or \$0.30 decrease per prescription dispensed. The rate variance was comprised of approximately \$0.3 million due to deflation on drugs dispensed between periods and by \$2.7 million due to the increase in the generic dispensing rate from 78.3% to 78.4% and certain pricing concessions.

The decrease in hospital management revenues of \$0.1 million for the three months ended December 31, 2011 compared to the three months ended September 30, 2011 was primarily due to an overall reduction in pass through costs partially offset by an increase in the number of contracts serviced.

**Cost of Goods Sold**

Institutional pharmacy cost of goods sold decreased \$23.7 million for the three months ended December 31, 2011 compared to the three months ended September 30, 2011 primarily due to a decrease in overall total drug costs as a percent of revenues of 105 bps due primarily to the increased generic dispensing rate, which has improved margins, and higher generic rebates as a result of the Amended Prime Vendor Agreement. Other costs included in cost of goods sold increased as a percentage of revenues 25 bps.

Hospital management cost of goods sold remained unchanged for the three months ended December 31, 2011 as compared to the three months ended September 30, 2011.

**Gross Profit and Operating Expenses**

Gross profit and other operating expenses were the following for the periods presented (dollars in millions):

	September 30, 2011		Quarter Ended Increase (Decrease)		December 31, 2011	
	Amount	% of Total Revenues			Amount	% of Total Revenues
<b>Gross profit and operating expenses:</b>						
Total gross profit	\$ 75.3	14.5%	\$ 0.6	0.8%	\$ 75.9	15.3%
Selling, general and administrative expenses	54.7	10.5	(1.2)	(2.2)	53.5	10.8
Amortization expense	3.0	0.6	(0.4)	(13.3)	2.6	0.5
Impairment of intangible assets	5.1	1.0	(5.1)	(100.0)		
Integration, merger related costs and other charges	1.8	0.3	1.9	105.6	3.7	0.7
Interest expense, net	2.6	0.5	(0.1)	(3.8)	2.5	0.5
Income before provision for income taxes	8.1	1.6	5.5	67.9	13.6	2.8
Provision for income taxes	3.3	0.6	2.4	72.7	5.7	1.2
Net income	\$ 4.8	1.0%	\$ 3.1	64.6%	\$ 7.9	1.6%

Institutional pharmacy gross profit for the three months ended December 31, 2011 was \$74.1 million or \$7.45 per prescription dispensed compared to \$73.4 million or \$7.09 per prescription dispensed for the three months ended September 30, 2011. The increase in gross profit was due primarily to the increase in generic rebates for the period due to the additional brand to generic conversions. Institutional pharmacy gross profit margin for the three months ended December 31, 2011 was 15.4% compared to 14.6% for the three months

**Table of Contents**

ended September 30, 2011. Gross profit margin was positively impacted by higher generic rebates and better pricing terms as a result of the Amended Prime Vendor Agreement partially offset by certain pricing concessions.

Hospital management gross profit decreased \$0.1 million for the three months ended December 31, 2011 as compared to the three months ended September 30, 2011 due to the decrease in revenue referred to above.

**Selling, General and Administrative Expenses (Dollars in millions)**

	September 30, 2011		Quarter Ended Increase (Decrease)		December 31, 2011	
	Amount	% of Total Revenues	Amount	% of Total Revenues	Amount	% of Total Revenues
<b>Selling, general and administrative expenses:</b>						
Total wages, benefits and contract labor	\$ 28.7	5.5%	\$ (3.4)	(11.8)%	\$ 25.3	5.1%
Contracted services	3.8	0.7	(0.1)	(2.6)	3.7	0.7
Provision for doubtful accounts	6.4	1.2	0.8	12.5	7.2	1.5
Supplies	1.4	0.3	0.3	21.4	1.7	0.3
Travel expenses	1.2	0.2	0.2	16.7	1.4	0.3
Professional fees	3.8	0.7	0.4	10.5	4.2	0.9
Stock-based compensation	1.3	0.3	0.1	7.7	1.4	0.3
Depreciation	2.3	0.4	0.2	8.7	2.5	0.5
Rent	1.2	0.2	(0.2)	(16.7)	1.0	0.2
Maintenance	0.6	0.1			0.6	0.1
Other costs	4.0	0.9	0.5	12.5	4.5	0.9
<b>Total selling general and administrative expenses</b>	<b>\$ 54.7</b>	<b>10.5%</b>	<b>\$ (1.2)</b>	<b>(2.2)%</b>	<b>\$ 53.5</b>	<b>10.8%</b>

Selling, general and administrative expenses decreased \$1.2 million for the three months ended December 31, 2011, compared to the three months ended September 30, 2011. The decrease of \$1.2 million is due primarily to a decrease in salaries and wages expense of \$3.4 million and rent costs of \$0.2 million, partially offset by increase in bad debt expense of \$0.8 million. Professional fees also increased \$0.4 million due to the increase in legal related fees. All other costs included in selling, general and administrative expenses increased approximately \$1.2 million.

**Depreciation and Amortization (Dollars in millions)**

Depreciation expense for the periods presented is as follows:

	September 30, 2011		Quarter Ended Increase (Decrease)		December 31, 2011	
	Amount	% of Total Revenues	Amount	% of Total Revenues	Amount	% of Total Revenues
Leasehold improvements	\$ 0.4	0.1%	\$ 0.5	0.1%		
Equipment and software	4.3	0.8	4.4	0.9		
Leased equipment	0.1	NM	0.3	NM		
<b>Total depreciation expense</b>	<b>\$ 4.8</b>	<b>0.9%</b>	<b>\$ 5.2</b>	<b>1.0%</b>		
Depreciation expense recorded in cost of goods sold	\$ 2.5	0.5%	\$ 2.7	0.5%		
Depreciation expense recorded in selling, general & administrative expenses	2.3	0.4	2.5	0.5		



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Total depreciation expense	\$ 4.8	0.9%	\$ 5.2	1.0%
Total capital expenditures	\$ 3.2	0.6%	\$ 3.8	0.8%

**Table of Contents**

Depreciation expense increased \$0.4 million for the three months ended December 31, 2011, compared to the three months ended September 30, 2011.

Amortization expense related to certain identifiable intangibles for the periods presented is as follows:

	Quarter Ended			
	September 30, 2011		December 31, 2011	
	Amount	% of Revenues	Amount	% of Revenues
Trade names	\$ 0.4	0.1%	\$ 0.4	0.1%
Non-compete agreements	0.5	0.1	0.5	0.1
Customer relationships	2.1	0.4	1.7	0.3
Total amortization expense	\$ 3.0	0.6%	\$ 2.6	0.5%

Amortization expense decreased \$0.4 million for the three months ended December 31, 2011, compared to the three months ended September 30, 2011 as a result of certain intangibles impaired in the third quarter 2011, therefore no amortization expense was recognized in the fourth quarter 2011 on those intangibles.

**Impairment of Intangible Assets**

During the third quarter of 2011, the Corporation recorded a pre-tax impairment charge of \$5.1 million related to finite-lived customer relationships. The impairment, which related to the Institutional Pharmacy Segment, was incurred as the result of non-renewal of certain customer contracts. The impairment was related to intangible assets acquired in an acquisition during the year ended December 31, 2005. These asset groups were assessed for recoverability and management determined the finite-lived customer relationship assets to be impaired. No other assets within the asset groups were deemed impaired. Using a discounted cash flow analysis, the Corporation determined the pre-tax impairment charge of \$5.1 million was required to write the carrying value down to fair value, resulting in a loss per diluted common share impact of \$0.11. The Corporation recognized the impairment as a permanent write-down of the cost basis and accumulated amortization of the affected assets.

**Integration, Merger and Acquisition Related Costs and Other Charges (Dollars in millions, except per share amounts)**

	Quarter Ended	
	September 30, 2011	December 31, 2011
<b>Integration costs and other charges:</b>		
Pre-Pharmacy Transaction litigation matters	\$ (2.0)	\$
Tender offer costs	1.1	1.7
Professional and advisory fees	0.2	0.3
Facility costs	0.3	
Other costs	0.1	
	(0.3)	2.0
<b>Acquisition related costs:</b>		
Professional and advisory fees	0.9	0.8
General and administrative	0.1	0.1
Employee costs	0.5	0.4
Severance costs	0.2	0.1
Facility costs	0.3	0.2
Other costs	0.1	0.1

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	2.1	1.7
Total integration, merger and acquisition related costs and other charges	\$ 1.8	\$ 3.7
Negative effect on earnings per diluted share	\$ (0.04)	\$ (0.07)

**Table of Contents**

The Corporation incurred integration, costs and other charges during the three months ended December 31, 2011 and September 30, 2011 related to costs to convert data and integrate systems. Integration costs and other charges increased \$2.3 million for the three months ended December 30, 2011 compared to the three months ended September 30, 2011. During the second quarter of 2010, the Corporation recorded an estimated liability of \$5.0 million related to certain claims arising from time periods prior to July 31, 2007. During the third quarter of 2011, the Corporation was informed that one claim would not be pursued. Therefore, the Corporation reversed \$2.0 million of the estimated liability recorded in the third quarter 2010.

Acquisition costs were lower in the three months ended December 31, 2011 compared to three months ended September 30, 2011 due to the timing of the costs associated with the pharmacy acquisition in the fourth quarter 2011.

The Corporation has incurred various expenses as a result of Omnicare's unsolicited tender offer including legal, investment banking and other fees. During the three months ended September 30, 2011 and December 31, 2011 \$1.1 million and \$1.7 million, respectively, of tender offer costs were incurred. The Corporation anticipates that significant additional tender offer costs will continue to be incurred through the duration of the tender offer; however, the amount of these expenses cannot be reasonably estimated.

**Interest Expense (Dollars in millions)**

	Quarter Ended	
	September 30, 2011	December 31, 2011
<b>Interest expense, net:</b>		
Term Debt	\$ 1.8	\$ 2.0
Revolving credit facility	0.6	0.4
Subtotal (including commitment fees and letters of credit fees)	2.4	2.4
<b>Other:</b>		
Interest expense (income)		
Amortization of deferred financing fees	0.2	0.1
<b>Total interest expense, net</b>	<b>\$ 2.6</b>	<b>\$ 2.5</b>
<b>Interest rate (excluding applicable margin):</b>		
Average interest rate on variable term debt	0.49%	0.29%
LIBOR 1 month, at beginning of period	0.19%	0.24%
LIBOR 1 month, at end of period	0.24%	0.30%
LIBOR 3 months, at beginning of period	0.25%	0.37%
LIBOR 3 months, at end of period	0.37%	0.58%

Interest expense decreased \$0.1 million for the three ended December 31, 2011, compared to the three months ended September 30, 2011 due to fewer borrowings on the revolving credit facility through the period.

**Tax Provision (Dollars in millions)**

	Quarter Ended	
	September 30, 2011	December 31, 2011
Tax provision	\$ 3.3	\$ 5.7
Total provision as a percentage of pre-tax income	40.9%	41.8%

**Table of Contents**

Our effective tax rate for the three months ended December 31, 2011 was 41.8%, comprised of the 35.0% federal rate, 4.5% for the state rate, and 2.3% for the permanent differences and other discrete items. Our effective tax rate for the three months ended September 30, 2011 was 40.9%, comprised of the 35.0% federal rate, 4.5 % for the state rate, and 1.4% for the permanent differences and other discrete items.

The effective rate, excluding the discrete items, for the period ended December 31, 2011 would have been 40.5%, comprised of the 35.0% federal rate, 4.5 % for the state rate, and 1.0% for permanent items. The rate for the period ended September 30, 2011 was unfavorably impacted by certain discrete items without which the effective rate would have been 40.5%.

**Liquidity and Capital Resources**

The following compares the Corporation's Statement of Cash Flows for the three months ended September 30, 2011 and December 31, 2011 (dollars in millions):

	Quarter Ended	
	September 30, 2011	December 31, 2011
<b>Cash flows provided by (used in) operating activities:</b>		
Net income	\$ 4.8	\$ 7.9
<b>Adjustments to reconcile net income to net cash provided by (used in) operating activities:</b>		
Depreciation	4.8	5.2
Amortization	3.0	2.6
Impairment charge	5.1	
Integration, merger and acquisition related costs and other charges	0.5	0.3
Stock-based compensation	1.3	1.4
Amortization of deferred financing fees	0.2	0.1
Deferred income taxes	2.9	4.1
Loss on disposition of equipment	0.1	(0.2)
Other	(0.2)	0.4
<b>Change in operating assets and liabilities:</b>		
Accounts receivable, net	6.1	11.3
Inventory	10.8	(9.2)
Prepays and other assets	1.9	(2.8)
Accounts payable	(28.3)	(3.7)
Salaries, wages and other compensation	(0.9)	(0.5)
Other accrued and long-term liabilities	(0.1)	(2.4)
<b>Net cash provided by operating activities</b>	<b>12.0</b>	<b>14.5</b>
<b>Cash flows provided by (used in) investing activities:</b>		
Purchase of equipment and leasehold improvements	(3.2)	(3.8)
Acquisitions, net of cash acquired		(42.5)
Proceeds from sale of assets	0.1	0.1
<b>Net cash used in investing activities</b>	<b>(3.1)</b>	<b>(46.2)</b>
<b>Cash flows provided by (used in) financing activities:</b>		
Net Activity of long-term revolving credit facility	(13.0)	39.0
Repayments of capital lease obligations	(0.3)	(0.1)
Issuance of common stock	0.1	
Treasury stock at cost		(0.1)
<b>Net cash (used in) provided by financing activities</b>	<b>(13.2)</b>	<b>38.8</b>
<b>Change in cash and cash equivalents</b>	<b>(4.3)</b>	<b>7.1</b>

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Cash and cash equivalents at beginning of period	14.6	10.3
Cash and cash equivalents at end of period	\$ 10.3	\$ 17.4
Supplemental information:		
Cash paid for interest	\$ 2.6	\$ 2.5
Cash paid (refund) for taxes	\$ (0.2)	\$ 0.4

**Table of Contents**

Cash provided by operating activities would have been \$31.8 million for the three months ended December 31, 2011 as compared to \$30.6 million for the three months ended September 30, 2011, as adjusted for the items shown in the table below. Cash provided by operating activities increased \$29.6 million for the three months ended December 31, 2011 as compared to the three months ended September 30, 2011 due to an additional payment made to AmerisourceBergen in the third quarter. Cash provided by operating activities decreased during the fourth quarter of 2011 due to an increase in inventory purchases as a result of the Corporation implementing changes in its branded pharmaceutical purchasing practices, whereas in the third quarter of 2011 inventory purchases decreased. Cash provided by operating activities also decreased for the three months ended December 31, 2011 and September 30, 2011, due to an increase in rebate receivables relating to the AmerisourceBergen Amended Prime Vendor Agreement. As shown in the table below, cash from operating activities adjusted for these items would have aggregated \$31.8 million as compared to \$30.6 million for the three months ended December 31, 2011 and September 30, 2011, respectively.

	Quarter Ended	
	September 30, 2011	December 31, 2011
Net cash provided by operating activities	\$ 12.0	\$ 14.5
Additional payment to AmerisourceBergen due to additional Friday	29.6	
(Decrease) Increase in inventory due to branded pharmaceutical purchasing practices and increase in rebate receivables due from AmerisourceBergen	(11.0)	17.3
Adjusted cash provided by operating activities	\$ 30.6	\$ 31.8

**Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

On May 2, 2011, the Corporation entered into the Credit Agreement. The Credit Agreement replaced the \$425.0 million five-year credit agreement dated as of July 31, 2007. The Credit Agreement consists of a \$250.0 million term loan facility and a \$200.0 million revolving credit facility. Borrowings under the Credit Agreement bear interest at a floating rate equal to, at the Corporation's option, a base rate plus a margin between 1.25% and 2.00% per annum, or an adjusted LIBO Rate plus a margin between 2.25% and 3.00% per annum, in each case depending on the leverage ratio of the Corporation as defined by the Credit Agreement. The base rate is the greater of the prime lending rate in effect on such day, the federal funds effective rate published by the Federal Reserve Bank of New York on such day plus 0.5%, and the adjusted LIBO Rate for deposits for a period equal to one month plus 1.0%. As of December 31, 2011, borrowing under the Credit Agreement bore interest at a rate of 3.05% per annum based upon the one month adjusted LIBO rate and the revolving credit facility bore interest at a rate of 5.00% per annum based upon the prime rate.

Based upon the amount of variable rate debt outstanding as of December 31, 2011, a 100 basis point change in interest rates would affect the Corporation's future pre-tax earnings by approximately \$3.0 million on an annual basis. The estimated change to the Corporation's interest expense is determined by considering the impact of hypothetical interest rates on the Corporation's borrowing cost and debt balances. These analyses do not consider the effects, if any, of the potential changes in the Corporation's credit ratings or leverage and the overall level of economic activity of the Corporation. Further, in the event of a change of significant magnitude, the Corporation's management would expect to take actions intended to further mitigate its exposure to such change.

**Table of Contents**

**Item 8. Financial Statements and Supplementary Data**

**Index to Consolidated Financial Statements**

<u>Reports of Independent Registered Public Accounting Firms</u>	F-2
<u>Consolidated Income Statements for the years ended December 31, 2009, 2010 and 2011</u>	F-5
<u>Consolidated Balance Sheets as of December 31, 2010 and 2011</u>	F-6
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2009, 2010 and 2011</u>	F-7
<u>Consolidated Statements of Stockholders' Equity for the years ended December 31, 2009, 2010 and 2011</u>	F-8
<u>Notes to Consolidated Financial Statements for the years ended December 31, 2009, 2010 and 2011</u>	F-9

F-1



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**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

PharMerica Corporation:

We have audited the accompanying consolidated balance sheets of PharMerica Corporation and subsidiaries (the Corporation) as of December 31, 2010 and 2011, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the two year period ended December 31, 2011. We also have audited the Corporation's internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Corporation's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Corporation's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PharMerica Corporation and subsidiaries as of December 31, 2010 and 2011, and the results of their operations and their cash flows for each of the years in the two year period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles. Also in our opinion, PharMerica Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

**Table of Contents**

As described in Management's Annual Report on Internal Control over Financial Reporting under Item 9A, management has excluded the Pharmacy Management Group acquisition from its assessment of internal control over financial reporting as of December 31, 2011 because it was acquired by the Corporation on December 31, 2011. We have also excluded the Pharmacy Management Group acquisition from our audit of internal control over financial reporting. The total assets of Pharmacy Management Group represent 5.7% of the related consolidated balance sheet amount as of December 31, 2011.

/s/ KPMG LLP

Louisville, Kentucky

February 9, 2012

F-3

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of

PharMerica Corporation:

In our opinion, the consolidated statements of income, shareholders' equity and cash flows for the year ended December 31, 2009 present fairly, in all material respects, the results of operations and cash flows of PharMerica Corporation and its subsidiaries for the year ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

Louisville, Kentucky

February 4, 2010

F-4

**Table of Contents****PHARMERICA CORPORATION****CONSOLIDATED INCOME STATEMENTS****For the Years Ended December 31, 2009, 2010 and 2011****(In millions, except share and per share amounts)**

	<b>2009</b>	<b>2010</b>	<b>2011</b>
Revenues	\$ 1,841.2	\$ 1,847.3	\$ 2,081.1
Cost of goods sold	1,565.7	1,607.0	1,787.8
Gross profit	275.5	240.3	293.3
Selling, general and administrative expenses	190.8	180.6	214.9
Amortization expense	9.0	9.3	11.0
Impairment of intangible assets			5.1
Integration, merger and acquisition related costs and other charges	5.2	14.6	15.3
Operating income	70.5	35.8	47.0
Interest expense, net	9.4	3.6	8.8
Income before income taxes	61.1	32.2	38.2
Provision for income taxes	18.9	13.0	14.8
Net income	\$ 42.2	\$ 19.2	\$ 23.4
<b>Earnings per common share:</b>			
Basic	\$ 1.39	\$ 0.64	\$ 0.80
Diluted	\$ 1.39	\$ 0.64	\$ 0.79
<b>Shares used in computing earnings per common share:</b>			
Basic	30,266,272	30,007,268	29,343,221
Diluted	30,402,768	30,133,031	29,468,452

See accompanying Notes to Consolidated Financial Statements

**Table of Contents**

**PHARMERICA CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

As of December 31, 2010 and 2011

(In millions, except share and per share amounts)

	(As Adjusted) December 31, 2010	December 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 10.8	\$ 17.4
Accounts receivable, net	236.9	232.4
Inventory	88.4	130.5
Deferred tax assets, net	23.5	36.5
Prepays and other assets	24.6	34.5
	384.2	451.3
Equipment and leasehold improvements	136.0	145.0
Accumulated depreciation	(76.5)	(92.6)
	59.5	52.4
Deferred tax assets, net	28.7	0.6
Goodwill	179.4	214.2
Intangible assets, net	102.2	100.2
Other	5.7	14.7
	\$ 759.7	\$ 833.4
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 74.2	\$ 54.1
Salaries, wages and other compensation	22.0	35.1
Current portion of long-term debt		6.3
Other accrued liabilities	7.1	6.7
	103.3	102.2
Long-term debt	245.6	293.7
Other long-term liabilities	26.4	23.7
Commitments and contingencies (See Note 6)		
Stockholders' equity:		
Preferred stock, \$0.01 par value per share; 1,000,000 shares authorized and no shares issued, December 31, 2010 and 2011		
Common stock, \$0.01 par value per share; 175,000,000 shares authorized; 30,696,261 and 30,794,000 shares issued as of December 31, 2010 and 2011, respectively	0.3	0.3
Capital in excess of par value	349.7	355.9
Retained earnings	45.0	68.4
Treasury stock at cost, 1,336,817 and 1,350,128 shares at December 31, 2010 and December 31, 2011, respectively	(10.6)	(10.8)

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	384.4	413.8
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	\$ 759.7	\$ 833.4
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See accompanying Notes to Consolidated Financial Statements

F-6

**Table of Contents****PHARMERICA CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS****For the Years Ended December 31, 2009, 2010 and 2011****(In millions)**

	2009	2010	2011
<b>Cash flows provided by (used in) operating activities:</b>			
Net income	\$ 42.2	\$ 19.2	\$ 23.4
<b>Adjustments to reconcile net income to net cash provided by (used in) operating activities:</b>			
Depreciation	18.0	18.8	20.1
Amortization	9.0	9.3	11.0
Impairment charge			5.1
Integration, merger and acquisition related costs and other charges	0.4	0.6	1.5
Stock-based compensation	4.6	4.8	5.9
Amortization of deferred financing fees	0.4	0.6	0.8
Deferred income taxes	19.7	12.3	13.9
Loss on disposition of equipment	0.3	0.3	0.1
Other	(0.3)		0.2
<b>Change in operating assets and liabilities:</b>			
Accounts receivable, net	11.3	28.4	9.1
Inventory	(2.4)	8.1	(38.3)
Prepays and other assets	(6.2)	4.6	(9.7)
Accounts payable	(1.2)	1.5	(25.0)
Salaries, wages and other compensation	(9.8)	(11.2)	11.1
Other accrued liabilities	(1.0)	0.9	(2.4)
<b>Net cash provided by operating activities</b>	<b>85.0</b>	<b>98.2</b>	<b>26.8</b>
<b>Cash flows provided by (used in) investing activities:</b>			
Purchase of equipment and leasehold improvements	(21.6)	(12.6)	(13.2)
Acquisitions, net of cash acquired	(54.7)	(120.7)	(51.0)
Cash proceeds from sale of assets	0.1	0.1	0.2
Other	0.1		
<b>Net cash used in investing activities</b>	<b>(76.1)</b>	<b>(133.2)</b>	<b>(64.0)</b>
<b>Cash flows provided by (used in) financing activities:</b>			
Repayments of long-term debt			(240.0)
Proceeds from long-term debt			250.0
Net activity of long-term revolving credit facility		5.6	44.4
Payment of debt issuance costs			(9.8)
Repayments of capital lease obligations	(0.6)	(0.7)	(0.8)
Issuance of common stock	1.4	0.3	0.2
Treasury stock at cost		(10.6)	(0.2)
Tax benefit from stock-based compensation	0.2		
<b>Net cash provided by (used in) financing activities</b>	<b>1.0</b>	<b>(5.4)</b>	<b>43.8</b>
<b>Change in cash and cash equivalents</b>	<b>9.9</b>	<b>(40.4)</b>	<b>6.6</b>
Cash and cash equivalents at beginning of period	41.3	51.2	10.8

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Cash and cash equivalents at end of period	\$ 51.2	\$ 10.8	\$ 17.4
Supplemental information:			
Cash paid for interest	\$ 11.2	\$ 3.2	\$ 7.6
Cash paid for taxes	\$ 1.6	\$ 0.4	\$ 0.5
Supplemental schedule of non-cash activities:			
Fair value of assets acquired	\$ (1.5)	\$	\$
Capital lease obligations	\$ 1.8	\$ 0.4	\$

See accompanying Notes to Consolidated Financial Statements

F-7



**Table of Contents**

**PHARMERICA CORPORATION**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

**For the Years Ended December 31, 2009, 2010 and 2011**

(In millions, except share amounts)

	Common Stock		Capital in Excess of Par Value	Accumulated Other Comprehensive Income (Loss)	Retained (Deficit) Earnings	Treasury Stock	Total
	Shares	Amount					
Balance at December 31, 2008	30,477,558	\$ 0.3	\$ 338.7	\$ (2.8)	\$ (16.4)	\$	\$ 319.8
Comprehensive income:							
Net income					42.2		42.2
Change in fair value of interest rate swap, net				2.8			2.8
Total comprehensive income				2.8	42.2		45.0
Grant and forfeiture of non-vested restricted stock							
	34,964						
Exercise of stock options	107,308		1.4				1.4
Stock-based compensation non-vested restricted stock			2.5				2.5
Stock-based compensation stock options			2.1				2.1
Income tax benefit in connection with the issuance of common stock under stock-based compensation plans			0.1				0.1
Balance at December 31, 2009	30,619,830	\$ 0.3	\$ 344.8	\$	\$ 25.8	\$	\$ 370.9
Comprehensive income:							
Net income					19.2		19.2
Total comprehensive income					19.2		19.2
Exercise of stock options and tax components of stock-based awards, net							
	22,072		0.1				0.1
Vested restricted stock units	49,664						
Vested performance share units	4,695						
Treasury stock at cost	(1,336,817)					(10.6)	(10.6)
Stock-based compensation non-vested restricted stock			2.2				2.2
Stock-based compensation stock options			2.6				2.6
Balance at December 31, 2010	29,359,444	\$ 0.3	\$ 349.7	\$	\$ 45.0	\$ (10.6)	\$ 384.4
Comprehensive income:							
Net income					23.4		23.4
Total comprehensive income					23.4		23.4
Exercise of stock options and tax components of stock-based awards, net							
	18,713		0.3				0.3

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Vested restricted stock units	79,026								
Treasury stock at cost	(13,311)							(0.2)	(0.2)
Stock-based compensation non-vested restricted stock									
								3.5	3.5
Stock-based compensation stock options								2.4	2.4
Balance at December 31, 2011	29,443,872	\$ 0.3	\$ 355.9	\$	\$ 68.4	\$ (10.8)			\$ 413.8

See accompanying Notes to Consolidated Financial Statements

F-8

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**Table of Contents**

**PHARMERICA CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Nature of Business*

PharMerica Corporation (the Corporation) is an institutional pharmacy services company that services healthcare facilities and provides pharmacy management services to hospitals. The Corporation is the second largest institutional pharmacy services company in the United States, operating 95 institutional pharmacies in 44 states. The Corporation's customers are typically institutional healthcare providers, such as nursing centers, assisted living facilities, hospitals and other long-term alternative care settings and generally the primary source of supply of pharmaceuticals to its customers. The Corporation also provides pharmacy management services to 91 hospitals in the United States.

*Principles of Consolidation*

All intercompany transactions have been eliminated.

*Use of Estimates*

The accompanying consolidated financial statements have been prepared in accordance with U.S. GAAP which requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosure of contingent liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates are involved in collectability of accounts receivable, revenue recognition, inventory valuation, supplier rebates, the valuation of long-lived assets and goodwill, accounting for income taxes and stock-based compensation. Actual amounts may differ from these estimates.

Potential risks and uncertainties, many of which are beyond the control of the Corporation, include, but are not necessarily limited to, such factors as the impact of Omnicare's unsolicited tender offer, the impact of litigation by Omnicare and other stockholders relating to Omnicare's unsolicited tender offer, overall economic, financial and business conditions; delays and reductions in reimbursement by the government and other payers to the Corporation and/or its customers; the overall financial condition of the Corporation's customers; the effect of new government regulations, executive orders and/or legislative initiatives, including those relating to reimbursement and drug pricing policies and changes in the interpretation and application of such policies; efforts by payers to control costs; the outcome of litigation; the outcome of audit, compliance, administrative or investigatory reviews, including governmental/regulatory inquiries; delays or difficulties in integrating acquired businesses; other contingent liabilities; changes in international economic and political conditions; changes in interest rates; changes in tax laws and regulations; access to capital and financing; the demand for the Corporation's products and services; pricing and other competitive factors in the industry; changes in manufacturers' rebate programs; shifts in demand for generic drug equivalents; changes in insurance claims experience and related assumptions; variations in costs or expenses; and changes in accounting rules and standards.

*Unsolicited Tender Offer by Omnicare*

On August 23, 2011, Omnicare, Inc. (Omnicare) made public an unsolicited proposal to acquire all of the outstanding shares of the Corporation's common stock for \$15.00 per share in cash. After careful consideration and consultation with the Corporation's financial and legal advisors, the Corporation's Board of Directors determined unanimously that Omnicare's proposal undervalues the Corporation and was not in the best interests of the Corporation's stockholders. On September 7, 2011, Omnicare, through its wholly-owned subsidiary, Philadelphia Acquisition Sub, Inc., commenced an unsolicited tender offer to purchase all of the outstanding shares of the Corporation's common stock at \$15.00 per share. On September 18, 2011, the Board again met with

**Table of Contents**

**PHARMERICA CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

its financial and legal advisors, and after careful consideration, the Corporation's Board of Directors again unanimously recommended that the Corporation's stockholders reject the offer and not tender their shares of the Corporation's common stock because the Corporation's Board of Directors believes that Omnicare's tender offer (i) undervalues the Corporation and its prospects, (ii) is illusory because it is subject to significant regulatory and other uncertainty, and (iii) is opportunistic based on the Corporation's then traded market value. On September 20, 2011, the Corporation filed with the Securities and Exchange Commission (SEC) a Recommendation/Solicitation Statement on Schedule 14D-9 detailing the recommendation of the Corporation's Board of Directors in response to Omnicare's tender offer and the reasons it rejected the offer. See Note 6 Commitments and Contingencies for a discussion of certain litigation commenced in respect of Omnicare's tender offer and related actions. On October 5, 2011, Omnicare extended the expiration date of its tender offer until 5:00 p.m., New York City time, on Friday, December 2, 2011, unless further extended. On December 5, 2011, Omnicare extended the expiration date of its tender offer until 5:00 p.m., New York City time, on Friday, January 20, 2012, unless further extended. On January 19, 2012, Omnicare extended the expiration date of its tender offer until 5:00 p.m., New York City time, on Friday, January 27, 2012, unless further extended. On January 27, 2012, Omnicare extended the expiration of its tender offer until 5:00 p.m., New York City time, on Friday, February 17, 2012, unless further extended.

On August 25, 2011, after careful consideration and consultation with the Corporation's financial and legal advisors, the Corporation's Board of Directors adopted a rights plan and authorized the execution of the Rights Agreement, dated August 25, 2011 (the Rights Agreement), between the Corporation and Mellon Investor Services LLC, as Rights Agent. On August 25, 2011, the Board of Directors of the Corporation declared a dividend of one preferred share purchase right (a Right) for each outstanding share of common stock, par value \$0.01 per share. The dividend was payable on September 6, 2011 to the stockholders of record on September 6, 2011. The Rights will expire on the earlier of August 25, 2021 or redemption by the Corporation. However, the rights will expire immediately at the final adjournment of the Corporation's 2012 annual meeting of stockholders if stockholder approval of the Rights Agreement has not been received prior to that time. The Rights Agreement is designed to prevent third parties from opportunistically acquiring the Corporation in a transaction that the Corporation's Board of Directors believes is not in the best interests of the Corporation's stockholders. In general terms, it works by imposing a significant penalty upon any person or group that acquires beneficial ownership of 15 percent or more of our outstanding common stock without the prior approval of the Corporation's Board of Directors. The Corporation's Board of Directors believes the Rights Agreement has helped the Corporation's stockholders at this time by effectively preventing Omnicare from opportunistically acquiring the Corporation at a price that the Corporation's Board of Directors believes is inadequate for the reasons discussed above. The Rights Agreement has been narrowly tailored in a manner that the Corporation's Board of Directors believes appropriately balances the interests of the Corporation's stockholders in connection with what the Corporation's Board of Directors considers an opportunistic, illusory and disadvantageous proposal, against the need to avoid excessive anti-takeover protections that ultimately may adversely impact stockholder value. The Rights Agreement should not interfere with any merger or other business combination approved by the Board of Directors.

Pursuant to the requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the regulations thereunder (the HSR Act), Omnicare filed a Notification and Report Form with the Antitrust Division of the U.S. Department of Justice (the Antitrust Division) and the Federal Trade Commission (the FTC) relating to its proposed acquisition of the Corporation on September 7, 2011. On or about September 19, 2011, the Corporation submitted a responsive Notification and Report Form with the Antitrust Division and the FTC. On September 22, 2011, the Corporation received a request for additional information from the FTC relating to the tender offer. On September 22, 2011, Omnicare also received a request for additional information from the FTC relating to the tender offer (the Second Request). The Second Request

**Table of Contents**

**PHARMERICA CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

extended the waiting period under the HSR Act for 10 calendar days after the date Omnicare certified substantial compliance with the Second Request issued to Omnicare. On September 30, 2011, the FTC also issued a subpoena and civil investigative demand to the Corporation covering the same subject matter as the Second Request. The Corporation has produced a considerable amount of material in response to the FTC requests.

On November 18, 2011 Omnicare certified to the FTC that it had substantially complied with the Second Request. On November 18, 2011, Omnicare also executed a timing agreement with the FTC pursuant to which Omnicare agreed (i) to provide 14 days notice to the FTC prior to consummating its proposed acquisition and (ii) not to consummate its proposed acquisition prior to December 19, 2011 without the consent of the FTC. On December 2, 2011, Omnicare agreed with the FTC to extend the date prior to which Omnicare will not consummate its proposed acquisition to January 19, 2012, unless the FTC notifies Omnicare that it has closed its investigation relating to its proposed acquisition. On January 10, 2012, Omnicare agreed with the FTC that it will not consummate its proposed acquisition prior to January 26, 2012, unless the FTC notifies Omnicare that it has closed its investigation relating to its proposed acquisition. On January 27, 2012, the FTC issued an administrative complaint to block Omnicare's proposed acquisition of the Corporation. The complaint alleges that the proposed acquisition would be illegal and in violation of Section 15 of the FTC Act and Section 7 of the Clayton Act because it would harm competition and enable Omnicare to raise the price of drugs for Medicare Part D consumers and others. The case is scheduled to be heard before an administrative law judge at the FTC in June 2012.

The financial and outside legal advisors to the Corporation and Omnicare have continued to meet from time to time in an effort to agree upon an acceptable information sharing process relating to antitrust issues. On October 26, 2011, the Corporation and Omnicare and their respective outside legal advisors entered into a Confidentiality and Joint Defense Agreement (the Confidentiality and Joint Defense Agreement), which provides, among other things, for the parties to exchange on a confidential and privileged basis information in order to facilitate their respective assessment of the antitrust risk associated with a potential combination of the two companies. Although the Corporation's Board of Directors continues to believe that Omnicare's \$15.00 per share offer undervalues the Corporation, the Corporation is engaging in this analytical process in order to further its understanding of Omnicare's assessment of the antitrust risk related to a business combination. The Confidentiality and Joint Defense Agreement does not obligate the Corporation to enter a transaction with Omnicare and there can be no assurance that this review will lead to a definitive merger agreement or any transaction between the two companies.

In connection with these matters, for the year ended December 31, 2011, the Corporation expensed \$2.8 million of legal and advisory fees, which are included in integration, merger and acquisition related costs and other charges in the consolidated financial statements. The Corporation expects to incur significant additional costs in the future in connection with Omnicare's unsolicited tender offer (See Note 8).

*Cash and Cash Equivalents*

Cash and cash equivalents consist of cash on hand and cash equivalents with original maturities of three months or less. The Corporation places its cash in financial institutions that are federally insured. As of December 31, 2010 and 2011, the Corporation did not hold a material amount of funds in cash equivalent money market accounts. Management believes it effectively safeguards cash assets.

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)***Fair Value of Financial Instruments*

Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based upon assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the Corporation follows a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1: Observable inputs such as quoted prices in active markets;
- Level 2: Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3: Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.
- Assets and liabilities measured at fair value are based on one or more of the following three valuation techniques:

- A. *Market approach:* Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
- B. *Cost approach:* Amount that would be required to replace the service capacity of an asset (replacement cost).
- C. *Income approach:* Techniques to convert future amounts to a single present amount based upon market expectations (including present value techniques, option-pricing and excess earnings models).

Financial liabilities and non-financial assets recorded at fair value at December 31, 2010 and 2011, are set forth in the tables below (dollars in millions):

As of December 31, 2010	Asset/(Liability)	Level 1	Level 2	Level 3	Valuation Technique
<i>Financial Assets/(Liabilities)</i>					
Deferred Compensation Plan	\$ (4.0)	\$	\$ (4.0)	\$	A
Contingent Consideration	\$	\$	\$	\$	C
<i>As of December 31, 2011</i>					
As of December 31, 2011	Asset/(Liability)	Level 1	Level 2	Level 3	Valuation Technique
<i>Non-financial Assets</i>					
Intangible Assets	\$	\$	\$	\$	C
<i>Financial Assets/(Liabilities)</i>					
Deferred Compensation Plan	\$ (3.9)	\$	\$ (3.9)	\$	A
Contingent Consideration	\$	\$	\$	\$	C

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In the third quarter of 2011, certain intangible assets with carrying amounts of \$5.1 million were written down to their fair value resulting in an impairment charge of \$5.1 million. The fair value of intangible assets was derived using the income approach, which uses valuation techniques to convert future amounts to a single present amount. See Note 4 for a further description of the impairment. The deferred compensation plan liability represents an unfunded obligation associated with the deferred compensation plan offered to eligible employees and members of the Board of Directors of the Corporation. The fair value of the liability associated with the deferred compensation plan is derived using pricing and other relevant information for similar assets or liabilities

F-12

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

generated by market transactions. The contingent consideration represented a future earn-out associated with our acquisition of an institutional pharmacy business based in West Virginia (the West Virginia Acquisition). The fair value of the liability associated with the contingent consideration was derived using the income approach with unobservable inputs, which included future gross profit forecast and present value assumptions, and there was little or no market data. The Corporation no longer believes it is probable that contingent consideration will be paid to the sellers, therefore, at December 31, 2010, the liability was relieved and remained the same at December 31, 2011. There were no transfers between the three-tier fair value hierarchy levels during the period.

The carrying amounts reported in the accompanying consolidated balance sheets for cash and cash equivalents, accounts receivable, inventory and accounts payable approximate fair value because of the short-term maturity of these instruments. The Corporation's debt approximates fair value due to the terms of the interest being set at variable market interest rates.

*Accounts Receivable and Allowance for Doubtful Accounts*

Accounts receivable primarily consist of amounts due from Prescription Drug Plans (PDPs) under Medicare Part D, institutional healthcare providers, the respective state Medicaid programs, third party insurance companies, and private payers. The Corporation's ability to collect outstanding receivables is critical to its results of operations and cash flows. To provide for accounts receivable that could become uncollectible in the future, the Corporation establishes an allowance for doubtful accounts to reduce the carrying value of such receivables to the extent it is probable that a portion or all of a particular account will not be collected.

The Corporation has an established process to determine the adequacy of the allowance for doubtful accounts, which relies on analytical tools, specific identification, and benchmarks to arrive at a reasonable allowance. No single statistic or measurement determines the adequacy of the allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Corporation considers a number of factors, which include, but are not limited to, the impact of changes in the regulatory and payer environment, historical trends, the financial viability of the payer, contractual reimbursement terms and other factors that may impact ultimate reimbursement. Accounts receivable are written off after collection efforts have been completed in accordance with the Corporation's policies.

The Corporation's accounts receivable and summarized aging categories are as follows (dollars in millions):

	December 31, 2010	December 31, 2011
Institutional healthcare providers	\$ 160.4	\$ 169.0
Medicare Part D	52.3	47.1
Private payor and other	36.4	33.3
Insured	10.0	10.7
Medicaid	12.5	20.1
Medicare	2.1	0.8
Allowance for doubtful accounts	(36.8)	(48.6)
	\$ 236.9	\$ 232.4
0 to 60 days	61.8%	61.2%
61 to 120 days	22.0%	19.5%
Over 120 days	16.2%	19.3%



100.0%

100.0%

F-13

Table of Contents

## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The following is a summary of activity in the Corporation's allowance for doubtful accounts (dollars in millions):

	Beginning Balance	Acquisitions/ Transfers	Charges to Costs and Expenses	Write-offs	Ending Balance
Allowance for doubtful accounts:					
Year Ended December 31, 2009	\$ 46.5	\$ 3.5	\$ 16.6	\$ (26.4)	\$ 40.2
Year Ended December 31, 2010	\$ 40.2	\$	\$ 18.5	\$ (21.9)	\$ 36.8
Year Ended December 31, 2011	\$ 36.8	\$	\$ 24.8	\$ (13.0)	\$ 48.6

*Concentration of Credit Risk*

For the years ended December 31, 2009, 2010 and 2011, the Corporation derived approximately 13.0%, 13.0% and 13.7% of its revenues from a single customer, respectively, including all payer sources associated with the residents of its long-term care facilities.

*Deferred Financing Fees*

The Corporation capitalizes financing fees related to acquiring or issuing new debt instruments. These expenditures include bank fees and premiums, legal costs, and filing fees. The Corporation amortizes these deferred financing fees using the effective interest method.

*Inventory*

Inventory is primarily located at the Corporation's institutional pharmacy locations. Inventory consists solely of finished products (primarily prescription drugs) and is valued at the lower of first-in, first-out cost (FIFO) or market. Physical inventories are performed on a quarterly basis at the end of the quarter at all pharmacy sites. Cost of goods sold is recorded based upon the actual results of the physical inventory counts.

*Equipment and Leasehold Improvements*

Equipment and leasehold improvements are recorded at cost on the acquisition date and are depreciated using the straight-line method over their estimated useful lives or lease term, if shorter, as follows (in years):

	Estimated Useful Lives
Leasehold improvements	1-7
Equipment and software	3-10
Leased equipment	1-5

Expenditures for maintenance, repairs and renewals of minor items are expensed as incurred. Major rebuilds and improvements are capitalized. For the years ended December 31, 2009, 2010 and 2011, maintenance and repairs were \$6.4 million, \$6.1 million and \$7.5 million, respectively.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets is assessed by a comparison of the carrying amount of the asset to the estimated future

undiscounted net cash flows expected to

F-14

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**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

be generated by the asset or group of assets. If estimated future undiscounted net cash flows are less than the carrying amount of the asset or group of assets, the asset is considered impaired and an expense is recorded in an amount required to reduce the carrying amount of the asset to its then fair value. The Corporation did not record impairment charges on equipment and leasehold improvements for the years ended December 31, 2009, 2010 or 2011.

The Corporation's equipment and leasehold improvements are further described in Note 3.

*Capitalization of Internal Software Costs*

The Corporation capitalizes the costs incurred during the application development stage, which include costs to design the software configuration and interfaces, coding, installation, and testing. Costs incurred during the preliminary project stage along with post-implementation stages of internal use computer software are expensed as incurred. Capitalized development costs are amortized over various periods up to three years and are subject to impairment evaluations. Costs incurred to maintain existing software development are expensed as incurred. The capitalization and ongoing assessment of recoverability of development costs requires judgment by management with respect to certain external factors, including, but not limited to, technological and economic feasibility and estimated economic life. For the years ended December 31, 2010 and 2011, the Corporation capitalized internally developed software costs of \$1.4 million and \$2.1 million, respectively. As of December 31, 2010 and 2011, net capitalized software costs, including acquired assets and amounts for projects which have not been completed, totaled \$14.2 million and \$13.2 million, respectively.

*Goodwill and Other Intangibles*

Goodwill represents the excess purchase price of an acquired entity over the net amounts assigned to assets acquired and liabilities assumed. The Corporation's business is comprised of two reporting units, institutional pharmacy and hospital management, each of which are reviewed separately for impairment. In September 2011, the FASB issued ASU No. 2011-08 Intangibles Goodwill and Other intended to simplify goodwill impairment testing. Entities will be allowed to perform a qualitative assessment on goodwill impairment to determine whether it is more likely than not (defined as having a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The amendments in this ASU are effective for goodwill impairment tests performed in interim and annual periods for fiscal years beginning after December 15, 2011, with early adoption permitted. The Corporation early adopted the guidance at December 31, 2011. The Corporation performed a qualitative assessment of its institutional pharmacy reporting unit, and did not find it necessary to perform the first step of the two-step impairment test based on that analysis.

The Corporation's finite-lived intangible assets are comprised primarily of trade names, customer relationship assets and non-compete agreements primarily originating from business acquisitions. Finite-lived intangible assets are amortized on a straight-line basis over the course of their lives ranging from 5 to 20 years. For impairment reviews, intangible assets are reviewed on a specific pharmacy basis or as a group of pharmacies depending on the intangible assets under review. The Corporation's goodwill and intangible assets are further described in Note 4.

During the third quarter of 2011, the Corporation recorded a pre-tax impairment charge of \$5.1 million related to finite lived customer relationships. The impairment, which related to the Institutional Pharmacy Segment, was incurred as the result of non-renewal of certain customer contracts. The impairment was related to intangible assets acquired in an acquisition during the year ended December 31, 2005. These asset groups were

**Table of Contents**

**PHARMERICA CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

assessed for recoverability and management determined the finite lived customer relationship assets to be impaired, but no other assets within the asset groups were deemed impaired. Using a discounted cash flow analysis, the Corporation determined the pre-tax impairment charge of \$5.1 million was required to write the carrying value down to fair value, resulting in a loss per diluted common share impact of \$0.11. The Corporation recognized the impairment as a permanent write-down of the cost basis and accumulated amortization of the affected assets.

*Self-Insured Employee Health Benefits*

The Corporation is self-insured for the majority of its employee health benefits. The Corporation's self-insurance for employee health benefits includes a stop-loss policy to limit the maximum potential liability of the Corporation for both individual and aggregate claims per year. The Corporation records a monthly expense for self-insurance based on historical claims data and inputs from third-party administrators. For years ended December 31, 2009, 2010 and 2011, the expense for employee health benefits was \$19.3 million, \$18.3 million and \$20.3 million, respectively, the majority of which was related to its self-insured plans. As of December 31, 2010 and 2011, the Corporation had \$2.4 million and \$3.1 million, respectively, recorded as a liability for self-insured employee health benefits.

*Supplier Rebates*

The Corporation receives rebates on purchases from its vendors and suppliers. The Corporation generally accounts for these rebates and other incentives received from its vendors and suppliers, relating to the purchase or distribution of inventory, as a reduction of cost of goods sold and inventory. The Corporation considers these rebates to represent product discounts, and as a result, the rebates are allocated as a reduction of product cost and relieved through cost of goods sold upon the sale of the related inventory. For the years ended December 31, 2009, 2010 and 2011, rebates were \$34.1 million, \$37.2 million, and \$75.5 million, respectively. The Corporation had \$3.0 million, \$3.3 million, and \$6.1 million of rebates allocated as a reduction in inventory as of December 31, 2009, 2010, and 2011, respectively.

*Delivery Expenses*

The Corporation incurred delivery expenses of \$55.6 million, \$58.4 million, and \$67.4 million for the years ended December 31, 2009, 2010, and 2011, respectively, to deliver products sold to its customers. Delivery expenses are reported as a component of cost of goods sold in the accompanying consolidated income statements.

*Stock Option Accounting*

The Corporation recognizes stock-based compensation expense in its consolidated financial statements using the Black-Scholes-Merton option valuation model (see Note 9).

*Income Taxes*

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Corporation accrues for tax obligations, as appropriate, based on facts and circumstances in the various regulatory environments. Deferred tax assets and liabilities are more fully described in Note 10.

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)***Measurement Period Adjustments*

For the year ended December 31, 2011, the Corporation has adjusted certain amounts on the consolidated balance sheet as of December 31, 2010 as a result of measurement period adjustments related to the Chem Rx and Lone Star acquisitions (See Note 2).

**NOTE 2 ACQUISITIONS***2011 Acquisitions*

On April 1, 2011 the Corporation acquired an institutional pharmacy in Greenville, South Carolina. On December 31, 2011, the Corporation acquired the membership interests of an institutional pharmacy which operated three pharmacies in Ohio and Pennsylvania. Both acquisitions (the 2011 Acquisitions) were accounted for under the acquisition method of accounting. The aggregate purchase price of the 2011 Acquisitions was \$51.0 million in cash and assumed liabilities. The total purchase price of the 2011 Acquisitions was preliminarily allocated to the net tangible and identifiable intangible assets based on their fair values at the date of acquisition. The excess of the purchase price over the fair values of the net tangible and identifiable intangible assets was recorded as goodwill. For tax purposes, the transactions were considered asset acquisitions; therefore, the amount of goodwill recorded in the transactions of \$34.8 million will be tax deductible to the Corporation. The Corporation believes the resulting amount of goodwill reflects its expectation of the synergistic benefits of the 2011 Acquisitions.

The combined allocation of the purchase price associated with the 2011 Acquisitions was based upon the fair value of net tangible and identifiable intangible assets as of the date of acquisition. The preliminary purchase price allocations were as follows (dollars in millions):

Accounts receivable	\$ 4.6
Inventory	3.7
Other current assets	0.4
Equipment and leasehold improvements	0.4
Identifiable intangibles	12.5
Goodwill	34.8
<b>Total assets</b>	<b>56.4</b>
Current liabilities	(5.3)
Other long-term liabilities	(0.1)
<b>Total liabilities</b>	<b>(5.4)</b>
<b>Purchase price of 2011 Acquisitions</b>	<b>\$ 51.0</b>

The following is the fair value of the equipment and software of the 2011 Acquisitions acquired at the date of acquisition (dollars in millions):

**Equipment and leasehold improvements**

**Fair-Value**

		<b>Weighted Average Useful Life (Yr.)</b>
Equipment and software	\$ 0.4	4.7

F-17

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 2 ACQUISITIONS (Continued)**

The following are the fair values of the identifiable intangible assets of the 2011 Acquisitions acquired at the date of acquisition (dollars in millions):

<b>Identifiable Intangibles</b>	<b>Fair-Value</b>
Customer relationships	\$ 11.1
Trade name	0.5
Non-compete agreement	0.9
	\$ 12.5

***2010 Acquisitions******Chem Rx Acquisition***

On November 4, 2010, the Corporation acquired substantially all of the assets and assumed selected vendor contracts of Chem Rx Corporation and certain of its wholly-owned subsidiaries (collectively, Chem Rx). The Corporation's primary purpose in acquiring Chem Rx was to expand the Corporation's long-term care business into the New York and New Jersey markets. The acquisition of Chem Rx was made pursuant to Section 363 of the United States Bankruptcy Code (Bankruptcy Code).

The total purchase price of Chem Rx was allocated to the net tangible and identifiable intangible assets based upon the associated fair values on November 4, 2010. The excess of the purchase price over the fair value of the net tangible and identifiable intangible assets was recorded as goodwill. For tax purposes, the transaction was considered an asset acquisition, therefore, \$7.1 million of goodwill recorded in the transaction will be tax deductible to the Corporation. The Corporation believes the resulting amount of goodwill reflects its expectation of the synergistic benefits of being able to integrate Chem Rx.



**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 2 ACQUISITIONS (Continued)**

The allocation of the purchase price was based upon the fair value of net tangible and identifiable intangible assets as of November 4, 2010. The adjusted purchase price allocation was as follows (dollars in millions):

	Amounts Previously Recognized as of Acquisition Date (1)	Measurement Period Adjustments	Amounts Recognized as of Acquisition Date (Adjusted)
Accounts receivable (2)	\$ 33.1	\$ 10.5	\$ 43.6
Inventory (2)	14.1	(0.1)	14.0
Other current assets (2)	3.9	0.1	4.0
Equipment and leasehold improvements	4.9		4.9
Identifiable intangibles	4.0		4.0
Other long-term assets (2)	5.1	3.8	8.9
Goodwill (3)	27.6	(14.5)	13.1
 Total assets	 92.7	 (0.2)	 92.5
 Current liabilities (2)	 (13.3)	 0.2	 (13.1)
Other long-term liabilities	(8.8)		(8.8)
 Total liabilities	 (22.1)	 0.2	 (21.9)
 Purchase price of Chem Rx	 \$ 70.6	 \$	 \$ 70.6

(1) As previously reported in the Corporation's 2010 Annual Report on form 10-K.

(2) Represents an adjustment to specific assets and liabilities to reflect the change in fair value as of the acquisition date.

(3) Represents the cumulative change to goodwill for the changes in current assets, long-term assets, and current liabilities.

The Corporation recorded accounts receivable with a fair value of \$43.6 million as part of the adjusted purchase price of the Chem Rx acquisition. In addition, the Corporation also recorded a liability with a fair value of \$9.8 million related to an unfavorable operating lease as part of the purchase price. The unfavorable operating lease liability is being amortized to rental expense over the contractual term of the operating lease agreement.

The following are the fair values of the equipment and leasehold improvements of Chem Rx acquired at the date of acquisition (dollars in millions):

Equipment and leasehold improvements	Fair-Value	Weighted Average Useful Life (Yr.)
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Leasehold improvements	\$ 1.0	6.9
Equipment and software	3.9	3.5
	\$ 4.9	5.2

The following are the fair values of the identifiable intangible assets of Chem Rx acquired at the date of acquisition (dollars in millions):

Identifiable Intangibles	Fair-Value	Weighted Average Useful Life (Yr.)
Trade name	\$ 0.7	7.0
Customer relationships	3.3	6.0
	\$ 4.0	6.2

F-19

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 2 ACQUISITIONS (Continued)***Lone Star Acquisition*

On December 31, 2010, the Corporation through a wholly-owned subsidiary, acquired all of the membership interests of Lone Star Pharmacy LTD, a Texas Limited partnership, and Pharmastat Transport, LTD, a Texas limited partnership (collectively, Lone Star ), for \$50.0 million in cash and assumed liabilities. The Corporation's primary purpose in acquiring Lone Star was to increase the Corporation's market share in Texas and other states.

The total purchase price of Lone Star was allocated to the net tangible and identifiable intangible assets based upon their fair values on December 31, 2010. The excess of the purchase price over the fair values of the net tangible and identifiable intangible assets was recorded as goodwill. For tax purposes, the transaction was considered an asset acquisition; therefore, the amount of goodwill recorded in the transaction of \$25.9 million will be tax deductible to the Corporation. The Corporation believes the resulting amount of goodwill reflects its expectations of the synergistic benefits of being able to fully integrate the Lone Star business into its existing institutional pharmacy locations.

The allocation of the purchase price was based upon the fair value of net tangible and identifiable intangible assets as of December 31, 2010. The purchase price allocation was as follows (dollars in millions):

	Amounts Previously Recognized as of Acquisition Date (1)	Measurement Period Adjustments	Amounts Recognized as of Acquisition Date (Adjusted)
Accounts receivable (2)	\$ 6.7	\$ (0.1)	\$ 6.6
Inventory (2)	2.9	(0.1)	2.8
Other current assets (2)	0.4	0.2	0.6
Equipment and leasehold improvements	0.9		0.9
Identifiable intangibles	15.7		15.7
Goodwill	25.9		25.9
<b>Total assets</b>	<b>52.5</b>		<b>52.5</b>
Current liabilities	(1.3)		(1.3)
Accrued salaries	(1.1)		(1.1)
Other current liabilities	(0.1)		(0.1)
<b>Total liabilities</b>	<b>(2.5)</b>		<b>(2.5)</b>
Purchase price of Lone Star, net of cash acquired	\$ 50.0	\$	\$ 50.0

(1) As previously reported in the Corporation's 2010 Annual Report on form 10-K.

(2) Represents an adjustment to other current assets to reflect the change in fair value as of the acquisition date.

The following is the fair value of the equipment and software of Lone Star acquired at the date of acquisition (dollars in millions):

	Fair-Value	Weighted Average Useful Life (Yr.)
Equipment and leasehold improvements		
Equipment and software	\$ 0.9	3.4

F-20

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 2 ACQUISITIONS (Continued)**

The following are the fair values of the identifiable intangible assets of Lone Star acquired at the date of acquisition (dollars in millions):

<b>Identifiable Intangibles</b>	<b>Fair-Value</b>	<b>Weighted Average Useful Life (Yr.)</b>
Customer relationships	\$ 15.2	8.0
Trade name	0.3	6.0
Non-compete agreement	0.2	6.0
	\$ 15.7	7.9

*Other*

For the years ended December 31, 2009, 2010, and 2011, the Corporation incurred \$1.0 million, \$5.2 million, and \$12.9 million, respectively, of acquisition related costs, which have been classified as a component of integration, merger, and acquisition related costs and other charges (See Note 8).

*Pro forma*

The following unaudited pro forma consolidated financial information is not intended to represent or be indicative of the consolidated results of operations or financial condition of the Corporation that would have been reported had the acquisitions been completed as of the date or for the periods presented, and should not be taken as representative of the future consolidated results of operations or financial condition of the Corporation.

The unaudited pro forma effect of the acquisitions assuming the acquisitions occurred on January 1, 2010, excluding the impairment charge and the integration, merger and acquisition related costs and other charges and assuming an effective tax rate exclusive of discrete items for the years ended December 31, 2010 and 2011, would be as follows (dollars in millions, except per share amounts):

	<b>For the years ended December 31,</b>	
	<b>2010</b>	<b>2011</b>
Revenues	\$ 2,283.4	\$ 2,141.8
Net income	\$ 33.9	\$ 37.8
Earnings per common share:		
Basic	\$ 1.13	\$ 1.29
Diluted	\$ 1.12	\$ 1.28

**NOTE 3 EQUIPMENT AND LEASEHOLD IMPROVEMENTS**

Equipment and leasehold improvements consist of the following (dollars in millions):

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	December 31, 2010	December 31, 2011
Leasehold improvements	\$ 13.6	\$ 14.3
Equipment and software	115.4	123.2
Leased equipment	3.0	2.9
Construction in progress	4.0	4.6
	136.0	145.0
Accumulated depreciation	(76.5)	(92.6)
<b>Total Equipment and leasehold improvements</b>	<b>\$ 59.5</b>	<b>\$ 52.4</b>

F-21

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 3 EQUIPMENT AND LEASEHOLD IMPROVEMENTS (Continued)**

The following is a progression of equipment and leasehold improvements for the period presented (dollars in millions):

	Balance at December 31, 2009	Additions	Disposals	Balance at December 31, 2010	Additions	Disposals	Balance at December 31, 2011
Equipment and leasehold improvements:							
Leasehold improvements	\$ 11.6	\$ 2.1	\$ (0.1)	\$ 13.6	\$ 0.9	\$ (0.2)	\$ 14.3
Equipment and software	95.3	22.3	(2.2)	115.4	12.2	(4.4)	123.2
Leased equipment	2.6	0.4		3.0		(0.1)	2.9
Construction in progress	10.1	(6.1)		4.0	0.6		4.6
Sub-Total	119.6	18.7	(2.3)	136.0	13.7	(4.7)	145.0
Accumulated depreciation	(59.0)	(18.8)	1.3	(76.5)	(20.1)	4.0	(92.6)
Total	\$ 60.6	\$ (0.1)	\$ (1.0)	\$ 59.5	\$ (6.4)	\$ (0.7)	\$ 52.4

Depreciation expense totaled \$18.0 million, \$18.8 million, and \$20.1 million for the years ended December 31, 2009, 2010, and 2011, respectively.

Total estimated depreciation expense for the Corporation's equipment and leasehold improvements for the next five years and thereafter are as follows (dollars in millions):

Year Ending December 31,	
2012	\$ 17.1
2013	12.4
2014	7.7
2015	4.7
2016	2.4
Thereafter	8.1
Total	\$ 52.4

**NOTE 4 GOODWILL AND INTANGIBLES**

The following table presents the changes in the carrying amount of goodwill for the years ended December 31, 2010 and 2011 (dollars in millions):

Balance at December 31, 2009	\$ 140.1
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Integrity purchase accounting adjustments	0.3
Goodwill acquired from 2010 acquisitions	39.0
Balance at December 31, 2010, as adjusted	179.4
Goodwill acquired from 2011 acquisitions	34.8
Balance at December 31, 2011	\$ 214.2

F-22



**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 4 GOODWILL AND INTANGIBLES (Continued)**

The following table presents the components of the Corporation's intangible assets (dollars in millions):

	Balance at December 31, 2009		Balance at December 31, 2010		Balance at December 31, 2011	
Finite Lived Intangible Assets		Additions		Additions	Impairment	
Customer relationships	\$ 76.6	\$ 18.5	\$ 95.1	\$ 11.1	\$ (10.2)	\$ 96.0
Trade name	28.5	1.0	29.5	0.5		30.0
Non-compete agreements	4.7	1.2	5.9	2.5		8.4
Sub Total	109.8	20.7	130.5	14.1	(10.2)	134.4
Accumulated amortization	(19.0)	(9.3)	(28.3)	(11.0)	5.1	(34.2)
Net intangible assets	\$ 90.8	\$ 11.4	\$ 102.2	\$ 3.1	\$ (5.1)	\$ 100.2

Amortization expense relating to finite-lived intangible assets was \$9.0 million, \$9.3 million, and \$11.0 million for the years ended December 31, 2009, 2010 and 2011, respectively.

During the third quarter of 2011, the Corporation recorded a pre-tax impairment charge of \$5.1 million related to finite-lived customer relationships. The impairment, which related to the Institutional Pharmacy Segment, was incurred as the result of non-renewal of certain customer contracts. The impairment was related to intangible assets acquired in an acquisition during the year ended December 31, 2005. These asset groups were assessed for recoverability and management determined the finite-lived customer relationship assets to be impaired. No other assets within the asset groups were deemed impaired. Using a discounted cash flow analysis, the Corporation determined that the pre-tax impairment charge of \$5.1 million was required to write the carrying value down to fair value, resulting in a loss per diluted common share impact of \$0.11. The Corporation recognized the impairment as a permanent write-down of the cost basis and accumulated amortization of the affected assets.

Total estimated amortization expense for the Corporation's finite-lived intangible assets for the next five years and thereafter are as follows (dollars in millions):

Year Ending December 31,	
2012	\$ 10.6
2013	10.3
2014	10.3
2015	10.3
2016	9.9
Thereafter	48.8
	\$ 100.2

**NOTE 5 CREDIT AGREEMENT**

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On May 2, 2011, the Corporation entered into a long-term credit agreement (the Credit Agreement ) among the Corporation, the Lenders named therein, and Citibank, N.A. ( Citibank ), as Administrative Agent. The Credit Agreement replaced the \$425.0 million five-year credit agreement dated as of July 31, 2007, among the Corporation, JPMorgan Chase Bank, N.A., individually and as administrative agent, and certain lenders. The Credit Agreement consists of a \$250.0 million term loan facility and a \$200.0 million revolving credit facility. The terms and conditions of the Credit Agreement are customary to facilities of this nature.

F-23

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 5 CREDIT AGREEMENT (Continued)**

As of December 31, 2011, \$250.0 million was outstanding under the term loan facility and \$50.0 million was outstanding under the revolving credit facility. Indebtedness under the Credit Agreement matures on June 30, 2016, at which time the commitments of the Lenders to make revolving loans also expire.

The table below summarizes the term debt and revolving credit facility of the Corporation (dollars in millions):

	December 31, 2010	December 31, 2011
<b><i>Credit Agreement:</i></b>		
Term Debt payable to lenders at LIBOR plus applicable margin (3.05% as of December 31, 2011), matures June 30, 2016	\$	\$ 250.0
Replaced Term Debt payable to lenders at LIBOR plus applicable margin (1.27% as of December 31, 2010)	240.0	
Revolving Credit Facility payable to lenders, interest at LIBOR plus applicable margin (5.00% as of December 31, 2011), matures June 30, 2016		50.0
Replaced Revolving Credit Facility payable to lenders, interest at LIBOR plus applicable margin (3.25% as of December 31, 2010)	5.6	
Total debt	245.6	300.0
Less: Current portion of long-term debt		6.3
Total long-term debt	\$ 245.6	\$ 293.7

The Corporation's indebtedness had the following maturities for the next five years and thereafter (dollars in millions):

Year Ending December 31,	Term Debt	Revolving Credit Facility	Total Maturities
2012	\$ 6.3	\$	\$ 6.3
2013	12.5		12.5
2014	12.5		12.5
2015	112.5		112.5
2016	106.2	50.0	156.2
Thereafter			
	\$ 250.0	\$ 50.0	\$ 300.0

The Credit Agreement provides for the issuance of letters of credit which, when issued, reduce availability under the revolving credit facility. The aggregate amount of letters of credit outstanding as of December 31, 2011 was \$2.0 million. After giving effect to the letters of credit, total availability under the revolving credit facility was \$148.0 million as of December 31, 2011. The revolving credit facility contains a \$100.0 million accordion feature, which permits the Corporation to increase the total debt capacity, up to an aggregate of \$550.0 million, subject to

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securing additional commitments from existing or new lenders.

Borrowings under the Credit Agreement bear interest at a floating rate equal to, at the Corporation's option, a base rate plus a margin between 1.25% and 2.00% per annum, or an adjusted London Interbank Offered Rate ( LIBO Rate or LIBOR ) plus a margin between 2.25% and 3.00% per annum, in each case depending on the leverage ratio of the Corporation as defined by the Credit Agreement.

F-24

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 5 CREDIT AGREEMENT (Continued)**

The base rate is the greater of the prime lending rate in effect on such day, the federal funds effective rate published by the Federal Reserve Bank of New York on such day plus 0.5%, or the adjusted LIBO Rate for deposits for a period equal to one month plus 1.0%. Any changes in the base rate, federal funds rate or adjusted LIBO Rate shall be effective from and including the effective date of such change in the rate, as applicable. The Credit Agreement also provides for letter of credit fees between 2.25% and 3.00% and a commitment fee payable on the unused portion of the revolving credit facility, which shall accrue at a rate per annum ranging from 0.375% to 0.500%, in each case depending on the leverage ratio of the Corporation.

The Corporation's obligations under the Credit Agreement are secured by substantially all of the Corporation's assets. Those obligations are guaranteed by many of the Corporation's wholly-owned subsidiaries and the obligations of the guarantors are secured by substantially all of their assets. The foregoing includes a pledge of all of the equity interests of substantially all of the Corporation's direct and indirect domestic subsidiaries and a portion of the equity interests of any future foreign subsidiaries.

*Covenants*

The Credit Agreement requires the Corporation to satisfy an interest coverage ratio and a leverage ratio. The interest coverage ratio, which is tested as of the last day of any fiscal quarter on a trailing four quarter basis, can be no less than: 3.00:1.00. The leverage ratio, which also is tested quarterly, cannot exceed 4.00:1.00 from the end of the first full fiscal quarter ending after the effective date, through the quarter ending December 31, 2012; cannot exceed 3.75:1.00 for each of the four quarters in the year ending December 31, 2013; and cannot exceed 3.50:1.00 for all remaining quarters through the expiration of the agreement. In addition, capital expenditures (other than those funded with proceeds of asset sales or insurance proceeds) are restricted in any fiscal year to 3.0% of revenues.

In addition, the Credit Agreement contains customary affirmative and negative covenants, which among other things, limit the Corporation's ability to incur additional debt, create liens, pay dividends, effect transactions with the Corporation's affiliates, sell assets, pay subordinated debt, merge, consolidate, enter into acquisitions, and effect sale leaseback transactions.

The financial covenant requirements as defined by the Corporation's Credit Agreements are as follows:

	<b>Interest Coverage Ratio</b>	<b>Leverage Ratio</b>	<b>Capital Expenditures</b>
<b>Requirement</b>	<b>&gt;=3.00 to 1.00</b>	<b>&lt;=4.00 to 1.00</b>	<b>&lt;=3.00%</b>
December 31, 2011	11.99	2.44	0.63%

*Deferred Financing Fees*

The Corporation capitalized a total of \$9.8 million in deferred financing fees associated with the Credit Agreement and recorded them as other assets in the accompanying consolidated balance sheets. As of December 31, 2011, the Corporation had \$9.2 million of unamortized deferred financing fees.

**NOTE 6 COMMITMENTS AND CONTINGENCIES***Legal Action and Regulatory*

On September 7, 2011, Omnicare filed a lawsuit in the Court of Chancery of the State of Delaware against the Corporation and the members of the Corporation's Board of Directors, styled Omnicare, Inc. v. PharMerica Corporation, et al., Civil Action No. 6841-CS. In the action, Omnicare alleges that the members of the Board of



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**Table of Contents**

**PHARMERICA CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 6 COMMITMENTS AND CONTINGENCIES (Continued)**

Directors breached their fiduciary duties to the Corporation and its stockholders by, among other things, refusing to negotiate with Omnicare, failing to inform themselves of the merits of the tender offer, and failing to consider and negotiate the tender offer. Omnicare seeks declaratory and injunctive relief, including an order requiring the Board of Directors to render the Rights Agreement and Section 203 of the Delaware General Corporation Law ( DGCL ) inapplicable to Omnicare s tender offer and proposed merger. The Corporation and the Corporation s Board of Directors believe that the claims made by Omnicare are without merit and intend to defend them vigorously.

On September 9, 2011, the Louisiana Municipal Police Employees Retirement System ( LMPERS ) filed a lawsuit in the Court of Chancery of the State of Delaware, purportedly on behalf of a class of the Corporation s stockholders, against the Corporation and the members of the Corporation s Board of Directors, styled Louisiana Municipal Police Employees Retirement System v. Frank Collins, et al., Civil Action No. 6851-CS. In the action, LMPERS alleges that the members of the Board of Directors breached their fiduciary duties to the Corporation and its stockholders by, among other things, adopting the Rights Agreement and failing to respond appropriately to the tender offer. LMPERS seeks declaratory and injunctive relief, including an order certifying the case as a class action and an order enjoining application of the Rights Agreement and Section 203 of the DGCL to the tender offer and proposed merger.

On September 22, 2011, Hugh F. Drummond as Trustee of the FBO Hugh F. Drummond Trust ( Drummond ) filed a lawsuit in the Court of Chancery of the State of Delaware, purportedly on behalf of a class of the Corporation s stockholders, against the Corporation and the members of the Corporation s Board of Directors, styled Hugh F. Drummond as Trustee of the FBO Hugh F. Drummond Trust v. PharMerica Corp., et al., Civil Action No. 6882. In the action, Drummond alleges that the members of the Board of Directors breached their fiduciary duties to the Corporation and the Corporation s stockholders by, among other things, adopting the Rights Agreement and failing to respond appropriately to the tender offer. Drummond seeks declaratory and injunctive relief, including an order certifying the case as a class action and an order enjoining the directors and the Corporation from excluding strategic bidders, including Omnicare, imposing unreasonable preconditions on such strategic bidders, refusing to provide due diligence to strategic bidders, and conducting a limited sale process not designed to produce the best transaction for PharMerica s stockholders.

On October 3, 2011, the Court of Chancery of the State of Delaware entered an order consolidating the LMPERS and Drummond actions under the caption *In re PharMerica Corporation Shareholders Litigation*, Consolidated Civil Action No. 6851-CS. Plaintiffs in the consolidated action designated the complaint filed in the *Drummond* action as operative. The Corporation and its directors believe that the claims made by LMPERS and Drummond are without merit and intend to defend the consolidated action vigorously.

**Table of Contents**

**PHARMERICA CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 6 COMMITMENTS AND CONTINGENCIES (Continued)**

Pursuant to the requirements of the HSR Act, Omnicare filed a Notification and Report Form with the Antitrust Division and the FTC relating to its proposed acquisition of the Corporation on September 7, 2011. On or about September 19, 2011, the Corporation submitted a responsive Notification and Report Form with the Antitrust Division and the FTC. On September 22, 2011, the Corporation received a request for additional information from the FTC relating to the tender offer. On September 22, 2011, Omnicare also received the Second Request. The Second Request extended the waiting period under the HSR Act for 10 calendar days after the date Omnicare certified substantial compliance with the Second Request issued to Omnicare. On September 30, 2011, the FTC also issued a subpoena and civil investigative demand to the Corporation covering the same subject matter as the Second Request. The Corporation has produced a considerable amount of material in response to the FTC requests.

On November 18, 2011 Omnicare certified to the FTC that it had substantially complied with the Second Request. On November 18, 2011, Omnicare also executed a timing agreement with the FTC pursuant to which Omnicare agreed (i) to provide 14 days notice to the FTC prior to consummating its proposed acquisition and (ii) not to consummate its proposed acquisition prior to December 19, 2011 without the consent of the FTC. On December 2, 2011, Omnicare agreed with the FTC to extend the date prior to which Omnicare will not consummate its proposed acquisition to January 19, 2012, unless the FTC notifies Omnicare that it has closed its investigation relating to its proposed acquisition. On January 10, 2012, Omnicare agreed with the FTC that it will not consummate its proposed acquisition prior to January 26, 2012, unless the FTC notifies Omnicare that it has closed its investigation relating to its proposed acquisition. On January 27, 2012, the FTC issued an administrative complaint to block Omnicare's proposed acquisition of the Corporation. The complaint alleges that the proposed acquisition would be illegal and in violation of Section 15 of the FTC Act and Section 7 of the Clayton Act because it would harm competition and enable Omnicare to raise the price of drugs for Medicare Part D consumers and others. The case is scheduled to be heard before an administrative law judge at the FTC in June 2012.

The Corporation is responding to an investigation by the U.S. Attorney for the Eastern District of Wisconsin and by the Drug Enforcement Agency into the Corporation's alleged failure to comply with various laws and regulations relating to the control and dispensing of certain controlled substances as well as the potential filing of false claims for payments of certain controlled substances that the Corporation dispensed to nursing home residents. The Corporation has been informed that the government believes that the claims at issue were not eligible for payment due to the alleged non-compliance with various Medicare, Medicaid and other laws and regulations relating to the dispensing, control, sale, billing and reimbursement for such controlled substances. The Corporation denies the allegations made by the government and will defend itself in the event any actions are brought by the government. At this time, we are unable to estimate the outcome of the investigation. If the government brings claims and the Corporation is not successful in defending them, it could result in fines and recoupment of government claims.

In addition, the Corporation is involved in certain legal actions and regulatory investigations arising in the ordinary course of business. At this time, the Corporation is unable to determine the impact of these investigations on its consolidated financial position, results of operations, or liquidity.



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**Table of Contents**

**PHARMERICA CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 6 COMMITMENTS AND CONTINGENCIES (Continued)**

*FUL and AMP Changes*

The 2010 Health Care Legislation amended the Deficit Reduction Act of 2005 (the "DRA") to change the definition of the Federal Upper Limit or FUL by requiring the calculation of the FUL as no less than 175% of the weighted average, based on utilization, of the most recently reported monthly Average Manufacturer's Price or AMP for pharmaceutically and therapeutically equivalent multi-source drugs available through retail community pharmacies nationally.

In addition, the definition of AMP changed to reflect net sales only to drug wholesalers that distribute to retail community pharmacies and to retail community pharmacies that directly purchase from drug manufacturers. Further, the 2010 Health Care Legislation continues the current statutory exclusion of prompt pay discounts offered to wholesalers and adds three other exclusions to the AMP definition: i) bona fide services fees; ii) reimbursement for unsalable returned goods (recalled, expired, damaged, etc.); and iii) payments from and rebates/discounts to certain entities not conducting business as a wholesaler or retail community pharmacy. In addition to reporting monthly, the manufacturers are required to report the total number of units used to calculate each monthly AMP. CMS will use this information when it establishes FULs as a result of the new volume-weighted requirements pursuant to the 2010 Health Care Legislation.

In September 2011, CMS issued the first draft FUL reimbursement files for multiple source drugs, including the draft methodology used to calculate the FULs in accordance with the Health Care Legislation. These draft FUL prices are based on the manufacturer reported and certified July 2011 monthly AMP and AMP unit data. CMS continues to release this data monthly and is expected to do so going forward. CMS has not posted monthly AMPs for individual drugs, but only posted the weighted average of monthly AMPs in a FUL group and the calculation methodology.

On February 2, 2012, CMS issued proposed regulations further clarifying the AMP and FUL changes described above and indicated that the final rule would be issued sometime in 2013.

Until CMS provides final guidance and the industry adapts to this now public available pricing information, the Corporation is unable to fully evaluate the impact of the changes in FUL and AMP to its business.

*CMS Proposed Rule on Consultant Pharmacists*

In October 2011, Centers for Medicare and Medicaid Services ( "CMS") issued a proposed rule entitled "Medicare Program; Proposed Changes to the Medicare Advantage and the Medicare Prescription Drug Benefit Programs for Contract Year 2013 and Other Proposed Changes; Considering Changes to the Conditions of Participation for Long Term Care Facilities." In the proposed rule, CMS outlined its concerns, and requests comments, regarding certain contractual arrangements between Long Term Care ( "LTC") facilities, LTC pharmacies, consultant pharmacies, and pharmaceutical manufacturers. Specifically, CMS explained its perception that the provision of consulting services by the pharmacy providers which supplies the medication to the facility leads to lack of independence of consultant pharmacists. CMS proposed requiring the independence of consultant pharmacists from LTC pharmacies. The Corporation believes that the proposed rule, which could require the independence of consultant pharmacists, may increase overall costs for payers and customers and reduce the quality of care and service to long-term care patients and residents. However, until CMS provides additional guidance, the Corporation is unable to fully evaluate the impact of the changes in consultant pharmacist services to its business.

**Table of Contents**

**PHARMERICA CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 6 COMMITMENTS AND CONTINGENCIES (Continued)**

*Acquisitions*

The Corporation has historically acquired the assets of businesses with prior operating histories. Acquired companies may have unknown or contingent liabilities, including liabilities for failure to comply with healthcare laws and regulations, medical, and general professional liabilities, workers' compensation liabilities, previous tax liabilities, and unacceptable business practices. Although the Corporation institutes policies designed to conform practices to its standards following completion of acquisitions, there can be no assurance the Corporation will not become liable for past activities that may later be asserted to be improper by private plaintiffs or government agencies.

Although the Corporation generally seeks to obtain indemnification from prospective sellers covering such matters, there can be no assurance that any such matter will be covered by indemnification, or if covered, that such indemnification will be adequate to cover potential losses and fines. In the ordinary course of business, the Corporation enters into contracts containing standard indemnification provisions and indemnifications specific to a transaction such as business acquisitions and disposals of an operating facility. These indemnifications may cover claims against employment-related matters, governmental regulations, environmental issues, tax matters, as well as customer, third party payer, supplier, and contractual relationships. Obligations under these indemnities generally would be initiated by a breach of the terms of the contract or by a third party claim or event.

*Prime Vendor Agreement*

On January 4, 2011, the Corporation entered into an Amended and Restated Prime Vendor Agreement for Long-Term Care Pharmacies by and between AmerisourceBergen Drug Corporation ( ABDC ), a wholly owned subsidiary of AmerisourceBergen Corporation, the Corporation, Pharmacy Corporation of America and Chem Rx Pharmacy Services, LLC (the Amended Prime Vendor Agreement ). The Amended Prime Vendor Agreement became effective on January 1, 2011 and, upon its effectiveness, superseded in its entirety the Prime Vendor Agreement for Long-Term Care Pharmacies entered into as of August 1, 2007 between the Corporation and ABDC.

The Amended Prime Vendor Agreement incorporates Chem Rx and is otherwise substantially the same in scope except for modifications to select sourcing and rebate terms. The term of the Amended Prime Vendor Agreement was extended until September 30, 2013, with one-year automatic renewal periods unless either party provides prior notice of its intent not to renew.

*Information Technology Services Agreement*

On July 31, 2007, the Corporation entered into the IT Services Agreement with KHOI, a wholly owned subsidiary of Kindred Kindred. Pursuant to the IT Services Agreement, KHOI is the Corporation's exclusive provider of certain information services and support related to information technology infrastructure and financial systems for a period of five years, ending on July 31, 2012. The services provided by KHOI include business services necessary to operate, manage, and support certain financial applications the Corporation uses, including enabling and/or supporting technology infrastructure and technology procurement services to support certain business functions. Such services include, among other matters, functions for financial management systems, and payroll. The Corporation will support internally all other operating systems, including functions for order entry, pharmacy dispensing, clinical consulting, billing and collections, electronic medication management,

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 6 COMMITMENTS AND CONTINGENCIES (Continued)**

sales and marketing, medical records management, human resources, internal and external customer call center support, and general business systems.

Except for certain services that will be provided at cost, KHOI will provide such services to the Corporation at its cost plus 10%, which will be the actual costs and expenses incurred in providing these services, including certain overhead costs and per hour costs of the KHOI employees providing the services. The initial term of the IT Services Agreement is five years. The IT Services Agreement will automatically renew for successive one-year periods after the expiration of the initial five year term, absent 120 days prior written notice of termination as provided for in the agreement. The IT Services Agreement may be terminated by either party for cause and, in certain circumstances, by the Corporation in the event that KHOI undergoes a change of control to one of the Corporation's competitors. Following termination of the IT Services Agreement, KHOI must provide termination and expiration assistance for up to 180 days. The Corporation incurred \$11.5 million, \$11.1 million, and \$10.8 million in fees to Kindred under the terms of the IT Services Agreement for the years ended December 31, 2009, 2010, and 2011, respectively.

*Employment Agreements*

The Corporation has entered into employment agreements with certain of its executive officers. During the employment period, certain executive officers will be eligible to (i) participate in any short-term and long-term incentive programs established or maintained by the Corporation, (ii) participate in all incentive, savings and retirement plans and programs of the Corporation, (iii) participate, along with their dependents, in all welfare benefit plans and programs provided by the Corporation, and (iv) receive four weeks of paid vacation per calendar year.

The type of compensation due to each of the executive officers in the event of the termination of their employment period varies depending on the nature of the termination. The employment agreements do not entitle the executive officers to any additional payment or benefits solely upon the occurrence of a change in control but do provide additional payments or benefits or both upon a termination of employment in connection with a change in control. Additionally, the vesting of certain equity based grants made to certain executive officers accelerate upon the occurrence of a change in control.

*Leases*

The Corporation leases real estate properties, buildings, vehicles, and equipment under cancelable and non-cancelable leases. The leases expire at various times and have various renewal options. Certain leases that meet the lease capitalization criteria have been recorded as an asset and liability at the net present value of the minimum lease payments at the inception of the lease. Interest rates used in computing the net present value of the lease payments are based on the Corporation's incremental borrowing rate at the inception of the lease. The Corporation recorded the following lease expense for the periods presented (dollars in millions):

	2009	2010	2011
Pharmacy locations and administrative offices lease expense	\$ 13.9	\$ 14.0	\$ 14.4
Office equipment lease expense	2.8	2.1	2.5
<b>Total lease expense</b>	<b>\$ 16.7</b>	<b>\$ 16.1</b>	<b>\$ 16.9</b>

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 6 COMMITMENTS AND CONTINGENCIES (Continued)**

Future minimum lease payments for those leases having an initial or remaining non-cancelable lease term in excess of one year are as follows for the years indicated (dollars in millions):

<b>Year Ending December 31,</b>	<b>Operating Leases</b>	<b>Capital Lease Obligations</b>	<b>Total</b>
2012	\$ 14.4	\$ 0.2	\$ 14.6
2013	11.9		11.9
2014	7.5		7.5
2015	5.8		5.8
2016	4.4		4.4
Thereafter	13.6		13.6
<b>Total</b>	<b>\$ 57.6</b>	<b>\$ 0.2</b>	<b>\$ 57.8</b>

**NOTE 7 REVENUES**

The Corporation recognizes revenues at the time services are provided or products are delivered. A significant portion of these revenues are billed to PDPs under Medicare Part D, the state Medicaid programs, long-term care institutions, third party insurance companies, and private payers. Some claims are electronically adjudicated through online processing at the point the prescription is dispensed such that the Corporation's operating system is automatically updated with the actual amount to be reimbursed. As a result, revenues and the associated receivables are based upon the actual reimbursement to be received by the Corporation. For claims that are adjudicated on-line and are rejected or otherwise denied upon submission, the Corporation provides contractual allowances based upon historical trends, contractual reimbursement terms and other factors which may impact ultimate reimbursement. Amounts are adjusted to actual reimbursed amounts upon cash receipt.

Under the Medicare Part D benefit, payment is determined in accordance with the agreements the Corporation has negotiated with the Medicare Part D Plans. The remainder of the Corporation's billings are paid or reimbursed by individual residents, long-term care facilities (including revenues for residents funded under Medicare Part A), and other third party payers, including Medicaid and private insurers.

The Medicare and Medicaid programs are highly regulated. The failure, even if inadvertent, of the Corporation and/or client facilities to comply with applicable reimbursement regulations could adversely affect the Corporation's reimbursement under these programs and the Corporation's ability to continue to participate in these programs. In addition, failure to comply with these regulations could subject the Corporation to other penalties.

As noted, the Corporation obtains reimbursement for drugs it provides to enrollees of a given Medicare Part D Plan in accordance with the terms of the agreement negotiated between it and that Medicare Part D Plan. The Corporation has entered into such agreements with nearly all Medicare Part D Plan sponsors under which it will provide drugs and associated services to their enrollees. The Corporation in the ordinary course of business has ongoing discussions with Medicare Part D Plans and may, as appropriate, renegotiate agreements.

The Corporation's hospital pharmacy management revenues represent contractually defined management fees and the reimbursement of costs associated with the direct operations of hospital pharmacies, which are primarily comprised of personnel costs.



**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 7 REVENUES (Continued)**

A summary of revenues by payer type for the years ended December 31, are as follows (dollars in millions):

	2009		2010		2011	
	Amount	% of Revenues	Amount	% of Revenues	Amount	% of Revenues
Medicare Part D	\$ 852.6	46.3%	\$ 859.2	46.5%	\$ 998.5	48.0%
Institutional healthcare providers	545.6	29.6	556.2	30.1	615.6	29.6
Medicaid	165.8	9.0	169.5	9.2	217.4	10.4
Private and other	122.4	6.6	107.3	5.8	92.7	4.5
Insured	91.5	5.0	89.8	4.9	90.0	4.3
Medicare	6.8	0.4	7.4	0.4	4.4	0.2
Hospital management fees	56.5	3.1	57.9	3.1	62.5	3.0
Total	\$ 1,841.2	100.0%	\$ 1,847.3	100.0%	\$ 2,081.1	100.0%

Co-payments for the Corporation's services can be applicable under Medicare Part D, the state Medicaid programs, and certain third party payers and are typically not collected at the time products are delivered or services are provided. Co-payments under the Medicaid programs and third party plans are generally billed to the responsible party as part of the Corporation's normal billing procedures and are subject to the Corporation's normal collection procedures.

Under Medicare Part D, co-payments related to institutional residents who are both Medicare and Medicaid eligible (dual eligible) are due from the responsible party for up to the first thirty days of a beneficiary's stay in a skilled nursing facility, subsequent to which the PDPs are responsible for reimbursement.

Under certain circumstances, including state-mandated return policies under various Medicaid programs, the Corporation accepts returns of medications and issues a credit memorandum to the applicable payer. Product returns are processed in the period in which the return is accepted by the Corporation. A reserve has been established for such returns based on historical trends.

**NOTE 8 INTEGRATION, MERGER AND ACQUISITION RELATED COSTS AND OTHER CHARGES**

In fiscal year 2007, the Corporation began the integration of our pharmacy operating systems and the Corporation expects to continue to incur costs related to the integration of its pharmacy operating systems during fiscal 2012. In addition, the Corporation also incurs and will continue to incur costs related to acquisitions.

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 8 INTEGRATION, MERGER AND ACQUISITION RELATED COSTS AND OTHER CHARGES (Continued)**

The following is a summary of integration, merger and acquisition related costs and other charges incurred by the Corporation (dollars in millions, except per share amounts):

	Years Ended December 31,		
	2009	2010	2011
<b>Integration costs and other charges:</b>			
Pre-Pharmacy Transaction litigation matters	\$	\$ 5.0	\$ (2.0)
Tender offer costs			2.8
Professional and advisory fees	0.2	2.3	0.9
General and administrative	0.8	0.7	0.1
Employee costs	1.5	0.5	0.2
Severance costs	0.9	0.6	0.2
Facility costs	0.8	0.3	0.2
	4.2	9.4	2.4
<b>Acquisition related costs:</b>			
Professional and advisory fees	1.0	3.5	4.9
General and administrative		1.5	0.8
Employee costs		0.4	2.9
Severance costs			1.7
Facility costs		1.3	1.7
Contingent consideration		(1.7)	
Other		0.2	0.9
	1.0	5.2	12.9
<b>Total integration, merger and acquisition related costs and other charges</b>	<b>\$ 5.2</b>	<b>\$ 14.6</b>	<b>\$ 15.3</b>
Negative effect on earnings per diluted common share	\$ (0.10)	\$ (0.29)	\$ (0.32)

During the second quarter of 2010, the Corporation recorded an estimated liability of \$5.0 million related to certain claims arising from time periods prior to July 31, 2007. During the third quarter of 2011, the Corporation was informed that one claim would not be pursued. Therefore, the Corporation reversed \$2.0 million of the estimated liability recorded in 2010.

The Corporation has incurred various expenses as a result of Omnicare's unsolicited tender offer including legal, investment banking and other fees. During the year ended December 31, 2011, \$2.8 million of tender offer costs were incurred. The Corporation anticipates that significant additional tender offer costs will continue to be incurred through the duration of the tender offer; however, the amount of these expenses cannot be reasonably estimated.

**NOTE 9 COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS**

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### *Common Stock*

Holders of the Corporation's common stock are entitled to one vote for each share held of record on all matters on which stockholders may vote. There are no preemptive, conversion, redemption or sinking fund provisions applicable to the Corporation's common stock. In the event of liquidation, dissolution or winding up, holders of common stock are entitled to share ratably in the assets available for distribution, subject to any prior

F-33



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**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 9 COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS (Continued)**

rights of any holders of preferred stock then outstanding. Delaware law prohibits the Corporation from paying any dividends unless it has capital surplus or net profits available for this purpose. In addition, the Corporation's Credit Agreement imposes restrictions on its ability to pay dividends.

*Preferred Stock*

The certificate of incorporation authorizes the issuance of an aggregate of 1.0 million shares of preferred stock. On August 25, 2011, the Board of Directors designated 175,000 shares of preferred stock as Series A Junior Participating Preferred Stock ( Series A Junior Preferred Stock ). As of December 31, 2011, there were no shares of preferred stock outstanding.

The Series A Junior Preferred Stock is entitled to receive quarterly cumulative dividends in an amount per whole share equal to the greater of \$10.00 or 1,000 times the dividends declared on the common stock since the preceding quarterly dividend payment date, or with respect to the first quarterly dividend payment date, since the date of issuance, and a liquidation preference of a minimum of \$10.00 per whole share, plus an amount equal to any accrued dividends and distributions thereon, whether or not declared, to the date of payment, and will be entitled to an aggregate payment per whole share equal to 1,000 times the amount per share distributed to the holders of common stock. Holders of Series A Junior Preferred Stock are entitled to vote on each matter on which holders of common stock are entitled to vote, and have 1,000 votes per whole share. The preferred stockholders also are entitled to certain corporate governance and special voting rights, as defined in the certificate of designation.

Our Board of Directors may, from time to time, direct the issuance of shares of preferred stock in series and may, at the time of issuance, determine the designation, powers, rights, preferences and limitations of each series. Satisfaction of any dividend preferences of outstanding preferred stock would reduce the amount of funds available for the payment of dividends on our shares of common stock. Holders of preferred stock may be entitled to receive a preference payment in the event of any liquidation, dissolution or winding-up of the Corporation before any payment is made to the holders of our common stock. Under certain circumstances, the issuance of preferred stock may render more difficult or tend to discourage a merger, tender offer or proxy contest, the assumption of control by a holder of a large block of the Corporation's securities or the removal of incumbent management. The Board of Directors may issue shares of preferred stock with voting and conversion rights that could adversely affect the holders of common stock. Specifically, the Corporation's certificate of incorporation authorizes the Corporation's Board of Directors to adopt a rights plan without stockholder approval. This could delay or prevent a change in control of the Corporation or the removal of existing management.

On August 25, 2011, the Board of Directors adopted a Rights Plan, providing for the distribution of one right for each share of common stock outstanding. Each right entitles the holder to purchase one one-thousandth (1/1000<sup>th</sup>) of a share of Series A Junior Preferred Stock, par value \$0.01 per share, of the Corporation at a price of \$45.00 per one one-thousandth (1/1000<sup>th</sup>) of a share, subject to adjustment. The rights generally become exercisable at the discretion of the Board of Directors following a public announcement that 15% or more of the Corporation's common stock has been acquired or an intent to acquire has become apparent. The rights will expire on the earlier of August 25, 2021 or redemption by the Corporation. However, the rights will expire immediately at the final adjournment of the Corporation's 2012 annual meeting of stockholders if stockholder approval of the Rights Agreement has not been received prior to that time. Certain terms of the rights are subject

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**Table of Contents**

**PHARMERICA CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 9 COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS (Continued)**

to adjustment to prevent dilution. Further description and terms of the rights are set forth in the Rights Agreement.

On August 25, 2011, the Board of Directors declared a dividend of one Right for each outstanding share of common stock. The dividend was paid on September 6, 2011 to the stockholders of record on September 6, 2011.

*Treasury Stock Purchases*

In August 2010, the Board of Directors authorized a share repurchase of up to \$25.0 million of the Corporation's common stock. Share repurchases under this authorization may be made in the open market through unsolicited or solicited privately negotiated transactions, or in such other appropriate manner, and will be funded from available cash. The amount and timing of the repurchases will be determined by the Corporation's management and will depend on a variety of factors including price, corporate and regulatory requirements, capital availability and other market conditions. Common stock acquired through the share repurchase program will be held as treasury shares and may be used for general corporate purposes, including reissuances in connection with acquisitions, employee stock option exercises or other employee stock plans. The share repurchase program does not have an expiration date and may be limited, terminated or extended at any time without prior notice. During the year ended December 31, 2010 the Corporation repurchased 1,327,803 shares of common stock for an aggregate purchase price, including commissions, of \$10.5 million at an average purchase price of \$7.90 per share.

The Corporation did not repurchase shares under this program during the year ended December 31, 2011. Additionally, the Corporation has approximately \$14.5 million of shares that may yet be purchased under the share repurchase program. The Corporation may redeem shares from employees upon the vesting of the Corporation's stock awards for minimum statutory tax withholding purposes. The Corporation redeemed 13,311 shares of certain vested awards for an aggregate price of approximately \$0.2 million, during the year ended December 31, 2011. These shares have also been designated by the Corporation as treasury stock.

As of December 31, 2011, the Corporation had a total of 1,350,128 shares held as treasury stock.

*Amended and Restated 2007 Omnibus Incentive Plan*

The Corporation has adopted the Amended and Restated PharMerica Corporation 2007 Omnibus Incentive Plan (as amended and restated, the Omnibus Plan) under which the Corporation is authorized to grant equity-based and other awards to its employees, officers, directors, and consultants. In connection with the Corporation's 2010 Annual Meeting of Stockholders, the stockholders of the Corporation approved and adopted the amended and restated Omnibus Plan to, among other things, implement a fungible share pool effective as of January 1, 2010, and preserve preferential tax treatment as qualified performance-based compensation under Section 162(m) of the Internal Revenue Code.

The Corporation has reserved 7,237,000 shares of its common stock for awards to be granted under the Omnibus Plan plus 534,642 shares reserved for substitute equity awards. Under the fungible share pool, one share of stock will be subtracted from the share limit for each share of stock covered by a stock option or stock appreciation right award and 1.65 shares of stock will be subtracted from the share limit for each share of stock covered by any full-value award, including restricted share awards, restricted stock units and performance share

Table of Contents

## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**NOTE 9 COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS (Continued)**

awards at target. The following shares are not available for re-grant under the Omnibus Plan: (i) shares tendered by a participant or withheld by the Corporation to pay the purchase price of a stock option award or to satisfy taxes owed with respect to an award, (ii) shares subject to a stock appreciation right that are not issued in connection with such award's settlement upon the exercise thereof, and (iii) shares reacquired by the Corporation using cash proceeds received by the Corporation from the exercise of stock options. Effective January 1, 2010, shares subject to an award that is forfeited, expired or settled for cash, are available for re-grant under the Omnibus Plan as one share of stock for each share of stock covered by a stock option or appreciation right and 1.65 shares of stock for each share of stock covered by any other type of award.

The Corporation's Compensation Committee administers the Omnibus Plan and has the authority to determine the recipient of the awards, the types of awards, the number of shares covered, and the terms and conditions of the awards. The Omnibus Plan allows for grants of incentive stock options, non-qualified stock options, stock appreciation rights, restricted share awards and restricted stock units, deferred shares, performance awards, including cash bonus awards, and other stock-based awards.

Stock options granted to officers and employees under the Omnibus Plan generally vest in four equal annual installments and have a term of seven years. The restricted share awards granted to officers and employees generally vest in full upon the three-year anniversary of the date of grant. The restricted stock units granted to officers and employees generally vest in two or three equal annual installments. The restricted share awards granted to members of the Board of Directors vest in three equal annual installments. The restricted stock units granted to members of the Board of Directors vest in one annual installment. The performance share units granted under the Omnibus Plan vest based upon the achievement of a target amount of the Corporation's earnings before interest, income taxes, depreciation and amortization, integration, merger and acquisition related costs and other charges, impairment of intangible assets, and any changes in accounting principles, which reinforces the importance of achieving the Corporation's profitability objectives. The performance is generally measured over a three-year period.

As of December 31, 2011, total shares available for grants of stock-based awards pursuant to the Omnibus Plan were 3,168,057 shares. The 3,168,057 shares does not take into consideration the dilution of 1.65 shares of stock for any full-value award, including restricted stock awards, restricted stock units and performance share awards at target. The number of shares remaining available for future issuance calculated under the fungible share pool would be 2,747,573. On January 18, 2012, a long-term incentive award was granted which was comprised of 299,729 restricted stock units and 199,814 performance share units. The 2012 award reduced the amount of shares available for future issuance calculated under the fungible share pool to 1,923,327.

*Stock-Based Compensation Expense*

The following is a summary of stock-based compensation incurred by the Corporation (dollars in millions, except per share amounts):

	Years Ended December 31,		
	2009	2010	2011
Stock option compensation expense	\$ 2.1	\$ 2.6	\$ 2.4
Nonvested stock compensation expense	2.5	2.2	3.5
<b>Total Stock Compensation Expense</b>	<b>\$ 4.6</b>	<b>\$ 4.8</b>	<b>\$ 5.9</b>

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 9 COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS (Continued)**

As of December 31, 2011, there was \$9.8 million of total unrecognized compensation cost related to the Corporation's stock compensation arrangements. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

Total estimated stock-based compensation expense for the Corporation's stock options and nonvested stock awards for the next five years and thereafter are as follows (dollars in millions):

Year Ending December 31,	Stock Options	Nonvested Restricted Shares	Nonvested Restricted Stock Units	Performance Share Units	Total
2012	\$ 2.0	\$ 0.1	\$ 1.8	\$ 0.6	\$ 4.5
2013	1.6		1.6	0.6	3.8
2014	0.8		0.3	0.2	1.3
2015	0.2				0.2
2016					
Thereafter					
<b>Total</b>	<b>\$ 4.6</b>	<b>\$ 0.1</b>	<b>\$ 3.7</b>	<b>\$ 1.4</b>	<b>\$ 9.8</b>

The following weighted average assumptions were used to estimate the fair value of options granted during the periods presented, using the Black-Scholes-Merton option valuation model:

	2009	2010	2011
Expected volatility (range)	36.36-41.07%	38.53-45.54%	42.23-46.34%
Risk free interest rate (range)	0.75-2.09%	0.49-2.47%	0.19-2.20%
Expected dividends			
Average expected term (years)	2.0-5.0	2.0-5.0	2.0-5.0
Average fair value per share of stock options granted based on the Black-Scholes-Merton model (dollars)	\$ 4.40	\$ 5.79	\$ 3.61
Weighted average fair value of options granted (in millions)	\$ 2.5	\$ 3.3	\$ 2.4

*Expected Volatility*

Volatility is a measure of the tendency of investment returns to vary around a long-term average rate. Historical volatility is an appropriate starting point for setting this assumption. The Corporation also considers how future experience may differ from the past. This may require using other factors to adjust historical volatility, such as implied volatility, peer-group volatility and the range and mean-reversion of volatility estimates over various historical periods. The peer-group utilized consisted of fourteen companies in 2009 and 2010 and twelve companies in 2011, in the same or similar industries as the Corporation. The Corporation estimates the volatility of its common stock in conjunction with the Corporation's annual grant and volatility is calculated utilizing the historical volatility of the Corporation and its peer-group. To the extent material grants are made subsequent to the Corporation's annual grant, the volatility calculation is updated through the most recent grant date of

the awards.

F-37

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 9 COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS (Continued)***Risk-Free Interest Rate*

The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for the expected term of the option.

*Expected Dividends*

The Corporation has never paid any cash dividends on its common stock and does not anticipate paying any cash dividends in the foreseeable future. Consequently, it uses an expected dividend yield of zero.

*Expected Term*

The Corporation calculated an expected term using management's estimate and expectation of option exercises. The majority of the Corporation's stock options are on a graded-vesting schedule. The Corporation estimates the value of awards with graded vesting by treating each vesting tranche as a separate award. Management has determined to value each tranche of the awards separately utilizing a multiple fair value method.

*Stock Option Activity*

The following table summarizes option activity for the periods presented:

	Number of Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Term	Aggregate Intrinsic Value (in millions)
Outstanding shares at December 31, 2008	1,332,649	\$ 15.47	5.7 years	\$ 0.9
Granted	567,633	15.18		
Exercised	(107,308)	12.69		
Canceled	(59,649)	14.63		
Outstanding shares at December 31, 2009	1,733,325	\$ 15.60	5.2 years	\$ 1.0
Granted	562,993	18.27		
Exercised	(22,072)	12.66		
Canceled	(50,503)	16.60		
Outstanding shares at December 31, 2010	2,223,743	\$ 16.28	4.7 years	\$ 0.1
Granted	657,576	10.89		
Exercised	(18,713)	12.34		
Canceled	(118,595)	15.00		
Outstanding shares at December 31, 2011	2,744,011	\$ 15.07	4.2 years	\$ 3.1

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Exercisable shares at December 31, 2011	1,442,613	\$	16.02	3.2 years	\$	0.3
Expired shares during 2011	27,238	\$	15.65			

The total intrinsic value of stock options exercised for the years ended December 31, 2009, 2010, and 2011 was \$0.8 million, \$0.1 million, and less than \$0.1 million, respectively. Cash received from stock option exercises during the year ended December 31, 2011 was \$0.3 million. The total fair value of options vested for the years ended December 31, 2009, 2010, and 2011 was \$2.1 million, \$2.3 million, and \$2.3 million, respectively. The Corporation expects to recognize stock based compensation expense for stock options over a remaining weighted average period of 1.74 years.

F-38

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 9 COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS (Continued)***Nonvested Shares*

The following table summarizes nonvested share activity for the periods presented:

	Number of Shares	Weighted- Average Grant Date Fair Value
Outstanding shares at December 31, 2008	342,591	\$ 15.93
Granted Restricted Stock	35,633	17.96
Granted Restricted Stock Units	99,332	15.06
Granted Performance Share Units	152,580	15.16
Forfeited	(11,533)	14.52
Vested	(84,201)	14.34
Outstanding shares at December 31, 2009	534,402	\$ 15.98
Granted Restricted Stock Units	39,144	16.35
Granted Performance Share Units	178,472	18.00
Forfeited	(70,387)	15.52
Vested	(191,776)	16.20
Outstanding shares at December 31, 2010	489,855	\$ 16.72
Granted Restricted Stock Units	498,333	11.34
Granted Performance Share Units	186,533	10.78
Forfeited	(207,204)	14.27
Vested	(151,028)	16.50
Outstanding shares at December 31, 2011	816,489	\$ 12.69

The total fair value of shares vested for the years ended December 31, 2009, 2010, and 2011 was \$1.2 million, \$3.1 million, and \$2.5 million, respectively. The Corporation expects to recognize stock based compensation expense for nonvested shares over a weighted average period of less than one year to 1.24 years. The 2009 long-term incentive award was not achieved; therefore, 133,256 performance share units representing that award are included in the forfeited amount of 207,204 shown in the above table.

Based upon the achievement of the performance criteria at the end of the performance cycle for the performance share units issued to date, the Corporation may issue no shares or a maximum of 545,499 shares.

*401K Plan*

The Corporation sponsors a defined contribution retirement plan for all eligible employees, as defined in the plan document. The plan is qualified under Section 401(k) of the Internal Revenue Code. Contributions to the plan are based upon employee contributions and the Corporation's matching contributions. For the years ended December 31, 2009, 2010, and 2011, the Corporation's matching contributions to the



plan were \$5.3 million, \$5.1 million, and \$5.9 million, respectively.

*Deferred Compensation Plans*

The Corporation maintains an unfunded deferred compensation plan for certain management and highly compensated employees. Under the plan, a participant may elect to defer up to 50% of such participant's annual base salary and up to 100% of such participant's annual short-term incentive program cash bonus into the plan during each plan year. In addition, the Corporation may, in its sole discretion, make discretionary contributions to a participant's account.

Table of Contents

## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**NOTE 9 COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS (Continued)**

The Corporation also maintains a deferred compensation plan for the directors of the Corporation. The directors of the Corporation may elect to defer up to 100% of their cash fees and their stock fees in any one year. If a director elects to defer his/her restricted share grant, the shares will be deferred as they vest until the participant elects for the deferred compensation to be a taxable event.

As of December 31, 2010 and 2011, the Corporation had \$4.0 million and \$3.9 million, respectively, recognized as a long-term liability related to the deferred compensation plans in the accompanying consolidated balance sheets.

**NOTE 10 INCOME TAXES**

The provision for income taxes is based upon the Corporation's annual income or loss before income taxes for each respective accounting period. The following table summarizes our provision for income taxes for the periods presented (dollars in millions):

	2009	2010	2011
Current provision:			
Federal	\$ 0.2	\$	\$ 0.1
State	0.5	0.3	0.8
Total	0.7	0.3	0.9
Deferred provision (benefit):			
Federal	21.9	11.4	12.4
State	(3.7)	1.3	1.5
Total	18.2	12.7	13.9
Total provision for income taxes	\$ 18.9	\$ 13.0	\$ 14.8

A reconciliation of the Corporation's effective tax rate and the U.S. statutory rate is as follows for the years ended December 31:

	2009	2010	2011
U.S. statutory rate applied to pretax income	35.0%	35.0%	35.0%
Differential arising from:			
State taxes	4.5	4.7	4.5
Valuation Allowance	(7.9)		(0.1)
Other	(0.7)	0.5	(0.7)
Effective tax rate	30.9%	40.2%	38.7%

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The provision for income taxes as a percentage of taxable income for the years ended December 31, 2010 and 2011 was significantly higher than for the year ended December 31, 2009 due to a discrete tax benefit recorded in the third quarter of 2009 related to the adoption of an internal legal entity restructuring plan. Excluding the one-time benefits associated with the Corporation's legal entity restructuring activities, the provision for income taxes for the year ended December 31, 2009 would have been \$24.6 million (40.2% of pre-tax income). In addition, the effective tax rate for 2011 was favorably impacted by the reserve release for

F-40

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 10 INCOME TAXES (Continued)**

unrecognized tax benefits. Excluding the one-time benefit associated with the reserve release and other discrete items the 2011 provision for income taxes would have been \$15.5 million (40.5% of pre-tax income). Apart from the discrete tax benefit recorded as a result of the internal restructuring, the effective tax rates in 2009, 2010 and 2011 are higher than the federal statutory rate largely as a result of the combined impact of state and local taxes and various non-deductible expenses.

The Corporation derives a current federal and state income tax benefit from the impact of deductions associated with the amortization of tax deductible goodwill acquired through business combinations. The tax basis of the Corporation's tax deductible goodwill was approximately \$111.7 million and \$121.6 million at December 31, 2010 and 2011, respectively.

The Corporation recognizes an asset or liability for the deferred tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets are recovered or liabilities are settled. The Corporation also recognizes as deferred tax assets the future tax benefits from net operating and capital loss carryforwards. As of December 31, 2011, the Corporation has federal net operating loss carryforwards of \$23.3 million (\$8.2 million net of tax) and state net operating loss carryforwards of \$185.6 million (\$9.6 million net of tax). The net operating losses have carryforward periods ranging from 1 to 20 years depending on the taxing jurisdiction.

A valuation allowance is provided for the Corporation's deferred tax assets if it is more likely than not that some portion or all of the net deferred tax assets will not be realized. The Corporation recognized deferred tax assets totaling \$52.2 million and \$37.1 million at December 31, 2010 and 2011, net of valuation allowances of \$1.6 million and \$1.0 million, respectively.

Current deferred income taxes consisted of (dollars in millions):

	\$,000,00.0 December 31, 2010		\$,000,00.0 December 31, 2011	
	Assets	Liabilities	Assets	Liabilities
Accrued expenses	\$ 3.2	\$	\$ 7.0	\$
Allowance for doubtful accounts	13.0		16.2	
Net operating losses	5.5		9.8	
Other	2.3		4.0	
Valuation allowance	(0.5)		(0.4)	
Total current deferred taxes	\$ 23.5	\$	\$ 36.6	\$

F-41

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 10 INCOME TAXES (Continued)**

Noncurrent deferred income taxes consisted of (dollars in millions):

	\$,000,000	\$,000,000	\$,000,000	\$,000,000
	December 31, 2010		December 31, 2011	
	Assets	Liabilities	Assets	Liabilities
Accelerated depreciation	\$ 3.3	\$ 9.2	\$ 4.4	\$ 9.5
Stock-based compensation	3.3		4.4	
Goodwill and intangibles		2.9		8.6
Net operating losses	31.0		8.0	
Other	8.0	0.4	7.0	0.2
Valuation allowances	(1.1)		(0.6)	
<b>Total noncurrent deferred taxes</b>	<b>\$ 41.2</b>	<b>\$ 12.5</b>	<b>\$ 18.8</b>	<b>\$ 18.3</b>
Noncurrent deferred taxes, net	\$ 28.7		\$ 0.5	

As of December 31, 2010, the Corporation had \$1.2 million recorded as a liability for unrecognized tax benefits for U.S. federal and state tax jurisdictions. The Corporation has no such liability recorded as of December 31, 2011. The net decrease of \$1.2 million for the year ended December 31, 2011 was primarily due to concluding the IRS audits for the years 2007 and 2008. There were no unrecognized tax benefits at December 31, 2011 that, if recognized, would affect the tax rate.

It is the Corporation's policy to accrue interest and penalties related to liabilities for income tax contingencies in the provision for income taxes. As of December 31, 2011, the Corporation had no accrued interest or penalties related to uncertain tax positions.

The federal statute of limitations remains open for tax years 2008 through 2010. The Corporation's consolidated U.S. income tax returns for 2007 and 2008 were examined by the IRS. In May 2011, the IRS concluded their examination with no significant findings.

State tax jurisdictions generally have statutes of limitation ranging from three to five years. The Corporation is no longer subject to state and local income tax examinations by tax authorities for years before 2006. The state income tax impact of federal income tax changes remains subject to examination by various states for a period of up to one year after formal notification of IRS settlement to the states. Kindred and AmerisourceBergen are responsible for any taxes that relate to periods before July 31, 2007.

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 11 EARNING PER SHARE**

The following table sets forth the computation of basic and diluted earnings per share (dollars in millions, except per share amounts):

	2009	2010	2011
<b>Numerator:</b>			
Numerator for basic and earnings per diluted share net income	\$ 42.2	\$ 19.2	\$ 23.4
<b>Denominator:</b>			
Denominator for basic earnings per share weighted average shares	30,266,272	30,007,268	29,343,221
<b>Effective of dilutive securities:</b>			
Employee stock options	47,845	14,085	9,763
Employee restricted shares	84,173	111,678	115,468
Employee performance share units	4,478		
Denominator for earnings per diluted share adjusted weighted average shares	30,402,768	30,133,031	29,468,452
Basic earnings per share	\$ 1.39	\$ 0.64	\$ 0.80
Earnings per diluted share	\$ 1.39	\$ 0.64	\$ 0.79
Unexercised employee stock options and unvested restricted shares excluded from the effect of dilutive securities above (a)	1,497,083	2,086,320	2,594,643

(a) These unexercised employee stock options and nonvested restricted shares were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the periods presented.

Stock options and restricted shares and units granted by the Corporation are treated as potential common shares outstanding in computing earnings per diluted share. Performance share units are treated as potential common shares outstanding in computing earnings per diluted share only when the performance conditions are met.

Common shares repurchased by the Corporation reduce the number of basic shares used in the denominator for basic and diluted earnings per share.

**NOTE 12 BUSINESS SEGMENT DATA**

The Corporation operates in two reportable business segments: institutional pharmacies and hospital pharmacy management. Institutional pharmacies provide pharmacy services to nursing centers and other healthcare providers and the hospital pharmacy management business provides management services to the majority of Kindred's hospitals. For business segment reporting purposes, the Corporation defines segment operating income as earnings before interest, income taxes, depreciation, amortization, impairment of intangible assets, integration, merger and acquisition related costs and other charges, and rent. Segment operating income reported for each of the Corporation's business segments

excludes the allocation of corporate overhead.

F-43

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 12 BUSINESS SEGMENT DATA (Continued)**

The following table sets forth the assets and goodwill amounts by reportable segment (dollars in millions):

	(As Adjusted) December 31, 2010	December 31, 2011
<b>Assets:</b>		
Institutional pharmacies	\$ 750.5	\$ 822.4
Hospital pharmacy management	9.2	11.0
	\$ 759.7	\$ 833.4
<b>Goodwill:</b>		
Institutional pharmacies	\$ 179.4	\$ 214.2
Hospital pharmacy management		
	\$ 179.4	\$ 214.2

The following table sets forth income statement information by reportable segment (dollars in millions):

	Year Ended December 31,		
	2009	2010	2011
<b>Revenues:</b>			
Institutional pharmacies	\$ 1,784.7	\$ 1,789.4	\$ 2,018.6
Hospital pharmacy management	56.5	57.9	62.5
	\$ 1,841.2	\$ 1,847.3	\$ 2,081.1
<b>Net income:</b>			
Segment operating income:			
Institutional pharmacies	\$ 113.3	\$ 89.0	\$ 109.5
Hospital pharmacy management	6.1	5.6	5.9
Segment operating income	119.4	94.6	115.4
Rent	16.7	16.1	16.9
Depreciation and amortization	27.0	28.1	31.1
Impairment of intangible assets			5.1
Integration, merger and acquisition related costs and other charges	5.2	14.6	15.3
Interest expense, net	9.4	3.6	8.8
Income before income taxes	61.1	32.2	38.2



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Provision for income taxes		18.9	13.0	14.8
Net income	\$	42.2	\$ 19.2	\$ 23.4

F-44

**Table of Contents****PHARMERICA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 12 BUSINESS SEGMENT DATA (Continued)**

	Year Ended December 31,		
	2009	2010	2011
<b>Rent:</b>			
Institutional pharmacies	\$ 16.6	\$ 16.0	\$ 16.9
Hospital pharmacy management	0.1	0.1	
	\$ 16.7	\$ 16.1	\$ 16.9
<b>Depreciation and amortization:</b>			
Institutional pharmacies	\$ 27.0	\$ 28.1	\$ 31.1
Hospital pharmacy management			
	\$ 27.0	\$ 28.1	\$ 31.1
<b>Capital expenditures, excluding acquisitions:</b>			
Institutional pharmacies	\$ 21.6	\$ 12.6	\$ 13.2
Hospital pharmacy management			
	\$ 21.6	\$ 12.6	\$ 13.2

**NOTE 13 UNAUDITED QUARTERLY FINANCIAL INFORMATION**

The quarterly interim information shown below has been prepared by the Corporation's management and is unaudited. It should be read in conjunction with the audited consolidated financial statements appearing herein (dollars in millions, except per share amounts).

	2010 Quarters				2011 Quarters			
	First	Second	Third	Fourth	First	Second	Third	Fourth
<b>Net revenues:</b>								
Institutional pharmacy revenues	\$ 448.3	\$ 435.9	\$ 427.7	\$ 477.5	\$ 519.6	\$ 516.0	\$ 503.0	\$ 480.0
Hospital management revenues	13.9	14.6	15.4	14.0	15.5	15.7	15.7	15.6
Total revenues	462.2	450.5	443.1	491.5	535.1	531.7	518.7	495.6
<b>Cost of goods sold:</b>								
Institutional pharmacy	386.8	380.1	372.8	416.9	455.9	441.6	429.6	405.9
Hospital management	12.1	12.8	13.5	12.0	13.5	13.7	13.8	13.8
Total cost of goods sold	398.9	392.9	386.3	428.9	469.4	455.3	443.4	419.7
<b>Gross profit:</b>								
Institutional pharmacy	61.5	55.8	54.9	60.6	63.7	74.4	73.4	74.1

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Hospital management	1.8	1.8	1.9	2.0	2.0	2.0	1.9	1.8
Total gross profit	63.3	57.6	56.8	62.6	65.7	76.4	75.3	75.9
Operating income	\$ 15.0	\$ 3.0	\$ 8.9	\$ 8.9	\$ 6.7	\$ 13.5	\$ 10.7	\$ 16.1
Net income	\$ 8.4	\$ 1.3	\$ 4.8	\$ 4.7	\$ 3.3	\$ 7.4	\$ 4.8	\$ 7.9
<b>Earnings per common share:</b>								
Basic	\$ 0.28	\$ 0.04	\$ 0.16	\$ 0.16	\$ 0.11	\$ 0.25	\$ 0.16	\$ 0.27
Diluted	\$ 0.27	\$ 0.04	\$ 0.16	\$ 0.16	\$ 0.11	\$ 0.25	\$ 0.16	\$ 0.27
<b>Shares used in computing earnings per common share:</b>								
Basic	30.4	30.4	30.0	29.2	29.3	30.4	29.4	29.4
Diluted	30.6	30.6	30.1	29.3	29.4	30.6	29.5	29.6

F-45

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**Table of Contents**

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

The Corporation has carried out an evaluation under the supervision and with the participation of management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act) as of the end of the period covered by this report. The Corporation's disclosure controls and procedures are designed so that information required to be disclosed in the Corporation's reports filed under the Exchange Act, such as this Annual Report on Form 10-K, is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. The Corporation's disclosure controls and procedures are also intended to ensure that such information is accumulated and communicated to the Corporation's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives, and management necessarily is required to use its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2011, the Corporation's disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in the reports that the Corporation files and submits under the Exchange Act is recorded, processed, summarized and reported as and when required and such information is accumulated and communicated as appropriate to allow timely decisions regarding required disclosures.

**Changes in Internal Control Over Financial Reporting**

There have been no changes in the Corporation's internal control over financial reporting during the quarter ended December 31, 2011, that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**Management's Annual Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

- (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Corporation;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Corporation are being made only in accordance with authorizations of management and directors of the Corporation; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Corporation's assets that could have a material effect on the financial statements.

**Table of Contents**

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2011. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*.

Based upon our assessment and those criteria, management has concluded that the Corporation maintained effective internal control over financial reporting as of December 31, 2011.

The Corporation has excluded the Pharmacy Management Group acquisition from its assessment of internal control over financial reporting as of December 31, 2011 because it was acquired by the Corporation on December 31, 2011. The total assets of Pharmacy Management Group represent 5.7% of the related consolidated balance sheet amount as of December 31, 2011. The Corporation continues to integrate new acquisitions into corporate processes. No potential internal control changes due to new acquisitions would be considered material to, or are reasonably likely to materially affect, our internal control over financial reporting.

The effectiveness of the Corporation's internal control over financial reporting as of December 31, 2011 has been audited by KPMG LLP, our independent registered public accounting firm, who also audited our consolidated financial statements as of and for each year in the two year period ended December 31, 2011 included in this Annual Report on Form 10-K, as stated in their report which appears with our accompanying consolidated financial statements.

**Item 9B. Other Information**

None.

**Table of Contents**

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information required by this Item is incorporated herein by reference from the Corporation's definitive proxy statement to be filed no later than 120 days after December 31, 2011. We refer to this proxy statement as the 2012 Proxy Statement.

**Item 11. Executive Compensation**

Incorporated herein by reference from the Corporation's 2012 Proxy Statement.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Incorporated herein by reference from the Corporation's 2012 Proxy Statement.

**Item 13. Certain Relationships and Related Transactions, and Director Independence.**

Incorporated herein by reference from the Corporation's 2012 Proxy Statement.

**Item 14. Principal Accounting Fees and Services.**

Incorporated herein by reference from the Corporation's 2012 Proxy Statement.

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**Table of Contents**

**PART IV**

**Item 15. Exhibits**

- (a)  
(1) All Financial Statements

Consolidated financial statements filed as part of this report are listed under Part II, Item 8 of this Form 10-K.

- (2) Financial Statement Schedules

No schedules are required because either the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the accompanying consolidated financial statements or the notes thereto.

- (3) Exhibits

dated as of October 25, 2006, by and among AmerisourceBergen Corporation, PharMerica, Inc., Kindred Healthcare, Inc., Kindred Pharmacy Services, Inc., Kindred Health Services, Inc. and Rhino Merger Corporation (1)

Amendment to the Merger Agreement, dated as of June 4, 2007, by and among AmerisourceBergen Corporation, PharMerica, Inc., Kindred Healthcare, Inc., Kindred Pharmacy Services, Inc., Kindred Health Services, Inc. and Rhino Merger Corporation (2)

Form of Purchase Agreement, dated as of September 26, 2010, by and between Chem Rx Corporation, and certain of its subsidiaries, as Seller, Chem Rx Acquisition Sub, LLC, as Buyer, and PharMerica Corporation as Registrant, as amended (3)

Form of the Registrant (3)

Form of Certificate of Designation (18).

Form of the Registrant (2)

Form of Certificate of Designation, dated as of August 25, 2011, between PharMerica Corporation and Mellon Investor Services LLC as Rights Agent, which includes the form of Certificate of Designation of Series A Preferred Stock as Exhibit B and the Summary of Rights to Purchase Shares of Preferred Stock of PharMerica Corporation as Exhibit C. (18)

Form of License Agreement, dated as of July 1, 2004 by and among Kindred Healthcare Operating, Inc., Kindred Hospitals East L.L.C., Kindred Hospitals West, L.L.C., Kindred Hospitals Lincoln, Inc. and Kindred Pharmacy Services, Inc. (5)

Form of Share Purchase Agreement, dated as of November 11, 2007 between Michael Culotta and Safari Holding Corporation (5)

Form of Share Purchase Agreement, dated as of November 11, 2007 between Anthony Hernandez and Safari Holding Corporation (5)

Form of Share Purchase Agreement (6)

**Table of Contents**

<b>Exhibit No.</b>	<b>Description</b>
10.5	Form CEO Stock Option Award Agreement (6)
10.6	Form Non-Qualified Stock Option Award Agreement (6)
10.7	Employment Agreement dated July 31, 2007 between Robert McKay and PharMerica Corporation (3)
10.8	Employment Agreement dated August 7, 2007 between Thomas Caneris and PharMerica Corporation (3)
10.9	Form Performance Share Award Agreement (3)
10.10	Form Long-Term Cash Award Agreement (3)
10.11	Form Director Restricted Share Award Agreement (3)
10.12	Form Director Non-Qualified Stock Option Award Agreement (10)
10.13	Form of Substitution NQSO Agreement for AmerisourceBergen 2001 Grants (3)
10.14	Form of Substitution NQSO Agreement for AmerisourceBergen 2002 Grants (3)
10.15	Form of Substitution NQSO Agreement for Kindred Grants (3)
10.16	Form of Substitution ISO Agreement for Kindred Grants (3)
10.17	IT Services Agreement (4)
10.18	Trademark License Agreement (4)
10.19	Summary of Director Compensation Program (4)
10.20	Form of Non-Qualified Stock Option Award Agreement (8)
10.21	Employment Agreement dated March 31, 2008 between John Kernaghan and PharMerica Corporation (9)
10.22	Form of Performance Share Award Agreement (adjusted EBITDA and adjusted ROIC) (11)
10.23	Summary of 2009 Long-Term Incentive Program (13)
10.24	Employment Agreement dated April 20, 2009 between William Monast and PharMerica Corporation (12)
10.25	Form of Restricted Stock Unit Award Agreement (14)
10.26	Summary of 2010 CEO Short-Term Incentive Program and 2010 Short-Term Incentive Program (15)
10.27	Summary of 2010 Long-Term Incentive Program (15)
10.28	Amended and Restated PharMerica Corporation 2007 Omnibus Incentive Plan Adopted May 26, 2010 (16)
10.29	Form of Director Restricted Stock Unit Award Agreement (16)
10.30	New Employment Agreement dated September 30, 2010 between Gregory S. Weishar and PharMerica Corporation (17)
10.31#	Amended and Restated Prime Vendor Agreement for Long-Term Care Pharmacies dated January 4, 2011 by and between AmerisourceBergen Drug Corporation, PharMerica Corporation, Pharmacy Corporation of America and Chem Rx Pharmacy Services, LLC (19)
10.32	Credit Agreement dated May 2, 2011 between PharMerica Corporation, the Lenders named therein, and Citibank, N.A., as Administrative Agent (20)



**Table of Contents**

<b>Exhibit No.</b>	<b>Description</b>
10.33	Guarantee and Collateral Agreement dated as of May 2, 2011 between PharMerica Corporation, Its subsidiaries Party thereto, and Citibank, N.A. as Collateral Agent (20)
10.34	Summary of 2011 CEO Short-Term Incentive Program and 2011 Short Term Incentive Program (20)
10.35	Summary of 2011 Long-Term Incentive Program (20)
10.36	Form of Indemnification Agreement (21)
10.37	Employment Agreement dated March 22, 2011 between Suresh Vishnubhatla and PharMerica Corporation (21)
21.1	Subsidiaries of the Registrant
23.1	Consent of KPMG LLP
23.2	Consent of PricewaterhouseCoopers LLP
31.1	Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 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 required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from the PharMerica Corporation Annual Report on Form 10-K for the year ended December 31, 2011 formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Statements of Income, (ii) the Consolidated Balance Sheets, (iii) the Consolidated Statements of Cash Flows, (iv) the Consolidated Statement of Stockholders' Equity, and (v) the Notes to the Consolidated Financial Statements, tagged as blocks of text (22)
(1)	Filed with Amendment No. 1 to the Corporation's Registration Statement on Form S-4/S-1 (Reg. No. 333-142940) filed with the Securities and Exchange Commission on May 24, 2007, and incorporated herein by reference.
(2)	Filed with Amendment No. 2 to the Corporation's Registration Statement on Form S-4/S-1 (Reg. No. 333-142940) filed with the Securities and Exchange Commission on June 27, 2007, and incorporated herein by reference.

**Table of Contents**

- (3) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 31, 2007, and incorporated herein by reference.
- (4) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 9, 2007, and incorporated herein by reference.
- (5) Filed with Amendment No. 3 to the Corporation's Registration Statement on Form S-4/S-1 (Reg. No. 333-142940) filed with the Securities and Exchange Commission on July 13, 2007, and incorporated herein by reference.
- (6) Filed with the Corporation's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 13, 2007, and incorporated herein by reference.
- (7) Filed with Amendment No. 1 to the Corporation's Annual Report on Form 10-K/A filed with the Securities and Exchange Commission on April 29, 2008, and incorporated herein by reference.
- (8) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 8, 2008, and incorporated herein by reference.
- (9) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on October 30, 2008, and incorporated herein by reference.
- (10) Filed with the Corporation's Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 5, 2009, and incorporated herein by reference.
- (11) Filed with the Corporation's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 9, 2009, and incorporated herein by reference.
- (12) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 3, 2009, and incorporated herein by reference.
- (13) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on April 30, 2009, and incorporated herein by reference.
- (14) Filed with the Corporation's Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 4, 2010, and incorporated herein by reference.
- (15) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 7, 2010, and incorporated herein by reference.

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- (16) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 5, 2010, and incorporated herein by reference.
  - (17) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 4, 2010, and incorporated herein by reference.
  - (18) Filed with the Corporation's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 25, 2011, and incorporated herein by reference.
  - (19) Filed with the Corporation's Annual Report on Form 10-K/A filed with the Securities and Exchange Commission on May 25, 2011, and incorporated herein by reference.
  - (20) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 4, 2011, and incorporated herein by reference.
  - (21) Filed with the Corporation's Schedule 14D-9 filed with the Securities and Exchange Commission on September 20, 2011, and incorporated herein by reference.
  - (22) As provided in Rule 406T of Regulation S-T, this information is furnished herewith and not filed for purposes of sections 11 and 12 of the Securities Act of 1933 and section 18 of the Securities Exchange Act of 1934.
- # Application has been made to the Securities and Exchange Commission to seek confidential treatment of certain provisions. Omitted material for which confidential treatment has been requested has been filed separately with the Securities and Exchange Commission.

Management contract or compensatory plan or arrangement.

**Table of Contents****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.

**PHARMERICA CORPORATION**

Date: February 9, 2012

By: /s/ GREGORY S. WEISHAR  
Gregory S. Weishar

**Chief Executive Officer and Director**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ GREGORY S. WEISHAR <b>(Gregory S. Weishar)</b>	Chief Executive Officer and Director	February 9, 2012
/s/ MICHAEL J. CULOTTA <b>(Michael J. Culotta)</b>	Executive Vice President and Chief Financial Officer	February 9, 2012
/s/ BERARD E. TOMASSETTI <b>(Berard E. Tomassetti)</b>	Senior Vice President and Chief Accounting Officer	February 9, 2012
/s/ FRANK E. COLLINS <b>(Frank E. Collins)</b>	Director	February 9, 2012
/s/ W. ROBERT DAHL JR. <b>(W. Robert Dahl Jr.)</b>	Director	February 9, 2012
/s/ MARJORIE W. DORR <b>(Marjorie W. Dorr)</b>	Director	February 9, 2012
/s/ DR. THOMAS P. GERRITY <b>(Dr. Thomas P. Gerrity)</b>	Director	February 9, 2012
/s/ THOMAS P. MAC MAHON <b>(Thomas P. Mac Mahon)</b>	Director	February 9, 2012
/s/ GEOFFREY G. MEYERS <b>(Geoffrey G. Meyers)</b>	Director	February 9, 2012

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/s/ DR. ROBERT A. OAKLEY

Director

February 9, 2012

**(Dr. Robert A. Oakley)**

97

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
21.1	Subsidiaries of the Registrant
23.1	Consent of KPMG LLP
23.2	Consent of PricewaterhouseCoopers LLP
31.1	Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 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 required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from the PharMerica Corporation Annual Report on Form 10-K for the year ended December 31, 2011 formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Statements of Income, (ii) the Consolidated Balance Sheets, (iii) the Consolidated Statements of Cash Flows, (iv) the Consolidated Statement of Stockholders' Equity, and (v) the Notes to the Consolidated Financial Statements, tagged as blocks of text