CVS CAREMARK CORP
Form 10-Q
May 01, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the

Securities Exchange Act of 1934

For the Quarterly Period Ended March 29, 2008

Commission File Number 001-01011

CVS CAREMARK CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**05-0494040**
(State of Incorporation)	*(I.R.S. Employer Identification Number)*

One CVS Drive, Woonsocket, Rhode Island 02895

(Address of principal executive offices)

Telephone: (401) 765-1500

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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller Reporting Company ¨

(Do not check if a smaller reporting company)

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

Common Stock, $0.01 par value, issued and outstanding at April 25, 2008:

1,429,378,000 shares

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Part I **Item 1**

CVS Caremark Corporation

Consolidated Condensed Statements of Operations

(Unaudited)

In millions, except per share amounts	*13 Weeks Ended* March 29, 2008	March 31, 2007
Net revenues	**$ 21,326.0**	$ 13,188.6
Cost of revenues	**17,033.0**	9,885.4
Gross profit	**4,293.0**	3,303.2
Total operating expenses	**2,922.9**	2,566.7
Operating profit	**1,370.1**	736.5
Interest expense, net	**130.9**	63.9
Earnings before income tax provision	**1,239.2**	672.6
Income tax provision	**490.7**	263.7
Net earnings	**748.5**	408.9
Preference dividends, net of income tax benefit	**3.5**	3.5
Net earnings available to common shareholders	**$ 745.0**	$ 405.4
Basic earnings per common share:		
Net earnings	**$ 0.52**	$ 0.45
Weighted average basic common shares outstanding	**1,429.8**	906.1
Diluted earnings per common share:		
Net earnings	**$ 0.51**	$ 0.43
Weighted average diluted common shares outstanding	**1,467.7**	939.8
Dividends declared per common share	**$ 0.06000**	$ 0.04875

See accompanying notes to consolidated condensed financial statements.

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Part I **Item 1**

CVS Caremark Corporation

Consolidated Condensed Balance Sheets

(Unaudited)

In millions, except share and per share amounts	March 29, 2008	December 29, 2007
Assets:		
Cash and cash equivalents	**$ 818.2**	$ 1,056.6
Short-term investments		27.5
Accounts receivable, net	**4,623.5**	4,579.6
Inventories	**7,989.3**	8,008.2
Deferred income taxes	**342.2**	329.4
Other current assets	**141.0**	148.1
Total current assets	**13,914.2**	14,149.4
Property and equipment, net	**6,021.5**	5,852.8
Goodwill	**23,922.1**	23,922.3
Intangible assets, net	**10,344.3**	10,429.6
Other assets	**364.9**	367.8
Total assets	**$ 54,567.0**	$ 54,721.9
Liabilities:		
Accounts payable	**$ 3,405.0**	$ 3,593.0
Claims and discounts payable	**2,481.3**	2,484.3
Accrued expenses	**2,504.6**	2,556.8
Short-term debt	**1,341.9**	2,085.0
Current portion of long-term debt	**47.3**	47.2
Total current liabilities	**9,780.1**	10,766.3
Long-term debt	**8,349.0**	8,349.7
Deferred income taxes	**3,430.2**	3,426.1
Other long-term liabilities	**855.9**	857.9
Shareholders equity:		
Preference stock, series one ESOP convertible, par value $1.00: authorized 50,000,000 shares; issued and outstanding 3,752,000 shares at March 29, 2008 and 3,798,000 shares at December 29, 2007	**200.6**	203.0
Common stock, par value $0.01: authorized 3,200,000,000 shares; issued 1,596,404,000 shares at March 29, 2008 and 1,590,139,000 shares at December 29, 2007	**16.0**	15.9
Treasury stock, at cost: 165,809,000 shares at March 29, 2008 and 153,682,000 shares at December 29, 2007	**(5,854.6)**	(5,620.4)
Shares held in trust, 1,700,000 shares at March 29, 2008 and 9,224,000 shares at December 29, 2007	**(55.5)**	(301.3)
Guaranteed ESOP obligation	**(44.5)**	(44.5)
Capital surplus	**27,019.0**	26,831.9
Retained earnings	**10,919.7**	10,287.0
Accumulated other comprehensive loss	**(48.9)**	(49.7)
Total shareholders equity	**32,151.8**	31,321.9
Total liabilities and shareholders equity	**$ 54,567.0**	$ 54,721.9

See accompanying notes to consolidated condensed financial statements.

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Part I **Item 1**

CVS Caremark Corporation

Consolidated Condensed Statements of Cash Flows

(Unaudited)

In millions	*13 Weeks Ended* **March 29, 2008**	**March 31, 2007**
Cash flows from operating activities:		
Cash receipts from revenues	**$ 16,321.6**	$ 12,861.0
Cash paid for inventory	**(12,459.8)**	(9,486.7)
Cash paid to other suppliers and employees	**(2,989.1)**	(2,510.0)
Interest received	**6.3**	7.7
Interest paid	**(124.6)**	(109.7)
Income taxes paid	**(13.6)**	(54.6)
Net cash provided by operating activities	**740.8**	707.7
Cash flows from investing activities:		
Additions to property and equipment	**(400.3)**	(311.9)
Proceeds from sale-leaseback transactions	**5.3**	9.9
Acquisitions (net of cash acquired) and investments	**15.9**	(1,975.0)
Sale of short-term investment	**27.5**	
Proceeds from sale or disposal of assets	**4.8**	13.2
Net cash used in investing activities	**(346.8)**	(2,263.8)
Cash flows from financing activities:		
(Reductions in) additions to short-term debt	**(743.1)**	1,230.1
Dividends paid	**(85.9)**	(40.3)
Proceeds from exercise of stock options	**170.1**	56.9
Excess tax benefits from stock based compensation	**27.1**	7.7
Additions to long-term debt		500.0
Reductions in long-term debt	**(0.6)**	(18.3)
Net cash (used in) provided by financing activities	**(632.4)**	1,736.1
Net (decrease) increase in cash and cash equivalents	**(238.4)**	180.0
Cash and cash equivalents at beginning of period	**1,056.6**	530.7
Cash and cash equivalents at end of period	**$ 818.2**	$ 710.7
Reconciliation of net earnings to net cash provided by operating activities:		
Net earnings	**$ 748.5**	$ 408.9
Adjustments required to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	**299.3**	208.8
Stock based compensation	**13.2**	22.3
Deferred income taxes and other non-cash items	**(1.6)**	(20.2)
Change in operating assets and liabilities, providing/(requiring) cash, net of effects from acquisitions:		

Accounts receivable, net	**(43.8)**	198.9
Inventories	**18.8**	130.1
Other current assets	**4.1**	(20.8)
Other assets	**3.1**	10.1
Accounts payable and Claims and discounts payable	**(190.9)**	(188.3)
Accrued expenses	**(108.0)**	(47.8)
Other long-term liabilities	**(1.9)**	5.7
Net cash provided by operating activities	**$ 740.8**	$ 707.7

See accompanying notes to consolidated condensed financial statements.

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Part I **Item 1**

CVS Caremark Corporation

Notes to Consolidated Condensed Financial Statements

(Unaudited)

Note 1

The accompanying consolidated condensed financial statements of CVS Caremark Corporation and its wholly owned subsidiaries (the Company) have been prepared, in accordance with the rules and regulations of the Securities and Exchange Commission, without audit. In accordance with such rules and regulations, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted, although the Company believes the disclosures included herein are adequate to make the information presented not misleading. These consolidated condensed financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto, which are included in Exhibit 13 to the Company s Annual Report on Form 10-K for the fiscal year ended December 29, 2007 (the 2007 Form 10-K).

The Company adopted the Emerging Issues Task Force (EITF) Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements, at the beginning of fiscal 2008. EITF No. 06-4 requires the application of the provisions of SFAS No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions (SFAS 106) (if, in substance, a postretirement benefit plan exists), or Accounting Principles Board Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) to endorsement split-dollar life insurance arrangements. SFAS 106 requires us to recognize a liability for the discounted value of the future premium benefits that we will incur through the death of the underlying insureds. The adoption of EITF No. 06-4 did not have a material impact on the Company s consolidated results of operations, financial position and cash flows.

The Company adopted EITF No. 06-10, Accounting for Collateral Assignment Split-Dollar Life Insurance Agreements, at the beginning of fiscal 2008. EITF No. 06-10 provides guidance for determining a liability for the postretirement benefit obligation as well as recognition and measurement of the associated asset on the basis of the terms of the collateral assignment agreement. The adoption of EITF No. 06-10 did not have a material impact on the Company s consolidated results of operations, financial position and cash flows.

In the opinion of management, the accompanying consolidated condensed financial statements include all adjustments (consisting only of normal recurring adjustments), which are necessary to present a fair statement of the Company s results for the interim periods presented. Because of the influence of various factors on the Company s operations, including business combinations, certain holidays and other seasonal influences, net earnings for any interim period may not be comparable to the same interim period in previous years or necessarily indicative of earnings for the full fiscal year.

CVS Caremark Corporation

Notes to Consolidated Condensed Financial Statements

(Unaudited)

Note 2

Effective March 22, 2007, pursuant to the Agreement and Plan of Merger dated as of November 1, 2006, as amended (the Merger Agreement), Caremark Rx, Inc. (Caremark) was merged with and into a newly formed subsidiary of CVS Corporation, with the CVS subsidiary continuing as the surviving entity (the Caremark Merger). Following the merger, the Company changed its name to CVS Caremark Corporation. The Company believes CVS and Caremark are complementary companies and the combined company can be operated more efficiently than either company could have been operated on its own. The combined company is expected to benefit from its ability to provide efficient cost-management solutions to health plan sponsors and innovative programs to consumers, including expanded choice, improved access and more personalized service.

Under the terms of the Merger Agreement, Caremark shareholders received 1.67 shares of common stock, par value $0.01 per share, of the Company for each share of common stock of Caremark, par value $0.001 per share, issued and outstanding immediately prior to the effective time of the merger. In addition, Caremark shareholders of record as of the close of business on the day immediately preceding the closing date of the merger received a special cash dividend of $7.50 per share.

The merger was accounted for using the purchase method of accounting under U.S. Generally Accepted Accounting Principles. Under the purchase method of accounting, CVS Corporation was considered the acquirer of Caremark for accounting purposes and the total purchase price has been allocated to the assets acquired and liabilities assumed from Caremark based on their fair values as of March 22, 2007. Under the purchase method of accounting, the total consideration is approximately $26.9 billion and includes amounts related to Caremark common stock ($23.3 billion), Caremark stock options ($0.6 billion) and the special cash dividend ($3.2 billion), less shares held in trust ($0.3 billion). The consideration associated with the common stock and stock options was based on the average closing price of CVS common stock for the five trading days ending February 14, 2007, which was $32.67 per share. The results of the operations of Caremark have been included in the consolidated statements of operations since March 22, 2007.

The difference between the total purchase price, discussed above, and the amounts allocated to the assets acquired and liabilities assumed, discussed below, was recognized as goodwill in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations.

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Notes to Consolidated Condensed Financial Statements

(Unaudited)

Following is a summary of the assets acquired and liabilities assumed as of March 22, 2007, which was based on information that was available to management at the time the consolidated financial statements were prepared.

Assets Acquired and Liabilities Assumed as of March 22, 2007

In millions	
Cash and cash equivalents	$ 1,293.4
Short-term investments	27.5
Accounts receivable	2,472.7
Inventories	442.3
Deferred tax asset	95.4
Other current assets	31.2
Total current assets	4,362.5
Property and equipment[(1)]	305.3
Goodwill	20,881.4
Intangible assets [(2)]	9,319.7
Other assets	67.2
Total assets acquired	34,936.1
Accounts payable	960.8
Claims and discounts payable	2,430.1
Accrued expenses [(3)]	1,020.0
Total current liabilities	4,410.9
Deferred tax liability	3,581.4
Other long-term liabilities	93.2
Total liabilities assumed	8,085.5
Net assets acquired	$ 26,850.6

(1) Property and equipment includes proprietary technology ($108.1 million) with an estimated weighted average life of 3.5 years.

(2) Intangible assets include customer contracts and relationships ($2.9 billion) with an estimated weighted average life of 14.7 years, favorable leaseholds ($12.7 million) with an estimated weighted average life of 6.2 years, covenants not to compete ($9.0 million) with an estimated average life of 2 years and trade names ($6.4 billion), which are indefinitely lived.

(3)

Accrued expenses include $54.0 million for estimated severance, benefits and outplacement costs for approximately 340 Caremark employees, substantially all of whom had been terminated as of March 29, 2008. As of March 29, 2008, $48.1 million of the liability has been settled with cash payments. The remaining liability will require future cash payments through 2009. Accrued expenses also include $1.5 million for the estimated costs associated with the non-cancelable lease obligation of two locations. As of March 29, 2008, $0.8 million of the liability has been settled with cash payments. The remaining liability will require future cash payments through 2009.

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THE FOLLOWING PRO FORMA COMBINED RESULTS OF OPERATIONS HAVE BEEN PROVIDED FOR ILLUSTRATIVE PURPOSES ONLY AND DO NOT PURPORT TO BE INDICATIVE OF THE ACTUAL RESULTS THAT WOULD HAVE BEEN ACHIEVED BY THE COMBINED COMPANIES FOR THE PERIODS PRESENTED OR THAT WILL BE ACHIEVED BY THE COMBINED COMPANY IN THE FUTURE:

In millions, except per share amounts	*13 Weeks Ended* **March 31, 2007**
Pro forma:(1)(2)(3)(4)	
Net sales	$ 20,657.7
Net earnings	639.3
Basic earnings per share	$ 0.42
Diluted earnings per share	0.41

(1) The pro forma combined results of operations assume that the Caremark Merger occurred at the beginning of the period presented. These results have been prepared by adjusting the historical results of the Company to include the historical results of Caremark, incremental interest expense and the impact of the purchase price allocation discussed above.

(2) Inter-company revenues that occur when a Caremark customer uses a CVS/pharmacy retail store to purchase covered merchandise were eliminated. These adjustments had no impact on pro forma net earnings or pro forma earnings per share.

(3) The pro forma combined results of operations do not include any cost savings that may result from the combination of the Company and Caremark or any estimated costs that will be incurred by the Company to integrate the businesses.

(4) The pro forma combined results of operations for the thirteen weeks ended March 31, 2007, exclude $80.3 million pre-tax ($48.8 million after-tax) of stock option expense associated with the accelerated vesting of certain Caremark stock options, which vested upon consummation of the merger due to change in control provisions of the underlying Caremark stock option plans. The pro forma combined results for the thirteen weeks ended March 31, 2007 also exclude $42.9 million pre-tax ($26.1 million after-tax) related to change in control payments due upon the consummation of the merger due to change in control provisions in certain Caremark employment agreements. In addition, the pro forma combined results of operations for the thirteen weeks ended March 31, 2007, exclude merger related costs of $92.1 million pre-tax ($67.0 million after-tax), which primarily consist of investment banker fees, legal fees, accounting fees and other merger related costs incurred by Caremark.

Note 3

The Company currently operates two business segments: Retail Pharmacy and Pharmacy Services. The operating segments are businesses of the Company for which separate financial information is available and for which operating results are evaluated on a regular basis by executive management in deciding how to allocate resources and in assessing performance. The Company s business segments offer different products and services and require distinct technology and marketing strategies.

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(Unaudited)

As of March 29, 2008, the Retail Pharmacy Segment included 6,267 retail drugstores, the Company s online retail website, CVS.com® and its retail healthcare clinics. The retail drugstores are located in 40 states and the District of Columbia and operate under the CVS® or CVS/pharmacy® name. The retail healthcare clinics utilize nationally recognized medical protocols to diagnose and treat minor health conditions and are staffed by board-certified nurse practitioners and physician assistants. The retail healthcare clinics operate under the MinuteClinic® name and as of March 29, 2008, included 510 clinics located in 25 states, 485 of these clinics are located within the Company s retail drugstores.

The Pharmacy Services Segment provides a full range of pharmacy benefit management services to employers, managed care providers and other organizations. These services include mail order pharmacy services, specialty pharmacy services, plan design and administration, formulary management and claims processing, as well as providing insurance and reinsurance services in conjunction with prescription drug benefit plans. The specialty pharmacy business focuses on supporting individuals that require complex and expensive drug therapies. Currently, the Pharmacy Services segment operates under the Caremark Pharmacy Services®, Caremark Specialty Pharmacy®, PharmaCare Management Services®, CarePlus Pharmacy® and PharmaCare Pharmacy® names. As of March 29, 2008, the Pharmacy Services Segment included 56 retail specialty drugstores, 19 specialty mail order pharmacies and 7 mail service pharmacies located in 26 states and the District of Columbia.

The Company evaluates segment performance based on net revenue, gross profit and operating profit before the effect of non-recurring charges and gains and certain intersegment activities and charges.

Following is a reconciliation of the Company s business segments to the consolidated condensed financial statements as of and for the respective periods:

In millions	**Retail Pharmacy Segment**	**Pharmacy Services Segment(1)**	**Intersegment Eliminations(2)**	**Consolidated Totals**
13 Weeks Ended:				
March 29, 2008:				
Net revenue	**$ 11,845.6**	**$ 10,764.7**	**$ (1,284.3)**	**$ 21,326.0**
Gross profit	**3,505.0**	**788.0**		**4,293.0**
Operating profit	**840.1**	**530.0**		**1,370.1**
March 31, 2007:				
Net revenue	$ 11,239.2	$ 2,110.3	$ (160.9)	$ 13,188.6
Gross profit	3,105.7	197.5		3,303.2
Operating profit	625.9	110.6		736.5
Total assets:				
March 29, 2008	**$ 20,017.8**	**$ 34,801.8**	**$ (252.6)**	**$ 54,567.0**
December 29, 2007	19,962.6	35,015.1	(255.8)	54,721.9
Goodwill:				
March 29, 2008	**$ 2,579.9**	**$ 21,342.2**	**$**	**$ 23,922.1**
December 29, 2007	2,585.7	21,336.6		23,922.3

(1) Net revenues of the Pharmacy Services Segment include approximately $1,664.9 million and $156.0 million of Retail Co-payments for the thirteen weeks ended March 29, 2008 and March 31, 2007, respectively.

(2) Intersegment eliminations relate to intersegment revenues that occur when a Pharmacy Services Segment customer uses a Retail Pharmacy Segment store to purchase covered products. When this occurs, both segments record the revenue on a standalone basis.

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CVS Caremark Corporation

Notes to Consolidated Condensed Financial Statements

(Unaudited)

Note 4

The Company accounts for goodwill and intangible assets under SFAS No. 142, Goodwill and Other Intangible Assets. As such, goodwill and other indefinitely-lived intangible assets are not amortized, but are subject to annual impairment reviews, or more frequent reviews if events or circumstances indicate there may be an impairment. During the third quarter of 2007, the Company performed its required annual goodwill impairment test, which concluded there was no impairment of goodwill.

The carrying amount of goodwill was $23.9 billion at March 29, 2008 and December 29, 2007. There has been no impairment of goodwill during the thirteen weeks ended March 29, 2008. The carrying amount of indefinitely-lived assets was $6.4 billion as of March 29, 2008 and December 29, 2007. Intangible assets with finite useful lives are amortized over their estimated useful life.

Following is a summary of the Company s intangible assets as of the respective balance sheet dates:

	As of March 29, 2008		*As of December 29, 2007*	
In millions	**Gross Carrying Amount**	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
Trademarks (indefinitely- lived)	**$ 6,398.0**	**$**	$ 6,398.0	$
Customer relationships and Covenants not to compete	**4,448.9**	**(962.8)**	4,444.1	(876.9)
Favorable leases and Other	**626.8**	**(166.6)**	623.0	(158.6)
	$ 11,473.7	**$ (1,129.4)**	$ 11,465.1	$ (1,035.5)

The amortization expense related to finite-lived intangible assets for the thirteen week period ended March 29, 2008 was $97.9 million. The anticipated annual amortization expense for these intangible assets is $388.5 million, $374.8 million, $362.5 million, $353.8 million, $335.8 million and $315.8 million in 2008, 2009, 2010, 2011, 2012 and 2013, respectively.

Note 5

Accumulated other comprehensive loss consists of changes in the net actuarial gains and losses associated with pension and other post retirement benefit plans, unrealized losses on derivatives and adjustment to initially apply SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. In accordance with SFAS No. 158, the amount included in accumulated other comprehensive income related to the Company s pension and post retirement plans was $58.7 million pre-tax ($35.9 million after-tax) as of March 29, 2008 and December 29, 2007. The unrealized loss on derivatives totaled $20.5 million pre-tax ($13.0 million after-tax) and $21.9 million pre-tax ($13.8 million after-tax) as of March 29, 2008 and December 29, 2007, respectively.

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CVS Caremark Corporation

Notes to Consolidated Condensed Financial Statements

(Unaudited)

Following are the changes in comprehensive income:

In millions	*13 Weeks Ended* March 29, 2008	March 31, 2007
Net earnings, as reported	**$ 748.5**	$ 408.9
Other comprehensive loss:		
Reclassification of unrealized loss on derivatives	**0.8**	0.8
Total comprehensive income, net of taxes	**$ 749.3**	$ 409.7

As of March 29, 2008, the Company had no freestanding derivatives in place.

Note 6

Following are the components of net interest expense:

In millions	*13 Weeks Ended* March 29, 2008	March 31, 2007
Interest expense	**$ 137.2**	$ 71.6
Interest income	**(6.3)**	(7.7)
Interest expense, net	**$ 130.9**	$ 63.9

Note 7

On November 6, 2007, the Company entered into a $2.3 billion fixed dollar accelerated share repurchase agreement (the November ASR agreement) with Lehman Brothers, Inc. (Lehman). The November ASR agreement contained provisions that established the minimum and maximum number of shares to be repurchased during the term of the November ASR agreement. Pursuant to the terms of the November ASR agreement, on November 7, 2007, the Company paid $2.3 billion to Lehman in exchange for Lehman delivering 37.2 million shares of common stock to the Company. On November 26, 2007, upon establishment of the minimum number of shares to be repurchased, Lehman delivered an additional 14.4 million shares of common stock to the Company. The aggregate 51.6 million shares of common stock delivered to the Company by Lehman were placed into the Company s treasury account. The final settlement under the November ASR program occurred on March 28, 2008 and resulted in the Company receiving an additional 5.7 million shares of common stock during the first quarter of 2008, which were placed into the Company s treasury account upon delivery.

Note 8

As a result of the Caremark Merger, the Company acquired certain grantor trusts, which as of the 2007 fiscal year end held approximately 9.2 million shares of its common stock designated for use under various employee compensation plans. During the thirteen week period ended March 29, 2008, the Company transferred 7.5 million shares of the common stock held by the grantor trusts to the Company s treasury account. As of March 29, 2008, the grantor trusts held approximately 1.7 million of the Company s common stock. Since the Company holds the shares in the grantor trusts, they are excluded from the computation of basic and diluted shares outstanding.

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Notes to Consolidated Condensed Financial Statements

(Unaudited)

Note 9

Basic earnings per common share is computed by dividing: (i) net earnings, after deducting the after-tax Employee Stock Ownership Plan (ESOP) preference dividends, by (ii) the weighted average number of common shares outstanding during the period (the Basic Shares).

When computing diluted earnings per common share, the Company assumes that the ESOP preference stock is converted into common stock and all dilutive stock awards are exercised. After the assumed ESOP preference stock conversion, the ESOP Trust would hold common stock rather than ESOP preference stock and would receive common stock dividends ($0.24000 and $0.22875 annually per share in 2008 and 2007, respectively) rather than ESOP preference stock dividends (currently $3.90 annually per share). Since the ESOP Trust uses the dividends it receives to service its debt, the Company would have to increase its contribution to the ESOP Trust to compensate it for the lower dividends. This additional contribution would reduce the Company s net earnings, which in turn, would reduce the amounts that would have to be accrued under the Company s incentive compensation plans.

Diluted earnings per common share is computed by dividing: (i) net earnings, after accounting for the difference between the dividends on the ESOP preference stock and common stock and after making adjustments for the incentive compensation plans, by (ii) Basic Shares plus the additional shares that would be issued assuming that all dilutive stock awards are exercised and the ESOP preference stock is converted into common stock. Options to purchase 12.0 million and 7.3 million shares of common stock were outstanding as of March 29, 2008 and March 31, 2007, respectively, but were not included in the calculation of diluted earnings per share because the options exercise prices were greater than the average market price of the common shares and, therefore, the effect would be antidilutive.

Following is a reconciliation of basic and diluted earnings per common share for the respective periods:

	13 Weeks Ended	
In millions, except per share amounts	**March 29, 2008**	**March 31, 2007**
Numerator for earnings per common share calculation:		
Net earnings	**$ 748.5**	$ 408.9
Preference dividends, net of income tax benefit	**(3.5)**	(3.5)
Net earnings available to common shareholders, basic	**$ 745.0**	$ 405.4
Net earnings	**$ 748.5**	$ 408.9
Dilutive earnings adjustment	**(0.9)**	(1.1)
Net earnings available to common shareholders, diluted	**$ 747.6**	$ 407.8
Denominator for earnings per common share calculation:		
Weighted average common shares, basic	**1,429.8**	906.1
Effect of dilutive securities:		
ESOP preference stock	**17.5**	18.3
Stock options	**16.9**	12.9
Other stock awards	**3.5**	2.5
Weighted average common shares, diluted	**1,467.7**	939.8

Basic earnings per common share	**$**	**0.52**	$	0.45
Diluted earnings per common share	**$**	**0.51**	$	0.43

CVS Caremark Corporation

Notes to Consolidated Condensed Financial Statements

(Unaudited)

Note 10

In connection with certain business dispositions completed between 1991 and 1997, the Company continues to guarantee approximately 220 store lease obligations for a number of former subsidiaries, including Bob s Stores, Linens n Things, Marshalls, Kay-Bee Toys, Wilsons, This End Up and Footstar. Under these guarantees, the respective purchasers are required to indemnify the Company for these obligations. If any of the purchasers were to become insolvent and failed to make the required payments under a store lease, the Company could be required to satisfy these obligations. Linens Holding Co., which operates Linens n Things (Linens), recently announced that it is actively seeking to restructure its debt obligations. At the present time, the Company does not know what actions, if any, Linens will take and whether any such actions could require the Company to satisfy any of the Linens store lease obligations. However, the Company believes that any such liability would be unlikely to have a material effect on its financial position or future cash flows.

In December 2007, the Company received a document subpoena from the Office of Inspector General, United States Department of Health and Human Services (OIG), requesting information relating to the processing of Medicaid and other government agency claims on an adjudication platform of AdvancePCS (acquired by Caremark in 2004 and now known as CaremarkPCS, L.L.C.). The Company has initiated discussions with the OIG and with the U.S Department of Justice concerning our government claims processing activities on the two adjudication platforms used by AdvancePCS and one adjudication platform used by PharmaCare. We are also cooperating with the requests for information contained in the document subpoena by producing responsive documents on a rolling basis. We cannot predict with certainty the timing, outcome or consequence of any review of such information.

Caremark s subsidiary Caremark Inc. (now known as Caremark, L.L.C.) was named in a putative class action lawsuit filed in July 2004, in Tennessee federal court by an individual named Robert Moeckel, purportedly on behalf of the John Morrell Employee Benefits Plan, which was an employee benefit plan sponsored by a former Caremark client. The lawsuit, which sought unspecified damages and injunctive relief, alleged that Caremark Inc. acted as a fiduciary under ERISA and has breached certain alleged fiduciary duties under ERISA. In November 2007, the court granted Caremark Inc. s motion for partial summary judgment finding that it was not an ERISA fiduciary under the applicable PBM agreements and that the plaintiff may not sustain claims for breach of fiduciary duty. In April 2008, the court entered final judgment in favor of Caremark Inc. and dismissed with prejudice all claims asserted in the case.

Caremark was named in a putative class action lawsuit filed on October 22, 2003 in Alabama state court by John Lauriello, purportedly on behalf of participants in the 1999 settlement of various securities class action and derivative lawsuits against Caremark and others. Other defendants include insurance companies that provided coverage to Caremark with respect to the settled lawsuits. The Lauriello lawsuit seeks approximately $3.2 billion in compensatory damages plus other non-specified damages based on allegations that the amount of insurance coverage available for the settled lawsuits was misrepresented and suppressed. A similar lawsuit was filed on November 5, 2003, by Frank McArthur, also in Alabama state court, naming as defendants Caremark, several insurance companies, attorneys and law firms involved in the 1999 settlement. This lawsuit was subsequently stayed by the court as a later-filed class action.

CVS Caremark Corporation

Notes to Consolidated Condensed Financial Statements

(Unaudited)

In 2005, the trial court in the Lauriello case issued an order allowing the Lauriello case to proceed on behalf of the settlement class in the 1999 securities class action. McArthur then sought to intervene in the Lauriello case and to challenge the adequacy of Lauriello as class representative and his lawyers as class counsel. The trial court denied McArthur s motion to intervene, but the Alabama Supreme Court subsequently ordered the lower court to vacate its prior order on class certification and allow McArthur to intervene. Caremark and the other defendants filed motions to dismiss the complaint in intervention filed by McArthur. In November 2007, the trial court dismissed the attorneys and law firms named as defendants in the McArthur complaint in intervention and denied the motions to dismiss that complaint filed by Caremark and the insurance company defendants. The trial court later denied Lauriello s motion to dismiss claims asserted against him in McArthur s complaint in intervention and granted McArthur s motion to stay proceedings pending his appeal to the Alabama Supreme Court of the decision dismissing the attorneys and law firms as defendants.

The Company has been named in a putative class action lawsuit filed in California state court by Gabe Tong, purportedly on behalf of current and former pharmacists working in the Company s California stores. The lawsuit alleges that CVS failed to provide pharmacists in the purported class with meal and rest periods or to pay overtime as required under California law. In October 2007, the Company reached a conditional agreement resolving this matter, and in March 2008 the conditional agreement received preliminary court approval. In addition, the Company is party to other employment litigation arising in the normal course of its business, including several purported class action lawsuits pending in the State of California. The Company cannot predict the outcome of any of these employment litigation matters at this time, but none of these matters are expected to be material to the Company.

As previously disclosed, the United States Department of Justice and several state attorneys general investigated whether any civil or criminal violations resulted from certain practices engaged in by CVS and others in the pharmacy industry with regard to dispensing one of two different dosage forms of a generic drug (ranitidine) under circumstances in which some state Medicaid programs at various times reimbursed one dosage form at a different rate from the other. On March 18, 2008, the Company announced that it reached a settlement agreement with the various governmental agencies involved. The settlement called for payment of $36.7 million, plus approximately $800,000 in investigative costs and other fees. The Company also entered into a Corporate Integrity Agreement with the OIG, applicable to the Company s retail and mail service operations, providing for the maintenance of the Company s existing compliance program and code of conduct, as well as instituting certain employee training. CVS expressly denied engaging in any wrongful conduct, and agreed to settle the matter in order to defray the distraction, burden and expense of continuing the investigation.

The Company is also a party to other litigation arising in the normal course of its business, none of which is expected to be material to the Company. The Company can give no assurance, however, that our operating results and financial condition will not be materially adversely affected, or that we will not be required to materially change our business practices, based on: (i) future enactment of new healthcare or other laws or regulations; (ii) the interpretation or application of existing laws or regulations, as they may relate to our business or the pharmacy services industry; (iii) pending or future federal or state governmental investigations of our business or the pharmacy services industry; (iv) institution of government enforcement actions against us; (v) adverse developments in any pending qui tam lawsuit against us, whether sealed or unsealed, or in any future qui tam lawsuit that may be filed against us; or (vi) adverse developments in other pending or future legal proceedings against us or affecting the pharmacy services industry.

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Part I **Item 1**

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

CVS Caremark Corporation:

We have reviewed the accompanying consolidated condensed balance sheet of CVS Caremark Corporation and subsidiaries as of March 29, 2008, and the related consolidated condensed statement of operations and cash flows for the thirteen week period then ended. These financial statements are the responsibility of the Company s management. The consolidated condensed balance sheet of CVS Caremark Corporation and subsidiaries as of March 31, 2007, and for the thirteen week period then ended were reviewed by other accountants whose report (dated May 7, 2007) stated that they were not aware of any material modifications that should be made to those statements for them to be in conformity with U.S. generally accepted accounting principles.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements at March 29, 2008, and for the thirteen week period then ended for them to be in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated condensed financial statements, effective December 30, 2007, CVS Caremark Corporation adopted Emerging Issues Task Force (EITF) No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* and EITF No. 06-10, *Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements*.

/s/ Ernst & Young LLP

April 29, 2008

Boston, Massachusetts

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Part I **Item 2**

Management s Discussion and Analysis of Financial Condition and Results of Operations

Overview of Our Business

CVS Caremark is the largest provider of prescriptions in the United States. We fill or manage more than one billion prescriptions annually. As a fully integrated pharmacy services company, we drive value for our customers by effectively managing pharmaceutical costs and improving healthcare outcomes through our approximately 6,300 CVS/pharmacy® stores; our pharmacy benefit management, mail order and specialty pharmacy division, Caremark Pharmacy Services®; our retail healthcare clinic subsidiary, MinuteClinic®; and our online pharmacy, CVS.com®.

Today s healthcare delivery system is rapidly changing. Healthcare is becoming more consumer-centric as the U.S. healthcare system strains to manage growing costs and employers shift more responsibility for managing costs to employees. In addition, an aging population, increasing incidence of chronic disease and increasing utilization of the Medicare drug benefit is fueling demand for prescriptions and pharmacy services. Further, cost-effective generic drugs are becoming more widely available and new drug therapies to treat unmet healthcare needs and reduce hospital stays are being introduced. Consumers require medication management programs and better information to help them get the most out of their healthcare dollars. As a fully integrated pharmacy services company, we are well positioned to provide solutions that address these trends and improve the pharmacy services experience for consumers.

We also strive to improve clinical outcomes, resulting in better control over healthcare costs for employers and health plans. In that regard, we offer a broad spectrum of disease management, health assessment and wellness services to help plan participants manage and protect against potential health risks and avoid future health costs.

Our business is comprised of two operating segments: Retail Pharmacy and Pharmacy Services.

Results of Operations

The following discussion explains the material changes in our results of operations for the thirteen weeks ended March 29, 2008 and March 31, 2007 and the significant developments affecting our financial condition since December 29, 2007. We strongly recommend that you read our audited consolidated financial statements and footnotes and Management s Discussion and Analysis of Financial Condition and Results of Operations included as Exhibit 13 to our annual report on Form 10-K for the fiscal year ended December 29, 2007 (the 2007 Form 10-K) along with this report.

Effective March 22, 2007, we completed our merger with Caremark Rx, Inc. (Caremark). Following the merger with Caremark (the Caremark Merger), we changed our name to CVS Caremark Corporation. Accordingly, our results of operations for the thirteen weeks ended March 31, 2007 include 10 days of post-merger Caremark operations.

First Quarter (Thirteen Weeks Ended March 29, 2008 versus March 31, 2007)

Summary of the Consolidated Financial Results:

	13 Weeks Ended	
In millions, except per common share amounts	**March 29, 2008**	**March 31, 2007**
Net revenues	**$ 21,326.0**	$ 13,188.6
Gross profit	**4,293.0**	3,303.2
Total operating expenses	**2,922.9**	2,566.7
Operating profit	**1,370.1**	736.5
Interest expense, net	**130.9**	63.9
Earnings before income tax provision	**1,239.2**	672.6
Income tax provision	**490.7**	263.7

Net earnings	**$**	**748.5**	$	408.9
Diluted earnings per common share	**$**	**0.51**	$	0.43

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Part I **Item 2**

Management s Discussion and Analysis of Financial Condition and Results of Operations

Net revenues increased $8.1 billion during the thirteen weeks ended March 29, 2008 primarily due to the Caremark Merger, which resulted in an increase in Pharmacy Services revenue of $7.9 billion.

Gross profit increased $1.0 billion during the thirteen weeks ended March 29, 2008 due primarily to the Caremark Merger, including benefits resulting from purchasing synergies. In addition, we continued to benefit from the increased utilization of generic drugs (which normally yield a higher gross profit rate than equivalent brand name drugs) in both the Retail Pharmacy and Pharmacy Services segments. However, the increased use of generic drugs has resulted in pressure to decrease reimbursement payments to retail and mail order pharmacies for generic drugs. We expect this trend to continue.

Operating expenses increased $356.2 million during the thirteen weeks ended March 29, 2008. Total operating expense increased primarily due to the Caremark Merger, which resulted in incremental operating expenses, depreciation and amortization related to the intangible assets acquired and merger-related integration costs.

Interest expense, net consisted of the following:

	13 Weeks Ended	
In millions	**March 29, 2008**	**March 31, 2007**
Interest expense	**$ 137.2**	$ 71.6
Interest income	**(6.3)**	(7.7)
Interest expense, net	**$ 130.9**	$ 63.9

The increase in interest expense during the thirteen weeks ended March 29, 2008 is due to an increase in our average debt balance, which resulted primarily from the borrowings used to fund the special cash dividend paid to Caremark shareholders and the accelerated share repurchase program that commenced subsequent to the Caremark Merger.

Income tax provision ~ Our effective income tax rate was 39.6% for the thirteen weeks ended March 29, 2008, compared to 39.2% for the thirteen weeks ended March 31, 2007. The increase in our effective income tax rate was principally due to the Caremark Merger.

Net earnings increased $339.6 million or 83.1% to $748.5 million (or $0.51 per diluted share) for the thirteen weeks ended March 29, 2008, compared to $408.9 million (or $0.43 per diluted share) for the thirteen weeks ended March 31, 2007. The increase in net earnings was primarily due to the impact of the Caremark Merger and strong revenues and improved margin rates in the Retail Pharmacy and Pharmacy Services segments.

Part I **Item 2**

Management s Discussion and Analysis of Financial Condition and Results of Operations

Segment Analysis

We evaluate segment performance based on net revenues, gross profit and operating profit before the effect of certain intersegment activities and charges. Following is a reconciliation of the Company s business segments to the consolidated financial statements:

In millions	Retail Pharmacy Segment	Pharmacy Services Segment[1]	Intersegment Eliminations [2]	Consolidated Totals
13 Weeks Ended:				
March 29, 2008:				
Net revenue	**$ 11,845.6**	**$ 10,764.7**	**$ (1,284.3)**	**$ 21,326.0**
Gross profit	**3,505.0**	**788.0**		**4,293.0**
Operating profit	**840.1**	**530.0**		**1,370.1**