CVS CAREMARK CORP
Form 10-Q
August 05, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2014

o 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 001-01011

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)

Registrant's telephone number, including area code: (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 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 [X] No [ ]

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

Large accelerated filer [X]	Accelerated filer [ ]
Non-accelerated filer [ ] (Do not check if a smaller reporting company)	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 July 31, 2014:

1,158,126,112 shares

INDEX

Part I Item 1

CVS Caremark Corporation
Condensed Consolidated Statements of Income
(Unaudited)

In millions, except per share amounts	Three Months Ended June 30, 2014	2013	Six Months Ended June 30, 2014	2013
Net revenues	$34,602	$31,248	$67,291	$61,999
Cost of revenues	28,278	25,407	55,025	50,581
Gross profit	6,324	5,841	12,266	11,418
Operating expenses	4,116	3,869	8,034	7,752
Operating profit	2,208	1,972	4,232	3,666
Interest expense, net	158	126	316	252
Income before income tax provision	2,050	1,846	3,916	3,414
Income tax provision	804	721	1,541	1,335
Income from continuing operations	1,246	1,125	2,375	2,079
Loss from discontinued operations, net of tax	—	(1)	—	(1)
Net income	$1,246	$1,124	$2,375	$2,078
Basic earnings per share:				
Income from continuing operations	$1.07	$0.92	$2.03	$1.69
Loss from discontinued operations	$—	$—	$—	$—
Net income	$1.07	$0.92	$2.03	$1.69
Weighted average basic shares outstanding	1,165	1,227	1,172	1,230
Diluted earnings per share:				
Income from continuing operations	$1.06	$0.91	$2.01	$1.68
Loss from discontinued operations	$—	$—	$—	$—
Net income	$1.06	$0.91	$2.01	$1.68
Weighted average diluted shares outstanding	1,174	1,236	1,182	1,238
Dividends declared per share	$0.275	$0.225	$0.550	$0.450

See accompanying notes to condensed consolidated financial statements.

CVS Caremark Corporation
Condensed Consolidated Statements of Comprehensive Income
(Unaudited)

In millions	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Net income	$1,246	$1,124	$2,375	$2,078
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax	6	(16)	15	(18)
Cash flow hedges, net of tax	1	—	2	1
Total other comprehensive income (loss)	7	(16)	17	(17)
Comprehensive income	$1,253	$1,108	$2,392	$2,061

See accompanying notes to condensed consolidated financial statements.

CVS Caremark Corporation
Condensed Consolidated Balance Sheets
(Unaudited)

In millions, except per share amounts	June 30, 2014	December 31, 2013
Assets:		
Cash and cash equivalents	$1,612	$4,089
Short-term investments	100	88
Accounts receivable, net	9,533	8,729
Inventories	11,360	11,045
Deferred income taxes	979	902
Other current assets	554	472
Total current assets	24,138	25,325
Property and equipment, net	8,820	8,615
Goodwill	28,126	26,542
Intangible assets, net	9,906	9,529
Other assets	1,603	1,515
Total assets	$72,593	$71,526
Liabilities:		
Accounts payable	$5,780	$5,548
Claims and discounts payable	4,918	4,548
Accrued expenses	4,812	4,768
Current portion of long-term debt	1,119	561
Total current liabilities	16,629	15,425
Long-term debt	12,252	12,841
Deferred income taxes	4,091	3,901
Other long-term liabilities	1,489	1,421
Commitments and contingencies (Note 10)	—	—
Shareholders’ equity:		
CVS Caremark shareholders' equity:		
Preferred stock, par value $0.01: 0.1 share authorized; none issued or outstanding	—	—
Common stock, par value $0.01: 3,200 shares authorized; 1,688 shares issued and 1,160 shares outstanding at June 30, 2014 and 1,680 shares issued and 1,180 shares outstanding at December 31, 2013	17	17
Treasury stock, at cost: 527 shares at June 30, 2014 and 500 shares at December 31, 2013	(22,131)	(20,169)
Shares held in trust: 1 share at June 30, 2014 and December 31, 2013	(31)	(31)
Capital surplus	30,186	29,777
Retained earnings	30,221	28,493
Accumulated other comprehensive income (loss)	(132)	(149)
Total CVS Caremark shareholders' equity	38,130	37,938
Noncontrolling interest	2	—
Total shareholders’ equity	38,132	37,938
Total liabilities and shareholders’ equity	$72,593	$71,526

See accompanying notes to condensed consolidated financial statements.

CVS Caremark Corporation
Condensed Consolidated Statements of Cash Flows
(Unaudited)

In millions	Six Months Ended June 30, 2014	2013
Cash flows from operating activities:		
Cash receipts from customers	$62,932	$56,446
Cash paid for inventory and prescriptions dispensed by retail network pharmacies	(50,268)	(44,657)
Cash paid to other suppliers and employees	(7,787)	(7,452)
Interest received	6	2
Interest paid	(331)	(267)
Income taxes paid	(1,483)	(1,530)
Net cash provided by operating activities	3,069	2,542
Cash flows from investing activities:		
Purchases of property and equipment	(891)	(804)
Proceeds from sale-leaseback transactions	5	—
Proceeds from sale of property and equipment	7	11
Acquisitions (net of cash acquired) and other investments	(2,248)	(300)
Purchase of available-for-sale investments	(161)	—
Sales/maturities of available-for-sale investments	103	—
Net cash used in investing activities	(3,185)	(1,093)
Cash flows from financing activities:		
Decrease in short-term debt	—	(690)
Repayments of long-term debt	(41)	—
Dividends paid	(647)	(553)
Proceeds from exercise of stock options	266	309
Excess tax benefits from stock-based compensation	65	34
Repurchase of common stock	(2,001)	(748)
Net cash used in financing activities	(2,358)	(1,648)
Effect of exchange rate changes on cash and cash equivalents	(3)	(2)
Net decrease in cash and cash equivalents	(2,477)	(201)
Cash and cash equivalents at beginning of period	4,089	1,375
Cash and cash equivalents at end of period	$1,612	$1,174
Reconciliation of net income to net cash provided by operating activities:		
Net income	$2,375	$2,078
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	965	951
Stock-based compensation	77	66
Deferred income taxes and other noncash items	44	82
Change in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable, net	(584)	(575)
Inventories	(235)	192
Other current assets	(74)	165
Other assets	(23)	(138)
Accounts payable and claims and discounts payable	521	98

Accrued expenses	33	(401)
Other long-term liabilities	(30)	24
Net cash provided by operating activities	$3,069	$2,542

See accompanying notes to condensed consolidated financial statements.

6

CVS Caremark Corporation
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1 – Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of CVS Caremark Corporation and its majority-owned subsidiaries ("CVS Caremark" or the "Company") have been prepared in accordance with the rules and regulations of the U.S. Securities and Exchange Commission ("SEC") regarding interim financial reporting. In accordance with such rules and regulations, certain information and accompanying note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted, although the Company believes the disclosures included herein are adequate to make the information presented not misleading. These condensed consolidated 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 year ended December 31, 2013 (the "2013 Form 10-K").

In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all adjustments consisting only of normal recurring adjustments, necessary for a fair presentation of the 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 income for any interim period may not be comparable to the same interim period in previous years or necessarily indicative of income for the full year.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All material intercompany balances and transactions have been eliminated.

Fair Value of Financial Instruments

The Company utilizes the three-level valuation hierarchy for the recognition and disclosure of fair value measurements. The categorization of assets and liabilities within this hierarchy is based upon the lowest level of input that is significant to the measurement of fair value. The three levels of the hierarchy consist of the following:

- Level 1 – Inputs to the valuation methodology are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

- Level 2 – Inputs to the valuation methodology are quoted prices for similar assets and liabilities in active markets, quoted prices in markets that are not active or inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the instrument.

- Level 3 – Inputs to the valuation methodology are unobservable inputs based upon management's best estimate of inputs market participants could use in pricing the asset or liability at the measurement date, including assumptions about risk.

As of June 30, 2014, the carrying value of cash and cash equivalents, short-term and long-term investments, accounts receivable and accounts payable approximated their fair value due to the nature of these financial instruments. The

Company invests in money market funds, commercial paper and time deposits that are classified as cash and cash equivalents within the accompanying condensed consolidated balance sheets, as these funds are highly liquid and readily convertible to known amounts of cash. These investments are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. The Company’s short-term investments consist of certificates of deposit with initial maturities of greater than three months when purchased that mature in less than one year from the balance sheet date. The Company's long-term investments, which are classified as noncurrent other assets within the accompanying condensed consolidated balance sheet, consist of certificates of deposit and money market funds. These investments, which are classified within Level 1 of the fair value hierarchy, are carried at fair value, which approximated historical cost at June 30, 2014. The carrying amount and estimated fair value of the Company’s total long-term debt was $13.4 billion and $14.7 billion, respectively, as of June 30,

2014. The fair value of the Company’s long-term debt was estimated based on quoted prices currently offered in active markets for the Company’s debt, which is considered Level 1 of the fair value hierarchy.

Related Party Transactions

The Company has an equity method investment in SureScripts, LLC ("SureScripts"), which operates a clinical health information network. The Pharmacy Services and Retail Pharmacy segments utilize this clinical health information network in providing services to client plan members and retail customers. The Company expensed fees of approximately $11 million and $10 million in the three months ended June 30, 2014 and 2013, respectively, and $27 million and $23 million in the six months ended June 30, 2014 and 2013, respectively, for the use of this network.

The Company's investment in and equity in earnings in SureScripts for all periods presented is immaterial.

New Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU No. 2014-09 outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. This new guidance is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016; early adoption is not permitted. Companies have the option of using either a full retrospective or a modified retrospective approach to adopt the guidance. This update could impact the timing and amounts of revenue recognized. The Company is currently evaluating the effect that implementation of this update will have on its consolidated financial position and results of operations upon adoption.

Note 2 – Coram Acquisition

On January 16, 2014, the Company acquired 100 percent of the voting interests of Coram LLC ("Coram"), the specialty infusion services and enteral nutrition business unit of Apria Healthcare Group Inc., for cash consideration of approximately $2.1 billion, plus contingent consideration of approximately $0.1 billion. The purchase price is also subject to a working capital adjustment. Coram is one of the nation's largest providers of comprehensive infusion services, caring for approximately 165,000 patients annually. Coram has approximately 4,600 employees, including approximately 600 nurses and 250 dietitians, operating primarily through 84 branch locations and six centers of excellence for patient intake.

The contingent consideration is based on the Company’s future realization of Coram’s tax net operating loss carryforwards (“NOLs”) as of the date of the acquisition. The Company will pay the seller the first $60 million in tax savings realized from the future utilization of the Coram NOLs, plus 50% of any additional future tax savings from the remaining NOLs. The estimated fair value of the approximately $0.1 billion contingent consideration liability associated with the future realization of the Coram NOLs was estimated by discounting, to present value, the contingent payments expected to be made based on the Company’s estimate of the amount and timing of Coram NOLs that will ultimately be realized. The change in fair value of the contingent consideration liability recognized in earnings for the three and six months ended June 30, 2014 was immaterial.

The fair value of assets acquired and liabilities assumed were approximately $2.5 billion and $0.3 billion, respectively, which included accounts receivable of approximately $0.2 billion, identifiable finite-lived intangible assets of approximately $0.5 billion and goodwill of approximately $1.6 billion which is nondeductible for income tax purposes. The goodwill represents future economic benefits expected to arise from the Company's expanded presence in the specialty pharmaceuticals market, the assembled workforce acquired, and the expected synergies from combining operations with Coram. The assessment of fair value is preliminary and is based on information that was available to management at the time the condensed consolidated financial statements were prepared. Accordingly, such amounts may change. The most significant open items include the working capital adjustment, the accounting for deferred income taxes including the acquired NOLs, and the accounting for the related contingent consideration liability. The Company has requested additional information from the seller with respect to certain acquired tax attributes and uncertain tax positions and is awaiting the completion of a third party study to quantify the Company's annual NOL usage limitation.

Coram’s results of operations are included in the Company’s Pharmacy Services Segment beginning on January 16, 2014. Pro forma information for this acquisition is not presented as Coram’s results are immaterial to the Company’s condensed consolidated financial statements. During the six months ended June 30, 2014, acquisition costs of $14 million were expensed as incurred within operating expenses.

Note 3 – Goodwill

Below is a summary of the changes in the carrying amount of goodwill by segment for the six months ended June 30, 2014:

In millions	Pharmacy Services	Retail Pharmacy	Total
Balance, December 31, 2013	$19,658	$6,884	$26,542
Acquisitions	1,576	—	1,576
Foreign currency translation adjustments	—	9	9
Other [1]	(1)	—	(1)
Balance, June 30, 2014	$21,233	$6,893	$28,126

(1) "Other" represents immaterial purchase accounting adjustments for acquisitions.

Note 4 – Share Repurchase Program

On December 17, 2013, the Company's Board of Directors authorized a new share repurchase program for up to $6.0 billion of outstanding common stock (the "2013 Repurchase Program"). On September 19, 2012, the Company’s Board of Directors authorized a share repurchase program for up to $6.0 billion of outstanding common stock (the “2012 Repurchase Program”). The share repurchase authorizations, each of which was effective immediately, permitted the Company to effect repurchases from time to time through a combination of open market repurchases, privately negotiated transactions, accelerated share repurchase transactions, and/or other derivative transactions.

During the three months ended June 30, 2014, the Company repurchased an aggregate of approximately 16.0 million shares of common stock for approximately $1.2 billion pursuant to the 2013 Repurchase Program. During the six months ended June 30, 2014, the Company repurchased an aggregate of approximately 27.0 million shares of common stock for approximately $2.0 billion pursuant to the 2013 and 2012 Repurchase Programs. As of June 30, 2014, approximately $4.7 billion remained available for future repurchases under the 2013 Repurchase Program and the 2012 Repurchase Program was complete. The 2013 Repurchase Program may be modified or terminated by the Board of Directors at any time.

Note 5 – Accumulated Other Comprehensive Income

Accumulated other comprehensive income (loss) consists of foreign currency translation adjustments, unrealized losses on cash flow hedges executed in previous years associated with the issuance of long-term debt, and changes in the net actuarial gains and losses associated with pension and other postretirement benefit plans. The following table summarizes the activity within the components of accumulated other comprehensive income (loss).

Changes in accumulated other comprehensive income (loss) by component are shown below[1]:

In millions	Three Months Ended June 30, 2014 Foreign Currency	Losses on Cash Flow Hedges	Pension and Other Postretirement Benefits	Total
Balance, March 31, 2014	$(21)	$(12)	$(106)	$(139)
Other comprehensive income before reclassifications	6	—	—	6
Amounts reclassified from accumulated other comprehensive income (2)	—	1	—	1
Other comprehensive income	6	1	—	7
Balance, June 30, 2014	$(15)	$(11)	$(106)	$(132)

	Three Months Ended June 30, 2013 Foreign Currency	Losses on Cash Flow Hedges	Pension and Other Postretirement Benefits	Total
Balance, March 31, 2013	$(2)	$(15)	$(165)	$(182)
Other comprehensive income (loss) before reclassifications	(16)	—	—	(16)
Amounts reclassified from accumulated other comprehensive income (2)	—	—	—	—
Other comprehensive income (loss)	(16)	—	—	(16)
Balance, June 30, 2013	$(18)	$(15)	$(165)	$(198)

	Six Months Ended June 30, 2014 Foreign Currency	Losses on Cash Flow Hedges	Pension and Other Postretirement Benefits	Total
Balance, December 31, 2013	$(30)	$(13)	$(106)	$(149)
Other comprehensive income before reclassifications	15	—	—	15
Amounts reclassified from accumulated other comprehensive income (2)	—	2	—	2
Other comprehensive income	15	2	—	17
Balance, June 30, 2014	$(15)	$(11)	$(106)	$(132)

	Six Months Ended June 30, 2013 Foreign Currency	Losses on Cash Flow Hedges	Pension and Other Postretirement Benefits	Total
Balance, December 31, 2012	$—	$(16)	$(165)	$(181)
Other comprehensive income (loss) before reclassifications	(18)	—	—	(18)
Amounts reclassified from accumulated other comprehensive income (2)	—	1	—	1

Other comprehensive income (loss)	(18)	1	—	(17)
Balance, June 30, 2013	$(18)	$(15)	$(165)	$(198)

(1) All amounts are net of tax.
(2) The amounts reclassified from accumulated other comprehensive income for losses on cash flow hedges are recorded within interest expense, net on the condensed consolidated statement of income. The amounts reclassified from accumulated other comprehensive income for pension and other postretirement benefits are included in operating expenses on the condensed consolidated statement of income.

Note 6 – Stock-Based Compensation

Compensation expense related to stock options for the three and six months ended June 30, 2014 totaled $24 million and $50 million, respectively, compared to $22 million and $48 million for the three and six months ended June 30, 2013, respectively. Compensation expense related to restricted stock awards for the three and six months ended June 30, 2014 totaled $18 million and $27 million, respectively, compared to $10 million and $18 million for the three and six months ended June 30, 2013, respectively. During the three months ended June 30, 2014, the Company granted 4 million stock options with a weighted average fair value of $11.26 and a weighted average exercise price of $74.29. The Company had 32 million stock options outstanding as of June 30, 2014 with a weighted average exercise price of $46.49 and a weighted average contractual term of 4.46 years.

Note 7 – Interest Expense

The following are the components of net interest expense:

	Three Months Ended June 30,		Six Months Ended June 30,	
In millions	2014	2013	2014	2013
Interest expense	$161	$127	$322	$254
Interest income	(3)	(1)	(6)	(2)
Interest expense, net	$158	$126	$316	$252

Note 8 – Earnings Per Share

Basic earnings per share is computed by dividing: (i) net income by (ii) the weighted average number of shares outstanding in the period (the “Basic Shares”).

Diluted earnings per share is computed by dividing: (i) net income by (ii) Basic Shares plus the additional shares that would be issued assuming that all dilutive stock awards are exercised. Options to purchase approximately 4.1 million and 2.2 million shares of common stock were outstanding, but were not included in the calculation of diluted earnings per share for the three and six months ended June 30, 2014, respectively, because the options’ exercise prices were greater than the average market price of the common shares and, therefore, the effect would be antidilutive. For the same reason, options to purchase approximately 8.4 million and 4.5 million shares of common stock were outstanding, but were not included in the calculation of diluted earnings per share for the three and six months ended June 30, 2013, respectively.

The following is a reconciliation of basic and diluted earnings per share for the respective periods:

	Three Months Ended June 30,		Six Months Ended June 30,	
In millions, except per share amounts	2014	2013	2014	2013
Numerator for earnings per share calculations:				
Income from continuing operations	$1,246	$1,125	$2,375	$2,079
Loss from discontinued operations, net of tax	—	(1)	—	(1)
Net income	$1,246	$1,124	$2,375	$2,078
Denominators for earnings per share calculations:				
Weighted average shares, basic	1,165	1,227	1,172	1,230
Effect of dilutive securities:				
Stock options	8	8	8	7
Restricted stock units	1	1	2	1
Weighted average shares, diluted	1,174	1,236	1,182	1,238
Basic earnings per share:				
Income from continuing operations	$1.07	$0.92	$2.03	$1.69
Loss from discontinued operations	$—	$—	$—	$—
Net income	$1.07	$0.92	$2.03	$1.69
Diluted earnings per share:				
Income from continuing operations	$1.06	$0.91	$2.01	$1.68
Loss from discontinued operations	$—	$—	$—	$—
Net income	$1.06	$0.91	$2.01	$1.68

Note 9 – Segment Reporting

The Company has three reportable segments: Pharmacy Services, Retail Pharmacy and Corporate. The Company’s segments maintain separate financial information for which operating results are evaluated on a regular basis by the Company’s chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company evaluates its Pharmacy Services and Retail Pharmacy segments’ performance based on net revenue, gross profit and operating profit before the effect of nonrecurring charges and gains and certain intersegment activities. The Company evaluates the performance of its Corporate Segment based on operating expenses before the effect of nonrecurring charges and gains and certain intersegment activities.

The Pharmacy Services Segment provides a full range of pharmacy benefit management (“PBM”) services including mail service dispensing pharmacies, specialty pharmacy and infusion services, plan design and administration, formulary management, discounted drug purchase arrangements, Medicare Part D services, retail pharmacy network management services, prescription management systems, clinical services, disease management services and medical pharmacy management services. The Company’s customers are primarily employers, insurance companies, unions, government employee groups, managed care organizations and other sponsors of health benefit plans and individuals throughout the United States. In addition, through the Company’s SilverScript Insurance Company subsidiary, the Company is a national provider of drug benefits to eligible beneficiaries under the Federal Government’s Medicare Part D program. The Pharmacy Services business operates under the CVS Caremark® Pharmacy Services, Caremark®, CVS Caremark®, CarePlus CVS/pharmacy®, CVS/caremark™, CVS/specialty™, RxAmerica®, Accordant®, SilverScript®, Novologix® and Coram® names. As of June 30, 2014, the Pharmacy Services Segment operated 24 retail specialty pharmacy stores, 11 specialty mail order pharmacies, four mail service dispensing pharmacies, and 84 branches and six centers of excellence for infusion and enteral services located in 41 states, Puerto Rico and the District of Columbia.

The Retail Pharmacy Segment sells prescription drugs and a wide assortment of general merchandise, including over-the-counter drugs, beauty products and cosmetics, photo finishing, seasonal merchandise, greeting cards and convenience foods through the Company's CVS/pharmacy®, CVS®, Longs Drugs® and Drogaria Onofre® retail stores and online through CVS.com® and Onofre.com.br. As of June 30, 2014, the Retail Pharmacy Segment included 7,705 retail drugstores (of which 7,647 operated a pharmacy), 17 onsite pharmacies, 860 retail health care clinics, and the online retail websites, CVS.com and Onofre.com.br. The retail drugstores are located in 43 states, the District of Columbia, Puerto Rico and Brazil. The retail health care clinics operate under the MinuteClinic® name, and 852 are located within CVS/pharmacy stores. MinuteClinics utilize nationally-recognized medical protocols to diagnose and treat minor health conditions, perform health screenings, monitor chronic conditions and deliver vaccinations. The clinics are staffed by board-certified nurse practitioners and physician assistants who provide access to affordable care without appointment.

The Corporate Segment provides management and administrative services to support the Company. The Corporate Segment consists of certain aspects of executive management, corporate relations, legal, compliance, human resources, corporate information technology and finance departments.

In millions	Pharmacy Services Segment(1)	Retail Pharmacy Segment	Corporate Segment	Intersegment Eliminations(2)	Consolidated Totals
Three Months Ended					
June 30, 2014:					
Net revenues	$21,836	$16,871	$—	$(4,105)	$34,602
Gross profit	1,195	5,299	—	(170)	6,324
Operating profit (loss)	878	1,705	(205)	(170)	2,208
June 30, 2013:					
Net revenues	18,800	16,139	—	(3,691)	31,248
Gross profit	963	5,005	—	(127)	5,841
Operating profit (loss)	675	1,600	(176)	(127)	1,972
Six Months Ended					
June 30, 2014:					
Net revenues	42,031	33,351	—	(8,091)	67,291
Gross profit	2,129	10,483	—	(346)	12,266
Operating profit (loss)	1,518	3,455	(395)	(346)	4,232
June 30, 2013:					
Net revenues	37,111	32,179	—	(7,291)	61,999
Gross profit	1,731	9,952	—	(265)	11,418
Operating profit (loss)	1,174	3,132	(375)	(265)	3,666
Total assets:					
June 30, 2014	41,189	30,803	1,790	(1,189)	72,593
December 31, 2013	38,343	30,191	4,420	(1,428)	71,526
Goodwill:					
June 30, 2014	21,233	6,893	—	—	28,126
December 31, 2013	19,658	6,884	—	—	26,542

(1) Net revenues of the Pharmacy Services Segment include approximately $2.0 billion of retail co-payments for the three months ended both June 30, 2014 and 2013, as well as $4.2 billion of retail co-payments for the six months ended both June 30, 2014 and 2013.

(2) Intersegment eliminations relate to two types of transactions: (i) Intersegment revenues that occur when Pharmacy Services Segment customers use Retail Pharmacy Segment stores to purchase covered products. When this occurs, both the Pharmacy Services and Retail Pharmacy segments record the revenue on a stand-alone basis, and (ii) Intersegment revenues, gross profit and operating profit that occur when Pharmacy Services Segment customers, through the Company's intersegment activities (such as the Maintenance Choice® program), elect to pick-up their maintenance prescriptions at Retail Pharmacy Segment stores instead of receiving them through the mail. When this occurs, both the Pharmacy Services and Retail Pharmacy segments record the revenue, gross profit and operating profit on a standalone basis. The following amounts are eliminated in consolidation in connection with the intersegment activity described in item (ii) above: net revenues of $1.2 billion and $1.1 billion for the three months ended June 30, 2014 and 2013, respectively, and $2.3 billion and $2.0 billion for the six months ended June 30, 2014

and 2013, respectively; and gross profit and operating profit of $170 million and $127 million for the three months ended June 30, 2014 and 2013, respectively, and $346 million and $265 million for the six months ended June 30, 2014 and 2013, respectively.

Note 10 – Commitments and Contingencies

Lease Guarantees

Between 1991 and 1997, the Company sold or spun off a number of subsidiaries, including Bob's Stores, Linens 'n Things and Marshalls. In many cases, when a former subsidiary leased a store, the Company provided a guarantee of the store's lease obligations. When the subsidiaries were disposed of, the Company's guarantees remained in place, although each initial purchaser has indemnified the Company for any lease obligations the Company was required to satisfy. If any of the purchasers or any of the former subsidiaries were to become insolvent and failed to make the required payments under a store lease, the Company could be required to satisfy these obligations.

As of June 30, 2014, the Company guaranteed approximately 72 such store leases (excluding the lease guarantees related to Linens 'n Things, which have been recorded as a liability on the condensed consolidated balance sheet), with the maximum remaining lease term extending through 2026. Management believes the ultimate disposition of any of the remaining guarantees will not have a material adverse effect on the Company's consolidated financial condition, results of operations or future cash flows.

Legal Matters

The Company is a party to legal proceedings, investigations and claims in the ordinary course of its business, including the matters described below. The Company records accruals for outstanding legal matters when it believes it is probable that a loss will be incurred and the amount can be reasonably estimated. The Company evaluates, on a quarterly basis, developments in legal matters that could affect the amount of any accrual and developments that would make a loss contingency both probable and reasonably estimable. If a loss contingency is not both probable and estimable, the Company does not establish an accrued liability. None of the Company's accruals for outstanding legal matters are material individually or in the aggregate to the Company's financial position.

The Company's contingencies are subject to significant uncertainties, including, among other factors: (i) the procedural status of pending matters; (ii) whether class action status is sought and certified; (iii) whether asserted claims or allegations will survive dispositive motion practice; (iv) the extent of potential damages, fines or penalties, which are often unspecified or indeterminate; (v) the impact of discovery on the legal process; (vi) whether novel or unsettled legal theories are at issue; (vii) the settlement posture of the parties, and/or (viii) in the case of certain government agency investigations, whether a sealed qui tam lawsuit ("whistleblower" action) has been filed and whether the government agency makes a decision to intervene in the lawsuit following investigation.

Except as otherwise noted, the Company cannot predict with certainty the timing or outcome of the legal matters described below, and is unable to reasonably estimate a possible loss or range of possible loss in excess of amounts already accrued for these matters.

- In December 2007, the Company received a document subpoena from the Office of Inspector General ("OIG") within the U.S. Department of Health and Human Services ("HHS"), requesting information relating to the processing of Medicaid and certain other government agency claims on behalf of its clients (which allegedly resulted in underpayments from our pharmacy benefit management clients to the applicable government agencies) on one of the Company's adjudication platforms. The Company has provided documents and other information in response to this request for information. The Company has been conducting discussions with the United States Department of Justice ("DOJ") and the OIG regarding a possible settlement of this matter.

- Caremark (the term "Caremark" being used herein to generally refer to any one or more pharmacy benefit management subsidiaries of the Company, as applicable) was named in a putative class action lawsuit filed in October 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 in November 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 stayed as a later-filed class action, but McArthur was subsequently allowed to intervene in the Lauriello action. Following the close of class discovery, the trial court entered an Order on August 15, 2012 that granted the plaintiffs' motion to certify a class pursuant to Alabama Rules of Civil Procedure 23(b)(3) but denied their request that the class also be certified pursuant to Rule 23(b)(1). In addition, the August 15, 2012 Order appointed class representatives and class counsel. The defendants' appeal and plaintiffs' cross-appeal are pending before the Alabama Supreme Court. The proceedings in the trial court are stayed by statute pending a decision on the appeal and cross-appeal by the Alabama Supreme Court.

- Various lawsuits have been filed alleging that Caremark has violated applicable antitrust laws in establishing and maintaining retail pharmacy networks for client health plans. In August 2003, Bellevue Drug Co., Robert Schreiber, Inc. d/b/a Burns Pharmacy and Rehn-Huerbinger Drug Co. d/b/a Parkway Drugs #4, together with Pharmacy Freedom Fund and the National Community Pharmacists Association filed a putative class action against Caremark in Pennsylvania federal court, seeking treble damages and injunctive relief. This case was initially sent to arbitration based on the contract terms between the pharmacies and Caremark. In October 2003, two independent pharmacies, North Jackson Pharmacy, Inc. and C&C, Inc. d/b/a Big C Discount Drugs, Inc., filed a putative class action complaint in Alabama federal court against Caremark and two PBM competitors, seeking treble damages and injunctive relief. The North Jackson Pharmacy case against two of the Caremark entities named as defendants was transferred to Illinois federal court, and the case against a separate Caremark entity was sent to arbitration based on contract terms between the pharmacies and Caremark. The Bellevue arbitration was then stayed by the parties pending developments in the North Jackson Pharmacy court case.

In August 2006, the Bellevue case and the North Jackson Pharmacy case were both transferred to Pennsylvania federal court by the Judicial Panel on Multidistrict Litigation for coordinated and consolidated proceedings with other cases before the panel, including cases against other PBMs. Caremark appealed the decision which vacated an order compelling arbitration and staying the proceedings in the Bellevue case and, following the appeal, the Court of Appeals reinstated the order compelling arbitration of the Bellevue case. Following remand, plaintiffs in the Bellevue case sought dismissal of their complaint to permit an immediate appeal of the reinstated order compelling arbitration and pursued an appeal to the Third Circuit Court of Appeals. In November 2012, the Third Circuit Court reversed the district court ruling and directed the parties to proceed in federal court. Motions for class certification in the coordinated cases within the multidistrict litigation, including the North Jackson Pharmacy case, remain pending, and the court has permitted certain additional class discovery and briefing. The consolidated action is now known as the In Re Pharmacy Benefit Managers Antitrust Litigation.

- In November 2009, a securities class action lawsuit was filed in the United States District Court for the District of Rhode Island purportedly on behalf of purchasers of CVS Caremark Corporation stock between May 5, 2009 and November 4, 2009. Plaintiffs subsequently amended the lawsuit to allege a class period beginning October 30, 2008. The lawsuit names the Company and certain officers as defendants and includes allegations of securities fraud relating to public disclosures made by the Company concerning the PBM business and allegations of insider trading. In addition, a shareholder derivative lawsuit was filed in December 2009 in the same court against the directors and certain officers of the Company. This lawsuit, which was stayed pending developments in the related securities class action, includes allegations of, among other things, securities fraud, insider trading and breach of fiduciary duties and further alleges that the Company was damaged by the purchase of stock at allegedly inflated prices under its share repurchase program. In January 2011, both lawsuits were transferred to the United States District Court for the District of New Hampshire. In June 2012, the court granted the Company’s motion to dismiss the securities class action. The plaintiffs subsequently appealed the court’s ruling on the motion to dismiss. In May 2013, the First Circuit Court of Appeals vacated the prior ruling and remanded the case to the district court for further proceedings. In December 2013, the district court denied the Company’s renewed motion to dismiss the lawsuit. The derivative lawsuit is presently stayed pending further developments in the class action.

- In March 2010, the Company learned that various State Attorneys General offices and certain other government agencies were conducting a multi-state investigation of certain of the Company’s business practices similar to those being investigated at that time by the U.S. Federal Trade Commission (“FTC”). Twenty-eight states, the District of

Columbia and the County of Los Angeles are known to be participating in this investigation. The prior FTC investigation, which commenced in August 2009, was officially concluded in May 2012 when the consent order entered into between the FTC and the Company became final. The Company has cooperated in the multi-state investigation.

- In March 2010, the Company received a subpoena from the OIG requesting information about programs under which the Company has offered customers remuneration conditioned upon the transfer of prescriptions for drugs or medications to the Company's pharmacies in the form of gift cards, cash, non-prescription merchandise or discounts or coupons for non-prescription merchandise. The subpoena relates to an investigation of possible false or otherwise improper claims for payment under the Medicare and Medicaid programs. The Company has provided documents and other information in response to this request for information.

- In January 2012, the United States District Court for the Eastern District of Pennsylvania unsealed a first amended qui tam complaint filed in August 2011 by an individual relator, who is described in the complaint as having once been employed by a firm providing pharmacy prescription benefit audit and recovery services. The complaint seeks monetary damages and alleges that Caremark's processing of Medicare claims on behalf of one of its clients violated the federal false claims act. The United States, acting through the U.S. Attorney's Office in Philadelphia, Pennsylvania, declined to intervene in the lawsuit. Caremark filed a motion to dismiss the amended complaint and the DOJ filed a Statement of Interest with regard to Caremark's motion to dismiss. In December 2012, the court denied Caremark's motion to dismiss the amended complaint.

- In January 2012, the Company received a subpoena from the OIG requesting information about its Health Savings Pass program, a prescription drug discount program for uninsured or underinsured individuals, in connection with an investigation of possible false or otherwise improper claims for payment involving HHS programs. In February 2012, the Company also received a civil investigative demand from the Office of the Attorney General of the State of Texas requesting a copy of information produced under this OIG subpoena and other information related to prescription drug claims submitted by the Company's pharmacies to Texas Medicaid for reimbursement. In May 2014, the Company received a second set of civil investigative demands from the Attorney General of the State of Texas, requesting that the Company produce further information related to prescription drug claims submitted by the Company's pharmacies to Texas Medicaid for reimbursement. The Company is providing documents and other information in response to these requests for information.

- A purported shareholder derivative action was filed on behalf of nominal defendant CVS Caremark Corporation against certain of the Company’s officers and members of its Board of Directors. The action, which alleged a single claim for breach of fiduciary duty relating to the Company's alleged failure to properly implement internal regulatory controls to comply with the Controlled Substances Act and the Combat Methamphetamine Epidemic Act, was originally filed in June 2012. In addition, an amended complaint was filed in November 2012 and a Supplemental Complaint was filed in April 2013. In October 2013, the court granted the Company's motion to dismiss and entered judgment dismissing the action, without prejudice. Following dismissal of the action, the same purported shareholder sent a letter to the Company's Board of Directors demanding that the Board investigate her allegations and pursue legal action against certain directors and officers of the Company. A committee of the Board of Directors is conducting a review and intends to respond to the letter as appropriate.

- On October 12, 2012, the Drug Enforcement Agency (“DEA”) Administrator published its Final Decision and Order revoking the DEA license registrations for dispensing controlled substances at two of our retail pharmacy stores in Sanford, Florida. The license revocations for the two stores formally became effective on November 13, 2012. The pharmacies had voluntarily suspended dispensing controlled substances since April 2012, and have continued operating in that manner in compliance with the DEA Order. The Company has entered into discussions with the U.S. Attorney’s Office for the Middle District of Florida concerning civil penalties for violations of the Controlled Substances Act arising from the circumstances underlying the action taken against the two Sanford, Florida stores. The Company is also undergoing several audits by the DEA and is in discussions with the DEA and the U.S. Attorney’s Office in several locations. Whether agreements can be reached and on what terms is uncertain.

- In November 2012, the Company received a subpoena from the OIG requesting information concerning automatic refill programs used by pharmacies to refill prescriptions for customers. The Company has been cooperating and providing documents and other information in response to this request for information.

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In March 2014, the Company received a subpoena from the United States Attorney's Office for the District of Rhode Island, requesting documents and information concerning bona fide service fees and rebates received from certain pharmaceutical manufacturers in connection with certain drugs utilized under Part D of the Medicare Program. The Company has been cooperating with the government and producing documents in response to the subpoena.

The Company is also a party to other legal proceedings, government investigations, inquiries and audits 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 its business, financial condition and results of operations will not be materially adversely affected, or that the Company will not be required to materially change its business practices, based on: (i) future enactment of new health care or other laws or regulations; (ii) the interpretation or application of existing laws or regulations as they may relate to the Company's business, the pharmacy services, retail pharmacy or retail clinic industries or to the health care industry generally; (iii) pending or future federal or state governmental investigations of the Company’s business or the pharmacy services, retail pharmacy or retail clinic industry or of the health care industry generally; (iv) pending or future government enforcement actions against the Company; (v) adverse developments in any pending qui tam lawsuit against the Company, whether sealed or unsealed, or in any future qui tam lawsuit that may be filed against the Company; or (vi) adverse developments in pending or future legal proceedings against the Company or affecting the pharmacy services, retail pharmacy or retail clinic industry or the health care industry generally.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
CVS Caremark Corporation

We have reviewed the condensed consolidated balance sheet of CVS Caremark Corporation (the Company) as of June 30, 2014, and the related condensed consolidated statements of income and comprehensive income for the three-month and six-month periods ended June 30, 2014 and 2013, and the condensed consolidated statements of cash flows for the six-month periods ended June 30, 2014 and 2013. These financial statements are the responsibility of the Company's management.

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 (United States), 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 condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of CVS Caremark Corporation as of December 31, 2013, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the year then ended not presented herein and we expressed an unqualified audit opinion on those consolidated financial statements and included an explanatory paragraph for the Company's election to change its methods of accounting for prescription drug inventories in the Retail Pharmacy Segment effective January 1, 2012 in our report dated February 10, 2014. In our opinion, the accompanying condensed consolidated balance sheet of CVS Caremark Corporation as of December 31, 2013, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

August 5, 2014
Boston, Massachusetts

Part I Item 2

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

Overview of Our Business

CVS Caremark Corporation, together with its subsidiaries (collectively referred to in this document as “CVS Caremark”, the “Company”, “we”, "our" or “us”), is the largest pharmacy health care provider in the United States with integrated offerings across the entire spectrum of pharmacy care. We are uniquely positioned to deliver significant benefits to health plan sponsors through effective cost management solutions and innovative programs that engage plan members and promote healthier and more cost-effective behaviors. Our integrated pharmacy services model enhances our ability to offer plan members and consumers expanded choice, greater access and more personalized services to help them on their path to better health. We effectively manage pharmaceutical costs and improve health care outcomes through our pharmacy benefit management, mail service dispensing pharmacy and specialty pharmacy division, CVS Caremark® Pharmacy Services; our more than 7,700 CVS/pharmacy®, Longs Drugs® and Drogaria Onofre® retail stores; our retail-based health clinics subsidiary, MinuteClinic®; and our online retail pharmacies, CVS.com® and Onofre.com.br.

We currently have three reportable segments: Pharmacy Services, Retail Pharmacy and Corporate.

Pharmacy Services Segment

Our Pharmacy Services Segment provides a full range of PBM services, including mail service dispensing pharmacy, specialty pharmacy and infusion services, plan design and administration, formulary management, discounted drug purchase arrangements, Medicare Part D services, retail pharmacy network management services, prescription management systems, clinical services, disease management services and medical pharmacy management services. Our clients are primarily employers, insurance companies, unions, government employee groups, managed care organizations and other sponsors of health benefit plans and individuals throughout the United States. As a pharmacy benefits manager, we manage the dispensing of pharmaceuticals through our mail service dispensing pharmacies and national network of more than 68,000 retail pharmacies, consisting of over 41,000 chain pharmacies (which includes our CVS/pharmacy stores) and approximately 27,000 independent pharmacies, to eligible members in the benefit plans maintained by our clients and utilize our information systems to perform, among other things, safety checks, drug interaction screenings and brand to generic substitutions.

Our specialty pharmacies support individuals that require complex and expensive drug therapies. Our specialty pharmacy business includes mail order and retail specialty pharmacies that operate under the CVS Caremark® and CarePlus CVS/pharmacy® names. The Pharmacy Services Segment also provides health management programs, which include integrated condition management program for 17 rare conditions, through our Accordant® rare disease management offering. In addition, through our SilverScript Insurance Company subsidiary, we are a national provider of drug benefits to eligible beneficiaries under the Federal Government’s Medicare Part D program. The Pharmacy Services Segment operates under the CVS Caremark® Pharmacy Services, Caremark®, CVS Caremark®, CarePlus CVS/pharmacy®, CVS/caremark™, CVS/specialty™, RxAmerica®, Accordant®, SilverScript®, Novologix® and Coram® names. As of June 30, 2014, the Pharmacy Services Segment operated 24 retail specialty pharmacy stores, 11 specialty mail order pharmacies, four mail service dispensing pharmacies, and 84 branches and six centers of excellence for infusion and enteral services located in 41 states, Puerto Rico and the District of Columbia.

Retail Pharmacy Segment

Our Retail Pharmacy Segment sells prescription drugs and a wide assortment of general merchandise, including over-the-counter drugs, beauty products and cosmetics, photo finishing, seasonal merchandise, greeting cards and convenience foods through our CVS/pharmacy, CVS®, Longs Drugs, and Drogaria Onofre retail stores and online through CVS.com and Onofre.com.br. Our Retail Pharmacy Segment derives the majority of its revenues through the sale of prescription drugs, which are dispensed by our more than 23,000 retail pharmacists. Our Retail Pharmacy Segment also provides health care services through our MinuteClinic health care clinics. MinuteClinics are staffed by nurse practitioners and physician assistants who utilize nationally recognized protocols to diagnose and treat minor health conditions, perform health screenings, monitor chronic conditions, and deliver vaccinations. As of June 30, 2014, our Retail Pharmacy Segment included 7,705 retail drugstores (of which 7,647 operated a pharmacy) located in 43 states, the District of Columbia, Puerto Rico and Brazil operating primarily under the CVS/pharmacy®, CVS®, Longs Drugs®, or Drogaria Onofre® names, 17 onsite pharmacies, 860 retail health care clinics operating under the MinuteClinic® name (of which 852 were located in CVS/pharmacy stores), and our online retail websites, CVS.com and Onofre.com.br.

Corporate Segment

The Corporate Segment provides management and administrative services to support the Company. The Corporate Segment consists of certain aspects of our executive management, corporate relations, legal, compliance, human resources, corporate information technology and finance departments.

Generic Sourcing Venture

In December 2013, we announced the signing of an agreement with Cardinal Health, Inc. ("Cardinal Health") to form a generic pharmaceutical sourcing entity. This entity began operations in July 2014 operating under the name Red Oak Sourcing, LLC (“Red Oak Sourcing”). The Red Oak Sourcing entity has an initial term of ten years. Under this arrangement, CVS Caremark and Cardinal Health contributed their sourcing and supply chain expertise to Red Oak Sourcing and agreed to source and negotiate generic pharmaceutical supply contracts for both companies through Red Oak Sourcing; however, Red Oak Sourcing will not own or hold inventory on behalf of either company. No physical assets (e.g., property and equipment) were contributed by either company to Red Oak Sourcing, and minimal funding was provided to capitalize the entity.

Results of Operations

The following discussion explains the material changes in our results of operations for the three and six months ended June 30, 2014 and 2013, and the significant developments affecting our financial condition since December 31, 2013. We strongly recommend that you read our audited consolidated financial statements and notes thereto 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 year ended December 31, 2013 (the “2013 Form 10-K”) along with this report.

Summary of the Condensed Consolidated Financial Results:

	Three Months Ended June 30,		Six Months Ended June 30,	
In millions	2014	2013	2014	2013
Net revenues	$34,602	$31,248	$67,291	$61,999
Cost of revenues	28,278	25,407	55,025	50,581
Gross profit	6,324	5,841	12,266	11,418
Operating expenses	4,116	3,869	8,034	7,752
Operating profit	2,208	1,972	4,232	3,666
Interest expense, net	158	126	316	252
Income before income tax provision	2,050	1,846	3,916	3,414
Income tax provision	804	721	1,541	1,335
Income from continuing operations	1,246	1,125	2,375	2,079
Loss from discontinued operations, net of tax	—	(1)	—	(1)
Net income	$1,246	$1,124	$2,375	$2,078

Net Revenues

Net revenues increased approximately $3.4 billion, or 10.7%, and $5.3 billion, or 8.5%, in the three and six months ended June 30, 2014, respectively, as compared to the prior year. The increase in the Pharmacy Services Segment was primarily driven by net new business, growth in specialty pharmacy including the acquisition of Coram and the impact of Specialty Connect®, drug inflation and product mix. The increase in the Retail Pharmacy Segment was primarily due to an increase in pharmacy same store sales and revenue from new stores. Net revenues in both periods were negatively impacted by increased generic dispensing rates for both the Pharmacy Services and Retail Pharmacy segments. However, the impact in the three and six months ended June 30, 2014 was lower than in the prior year due to a slow down in significant generic drug introductions. Generic prescription drugs typically have a lower selling price than brand name prescription drugs.

Please see the section entitled “Segment Analysis” below for additional information regarding net revenues.

Gross Profit

Gross profit dollars increased $483 million and $848 million in the three and six months ended June 30, 2014, respectively, as compared to the prior year. Gross profit as a percentage of net revenues decreased approximately 40 basis points and 20 basis points to approximately 18.3% and 18.2% in the three and six months ended June 30, 2014, respectively, as compared to the prior year. The decrease was primarily due to a change in the mix of business, as the lower margin Pharmacy Services Segment grew faster than the Retail Pharmacy Segment. Gross profit dollars for both the three and six months ended June 30, 2014, were positively impacted by an increase in generic dispensing rates compared to the prior year. In addition, during the three and six months ended June 30, 2014, gross profit was positively impacted by $69 million from the State of California's final decision to exclude certain drugs from previously proposed retroactive reimbursement rate adjustments for the state administered Medicaid program. Of the $69 million, $53 million was attributed to the Retail Pharmacy Segment and $16 million was attributed to the Pharmacy Services Segment. The reimbursement rate adjustment was recorded as an increase in net revenues in the condensed consolidated statements of income for the three and six months ended June 30, 2014.

Please see the section entitled “Segment Analysis” below for additional information regarding gross profit.

Operating Expenses

Operating expenses increased $247 million, or 6.4%, and $282 million, or 3.6%, in the three and six months ended June 30, 2014, respectively, as compared to the prior year. Operating expenses as a percentage of net revenues decreased approximately 50 basis points and 60 basis points to 11.9% in both the three and six months ended June 30, 2014, as compared to 12.4% and 12.5% in the prior year, respectively. Operating expenses as a percentage of net revenues decreased for the three and six months ended June 30, 2014 due to expense leverage from sales growth in both operating segments. The increase in operating expense dollars in the three months ended June 30, 2014, was primarily due to incremental store operating costs associated with operating more stores in our Retail Pharmacy Segment and increased costs associated with infusion services in our Pharmacy Services Segment due to the acquisition of Coram. The increase in operating expense dollars in the six months ended June 30, 2014, was primarily due to incremental weather-related costs and store operating costs associated with operating more stores in our Retail Pharmacy Segment and increased costs associated with infusion services in our Pharmacy Services Segment due to the acquisition of Coram.

Please see the section entitled “Segment Analysis” below for additional information regarding operating expenses.

Interest Expense, net

Interest expense, net, increased $32 million and $64 million in the three and six months ended June 30, 2014, as compared to the prior year. This increase is primarily due to the increase in long-term debt outstanding as a result of the $4 billion debt issuance that occurred in December 2013.

For additional information on our financing activities, please see the “Liquidity and Capital Resources” section later in Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Income Tax Provision

Our effective income tax rate was 39.2% and 39.3% for the three and six months ended June 30, 2014, respectively, compared to 39.1% for the three and six months ended June 30, 2013. The difference in the effective income tax rate for the three and six months ended June 30, 2014, was primarily due to certain permanent items.

Segment Analysis

We evaluate the performance of our Pharmacy Services and Retail Pharmacy segments based on net revenue, gross profit and operating profit before the effect of nonrecurring charges and gains and certain intersegment activities. We evaluate the performance of our Corporate Segment based on operating expenses before the effect of nonrecurring charges and gains and certain intersegment activities. The following is a reconciliation of our segments to the condensed consolidated financial statements:

In millions	Pharmacy Services Segment(1)	Retail Pharmacy Segment	Corporate Segment	Intersegment Eliminations (2)	Consolidated Totals
Three Months Ended					
June 30, 2014:					
Net revenues	$21,836	$16,871	$—	$(4,105)	$34,602
Gross profit	1,195	5,299	—	(170)	6,324
Operating profit (loss)	878	1,705	(205)	(170)	2,208
June 30, 2013:					
Net revenues	18,800	16,139	—	(3,691)	31,248
Gross profit	963	5,005	—	(127)	5,841
Operating profit (loss)	675	1,600	(176)	(127)	1,972
Six Months Ended					
June 30, 2014:					
Net revenues	42,031	33,351	—	(8,091)	67,291
Gross profit	2,129	10,483	—	(346)	12,266
Operating profit (loss)	1,518	3,455	(395)	(346)	4,232
June 30, 2013:					
Net revenues	37,111	32,179	—	(7,291)	61,999
Gross profit	1,731	9,952	—	(265)	11,418
Operating profit (loss)	1,174	3,132	(375)	(265)	3,666

(1) Net revenues of the Pharmacy Services Segment includes approximately $2.0 billion of retail co-payments for the three months ended both June 30, 2014 and 2013, as well as $4.2 billion of retail co-payments for the six months ended both June 30, 2014 and 2013.

(2) Intersegment eliminations relate to two types of transaction: (i) Intersegment revenues that occur when Pharmacy Services Segment customers use Retail Pharmacy Segment stores to purchase covered products. When this occurs, both the Pharmacy Services and Retail Pharmacy segments record the revenue on a stand-alone basis, and (ii) Intersegment revenues, gross profit and operating profit that occur when Pharmacy Services Segment customers, through the Company's intersegment activities (such as the Maintenance Choice® program), elect to pick-up their maintenance prescriptions at Retail Pharmacy Segment stores instead of receiving them through the mail. When this occurs, both the Pharmacy Services and Retail Pharmacy segments record the revenue, gross profit and operating profit on a standalone basis. The following amounts are eliminated in consolidation in connection with the intersegment activity described in item (ii) above: net revenues of $1.2 billion and $1.1 billion for the three months ended June 30, 2014 and 2013, respectively, and $2.3 billion and $2.0 billion for the six months ended June 30, 2014 and 2013, respectively; and gross profit and operating profit of $170 million and $127 million for the three months ended June 30, 2014 and 2013, respectively, and $346 million and $265 million for the six months ended June 30, 2014 and 2013, respectively.

Pharmacy Services Segment

The following table summarizes our Pharmacy Services Segment's performance for the respective periods:

In millions	Three Months Ended June 30, 2014		Three Months Ended June 30, 2013		Six Months Ended June 30, 2014		Six Months Ended June 30, 2013	
Net revenues	$21,836		$18,800		$42,031		$37,111	
Gross profit	1,195		963		2,129		1,731	
Gross profit % of net revenues	5.5	%	5.1	%	5.1	%	4.7	%
Operating expenses	317		288		611		557	
Operating expense % of net revenues	1.5	%	1.5	%	1.5	%	1.5	%
Operating profit	878		675		1,518		1,174	
Operating profit % of net revenues	4.0	%	3.6	%	3.6	%	3.2	%
Net revenues(1)(4):								
Mail choice(2)	$7,753		$6,036		$14,587		$11,905	
Pharmacy network(3)	14,025		12,709		27,327		25,100	
Other	58		55		117		105	
Pharmacy claims processed(1):								
Total	230.9		226.6		458.7		454.3	
Mail choice(2)	20.5		20.7		40.3		41.3	
Pharmacy network(3)	210.4		205.9		418.4		413.0	
Generic dispensing rate(1):								
Total	82.4	%	80.7	%	82.0	%	80.6	%
Mail choice(2)	74.6	%	75.8	%	72.5	%	75.6	%
Pharmacy network(3)	83.2	%	81.1	%	83.0	%	81.0	%
Mail choice penetration rate	21.6	%	22.4	%	21.4	%	22.3	%

(1) Pharmacy network net revenues, claims processed and generic dispensing rates do not include Maintenance Choice, which are included within the mail choice category.
(2) Mail choice is defined as claims filled at a Pharmacy Services mail facility, which includes specialty claims, as well as 90-day claims filled at retail pharmacies under the Maintenance Choice program.
(3) Pharmacy network is defined as claims filled at retail pharmacies, including our retail drugstores, but excluding Maintenance Choice activity.
(4) In May 2014, the Company implemented Specialty Connect, which integrates the Company's mail and retail capabilities, providing members with the choice to bring their specialty prescriptions to any CVS/pharmacy location. Whether submitted through our mail order pharmacy or at CVS/pharmacy, all prescriptions are filled through the Company's specialty mail order pharmacies, so all revenue from this specialty prescription services program is recorded within the Pharmacy Services Segment. Members then can choose to pick up their medication at their local CVS/pharmacy or have it sent to their home through the mail.

Medicare Part D

The Company participates in the Medicare Part D program by (1) providing Medicare Part D related PBM services to our health plan and other clients that have qualified as Medicare Part D plans, and (2) offering Medicare Part D pharmacy benefits through the Company's own SilverScript prescription drug plan ("PDP"), which offers benefits to individual members and through employer group waiver plans. At the beginning of the 2013 Medicare Part D plan year, the Company implemented an enrollment systems conversion process and other actions to consolidate its

Medicare Part D PDPs into the Company's SilverScript PDP. These consolidation efforts impacted certain enrollment and coverage determination services the Company provided to SilverScript enrollees following commencement of the 2013 plan year. Effective January 15, 2013, the Centers for Medicare and Medicaid Services (“CMS”) imposed intermediate sanctions on the SilverScript PDP, consisting of immediate suspension of further plan enrollment and marketing activities. On December 20, 2013, the Company announced that CMS completed its review of the corrective actions taken to address the enrollment processing and related issues resulting from the Company’s plan consolidation efforts and the sanctions were removed. SilverScript began to enroll new choosers with effective dates starting in February as they aged into Medicare. The low income subsidy ("LIS") auto-enrollment and annual reassignment exclusion was lifted on February 21, 2014 and SilverScript began receiving LIS enrollees again with effective dates May 1, 2014 and forward.

Net Revenues

Net revenues increased $3.0 billion, or 16.2%, to $21.8 billion in the three months ended June 30, 2014, as compared to the prior year. As you review our Pharmacy Services Segment’s performance in this area, we believe you should consider the following important information that impacted the three months ended June 30, 2014:

- Our mail choice claims processed decreased 1.0% to 20.5 million claims in the three months ended June 30, 2014, compared to 20.7 million claims in the prior year. The decrease in mail choice claims was driven by a decline in traditional mail volumes, which was partially offset by growth in our Maintenance Choice program.

- Our average revenue per mail choice claim increased by 29.7%, compared to the prior year. This increase was primarily due to growth in specialty pharmacy, drug inflation and product mix.

- Our pharmacy network claims processed increased 2.2% to 210.4 million claims in the three months ended June 30, 2014, compared to 205.9 million claims in the prior year. The increase in the pharmacy network claim volume was primarily due to net new business and growth in Managed Medicaid, partially offset by a decrease in Medicare Part D claims. Medicare Part D claims were negatively impacted by the CMS sanctions in place during 2013 discussed previously in this section.

- Our average revenue per pharmacy network claim processed increased 8.0%, as compared to the prior year. This increase was primarily due to drug inflation and changes in the drug mix, partially offset by increases in the generic dispensing rate.

- In May 2014, the Company implemented Specialty Connect, which integrates the Company's mail and retail capabilities, providing members with the choice to bring their specialty prescriptions to any CVS/pharmacy location. Whether submitted through our mail order pharmacy or at CVS/pharmacy, all prescriptions are filled through the Company’s specialty mail order pharmacies, so all revenue from this specialty prescription services program is recorded within the Pharmacy Services Segment. Members then can choose to pick up their medication at their local CVS/pharmacy or have it sent to their home through the mail.

Net revenues increased $4.9 billion, or 13.3%, to approximately $42.0 billion in the six months ended June 30, 2014, as compared to the prior year. As you review our Pharmacy Services Segment’s performance in this area, we believe you should consider the following important information that impacted the six months ended June 30, 2014:

- Our mail choice claims processed decreased 2.3% to 40.3 million claims in the six months ended June 30, 2014, compared to 41.3 million claims in the prior year. The decrease in mail choice claims was driven by a decline in traditional mail volumes, which was partially offset by growth in our Maintenance Choice program.

- Our average revenue per mail choice claim increased by 25.4%, compared to the prior year. This increase was primarily due to growth in specialty pharmacy, drug inflation and product mix.

- Our pharmacy network claims processed increased 1.3% to 418.4 million claims in the six months ended June 30, 2014, compared to 413.0 million claims in the prior year. The increase in the pharmacy network claim volume was primarily due to net new business and growth in Managed Medicaid, partially offset by a decrease in Medicare Part D claims. Medicare Part D claims were negatively impacted by the CMS sanctions in place during 2013 discussed previously in this section.

- Our average revenue per pharmacy network claim processed increased 7.5%, as compared to the prior year. This increase was primarily due to drug inflation and changes in the drug mix, partially offset by increases in the generic dispensing rate.

Gross Profit

Gross profit in our Pharmacy Services Segment includes net revenues less cost of revenues. Cost of revenues includes (i) the cost of pharmaceuticals dispensed, either directly through our mail service, specialty mail and specialty retail pharmacies or indirectly through our retail pharmacy networks, (ii) shipping and handling costs and (iii) the operating costs of our mail service dispensing pharmacies, customer service operations and related information technology support.

Gross profit increased $232 million, or 24.0%, to approximately $1.2 billion in the thre