

EXPRESS SCRIPTS INC
Form 10-K
February 21, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2007, OR
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____.

Commission File Number: 0-20199

EXPRESS SCRIPTS, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

43-1420563
(I.R.S. employer identification no.)

One Express Way, St. Louis, MO
(Address of principal executive offices)

63121
(Zip Code)

Registrant's telephone number, including area code: (314) 996-0900

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

Common Stock, \$0.01 par value
(Title of Class)

Preferred Share Purchase Rights
(Title of Class)

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

None

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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 []

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

Yes ___ No X

The aggregate market value of Registrant's voting stock held by non-affiliates as of June 30, 2007, was \$12,726,501,000 based on 254,479,000 such shares held on such date by non-affiliates and the average sale price for the Common Stock on such date of \$50.01 as reported on the Nasdaq Global Select Market. Solely for purposes of this computation, the Registrant has assumed that all directors and executive officers of the Registrant are affiliates of the Registrant. The Registrant has no non-voting common equity.

Common stock outstanding as of January 31, 2008:

252,808,000 Shares

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates by reference portions of the definitive proxy statement for the Registrant's 2008 Annual Meeting of Stockholders, which is expected to be filed with the Securities and Exchange Commission not later than 120 days after the registrant's fiscal year ended December 31, 2007.

Information included in or incorporated by reference in this Annual Report on Form 10-K, other filings with the Securities and Exchange Commission (the “SEC”) and our press releases or other public statements, contain or may contain forward looking statements. Please refer to a discussion of our forward looking statements and associated risks in “Item 1—Business—Forward Looking Statements and Associated Risks” and “Item 1A—Risk Factors” in this Annual Report on Form 10-K.

PART I

THE COMPANY

Item 1 — Business

Industry Overview

Prescription drugs are playing a greater role in healthcare and today constitute the first line of treatment for many medical conditions. As pharmaceutical research opens the potential for even more effective drugs, demand can be expected to increase. For millions of people, prescription drugs equate to the hope of improved health and quality of life. At the same time, prescription drug costs are shaping one of the most persistent challenges to health care financing. Even as pharmaceutical development opens new paths to better healthcare, we confront the possibility that high costs may limit access to these therapies.

As one of the fastest growing components for health care costs in the United States, prescription drug costs accounted for approximately 10.1% of United States health care expenditures in 2007 and are expected to increase to about 12.0% in 2016 according to United States Centers for Medicare & Medicaid (“CMS”) estimates. Based upon information included in our 2006 Annual Drug Trend report, described below under “Company Operations—Clinical Support,” annual per member unmanaged drug spending rose 7.2% in 2006. In response to cost pressures being exerted on health benefit providers such as managed care organizations, health insurers, employers and unions, we develop innovative strategies designed to keep medications affordable.

We help health benefit providers address access and affordability concerns resulting from rising drug costs. We manage the cost of the drug benefit by performing the following functions:

- evaluating drugs for price, value and efficacy in order to assist clients in selecting a cost-effective formulary;
 - leveraging purchasing volume to deliver discounts to health benefit providers;
 - promoting the use of generics and low-cost brands; and
- offering cost-effective home delivery pharmacy and specialty services which result in drug-cost savings for plan sponsors and co-payment savings for members.

We work with clients, manufacturers, pharmacists and physicians to increase efficiency in the drug distribution chain, to manage costs in the pharmacy benefit, and to improve members’ health outcomes and satisfaction.

Pharmacy Benefit Management (“PBM”) companies combine retail pharmacy claims processing, formulary management and home delivery pharmacy services to create an integrated product offering to manage the prescription drug benefit for payors. Some PBMs now provide specialty services to provide treatments for diseases that rely upon high-cost injectable, infused, oral, or inhaled drugs which traditional retail pharmacies are unable to supply due to their high cost and sensitive handling and storage needs. PBMs also have broadened their service offerings to include compliance programs, outcomes research, drug therapy management programs, sophisticated data analysis and other distribution services.

Company Overview

We are one of the largest PBMs in North America and we provide a full range of services to our clients, which include HMOs, health insurers, third-party administrators, employers, union-sponsored benefit plans, workers' compensation plans and government health programs.

Our PBM services include:

- retail network pharmacy management
 - retail drug card programs
 - home delivery pharmacy services
 - benefit design consultation
 - drug utilization review
 - specialty services
- drug formulary management programs
- compliance and therapy management programs for our clients

Services from our Specialty and Ancillary Services ("SAAS") segment, which consists of the Specialty operations of CuraScript, Inc. ("CuraScript"), and our Specialty Distribution Services ("SDS") and Phoenix Marketing Group LLC ("PMG") lines of business, include:

• delivery of injectible biopharmaceutical products to patients' homes, physician offices, and certain associated patient care services

- distribution of pharmaceuticals and medical supplies to providers and clinics
 - third party logistics services for contracted pharma clients
- bio-pharma services including reimbursement and customized logistics solutions
- distribution of pharmaceuticals to low-income patients through pharmaceutical manufacturer-sponsored and company-sponsored generic patient assistance programs
 - distribution of pharmaceuticals requiring special handling or packaging
- distribution of sample units to physicians and verification of practitioner licensure

Our revenues are generated primarily from the delivery of prescription drugs through our contracted network of retail pharmacies, home delivery pharmacy services and SAAS services. Revenues from the delivery of prescription drugs to our members represented 98.4% of revenues in 2007, 98.3% in 2006, and 98.2% of revenues in 2005. Revenues from services, such as the administrative fees associated with the administration of retail pharmacy networks contracted by certain clients, market research programs, medication counseling services, certain specialty distribution services, and sample fulfillment and sample accountability services, comprised the remainder of our revenues.

Prescription drugs are dispensed to members of the health plans we serve primarily through networks of retail pharmacies that are under non-exclusive contracts with us and through the three home delivery fulfillment pharmacies and twenty-five specialty drug pharmacies we operated as of December 31, 2007. More than 60,000 retail pharmacies, which represent more than 95% of all United States retail pharmacies, participate in one or more of our networks. The top ten retail pharmacy chains represent approximately 56% of the total number of stores in our largest network.

We were incorporated in Missouri in September 1986, and were reincorporated in Delaware in March 1992. Our principal executive offices are located at One Express Way, Saint Louis, Missouri, 63121. Our telephone number is (314) 996-0900 and our web site is www.express-scripts.com. Through our website, we make available access to our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, all amendments to those reports (when applicable), and other filings with the SEC. Such access is free of charge and is available as soon as reasonably practicable after such information is filed with the SEC. In addition, the SEC maintains an internet site

(www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers filing electronically with the SEC (which includes us). Information included on our website is not part of this annual report.

Products and Services

Pharmacy Benefit Management Services

Overview. Our PBM services involve the management of outpatient prescription drug use to foster high quality, cost-effective pharmaceutical care. We offer our PBM services to our clients in the United States and Canada. Our PBM services include:

- retail network pharmacy management
 - retail drug card programs
 - home delivery pharmacy services
 - benefit design consultation
 - drug utilization review
 - specialty services
- drug formulary management programs
- compliance and therapy management programs for our clients

We consult with our clients to assist them in selecting plan design features that balance the client's requirements for cost control with member convenience. For example, some clients receive a smaller discount on pricing in the retail pharmacy network or home delivery pharmacy in exchange for receiving all or a larger share of the pharmaceutical manufacturer rebates. Other clients receive a greater discount on pricing at the retail pharmacy network or home delivery pharmacy in exchange for a smaller share of the pharmaceutical manufacturer rebates.

During 2007, 80.2% of our revenues were derived by our PBM operations, compared to 80.5% and 88.5% during 2006 and 2005, respectively. This decrease is mainly due to the acquisition of Priority in 2005, which is included in our SAAS segment. The number of retail pharmacy network claims processed decreased to 379.9 million in 2007 from 390.3 million in 2006. The number of home delivery pharmacy claims dispensed decreased to 40.8 million in 2007 from 41.2 million claims in 2006.

Retail Pharmacy Network Administration. We contract with retail pharmacies to provide prescription drugs to members of the pharmacy benefit plans we manage. In the United States, we negotiate with pharmacies to discount the price at which they will provide drugs to members. We manage national and regional networks in the United States that are responsive to client preferences related to cost containment, convenience of access for members, and network performance. We also manage networks of pharmacies that are customized for or under direct contract with specific clients. In addition, we have contracted Medicare Part D provider networks that are intended to comply with CMS access requirements for the Medicare Part D Prescription Drug Program.

All retail pharmacies in our pharmacy networks communicate with us online and in real time to process prescription drug claims. When a member of a plan presents his or her identification card at a network pharmacy, the network pharmacist sends the specified member and prescription information in an industry-standard format through our systems, which process the claim and respond to the pharmacy. The electronic processing of the claim includes, among other things, the following:

- confirming the member's eligibility for benefits under the applicable health benefit plan and the conditions to or limitations of coverage
- performing a concurrent drug utilization review and alerting the pharmacist to possible drug interactions and reactions or other indications of inappropriate prescription drug usage
- updating the member's prescription drug claim record

if the claim is accepted, confirming to the pharmacy that it will receive payment for the drug dispensed and according to its provider agreement with us
informing the pharmacy of the co-payment amount to be collected from the member based upon the client's plan design and the remaining payable amount due the pharmacy from the plan

Patient Services. As of December 31, 2007, we operated three home delivery pharmacies located in Maryland Heights, Missouri; Bensalem, Pennsylvania; and Tempe, Arizona. In addition to front-end order processing that occurs at our home delivery pharmacies, we also operate three standalone front-end order processing facilities in Troy, New York; Harrisburg, Pennsylvania; and Albuquerque, New Mexico. In addition, we operated nine contact centers located in Albuquerque, New Mexico; Bloomington, Minnesota; Farmington Hills, Michigan; Harrisburg, Pennsylvania; St. Marys, Georgia; Tempe, Arizona; Orlando, Florida; St. Louis, Missouri; and Pueblo, Colorado. Our pharmacies provide patients with convenient access to maintenance medications and enable us to manage our clients' drug costs through operating efficiencies and economies of scale. Through our home delivery pharmacies, we are directly involved with the prescriber and patient and, as a result, we believe we are generally able to achieve a higher level of generic substitutions and therapeutic interventions than can be achieved through the retail pharmacy networks.

Patient Care Contact Centers. Although we contract with health plans, the ultimate recipients of many of our services are the members of these health plans. We believe client satisfaction is dependent upon patient satisfaction. Domestic patients can call us toll-free, 24 hours a day, 7 days a week, to obtain information about their prescription drug plan from our trained patient care advocates and pharmacists.

Benefit Plan Design and Consultation. We offer consultation and financial modeling to assist our clients in selecting benefit plan designs that meet their needs for member satisfaction and cost control. The most common benefit design options we offer to our clients are:

- financial incentives and reimbursement limitations on the drugs covered by the plan, including drug formularies, tiered co-payments, deductibles or annual benefit maximums
 - generic drug utilization incentives
- incentives or requirements to use only certain network pharmacies or to order certain maintenance drugs (i.e. therapies for diabetes, high blood pressure, etc.) only for home delivery
 - reimbursement limitations on the amount of a drug which can be obtained in a specific period
- utilization management programs such as Step Therapy and Prior Authorization, that focus the use of medications according to clinically developed algorithms

The client's choice of benefit design is entered into our electronic claims processing system, which applies the plan design parameters as claims are submitted and enables our clients and us to monitor the financial performance of the plan.

Formulary Development, Compliance and Therapy Management. Formularies are lists of drugs to which benefit design is applied under the applicable plan. We have many years of formulary development expertise and maintain an extensive clinical pharmacy department.

Our foremost consideration in the formulary development process is the clinical appropriateness of the drug. In developing formularies, we first perform a rigorous assessment of the available evidence regarding the drug's safety and clinical effectiveness. No new drug is added to the formulary until it is approved by our National Pharmacy & Therapeutics Committee ("P&T Committee") – a panel composed of nineteen independent physicians and pharmacists in active clinical practice, representing a variety of specialties and practice settings, typically with major academic affiliations. We fully comply with the P&T Committee's clinical recommendations. In making its clinical recommendation, the P&T Committee does not consider any information regarding the discount or rebate arrangement we might negotiate with the manufacturer. This is designed to ensure the clinical recommendation is not affected by our financial arrangements. After the clinical recommendation is made, the drugs are evaluated on an economic basis

to determine optimal cost-effectiveness.

We administer a number of different formularies for our clients. The use of formulary drugs is encouraged through various benefit design features. Historically, many clients selected a plan design that included an open formulary in which all drugs were covered by the plan. Today, a majority of our clients are selecting formularies which are designed to be used with various financial or other incentives, such as three-tier co-payments, that drive the selection of formulary drugs over their non-formulary alternatives. Some clients select closed formularies, in which benefits are available only for drugs listed on the formulary. In 2007, about 76% of all claims fell into three-tier or closed categories compared to 75% for 2006 and 69% for 2005. Use of formulary drugs can be encouraged in the following ways:

- through plan design features, such as tiered co-payments, which require the member to pay a higher amount for a non-formulary drug
- by educating members and physicians with respect to benefit design implications
 - by promoting the use of lower cost generic alternatives
- by implementing utilization management programs such as step therapy and prior authorization, that focus the use of medications according to clinically developed algorithms

We also provide formulary compliance services to our clients. For example, if a doctor has prescribed a drug that is not on a client's formulary, we notify the pharmacist through our claims processing system. The pharmacist may then contact the doctor to attempt to obtain the doctor's consent to change the prescription to the appropriate formulary product. The doctor has the final decision-making authority in prescribing the medication.

We also offer innovative clinically based intervention programs to assist and manage patient quality of life, client drug trend, and physician communication/education. These programs encompass comprehensive point of service and retrospective drug utilization review, physician profiling, academic detailing, prior authorization, disease care management, and clinical guideline dissemination to physicians.

Information Reporting and Analysis Programs. Through the use of sophisticated information and reporting systems we are better able to manage the prescription drug benefit. We analyze prescription drug data to identify cost trends and budget for expected drug costs, assess the financial impact of plan design changes and assist clients in identifying costly utilization patterns through an online prescription drug decision support tool.

We offer education programs to members in managing clinical outcomes and the total health care costs associated with certain conditions such as asthma, diabetes and cardiovascular disease. These programs are based on the premise that better informed patient and physician behavior can positively influence medical outcomes and reduce overall medical costs. We identify patients who may benefit from these programs through claims data analysis or self-enrollment.

We offer a tiered approach to member education and wellness, ranging from information provided through our internet site, to educational mailings, to our intensive one-on-one registered nurse or pharmacist counseling. The programs include providing patient profiles directly to their physicians, as well as measurements of the clinical, personal and economic outcomes of the programs.

Rebate Programs. We develop, manage and administer rebate programs that allow pharmaceutical manufactures to provide rebates and administrative fees based on utilization of their products by members of our clients' benefit plans. The rebate portion that the client receives varies in accordance with each client contract.

Our rebates are determined based on the characteristics of the formulary design selected by the client and their pharmacy benefit structure. In addition, since 2006, rebates available on utilization of pharmaceutical products paid for under the federal Medicare Part D benefit have been captured through a rebate program specifically designed and

operated for that purpose. The amount of rebates generated by these types of programs is a function of the particular product dispensed and the level of utilization that occurs. Manufacturers participating in our rebate programs pay us administrative fees in connection with the services and systems we provide through the rebate program.

Electronic Claims Processing System. Our electronic claims processing system enables us to implement sophisticated intervention programs to assist in managing prescription drug utilization. The system can alert the pharmacist to generic substitution and therapeutic intervention opportunities as well as formulary compliance issues, or administer prior authorization and step-therapy protocol programs at the time a claim is submitted for processing. Our claims processing system also creates a database of drug utilization information that can be accessed both at the time the prescription is dispensed and also on a retrospective basis to analyze utilization trends and prescribing patterns for more intensive management of the drug benefit.

Consumer Health and Drug Information. We maintain a public website, www.DrugDigest.org, dedicated to helping consumers make informed decisions about using drugs. Much of the information on [DrugDigest.org](http://www.DrugDigest.org) is written by pharmacists – primarily doctors of pharmacy who are also affiliated with academic institutions. We continually work to expand the interactive tools available on [DrugDigest.org](http://www.DrugDigest.org) which provide consumers an opportunity to take an even more active role in maintaining their own health. The information on [DrugDigest.org](http://www.DrugDigest.org) includes:

- a drug interaction checker
- a drug side effect comparison tool
- tools to check for less expensive generic and alternative drugs
- audible drug name pronunciations
- comparisons of different drugs used to treat the same health condition
 - information on health conditions and their treatments
- instructional videos showing administration of specific drug dosage forms
 - monographs on drugs and dietary supplements
 - photographs of pills and capsules
- interactive care pathways and health risk assessments

Many features of [DrugDigest.org](http://www.DrugDigest.org) are available in the limited-access member website at www.express-scripts.com. The member website gives our clients' members access to personalized current and, in many cases, previous drug histories. Members can use the interactive tools from [DrugDigest.org](http://www.DrugDigest.org) to check for drug interactions and find possible side effects for all of the drugs they take.

To facilitate communications between members and physicians, health condition information from [DrugDigest.org](http://www.DrugDigest.org) has been compiled into "For Your Physician Visit", which is available on the member website. Using it, members complete and print appropriate checklists on conditions such as diabetes and depression. Discussing the completed checklists gives both the member and the physician a better understanding of the member's true health status. Information on [DrugDigest.org](http://www.DrugDigest.org) does not constitute part of this document.

SAAS Services

Overview. Our SAAS segment includes the Specialty operations of CuraScript, and our SDS and PMG lines of business. Through our SAAS segment we provide specialty services, including delivery of injectible drugs to patient homes, physician offices and certain associated patient care services; distribution of pharmaceuticals and medical supplies to providers and clinics; third party logistics services for contracted pharma clients; and bio-pharma services including reimbursement and customized logistics solutions. The SAAS segment also includes distribution of specialty pharmaceuticals requiring special handling or packaging; distribution of pharmaceuticals to low-income patients through manufacturer-sponsored branded and company-sponsored generic patient assistance programs; and distribution of sample units to physicians and verification of practitioner licensure. During 2007, 19.8% of our

revenues were derived from SAAS services, compared to 19.5% and 11.5% during 2006 and 2005, respectively.

Collectively under the CuraScript name, we now operate four integrated brands that service the patient through multiple paths: Payors, Providers and Pharma. CuraScriptSP operates specialty pharmacies in eight states with primary operations located in Orlando, Florida. These locations provide patient care and direct specialty home delivery to our patients. CuraScriptSD provides specialty distribution of pharmaceuticals and medical supplies direct to providers and clinics, performs third-party logistics services for contracted pharmaceutical manufacturers and operates a Group Purchasing Organization (“GPO”) for many of our clients. We currently operate CuraScriptSD specialty distribution centers located in Grove City, OH and Sparks, NV. FreedomFP provides fertility services to both providers and patients and is located in Byfield, MA. Finally, HealthBridge provides Bio-Pharma services including reimbursement and customized logistics solutions. In total, the collective CuraScript brand diversely positions us solidly within the Specialty market and serves as a pathway to the patient.

Discontinued Operations. During the fourth quarter of 2007, we identified our CuraScript Infusion Pharmacy, Inc. line of business (“IP”) as available for sale as we considered it non-core to our future operations. As a result, IP is classified as a discontinued operation. IP is headquartered in Louisville, Kentucky and operates twelve infusion pharmacies in six states. IP offers a broad range of infused therapies in the home to patients with acute or chronic conditions.

Prior to being classified as a discontinued operation, IP was included in our SAAS segment. We recorded IP revenues of \$104.2 million in 2007, \$106.0 million in 2006, and \$23.6 million in 2005. The results of operations for IP are reported as discontinued operations for all periods presented in the accompanying Consolidated Statements of Operations in accordance with Financial Accounting Standard (“FAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”. Additionally, for all periods presented, assets and liabilities of the discontinued operations are segregated in the accompanying Consolidated Balance Sheets, and cash flows of our discontinued operations are segregated in our accompanying Consolidated Statement of Cash Flows.

In connection with the classification of IP as a discontinued operation, we recorded a charge of \$34.0 million in the fourth quarter of 2007, the majority of which reflects the IP goodwill and intangible asset impairment losses and the subsequent write-down of IP assets to fair market value (see—“Critical Accounting Policies—Asset Impairment”).

Payor Services. We offer health plan providers and their members customized disease-specific treatment programs which cover both pharmacy and medical benefits. In addition to helping payors design a customized plan, we assist with eligibility review, prior authorization coordination, monitoring and reporting of patient therapy adherence as well as electronic claims processing and billing. Our monitoring and reporting of patient therapy includes clinical tracking, plan-specific reports, and provider treatment and dispensing patterns. We are able to provide a clinical and financial picture of plan members with chronic illnesses which measures pharmacy expenses and patients’ treatment progress.

Physician Services. Through our CuraScriptSD business unit we provide distribution services primarily to office and clinic-based physicians treating chronic disease patients who regularly order high-dollar-value pharmaceuticals. We are able to provide to these physicians competitive pricing on pharmaceuticals and medical supplies.

Biotech Services. In our June 2007 Specialty Pharmacy Management Guide and Trend Report, we reported at the end of 2006 there were more than 400 specialty drugs in clinical trials. For new biopharmaceuticals being launched, we can provide biotech manufacturers product distribution management services. We design strategies tailored to each product’s needs with a focus on identifying opportunities to educate the marketplace regarding drug effectiveness, proper utilization and payor acceptance.

Other Services. We also provide a range of centralized supply chain services which can include sampling programs, patient assistance programs, and clinical trial assistance as well as specialized shipping and storage and customized dosing.

We are a leader in sample accountability, database management and practitioner verification services for the pharmaceutical industry, operating the nation's largest prescription drug sample fulfillment business.

We provide specialty distribution services, consisting of the distribution of, and creation of a database of information for, products requiring special handling or packaging, products targeted to a specific physician or patient population, and products distributed to low-income patients. Our services include eligibility, fulfillment, inventory, insurance verification/authorization and payment. We also administer sample card programs for certain manufacturers where the ingredient costs of pharmaceuticals dispensed from retail pharmacies are included in revenues, as well as costs of revenues. These services are provided from our Maryland Heights, Missouri facility.

Segment Information

We report segments on the basis of services offered and have determined we have two reportable segments: PBM and SAAS. Our domestic and Canadian PBM operating segments have similar characteristics and as such have been aggregated into a single PBM reporting segment. Our SAAS segment includes the Specialty operations of CuraScript, and our SDS and PMG lines of business. Information regarding our segments appears in Note 13 of the notes to our consolidated financial statements and is incorporated by reference herein.

Suppliers

We maintain a large inventory of brand name and generic pharmaceuticals in our home delivery pharmacies and biopharmaceutical products in our specialty pharmacies and distribution centers along with other high cost oral agents used to treat patients with rare or chronic disease. If a drug is not in our inventory, we can generally obtain it from a supplier within one business day. We purchase our pharmaceuticals either directly from manufacturers or through wholesalers. Currently, approximately 95% of our branded pharmaceutical purchases by our home delivery pharmacies and approximately 75% of our purchases by our SAAS segment are through one wholesaler. Generic pharmaceuticals are generally purchased directly from manufacturers. We believe that alternative sources of supply for most generic and brand name pharmaceuticals are readily available. Due to the unique nature of the specialty market, the services patients require and our reach nationally, we are able to purchase and supply most of the current limited distributed specialty drugs.

Clients

We are a provider of PBM services to several market segments. Our clients include HMOs, health insurers, third-party administrators, employers, union-sponsored benefit plans, workers compensation plans and government health programs. We provide Specialty services to customers who also include HMOs, health insurers, third-party administrators, employers, union-sponsored benefit plans, government health programs office-based oncologists, renal dialysis clinics, ambulatory surgery centers, primary care physicians, retina specialists, and others.

Our top five clients collectively represented 17.4%, 17.8%, and 23.6% of revenues during 2007, 2006 and 2005 respectively. None of our clients accounted for 10% or more of our consolidated revenues in fiscal years 2007, 2006 or 2005.

Medicare Prescription Drug Coverage

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "MMA") created the federal Voluntary Prescription Drug Benefit Program under "Part D" of the Social Security Act. Since January 1, 2006, eligible Medicare beneficiaries have been able to obtain prescription drug coverage under Part D by enrolling in a prescription drug plan ("PDP") or a "Medicare Advantage" plan that offers prescription drug coverage (an "MA-PD"). In addition, the MMA, created an opportunity for employers offering eligible prescription drug coverage for their Medicare-eligible

members to receive a subsidy payment by enrolling in the Retiree Drug Subsidy (“RDS”) program. To claim the subsidy, the beneficiaries than an employer claims cannot be enrolled in a PDP or MA-PD.

Our services support clients who have elected to become a PDP or an MA-PD. In addition, we support the needs of employers who enroll in the RDS program. We provide PBM services to these clients as well as new Part D functions that include managing member out of pocket costs, creation of Explanation of Benefits (“EOBs”), creation of the prescription data event, medication therapy management services, and various reporting required by CMS.

In 2006, we were approved by CMS to function as a Part D PDP plan sponsor through our wholly owned subsidiary Express Scripts Insurance Company. Beginning January 1, 2007, our PDP offers prescription drug coverage nationally and in Puerto Rico. The Express Scripts Insurance Company is licensed by the Arizona Department of Insurance as a Disability Insurer which meets the CMS requirements of a risk-bearing entity regulated under state insurance laws or similar statutes. Express Scripts Insurance Company has also been granted licenses in the states of Delaware, Idaho, Indiana, Montana, New York, Oklahoma, Pennsylvania, South Dakota, Texas, Utah, West Virginia, Nebraska, Hawaii, Nevada and the District of Columbia as a result of the filing of our Uniform Certificate of Authority Application expansion application. Express Scripts Insurance Company has filed expansion applications in other regions in which we may seek to do business, and until licenses are granted, will operate under CMS federal waivers which allow PDPs to waive the state licensure requirement for the initial three years of the prescription drug coverage offering.

Acquisitions and Joint Ventures

On October 10, 2007, we purchased Connect Your Care, LLC (“CYC”), a leading provider of consumer directed healthcare technology solutions to the employer, health plan and financial services markets. The purchase price was funded through internally generated cash. The purchase agreement includes an earnout provision, payable after three years based on the performance of the business. This acquisition is reported as part of our PBM segment, and will not have a material impact on earnings.

On October 14, 2005, we acquired the capital stock of Priority Healthcare in a cash transaction for \$28 per share, or approximately \$1.3 billion. The \$1.3 billion purchase price was financed with approximately \$167.0 million of cash on hand and the remainder by adding \$1.6 billion in Term A loans through a new credit facility which replaced our prior credit facility. As a result of this refinancing, we wrote-off approximately \$3.8 million in deferred financing fees relating to our prior credit facility in the fourth quarter of 2005. The Priority acquisition has enhanced our ability to provide comprehensive clinical services in many disease states.

We regularly review potential acquisitions and affiliation opportunities. We believe available cash resources, bank financing or the issuance of additional common stock or other securities could be used to finance future acquisitions or affiliations. There can be no assurance we will make new acquisitions or establish new affiliations in 2008 or thereafter.

Company Operations

General. As of December 31, 2007, our PBM segment operated three home delivery pharmacies, three standalone front-end processing centers, and nine patient contact centers out of leased and owned facilities; and our SAAS segment operated twenty-five specialty drug pharmacies. Electronic pharmacy claims processing takes place at facilities owned by Electronic Data Systems Corp. (“EDS”) and by International Business Machines Corp. (“IBM”). At our Canadian facilities, we have sales and marketing, client services, pharmacy help desk, clinical, network contracting and management, and certain management information systems capabilities.

Corporate Marketing and Brand Management. In the United States, our sales managers and directors market and sell PBM services, supported by a team of client-service representatives, clinical pharmacy managers, and benefit analysis

consultants. This team works with clients to make prescription drug use safer and more affordable. A dedicated sales staff cross-markets SAAS services to our PBM clients. In addition, sales personnel dedicated to our SAAS segment use direct marketing to generate new customers and solidify existing customer relationships. In Canada, marketing and sales efforts are conducted by our staff based in Mississauga, Ontario.

Network Contracting and Management. Our Network Contracting and Management group is responsible for contracting and administering our pharmacy networks. To participate in our retail pharmacy networks, pharmacies must meet certain qualifications, including the requirement that all applicable, credentialing state and/or licensing requirements are being maintained. Pharmacies can contact our pharmacy help desk toll-free, 24 hours a day, 7 days a week, for information and assistance in filling prescriptions for our clients' members. In addition, our Network Contracting and Management group audits pharmacies in the retail pharmacy networks to determine compliance with the terms of their contracts.

Clinical Support. Our staff of highly-trained pharmacists and physicians provides clinical support for our PBM services. These health care professionals are responsible for a wide range of activities including tracking the drug pipeline; identifying emerging medication-related safety issues and notifying physicians, clients, and patients (if appropriate); providing drug information services; formulary management; development of utilization management, safety (concurrent and retrospective Drug Utilization Review), and other clinical interventions that identify and/or contact physicians, pharmacists, or patients.

Our staff works closely with the P&T Committee during development of our formulary and selected utilization management programs. The P&T Committee ensures our decisions are evidence-based, clinically sound, and meet the current standard of medical practice. The P&T Committee's guidance results in decisions which are clinically appropriate and not merely superseded by financial considerations.

We have a research team whose mission is to conduct timely, rigorous and objective research that supports evidence-based pharmacy benefit management. Using pharmacy and medical claims data together with member surveys, the research department conducts studies to evaluate clinical, economic and member impact of pharmacy benefits. The release of our 2006 Annual Drug Trend report in June 2007 marked our tenth consecutive year of tracking prescription drug trends. Based on a large sample of our membership, the 2006 Annual Drug Trend report not only examines trends in pharmaceutical utilization and cost, it also investigates the factors that underlie those trends. The current 2006 Annual Drug Trend report and results of our other studies are shared at our annual Outcomes Conference. We also present at other client forums, speak at professional meetings and publish in health-related journals.

Information Technology. Our Information Technology department supports our pharmacy claims processing systems, our Specialty pharmacy systems and other management information systems essential to our operations. Uninterrupted point-of-sale electronic retail pharmacy claims processing is a significant operational requirement for us. Claims for our PBM segment are presently processed in the United States through systems which are maintained, managed and operated domestically by EDS. Canadian claims are processed through systems maintained, managed and operated by IBM. We believe we have substantial capacity for growth in our United States and Canadian claims processing facilities.

Specialty pharmacy operations are supported by multiple pharmacy systems which are maintained, managed and operated internally. We are currently in the process of standardizing our Specialty pharmacy operations on a common application and platform.

We leverage EDS and SunGard Recovery Services to provide certain disaster recovery services for systems located at the EDS data centers. For systems not covered by an EDS and SunGard Recovery Services arrangement, such as our Specialty pharmacy data centers, the corporate disaster recovery organization manages internal recovery services.

Competition

There are a number of other PBMs in the United States against which we compete. Some of these are independent PBMs, such as Catalyst RX, Innoviant, Medco, MedImpact, and PerformRX. Others are owned by managed care organizations such as Aetna Inc., CIGNA Corporation, First Health, Humana Inc., Prime Therapeutics and Wellpoint Health Networks Inc. Some are owned by retail pharmacies, such as Caremark (owned by CVS), RX America (owned by Longs Drug Stores), Rite Aid Health Solutions and Walgreens Health Initiatives. Wal-Mart Stores, Inc. also recently announced that it may engage in certain activities competitive with PBMs. We also compete against specialized providers, such as Argus and SXC Health Solutions. Some of these competitors may have greater financial, marketing and technological resources. In addition, other companies may enter into the business and become increasingly competitive as there are no meaningful barriers to entry.

Government Regulation and Compliance

Many aspects of our businesses are regulated by federal and state laws and regulations. Since sanctions may be imposed for violations of these laws, compliance is a significant operational requirement and we maintain a comprehensive Compliance program. We believe we are operating our business in substantial compliance with all existing legal requirements material to the operation of our businesses. There are, however, significant uncertainties involving the application of many of these legal requirements to our business. In addition, there are numerous proposed health care laws and regulations at the federal and state levels, many of which could adversely affect our business or financial position. We are unable to predict what additional federal or state legislation or regulatory initiatives may be enacted in the future relating to our business or the health care industry in general, or what effect any such legislation or regulations might have on us. We cannot provide any assurance that federal or state governments will not impose additional restrictions or adopt interpretations of existing laws that could have a material adverse effect on our consolidated results of operations, consolidated financial position and/or consolidated cash flow from operations.

Pharmacy Benefit Management Regulation Generally. Certain federal and state laws and regulations affect or may affect aspects of our PBM business. Among the laws and regulations that may impact our business are the following:

Anti-Kickback Laws. Subject to certain exceptions and “safe harbors,” the federal anti-kickback statute generally prohibits, among other things, knowingly and willfully paying or offering any payment or other remuneration to induce a person to purchase, lease, order, or arrange for (or recommend purchasing, leasing, or ordering) items (including prescription drugs) or services reimbursable in whole or in part under Medicare, Medicaid or another federal health care program. Several states also have similar laws, some of which apply similar anti-kickback prohibitions to items or services reimbursable by non-governmental payors. Sanctions for violating these federal and state anti-kickback laws may include criminal and civil fines and exclusion from participation in the federal and state healthcare programs.

The federal anti-kickback statute has been interpreted broadly by courts, the Office of Inspector General (“OIG”) within the Department of Health and Human Services (“HHS”), and administrative bodies. Because of the federal statute’s broad scope, federal regulations establish certain “safe harbors” from liability. A practice that does not fall within a safe harbor is not necessarily unlawful, but may be subject to scrutiny and challenge. Anti-kickback laws have been cited as a partial basis, along with state consumer protection laws discussed below, for investigations and multi-state settlements relating to financial incentives provided by drug manufacturers to retail pharmacies in connection with “product conversion” programs.

Self-Referral Laws. The federal physician self-referral law, known as the “Stark Law,” prohibits physicians from referring Medicare or Medicaid beneficiaries for “designated health services” (which include, among other things, outpatient prescription drugs) to an entity with which the physician or an immediate family member of the physician has a financial relationship and prohibits the entity receiving a prohibited referral from presenting a claim to Medicare

or Medicaid for the designated health service furnished under the prohibited referral. Our home delivery pharmacies dispense certain outpatient prescription drugs that may be directly or indirectly reimbursed by the Medicare or Medicaid programs, potentially making us subject to the Stark Law's requirements with respect to such pharmacy operations. Possible penalties for violation of the Stark Law include denial of payment, refund of amounts collected in violation of the statute, civil monetary penalties and Medicare and Medicaid program exclusion.

Our home delivery services may also be subject to state statutes and regulations that restrict the ability of physicians to refer patients to entities with which they have a financial relationship. These state laws may vary from the federal Stark Law and vary significantly from state to state. Some of these state statutes and regulations apply to items and services reimbursed by private payors. Violation of these laws may result in prohibition of payment for items or services provided, loss of pharmacy or health care provider licenses, fines and criminal penalties.

False Claims Act and Related Criminal Provisions. The federal False Claims Act (the "False Claims Act") imposes civil penalties for knowingly making or causing to be made false claims or false records or statements with respect to governmental programs, such as Medicare and Medicaid, in order to obtain reimbursement. Private individuals may bring qui tam or "whistle blower" suits against providers under the False Claims Act, which authorizes the payment of a portion of any recovery to the individual bringing suit. Some federal district courts have interpreted the False Claims Act as applying to claims for reimbursement that violate the anti-kickback statute or federal physician self-referral law under certain circumstances. The False Claims Act generally provides for the imposition of civil penalties and for treble damages, resulting in the possibility of substantial financial penalties. Criminal statutes that are similar to the False Claims Act provide that if a corporation is convicted of presenting a claim or making a statement that it knows to be false, fictitious or fraudulent to any federal agency it may be fined. Some states also have enacted statutes similar to the False Claims Act which may include criminal penalties, substantial fines, and treble damages.

ERISA Regulation. The Employee Retirement Income Security Act of 1974 ("ERISA") regulates certain aspects of employee pension and health benefit plans, including self-funded corporate health plans with respect to which we have agreements to provide PBM services. We believe that the conduct of our business is not generally subject to the fiduciary obligations of ERISA, and our agreements with our clients provide that we are not the fiduciary of the applicable plan. However, there can be no assurance that the U.S. Department of Labor (the "DOL"), which is the agency that enforces ERISA, would not assert that the fiduciary obligations imposed by ERISA apply to certain aspects of our operations or that courts in private ERISA litigation would not so rule.

In addition to its fiduciary provisions, ERISA imposes civil and criminal liability on service providers to health plans and certain other persons if certain forms of illegal remuneration are made or received. These provisions of ERISA are similar, but not identical, to the health care anti-kickback statutes discussed above, although ERISA lacks the statutory and regulatory "safe harbor" exceptions incorporated into the health care statutes. Like the health care anti-kickback laws, the corresponding provisions of ERISA are broadly written and their application to particular cases is often uncertain. See "Item 3 – Legal Proceedings" for discussion of current proceedings involving us relating to these laws or regulations.

On December 13, 2007 the DOL published a proposed regulation relating to Service Provider Disclosures Under ERISA Section 408(b)(2). As proposed, the regulation requires comprehensive disclosure of direct and indirect compensation received by "service providers" to ERISA plans. The company is evaluating the proposed rule. Because we are unable to predict whether this regulation will be adopted, or the final form of such regulation if adopted, we can give no assurance that the implementation of any business changes which may be necessary to comply with such regulations would not have a material adverse effect on our business and financial results.

State Fiduciary Legislation. Statutes have been introduced in several states that purport to declare that a PBM is a fiduciary with respect to its clients. We believe that the fiduciary obligations that such statutes would impose would be similar, but not identical, to the scope of fiduciary obligations under ERISA. To date only two jurisdictions – Maine and the District of Columbia – have enacted such a statute. Our trade association, Pharmaceutical Care Management

Association (“PCMA”), filed suit in federal courts in Maine and the District of Columbia alleging, among other things, that the statute is preempted by ERISA with respect to welfare plans that are subject to ERISA. In the Maine case the United States District Court upheld the statute. That decision was affirmed by the United States Court of Appeals for the First Circuit. In the District of Columbia case, the court vacated the preliminary injunctions and granted the District of Columbia’s motion for summary judgment. This decision is currently on appeal to the United States Court of Appeals for the D.C. Circuit. Widespread enactment of such statutes could have a material adverse effect upon our financial condition, results of operations and cash flows.

Consumer Protection Laws. Most states have consumer protection laws that previously have been the basis for investigations and multi-state settlements relating to financial incentives provided by drug manufacturers to retail pharmacies in connection with drug switching programs. Such statutes have also been cited as the basis for claims against PBMs either in civil litigation or pursuant to investigations by state Attorneys General. See “Item 3 – Legal Proceedings” for discussion of current proceedings relating to these laws or regulations.

Network Access Legislation. A majority of states now have some form of legislation affecting our ability to limit access to a pharmacy provider network or removal of a network provider. Such legislation may require us or our clients to admit any retail pharmacy willing to meet the plan’s price and other terms for network participation (“any willing provider” legislation); or may provide that a provider may not be removed from a network except in compliance with certain procedures (“due process” legislation). We have not been materially affected by these statutes.

Legislation Affecting Plan Design. Some states have enacted legislation that prohibits managed care plan sponsors from implementing certain restrictive benefit plan design features, and many states have introduced legislation to regulate various aspects of managed care plans, including provisions relating to the pharmacy benefit. For example, some states, under so-called “freedom of choice” legislation, provide that members of the plan may not be required to use network providers, but must instead be provided with benefits even if they choose to use non-network providers. Other states have enacted legislation purporting to prohibit health plans from offering members financial incentives for use of home delivery pharmacies. Legislation has been introduced in some states to prohibit or restrict therapeutic intervention, or to require coverage of all FDA approved drugs. Other states mandate coverage of certain benefits or conditions, and require health plan coverage of specific drugs if deemed medically necessary by the prescribing physician. Such legislation does not generally apply to us directly, but it may apply to certain of our clients, such as HMOs and health insurers. If such legislation were to become widely adopted and broad in scope, it could have the effect of limiting the economic benefits achievable through pharmacy benefit management.

Licensure Laws. Many states have licensure or registration laws governing certain types of managed care organizations, including preferred provider organizations (“PPOs”), third party administrators (“TPAs”), and companies that provide utilization review services. The scope of these laws differs from state to state, and the application of such laws to the activities of PBMs often is unclear. We have registered under such laws in those states in which we have concluded that such registration is required. Because of increased regulatory requirements on some of our managed care clients affecting prior authorization of drugs before coverage is approved, we have obtained utilization review licenses in selected states through our subsidiary, ESI Utilization Management Company. Moreover, we have received full accreditation for URAC Pharmacy Benefit Management version 1.0 Standards, which includes quality standards for drug utilization management. In addition, accreditation agencies’ requirements for managed care organizations such as the National Committee on Quality Assurance (“NCQA”), and Medicare Part D regulations for PDP and MA-PDPs may affect the services we provide to such organizations.

Legislation regulating PBM activities in a comprehensive manner has been and continues to be considered in a number of states. In the past, certain organizations, such as the National Association of Insurance Commissioners (“NAIC,” an organization of state insurance regulators), as well as certain state pharmacy boards have considered proposals to regulate PBMs and/or certain PBM activities, such as formulary development and utilization management. While the actions of the NAIC would not have the force of law, they may influence states to adopt model legislation that such organizations promulgate.

Legislation and Regulation Affecting Drug Prices. Some states have adopted so-called “most favored nation” legislation providing that a pharmacy participating in the state Medicaid program must give the state the best price that the pharmacy makes available to any third party plan. Such legislation may adversely affect our ability to negotiate discounts in the future from network pharmacies. Other states have enacted “unitary pricing” legislation, which mandates that all wholesale purchasers of drugs within the state be given access to the same discounts and incentives. Such legislation, if enacted in a state where one of our home delivery pharmacies is located, could adversely affect our ability to negotiate discounts on our purchase of prescription drugs to be dispensed by our home delivery pharmacies.

In addition, federal and state agencies and enforcement officials are investigating the effects of pharmaceutical industry pricing practices such as how average wholesale price (“AWP”) is calculated and how pharmaceutical manufacturers report their “best price” on a drug under the federal Medicaid rebate program. AWP is a standard pricing benchmark (calculated by a third-party such as First Data Bank or Medispan) used throughout the industry, including us, as a basis for calculating drug prices under our contracts with health plans and pharmacies and rebates with pharmaceutical manufacturers. Changes to the AWP standard could alter the calculation of drug prices for federal programs. We are unable to predict whether any such changes will occur, and if so, if such changes would have a material adverse impact on our consolidated results of operations, consolidated financial position and/or consolidated cash flow from operations.

Further, the federal Medicaid rebate program requires participating drug manufacturers to provide rebates on all drugs purchased by state Medicaid programs. Manufacturers of brand name products must provide a rebate equivalent to the greater of (a) 15.1% of the “average manufacturer price” (“AMP”) paid by wholesalers for products distributed to the retail pharmacy class of trade and (b) the difference between AMP and the “best price” available to essentially any customer other than the Medicaid program, with certain exceptions. We negotiate rebates with drug manufacturers and, in certain circumstances, sell services to drug manufacturers. Investigations have been commenced by certain governmental entities which question whether “best prices” were properly calculated, reported and paid by the manufacturers to the Medicaid programs. We are not responsible for such calculations, reports or payments. There can be no assurance, however, that our ability to negotiate rebates with, or sell services to, drug manufacturers will not be materially adversely affected by such investigations in the future.

Regulation of Financial Risk Plans. Fee-for-service prescription drug plans generally are not subject to financial regulation by the states. However, if a PBM offers to provide prescription drug coverage on a capitated basis or otherwise accepts material financial risk in providing the benefit, laws in various states may regulate the PBM. Such laws may require that the party at risk establish reserves or otherwise demonstrate financial responsibility. Laws that may apply in such cases include insurance laws, HMO laws or limited prepaid health service plan laws. In addition, we own the Express Scripts Insurance Company (“ESIC”). In 2007 ESIC contracted with CMS for Medicare Part D offerings which we provide to employers. We believe ESIC is in compliance with the applicable laws of the states in which it is licensed.

Pharmacy Regulation. Our home delivery and specialty pharmacies are licensed to do business as a pharmacy in the state in which they are located. Most of the states into which we deliver pharmaceuticals have laws that require out-of-state home delivery pharmacies to register with, or be licensed by, the board of pharmacy or similar regulatory body in the state. These states generally permit the pharmacy to follow the laws of the state in which the home delivery service is located, although certain states require that we also comply with certain laws in that state. We believe we have registered each of our pharmacies in every state in which such registration is required and that we comply with all required laws and regulations. In addition, our pharmacists and nurses are licensed in those states where their activity requires it. Our various pharmacy facilities also maintain certain Medicare and state Medicaid provider numbers as pharmacies providing services under these programs. Participation in these programs requires our pharmacies to comply with the applicable Medicare and Medicaid provider rules and regulations, and exposes the pharmacies to various changes the federal and state governments may impose regarding reimbursement amounts to be

paid to participating providers under these programs. In addition, several of our pharmacy facilities are participating providers under the new Part D Medicare program created pursuant to The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the “Act”). As a condition to becoming a participating provider under Part D of the Act, the pharmacies are required to adhere to certain requirements applicable to the Part D Medicare program.

Other statutes and regulations affect our home delivery operations including the federal and state anti-kickback laws, federal Stark Law and state physician self-referral laws described above. Federal and state statutes and regulations govern the labeling, packaging, advertising and adulteration of prescription drugs and the dispensing of controlled substances. The Federal Trade Commission requires mail order sellers of goods generally to engage in truthful advertising, to stock a reasonable supply of the product to be sold, to fill mail orders within thirty days, and to provide clients with refunds when appropriate. The United States Postal Service has statutory authority to restrict the delivery of drugs and medicines through the mail to a degree that could have an adverse effect on our home delivery operations.

HIPAA and Other Privacy Legislation. Most of our activities involve the receipt or use of confidential medical information concerning individual members. In addition, we use aggregated and anonymized data for research and analysis purposes and, in some cases, provide access to such data to third parties. Various federal and state laws, including the Health Insurance Portability and Accountability Act (“HIPAA,” as discussed below), regulate and restrict the use, disclosure and security of confidential medical information and new legislation is proposed from time to time in various states. To date, no such laws have been adopted that adversely impact our ability to provide our services, but there can be no assurance that federal or state governments will not enact legislation, impose restrictions or adopt interpretations of existing laws that could have a material adverse effect on our consolidated results of operations, consolidated financial position and/or consolidated cash flow from operations.

The HHS privacy and security regulations under HIPAA impose restrictions on the use and disclosure of individually identifiable health information by certain entities. The security regulations relate to the security of protected health information when it is maintained or transmitted electronically. Other HIPAA requirements relate to electronic transaction standards and code sets for processing of pharmacy claims. We are required to comply with certain aspects of the privacy, security and transaction standard regulations and we believe we are in compliance in all material respects with such regulations to the extent they apply to us.

SAAS Services. Many of the laws and regulations cited above with respect to our PBM activities also apply with respect to our various specialty services. Of particular relevance are the federal and state anti-kickback laws, state pharmacy regulations and HIPAA, which are described above. In addition, as a condition to conducting our wholesale business, we must maintain various permits and licenses with the appropriate state and federal agencies, and we are subject to various wholesale distributor laws that regulate the conduct of wholesale distributors, including, but not limited to, maintaining pedigree papers in certain instances. Finally, one of our lines of services, PMG, conducts certain activities, including the distribution of drug samples, that are subject to the requirements of the federal Prescription Drug Marketing Act and many of the other federal and state laws and regulations discussed above.

Service Marks and Trademarks

We, and our subsidiaries, have registered certain service marks including “Express Scripts” and “CuraScript” with the United States Patent and Trademark Office. Our rights to these marks will continue so long as we comply with the usage, renewal filings, and other legal requirements relating to the usage and renewal of service marks.

We also have several pending applications for registration for other trademarks and service marks including, but not limited to, “CuraScriptSP Specialty Pharmacy and Design”, and “CuraScriptIP Infusion Pharmacy and Design”. If we are unable to obtain registrations for any of these pending applications, we believe there would be no material adverse effect on our consolidated results of operations, consolidated financial position, and/or consolidated cash flow from operations.

We also have several pending applications for registration for other trademarks and service marks including, but not limited to, “CuraScriptSP Specialty Pharmacy and Design”, and “CuraScriptIP Infusion Pharmacy and Design”. If we are unable to obtain registrations for any of these pending applications, we believe there would be no material adverse effect on our consolidated results of operations, consolidated financial position, and/or consolidated cash flow from operations.

Insurance

Our PBM operations, including the dispensing of pharmaceutical products by our home delivery pharmacies, our SAAS operations, including the distribution of specialty drugs, and the services rendered in connection with our disease management operations, may subject us to litigation and liability for damages. Commercial insurance coverage is difficult to obtain and cost prohibitive, particularly for certain types of claims. As such, we may maintain significant self insured retentions when deemed most appropriate and cost effective. We have established certain self-insurance reserves to cover potential claims. There can be no assurance that we will be able to maintain our general, professional, or managed care errors and omissions liability insurance coverage in the future or that such insurance coverage, together with our self-insurance reserves, will be adequate to cover potential future claims. A claim, or claims, in excess of our insurance coverage could have a material adverse effect upon our consolidated results of operations, consolidated financial position and/or consolidated cash flow from operations.

Employees

As of December 31, 2007 and 2006, we employed approximately 11,820 and 11,300 employees, respectively, which includes approximately 220 employees in Canada. Approximately 1,400 of the United States employees are members of collective bargaining units. Specifically, we employ members of the Service Employees International Union at our Bensalem, Pennsylvania facility; members of the United Auto Workers Union at our Farmington Hills, Michigan facility; members of the American Federation of State, County and Municipal Employees at our Harrisburg, Pennsylvania and East Hanover, New Jersey facilities; and members of the United Food and Commercial Workers Union at our Albuquerque, New Mexico facility. We believe our relationships with our employees and the unions that represent them are good.

Executive Officers of the Registrant

Our executive officers and their ages as of February 1, 2008 are as follows:

Name	Age	Position
George Paz	52	Chairman, President and Chief Executive Officer
Edward Stiften	53	Executive Vice President, and Chief Financial Officer
Thomas M. Boudreau	56	Executive Vice President, Law and Strategy
Michael Holmes	49	Executive Vice President and Chief Administrative Officer
Edward Ignaczak	42	Executive Vice President – Sales and Account Management
Patrick McNamee	48	Executive Vice President, Operations and Technology
Agnes Rey-Giraud	43	Executive Vice President – Trade Relations and Developing Markets
Kelley Elliott	35	Vice President, Chief Accounting Officer and Controller

Mr. Paz was elected a director of the Company in January 2004 and has served as Chairman of the Board since May 2006. Mr. Paz was first elected President in October 2003 and also assumed the role Chief Executive Officer on April 1, 2005. Mr. Paz joined us and was elected Senior Vice President and Chief Financial Officer in January 1998 and continued to serve as our Chief Financial Officer following his election to the office of President until his successor joined us in April 2004.

Mr. Stiften was named Executive Vice President, Chief Financial Officer in November 2007. He was elected Senior Vice President and Chief Financial Officer in April 2004. Prior to joining us, Mr. Stiften worked for BJC HealthCare, a hospital and health care organization, serving as Vice President and Chief Financial Officer since 1998. Mr. Stiften has announced his retirement effective May 31, 2008.

Mr. Boudreau was named Executive Vice President, Law & Strategy in November 2007. Mr. Boudreau was previously elected Senior Vice President, General Counsel and Secretary in October 1994. He has served as General Counsel since June 1994.

Mr. Holmes was named Executive Vice President and Chief Administrative Officer in November 2007. He was elected Senior Vice President and Chief Human Resources Officer in December 2005. Prior to joining us, Mr. Holmes worked for Edward D. Jones & Co., L.P., a financial services company, as Principal from October 1996 through December 2004.

Mr. Ignaczak was named Executive Vice President, Sales and Account Management in November 2007. He was elected Senior Vice President — Sales and Account Management in December 2002. Mr. Ignaczak joined us in April 1998 and served as the Vice President and General Manager of our National Employer Division between April 1998 and December 2002.

Mr. McNamee was named Executive Vice President, Operations & Technology in November 2007. He was elected Senior Vice President, Operations & Technology, with responsibility for Client & Patient Services and Information Technology in May 2007. Mr. McNamee joined us and was elected Senior Vice President and Chief Information Officer in February 2005. Prior to joining us, Mr. McNamee worked for Misys Healthcare Systems, a health care technology company, as President and General Manager, Physician Systems, from September 2003 through February 2005. Mr. McNamee was employed by various subsidiaries of General Electric Corporation from July 1989 through September 2003, including as President, GE OEC Medical Systems, a surgery x-ray manufacturing business, from July 2002 through September 2003.

Ms. Rey-Giraud was named Executive Vice President, Trade Relations & Developing Markets in November 2007. She was elected Senior Vice President — Strategy and Business Development in January 2006 and Senior Vice President — Supply Chain Organization in September 2006. Ms. Rey-Giraud served as Senior Vice President of Product Management between December 2003 and January 2006, and served as Senior Vice President — Program Development between July 2002 and December 2003. Ms. Rey-Giraud served as Vice President and General Manager — eBusiness between January 2000 and July 2002.

Ms. Elliott was elected Vice President, Chief Accounting Officer and Controller in December 2005. Ms. Elliott previously served in our Internal Audit Department between February 2002 and December 2005, most recently as Vice President.

Available Information

We make available through our website (www.express-scripts.com), access to our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, all amendments to those reports (when applicable), and other filings with the SEC. Such access is free of charge and is available as soon as reasonably practicable after such information is filed with the SEC. In addition, the SEC maintains an internet site (www.sec.gov) containing reports, proxy and information statements, and other information regarding issuers filing electronically with the SEC (which includes us). Information included on our website is not part of this annual report.

Forward Looking Statements and Associated Risks

Information we have included or incorporated by reference in this Annual Report on Form 10-K, and information which may be contained in our other filings with the Securities and Exchange Commission (the “SEC”) and our press releases or other public statements, contain or may contain forward-looking statements. These forward-looking statements include, among others, statements of our plans, objectives, expectations or intentions.

Our forward-looking statements involve risks and uncertainties. Our actual results may differ significantly from those projected or suggested in any forward-looking statements. We do not undertake any obligation to release publicly any revisions to such forward-looking statements to reflect events or circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events. Factors which might cause such a difference to occur include, but are not limited to:

- results in regulatory matters, the adoption of new legislation or regulations (including increased costs associated with compliance with new laws and regulations), more aggressive enforcement of existing legislation or regulations, or a change in the interpretation of existing legislation or regulations
- costs and uncertainties of adverse results in litigation, including a number of pending class action cases that challenge certain of our business practices
- continued pressure on margins resulting from client demands for lower prices, enhanced service offerings and/or higher service levels
- the possible termination of, or unfavorable modification to, contracts with key clients or providers, some of which could have a material impact on our financial results
- investigations of certain PBM practices and pharmaceutical pricing, marketing and distribution practices currently being conducted by various regulatory agencies and state attorneys general
- the possible loss, or adverse modification of the terms, of contracts with pharmacies in our retail pharmacy network
- uncertainties associated with our acquisitions, which include integration risks and costs, uncertainties associated with client retention and repricing of client contracts, and uncertainties associated with the operations of acquired businesses
- changes in industry pricing benchmarks such as average wholesale price (“AWP”) and average manufacturer price (“AMP”), which could have the effect of reducing prices and margins
- competition in the PBM and specialty pharmacy industries, and our ability to consummate contract negotiations with prospective clients, as well as competition from new competitors offering services that may in whole or in part replace services that we now provide to our customers
 - our ability to continue to develop new products, services and delivery channels
- increased compliance risk relating to our contracts with the DoD TRICARE Management Activity and various state governments and agencies
- uncertainties regarding the Medicare Part D prescription drug benefit, including the financial impact to us to the extent that we participate in the program on a risk-bearing basis, uncertainties of client or member losses to other providers under Medicare Part D, and increased regulatory risk
 - our ability to maintain growth rates, or to control operating or capital costs
- the possible loss, or adverse modification of the terms, of relationships with pharmaceutical manufacturers, or changes in pricing, discount or other practices of pharmaceutical manufacturers or interruption of the supply of any pharmaceutical products
- uncertainties associated with U.S. Centers for Medicare & Medicaid’s (“CMS”) implementation of the Medicare Part B Competitive Acquisition Program (“CAP”), including the potential loss of clients/revenues to providers choosing to participate in the CAP
 - the use and protection of the intellectual property we use in our business
- our leverage and debt service obligations, including the effect of certain covenants in our borrowing agreements
- general developments in the health care industry, including the impact of increases in health care costs, changes in drug utilization and cost patterns and introductions of new drugs
 - increase in credit risk relative to our clients due to adverse economic trends or other factors

- our ability to attract and retain qualified employees
- other risks described from time to time in our filings with the SEC

These and other relevant factors, including those risk factors in “Item 1A—Risk Factors” in this Annual Report and any other information included or incorporated by reference in this Report, and information which may be contained in our other filings with the SEC, should be carefully considered when reviewing any forward-looking statement.

Item 1A—Risk Factors

General Risk Factors

We operate in a very competitive industry, and competition could compress our margins, and impair our ability to attract and retain clients.

Our ability to maintain growth rates is dependent upon our ability to attract new clients and retain existing clients, as well as cross-sell additional services to existing clients. We operate in a very competitive environment. Some of our competitors may offer services and pricing terms we may not be able to offer. Larger competitors may have scale advantages that we cannot duplicate. Our contracts with clients generally do not have terms longer than three years and, in some cases, are terminable by the client on relatively short notice. This competition may make it difficult for us to retain existing clients, sell to new clients and cross-sell additional services to clients, which could materially adversely affect our business and financial results.

Over the last several years, competition in the marketplace has also caused many PBMs, including us, to reduce the prices charged to clients for core services and share a larger portion of the formulary fees and related revenues received from pharmaceutical manufacturers with clients. This combination of lower pricing and increased revenue sharing, as well as increased demand for enhanced service offerings and higher service levels, has put pressure on operating margins. This pressure may continue, and we can give no assurance new services provided to clients will fully compensate for these reduced margins.

We believe the managed care industry is undergoing substantial consolidation, and another party that is not our client could acquire some of our managed care or other clients. In such case, the likelihood such client would renew its contract with us, as opposed to one of our competitors, could be reduced.

Pending and future litigation could subject us to significant monetary damages and/or require us to change our business practices

We are subject to risks relating to litigation and other proceedings in connection with our PBM operations, including the dispensing of pharmaceutical products by our home delivery pharmacies, and the services rendered in connection with our disease management and our pharmaceutical services operations. A list of a number of the more significant proceedings pending against us is included under “Item 3—Legal Proceedings.” These proceedings generally seek unspecified monetary damages and injunctive relief on behalf of a class of plaintiffs that are either clients or individual members of health plans. While we believe these suits are without merit and intend to contest them vigorously, we can give no assurance that an adverse outcome in one or more of these suits would not have a material adverse effect on our business and financial results.

We are presently responding to several subpoenas and requests for information from governmental agencies, as described in “Item 3—Legal Proceedings.” We cannot predict with certainty what the result of any such inquiry might be. In addition to potential monetary liability arising from these suits and proceedings, we are incurring costs in the defense of the suits and in providing documents to government agencies. Certain of the costs are covered by our insurance, but certain other costs are not insured. Such costs have become material to our financial performances and we can give no assurance that such costs will not increase in the future.

Commercial liability insurance coverage continues to be difficult to obtain for companies in our business sector which can cause unexpected volatility in premiums and/or retention requirements dictated by insurance carriers. We have established certain self-insurance reserves to cover anticipated losses within our retained liability for previously reported claims and the cost to defend these claims. There can be no assurance general, professional, managed care errors and omissions, and/or other liability insurance coverage will be reasonably available in the future or such insurance coverage, together with our self-insurance reserves, will be adequate to cover future claims. A claim, or claims, in excess of our insurance coverage could have a material adverse effect on our business and financial results.

State and Federal regulations could restrict our ability to conduct business

Numerous state and federal laws and regulations affect our business and operations. The categories include, but are not necessarily limited to:

- health care fraud and abuse laws and regulations, which prohibit certain types of payments and referrals as well as false claims made in connection with health benefit programs
- ERISA and related regulations, which regulate many health care plans
 - state legislation regulating PBMs or imposing fiduciary status on PBMs
 - consumer protection and unfair trade practice laws and regulations
- network pharmacy access laws, including “any willing provider” and “due process” legislation, that affect aspects of our pharmacy network contracts
 - wholesale distributor laws, including pedigree paper laws
- legislation imposing benefit plan design restrictions, which limit how our clients can design their drug benefit plans
 - various licensure laws, such as managed care and third party administrator licensure laws
 - drug pricing legislation, including “most favored nation” pricing and “unitary pricing” legislation
 - pharmacy laws and regulations
 - privacy and confidentiality laws and regulations, including those under HIPAA
 - the Medicare prescription drug coverage law
 - other Medicare and Medicaid reimbursement regulations
 - the Prescription Drug Marketing Act
 - potential regulation of the PBM industry by the U.S. Food and Drug Administration
 - pending legislation regarding importation of drug products into the United States
 - state laws regulating the business of insurance

These and other regulatory matters are discussed in more detail under “Item 1 — Business — Government Regulation” above.

We believe that we are operating our business in substantial compliance with all existing legal requirements material to the operation of our business. There are, however, significant uncertainties regarding the application of many of these legal requirements to our business, and state and federal law enforcement agencies and regulatory agencies from time to time have initiated investigations or litigation that involve certain aspects of our business or our competitors’ businesses. Accordingly, we cannot provide any assurance that one or more of these agencies will not interpret or apply these laws in a manner adverse to our business, or, if there is an enforcement action brought against us, that our interpretation would prevail. In addition, there are numerous proposed health care laws and regulations at the Federal and state levels, many of which could materially affect our ability to conduct our business or adversely affect our financial results. We are unable to predict what additional Federal or state legislation or regulatory initiatives may be enacted in the future relating to our business or the health care industry in general, or what effect any such legislation or regulations might have on us.

Various governmental agencies have conducted investigations into certain PBM business practices. Many of these investigations have resulted in other PBMs agreeing to civil penalties, including the payment of money and corporate

integrity agreements. We have received subpoenas from a number of State Attorneys General. We cannot predict what effect, if any, these investigations may ultimately have on us or on the PBM industry generally (see “Item 3—Legal Proceedings”).

The State of Maine and the District of Columbia each have enacted statutes that purport to declare that a PBM is a fiduciary with respect to its clients. Our trade association, PCMA, filed suit in Federal District Courts in Maine and the District of Columbia alleging, among other things, that these statutes are preempted by ERISA with respect to welfare plans that are subject to ERISA. The Federal District Court in Maine ruled the statute valid, and the First Circuit Court of Appeals affirmed. The case challenging the D.C. statute is on appeal. Other states are considering but have not yet enacted similar fiduciary statutes, and we cannot predict what effect, if any, these and similar statutes may have on our business and financial results.

Most of our activities involve the receipt or use of confidential medical information concerning individuals. In addition, we use aggregated and anonymized data for research and analysis purposes and in some cases provide access to such data to pharmaceutical manufacturers. Various federal and state laws, including HIPAA, regulate and restrict the use, disclosure and security of confidential medical information and new legislation is proposed from time to time in various states. To date, no such laws have been adopted that adversely impact our ability to provide services, but there can be no assurance that federal or state governments will not enact legislation, impose restrictions or adopt interpretations of existing laws that could have a material adverse effect on our business and financial results.

Effective as of 2007, our subsidiary, ESIC, began offering a prescription drug plan (“PDP”) in connection with the Medicare Part D program for purposes of making employer/union-only group waiver plans (known as “EGWP” plans) available for applicable clients. As a licensed insurer organized and licensed under the laws of the State of Arizona, ESIC will be subject to state and federal laws regulating the business of insurance in all jurisdictions in which ESIC offers its PDP. CMS regulations and applicable guidance currently require that ESIC be authorized to offer its prescription drug plan to individuals residing in all fifty states and Puerto Rico. As a PDP sponsor, ESIC will be subject to compliance with all federal laws and regulations applicable to such sponsors as a result of the MMA and the regulations promulgated in connection with implementation of the Medicare Part D drug benefit. While many state insurance laws and regulations are well-established, CMS continues to provide guidance and promulgate new regulations in an attempt to assist PDPs and state regulators to determine the appropriate applicability of state insurance laws in the context of the federal Part D drug benefit provided through an EGWP plan. Uncertainty as to the applicability of state and federal laws to ESIC’s operations could have an impact on our ability to successfully offer products and services under the Part D drug benefit and our ability to comply with applicable laws in doing so.

If we lose our relationship with one or more key pharmacy providers, or our relationship is modified in an unfavorable manner, our business could be impaired

More than 60,000 retail pharmacies, which represent more than 95% of all United States retail pharmacies, participate in one or more of our networks. However, the top ten retail pharmacy chains represent approximately 56% of the total number of stores in our largest network, and these pharmacy chains represent even higher concentrations in certain areas of the United States. Our contracts with retail pharmacies, which are non-exclusive, are generally terminable on relatively short notice by either party. If one or more of the top pharmacy chains elects to terminate its relationship with us, or attempts to renegotiate the terms of the relationship in a manner that is unfavorable to us, our members’ access to retail pharmacies and our business could be materially adversely affected. The continued growth of PBMs owned by the top pharmacy chains, or the acquisition of significant PBM operations by such chains, could increase the likelihood of our relationships with such pharmacy chains being adversely affected.

Changes in industry pricing benchmarks could materially impact our financial performance

Contracts in the prescription drug industry, including our contracts with retail pharmacy networks and with PBM and specialty pharmacy clients, generally use certain published benchmarks to establish pricing for prescription

drugs. These benchmarks include AWP, AMP and wholesale acquisition cost. Most of our client contracts utilize the AWP standard. Recent events have raised uncertainties as to whether payors, pharmacy providers, PBMs and others in the prescription drug industry will continue to utilize AWP as it has previously been calculated or whether other pricing benchmarks will be adopted for establishing prices within the industry.

Specifically, in the case of *New England Carpenters v First Data Bank et al*, a civil class action case brought against First Data Bank (“FDB”) and Medispan, the two most widely used companies that report data on prescription drug prices, FDB and Medispan agreed to reduce the reported AWP on approximately 8,500 drugs by 4.0% as well as to cease reporting AWP two years after final approval of the settlement. While the judge preliminarily approved the settlement, she has now refused final approval and has asked the parties to significantly amend the settlement. Specifically, the judge will not approve the roll-back on any more than 1,400 drugs and will not order the parties to cease publication of AWP. While we cannot predict the outcome of the case or, if the settlement is finally approved, the precise timing of the possible decrease in AWP, we believe that the potential effect of the settlement has been significantly reduced and that we have taken action to mitigate the effect on our operations. The amended settlement may still cause disruption in our retail networks due to the adverse impact on AWP-based retail pharmacy pricing.

Due to these and other uncertainties, we can give no assurance that the short or long-term impact of changes to industry pricing benchmarks will not have a material adverse effect on our business and financial results in future periods. Our various projections, including earnings guidance for 2008, contemplate what we have estimated to be the most probable impact resulting from the proposed FDB settlement. Actual results may be materially less favorable or materially more favorable than those estimated in formulating such projections.

Medicare Part D may adversely impact our business

In connection with the enactment of the MMA, CMS promulgated a substantial volume of new regulations implementing the federal government’s Voluntary Prescription Drug Benefit Program, known as Medicare “Part D.” The Office of Inspector General has also proposed new safe harbors and other regulations pursuant to the MMA. Both of these federal regulatory agencies continue to issue guidance with regard to the Part D program and compliance with related federal laws and regulations by Part D sponsors and their subcontractors. The receipt of federal funds made available through this program by us, our affiliates, or clients may be subject to compliance with these new regulations as well as the established laws and regulations governing the federal government’s payment for health care goods and services, including the Anti-Kickback Laws, the Stark Law, and the False Claims Act. There are many uncertainties about the financial and regulatory risks of participating in the Medicare Part D program, and we can give no assurance that these risks will not be material to our business in future periods.

In addition, due to the implementation of Medicare Part D, some of our employer clients may decide to stop providing pharmacy benefit coverage to retirees, instead allowing the retirees to choose their own Part D plans, which could result in us losing members. Extensive competition among Medicare Part D plans could also result in the loss of Medicare members by our managed care customers, which would also result in a decline in our membership base.

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

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

- discounts for drugs we purchase to be dispensed from our home delivery pharmacies;
- rebates based upon sales of drugs from our home delivery pharmacies and through pharmacies in our retail networks;
- administrative fees for managing rebate programs, including the development and maintenance of formularies which include the particular manufacturer’s products; and

- access to limited distribution specialty pharmaceuticals.

If several of these contractual relationships are terminated or materially altered by the pharmaceutical manufacturers, our business and financial results could be materially adversely affected. In addition, formulary fee programs have been the subject of debate in federal and state legislatures and various other public and governmental forums. Changes in existing laws or regulations or in interpretations of existing laws or regulations or the adoption of new laws or regulations relating to any of these programs may materially adversely affect our business.

Efforts to reduce health care costs and alter health care financing practices could adversely affect our business

Certain proposals have been made in the United States to control health care costs, including prescription drug costs, in response to increases in prescription drug utilization rates and drug prices. These proposals include “single-payer” government funded health care, and price controls on prescription drugs. If these or similar efforts are successful or if prescription drug utilization rates were to decrease significantly, whether due to a reversal in the growing role of prescription drugs in medical treatment or otherwise, our business and consolidated results of operations could be materially adversely affected.

We have designed our business model to compete within the current structure of the United States health care system. Changing political, economic and regulatory influences may affect health care financing and reimbursement practices. If the current health care financing and reimbursement system changes significantly, our business could be materially adversely affected. Congress periodically considers proposals to reform the United States health care system. These proposals may increase government involvement in health care and regulation of PBM services, or otherwise change the way our clients do business. Health plan sponsors may react to these proposals and the uncertainty surrounding them by reducing or delaying purchases of cost control mechanisms and related services that we provide. We cannot predict what effect, if any, these proposals may have on our business. Other legislative or market-driven changes in the health care system that we cannot anticipate could also materially adversely affect our business and financial results.

Item 1B—Unresolved Staff Comments

There are no material unresolved written comments that were received from the SEC Staff 180 days or more before the end of our fiscal year relating to our periodic or current reports under the Securities Exchange Act of 1934.

Item 2 – Properties

We operate our United States and Canadian PBM and SAAS segments out of leased and owned facilities throughout the United States and Canada. The Company's main facilities of our continuing operations are detailed in the table below.

PBM Facilities	SAAS Facilities
St. Louis, MO (HQ facility)	Orlando, Florida (two facilities)
Maryland Heights, Missouri (four facilities)	Lake Mary, Florida (two facilities)
Tempe, Arizona (two facilities)	Maryland Heights, Missouri (two facilities)
Bloomington, Minnesota (two facilities)	Lincoln Park, New Jersey (two facilities)
Bensalem, Pennsylvania (two facilities)	Montville, New Jersey
Troy, New York	Grove City, Ohio (two facilities)
Albuquerque, New Mexico	Byfield, Massachusetts
Farmington Hill, MI.	Sparks, Nevada
Montreal, Quebec	Braintree, Massachusetts
Mississauga, Ontario	Brewster, New York
Parsippany, New Jersey	
Swatara, Pennsylvania	
St. Mary's, Georgia	
Pueblo, Colorado	
Hunt Valley, Maryland	

Our St. Louis, Missouri facility houses our corporate headquarters offices. We believe our facilities generally have been well maintained and are in good operating condition. As of January 1, 2008, the existing facilities from continuing operations comprise approximately 2.8 million square feet in the aggregate. We signed a lease agreement during 2007 for an expansion of our corporate facilities. A new building is under construction and we do not anticipate taking possession until the first quarter of 2009. The annual lease commitments for the new building will begin at approximately \$2.7 million and the term of the lease is ten and a half years.

This entire document should be considered a draft and is subject to further review by Express Scripts management.

Item 3 – Legal Proceedings

We and/or our subsidiaries are defendants in a number of lawsuits that purport to be class actions. Each case seeks damages in an unspecified amount. We cannot ascertain with any certainty at this time the monetary damages or injunctive relief that any of the plaintiffs may seek to recover. In addition, we are the subject of a governmental investigation described below. Such investigations could result in civil damages or other sanctions, the nature and amount of which we cannot currently estimate. We cannot, however, provide any assurance that the outcome of any of these matters, or some number of them in the aggregate, will not be materially adverse to our financial condition, consolidated results of operations, cash flows or business prospects. In addition, the expenses of defending these cases may have a material effect on our financial results.

These matters are:

- **Multi-District Litigation** - The Judicial Panel on Multi-District Litigation on April 29, 2005 transferred a number of previously disclosed cases to the Eastern District of Missouri for coordinated or consolidated pretrial proceedings including the following: *Minshew v. Express Scripts* (Case No.Civ.4:02-CV-1503, United States District Court for the Eastern District of Missouri) (filed December 12, 2001); *Lynch v. National Prescription Administrators, et al.* (Case No.03 CV 1303, United States District Court for the Southern District of New York) (filed February 26, 2003); *Mixon v. Express Scripts, Inc.* (Civil Action No. 4:03CV1519, United States District Court for the Eastern District of Missouri) (filed October 23, 2003); *Wagner et al. v. Express Scripts* (Case No.04cv01018 (WHP), United States District Court for the Southern District of New York) (filed December 31, 2003); *Scheuerman, et al v. Express Scripts* (Case No.04-CV-0626 (FIS) (RFT), United States District Court for the Southern District of New York) (filed April 27, 2004); *Correction Officers' Benevolent Association of the City of New York, et al. v. Express Scripts, Inc.* (Case No.04-Civ-7098 (WHP), United States District Court for the Southern District of New York) (filed August 5, 2004); *United Food and Commercial Workers Unions and Employers Midwest Health Benefits Fund, et al v. National Prescription Administrators, Inc., et al.* (Case No.04-CV-7472, United States District Court for the Southern District of New York) (filed September 21, 2004); *Central Laborers' Welfare Fund, et al v. Express Scripts, Inc., et al* (Case No.B04-1002240, United States District Court for the Southern District of Illinois) (filed September 27, 2004); *New England Health Care Employees Welfare Fund v. Express Scripts, Inc.* (Case No.4:05-cv-1081, United States District Court for the Eastern District of Missouri) (filed October 28, 2004); and *Local 153 Health Fund, et al. v. Express Scripts Inc. and ESI Mail Pharmacy Service, Inc.* (Case No.B05-1004036, United States District Court for the Eastern District of Missouri) (filed May 27, 2005). The plaintiffs assert that certain of our business practices, including those relating to our contracts with pharmaceutical manufacturers for retrospective discounts on pharmaceuticals and those related to our retail pharmacy network contracts, constitute violations including fiduciary duties under the Federal Employee Retirement Income Security Act (ERISA), common law fiduciary duties, state common law, state consumer protection statutes, breach of contract, and deceptive trade practices. The putative classes consist of both ERISA and non-ERISA health benefit plans as well as beneficiaries. The various complaints seek money damages and injunctive relief. Discovery is proceeding in these cases. Plaintiffs have filed motions for class certification of the ERISA plans and for partial summary judgment on the issue of our fiduciary status under ERISA. These motions have been fully briefed and argued. On January 18, 2008, we filed a cross motion for summary judgment on the issue of our fiduciary status under ERISA.
- **Jerry Beeman, et al. v. Caremark, et al.** (Case No.021327, United States District Court for the Central District of California). On December 12, 2002, a complaint was filed against us and several other pharmacy benefit management companies. The complaint, filed by several California pharmacies as a putative class action, alleges rights to sue as a private attorney general under California law. The complaint alleges that we, and the other defendants, failed to comply with statutory obligations under California Civil Code Section 2527 to provide our California clients with the results of a bi-annual survey of retail drug prices. On July 12, 2004, the case was

dismissed with prejudice on the grounds that the plaintiffs lacked standing to bring the action. On June 2, 2006, the U.S. Court of Appeals for the Ninth Circuit reversed the district court's opinion on standing and remanded the case to the district court. The district court's denial of defendants' motion to dismiss on constitutionality grounds is currently on appeal to the Ninth Circuit. Plaintiffs have filed a motion for class certification.

- *Irwin v. AdvancePCS, et al.* (Case No.RG030886393, Superior Court of the State of California for Alameda County) (filed March 26, 2003). This case is brought by plaintiff alleging his right to sue as a private attorney general under California law. This case purports to be a class action against us and other PBM defendants on behalf of self-funded, non-ERISA health plans; and individuals with no prescription drug benefits that have purchased drugs at retail rates. The complaint alleges that certain business practices engaged in by us and by other PBM defendants violated California's Unfair Competition Law. The suit seeks unspecified monetary damages and injunctive relief. This case has been coordinated with the AFSCME case in Los Angeles County Superior Court. Our motion for judgment on the pleadings in our favor was granted on June 23, 2005, with plaintiffs given leave to file an amended complaint which they did on July 22, 2005. A third amended complaint was filed by the plaintiffs on April 8, 2006.
- *North Jackson Pharmacy, Inc., et al. v. Express Scripts* (Civil Action No. CV-03-B-2696-NE, United States District Court for the Northern District of Alabama) (filed October 1, 2003). This case purports to be a class action against us on behalf of independent pharmacies within the United States. The complaint alleges that certain of our business practices violate the Sherman Antitrust Act, 15 U.S.C §1, et. seq. The suit seeks unspecified monetary damages (including treble damages) and injunctive relief. Plaintiffs' motion for class certification was granted on March 3, 2006. A motion filed by the plaintiffs in an antitrust matter against Medco and Merck in the Eastern District of Pennsylvania before the Judicial Panel on Multi-District Litigation requesting transfer of this case and others to the Eastern District of Pennsylvania for MDL treatment was granted on August 24, 2006. We filed a motion to decertify the class on January 16, 2007, and it has been fully briefed and argued.
- *People of the State of New York, et al v. Express Scripts, Inc.* (Case No.4669-04, Supreme Court of the State of New York, County of Albany). On August 4, 2004, the State of New York filed a complaint against us and Cigna Life Insurance Co. The complaint alleges certain breaches of contract and violations of civil law in connection with our management of the prescription drug plan for the State of New York and its employees. The complaint also alleges certain violations of civil law in connection with the Company's therapeutic interchange programs. The State has requested injunctive relief, unspecified monetary damages and attorney's fees. The court originally stayed this action pending the outcome of the Wagner and Scheurman cases, referred to above, both of which assert claims relating to the New York State prescription drug plan. The court issued an order to lift the stay in February 2006. On July 25, 2006, our motion to dismiss this case was granted in part and denied in part. Specifically, the State's claims based on allegations of breach of fiduciary duty, negligent misrepresentation and violations of the State's Education Law were dismissed in their entirety. Portions of the State's claims alleging violations of the State's General Business Law Section 349 were also dismissed because of the running of the applicable statute of limitations. Discovery is now proceeding.
- *In re Express Scripts Securities Litigation* (Case No.4:04-CV-1009, United States District Court for the Eastern District of Missouri). On September 13, 2005, plaintiffs filed an amended complaint. The complaint alleges that Express Scripts and certain of our officers violated federal securities law. The complaint alleges that we failed to disclose certain alleged improper business practices and issued false and misleading financial statements and that certain officers violated insider trading laws. The complaint is brought on behalf of purchasers of our stock during the period October 29, 2003 to August 3, 2004. The complaint requests unspecified compensatory damages, equitable relief and attorney's fees. Defendants filed a motion to dismiss on October 28, 2005.
- *Derivative lawsuits: Scott Rehm, Derivatively on behalf of nominal Defendant, Express Scripts, Inc. v. Stuart Bascomb, et al* (Case No.044-1960a, Missouri Circuit Court, City of St. Louis) (filed August 27, 2004); *Charles Manzione, Derivatively on Behalf of Express Scripts, Inc. v. Barrett Toan et al* (Case No.4:04-CV-1608, United

States District Court for the Eastern District of Missouri) (filed October 22, 2004); Gary Miller Derivatively on behalf of nominal Defendant, Express Scripts, Inc. v. Stuart Bascomb, et al (Case No.042-08632, Missouri Circuit Court, City of St. Louis) (filed October 22, 2004). Judith Deserio, Derivatively on behalf of Nominal Defendant, Express Scripts, Inc. v. Stuart L. Bascomb, et al (filed December 22, 2004) was consolidated with Miller. Plaintiffs have filed shareholder derivative lawsuits against certain of our current and former directors and officers. The cases make various allegations including that the defendants caused us to issue false and misleading statements, insider selling, breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment. Plaintiffs demand unspecified compensatory damages, equitable relief and attorney's fees.

- Pearson's Pharmacy, Inc. and Cam Enterprises, Inc. d/b/a Altadena Pharmacy v. Express Scripts, Inc. (Case No. 3:06-CV-00073-WKW, United States District Court for the Middle District of Alabama) (filed January 26, 2006). On February 15, 2006, an amended complaint alleging a class action on behalf of all pharmacies reimbursed based upon Average Wholesale Price was filed. The complaint alleges that we fail to properly reimburse pharmacies for filling prescriptions. Plaintiffs seek unspecified monetary damages and injunctive relief. On March 31, 2006 we filed a motion to dismiss the complaint. On June 7, 2007, the court dismissed the claims for fraudulent misrepresentation, fraudulent suppression and unjust enrichment, leaving only a breach of contract claim.
- Inola Drug, Inc. v. Express Scripts, Inc. (Case No. 06-CV-117-TCK-SAJ, United States District Court for the Northern District of Oklahoma) On February 22, 2006, a class action lawsuit was filed alleging that our reimbursement to pharmacies violates the Oklahoma Third Party Prescriptions Act. The complaint also alleges that we fail to properly reimburse pharmacies for filling prescriptions based on Average Wholesale Price. The proposed classes include all pharmacies in the United States who contract with us and all pharmacies in Oklahoma who contract with us. On January 10, 2008, the court dismissed the unjust enrichment and fraud claims, leaving only the breach of contract and claim for injunctive relief. Plaintiff was given leave to file an amended complaint which it did on January 21, 2008. Plaintiff's motion for class certification has been fully briefed and argued.
- Aetna, Inc., et. al. vs. Express Scripts, Inc. and CuraScript, Inc. (Case No. 2:07-CV-05541-TJS, United States District Court for the Eastern District of Pennsylvania) On December 31, 2007, a complaint was filed alleging tortious interference with certain agreements between Plaintiffs and Priority Healthcare Corporation, a wholly-owned subsidiary of CuraScript, Inc. alleging damages of \$75.0 million. The agreements relate to a joint venture for the purpose of developing a specialty pharmacy business for Plaintiffs.

On July 21, 2004, we received a Civil Investigative Demand from the Attorney General of the State of Vermont. A total of 27 states and the District of Columbia have now issued substantially identical civil investigative demands. The civil investigative demands received to date seek documents regarding a wide range of our business practices. We are cooperating with this multi-state investigation.

In addition, in the ordinary course of our business there have arisen various legal proceedings, investigations or claims now pending against our subsidiaries and us. The effect of these actions on future financial results is not subject to reasonable estimation because considerable uncertainty exists about the outcomes. Where insurance coverage is not available for such claims, or in our judgment, is not cost-effective, we maintain self-insurance reserves to reduce our exposure to future legal costs, settlements and judgments related to uninsured claims. Our self-insured reserves are based upon estimates of the aggregate liability for the costs of uninsured claims incurred and the retained portion of insured claims using certain actuarial assumptions followed in the insurance industry and our historical experience. It is not possible to predict with certainty the outcome of these claims, and we can give no assurance that any losses in excess of our insurance and any self-insurance reserves will not be material.

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

No matters were submitted to a vote of security holders during the fourth quarter of 2007.

PART II

Item 5 — Market For Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Price of and Dividends on the Registrant’s Common Equity and Related Stockholder Matters

Market Information. Our common stock is traded on the Nasdaq Global Select Market (“Nasdaq”) under the symbol “ESRX”. The high and low prices, as reported by the Nasdaq, are set forth below for the periods indicated. These prices have been adjusted to reflect the two-for-one stock split effective June 22, 2007, in the form of a stock dividend of one share for each outstanding share to holders of record on June 8, 2007.

Common Stock	Fiscal Year 2007		Fiscal Year 2006	
	High	Low	High	Low
First Quarter	\$ 42.63	\$ 32.32	\$ 47.50	\$ 41.08
Second Quarter	51.35	40.41	44.44	31.92
Third Quarter	56.08	47.63	42.49	34.41
Fourth Quarter	74.40	53.08	38.90	29.40

Holders. As of December 31, 2007, there were 408 stockholders of record of our common stock. We estimate there are approximately 205,303 beneficial owners of our common stock.

Dividends. The Board of Directors has not declared any cash dividends on our common stock since the initial public offering. The Board of Directors does not currently intend to declare any cash dividends in the foreseeable future. The terms of our existing credit facility contain certain restrictions on our ability to declare or pay cash dividends.

Recent Sales of Unregistered Securities

None.

Issuer Repurchases of Equity Securities

The following is a summary of our stock repurchasing activity during the three months ended December 31, 2007 (share data in millions):

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of a	Maximum number of shares that may yet be purchased
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			publicly announced program	under the program
10/1/2007 –				
10/31/2007	-	\$ -	-	13.2
11/1/2007 –				
11/30/2007	-	-	-	13.2
12/1/2007 –				
12/31/2007	-	-	-	13.2
Fourth quarter				
2007 total	-	\$ -	-	-

We have a stock repurchase program, originally announced on October 25, 1996. In 2007, our Board of Directors authorized total increases in the program of 24.0 million shares. Treasury shares are carried at first in, first out cost. There is no limit on the duration of the program. During 2007, we repurchased 23.1 million shares for \$1,140.3 million, leaving 13.2 million shares remaining under the program. Current year repurchases were funded through borrowings under an amendment to our credit facility and through internally generated cash. Additional share repurchases, if any, will be made in such amounts and at such times as we deem appropriate based upon prevailing market and business conditions.

Item 6 – Selected Financial Data

The following selected financial data should be read in conjunction with our Consolidated Financial Statements, including the related notes, and “Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations”.

(in millions, except per share data)

Statement of Operations Data (for the Year Ended December 31):

	2007(1)	2006	2005(2)	2004(3)	2003
Revenues (4)	\$ 18,273.6	\$ 17,554.0	\$ 16,188.4	\$ 15,114.7	\$ 13,294.5
Cost of revenues(4)	16,507.0	16,077.8	14,997.3	14,170.5	12,428.2
Gross Profit	1,766.6	1,476.2	1,191.1	944.2	866.3
Selling, general and administrative	705.6	650.4	548.9	451.2	417.2
Operating income	1,061.0	825.8	642.2	493.0	449.1
Other expense, net	(116.1)	(83.6)	(28.4)	(42.4)	(43.8)
Income before income taxes	944.9	742.2	613.8	450.6	405.3
Provision for income taxes	344.4	266.8	214.3	172.4	154.7
Net income from continuing operations	600.5	475.4	399.5	278.2	250.6
Net (loss) income from discontinued operations, net of tax(5)	(32.7)	(1.0)	0.6	-	-
Cumulative effect of accounting change, net of tax(6)	-	-	-	-	(1.0)
Net income	\$ 567.8	\$ 474.4	\$ 400.1	\$ 278.2	\$ 249.6

Weighted average shares outstanding:(7)

Basic:	260.4	279.6	293.6	305.6	311.4
Diluted:	264.0	284.0	299.0	310.0	315.8

Basic earnings (loss) per share:(7)

Continuing operations	\$ 2.31	\$ 1.70	\$ 1.36	\$ 0.91	\$ 0.80
Discontinued operations(5)	(0.13)	-	-	-	-
Net earnings	\$ 2.18	\$ 1.70	\$ 1.36	\$ 0.91	\$ 0.80

Diluted earnings (loss) per share:(7)

Continuing operations	\$ 2.27	\$ 1.67	\$ 1.34	\$ 0.90	\$ 0.79
Discontinued operations(5)	(0.12)	-	-	-	-
Net earnings	\$ 2.15	\$ 1.67	\$ 1.34	\$ 0.90	\$ 0.79

Balance Sheet Data (as of December 31):

Cash and cash equivalents	\$ 434.7	\$ 131.0	\$ 477.9	\$ 166.1	\$ 396.0
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Working capital	(507.2)	(657.3)	(137.8)	(370.4)	(66.3)
Total assets	5,256.4	5,108.1	5,493.5	3,600.1	3,409.2
Debt:					
Short-term debt	260.1	180.1	110.0	22.1	-
Long-term debt	1,760.3	1,270.4	1,400.5	412.1	455.0
Stockholders' equity	696.4	1,124.9	1,464.8	1,196.2	1,194.0

Selected Data (for the Year Ended December 31):

Network pharmacy claims processed(8)	379.9	390.3	437.3	398.8	378.9
Home delivery pharmacy prescriptions filled	40.8	41.2	40.2	38.1	32.3
SAAS prescriptions filled	4.7	5.7	5.4	3.5	3.6

Cash flows provided by operating activities—

continuing operations	\$ 848.1	\$ 673.5	\$ 795.7	\$ 496.2	\$ 457.9
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Cash flows used in investing activities—

continuing operations	(55.8)	(100.8)	(1,367.5)	(397.0)	(42.8)
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Cash flows (used in) provided by financing activities—continuing operations

	(469.7)	(904.7)	887.0	(330.4)	(212.5)
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EBITDA from continuing operations(9)

	1,158.5	925.6	726.5	563.1	503.2
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(1)Includes the acquisition of CYC effective October 10, 2007.

(2)Includes the acquisition of Priority Healthcare Corporation, Inc. (“Priority”) effective October 14, 2005.

(3)Includes the acquisition of CuraScript, Inc. effective January 30, 2004.

(4)Excludes estimated retail pharmacy co-payments of \$3,746.3, \$4,175.3, \$5,821.8, \$5,545.9 and \$5,276.1 for the years ended December 31, 2007, 2006, 2005, 2004, and 2003, respectively. These are amounts we instructed retail pharmacies to collect from members. We have no information regarding actual co-payments collected.

(5)Includes the results of operations from the discontinued operations of IP, which was acquired as part of the Priority acquisition on October 14, 2005.

(6)As a result of the adoption of FAS 143, “Accounting for Asset Retirement Obligations” we recorded a \$1.0 million loss, net of tax, as the cumulative effect of change in accounting principle in 2003.

(7)Earnings per share and weighted average shares outstanding have been restated to reflect the two-for-one stock splits effective June 22, 2007 and June 24, 2005, respectively.

(8)Excluded from the network claims are manual claims and drug formulary only claims where we only administer the client’s formulary.

(9)EBITDA from continuing operations is earnings before other income (expense), interest, taxes, depreciation and amortization, or operating income plus depreciation and amortization. EBITDA is presented because it is a widely accepted indicator of a company’s ability to service indebtedness and is frequently used to evaluate a company’s performance. EBITDA, however, should not be considered as an alternative to net income, as a measure of operating performance, as an alternative to cash flow, as a measure of liquidity or as a substitute for any other measure computed in accordance with accounting principles generally accepted in the United States. In addition, our definition and calculation of EBITDA may not be comparable to that used by other companies.

We have provided below a reconciliation of EBITDA from continuing operations to net income and to net cash provided by continuing operating activities as we believe they are the most directly comparable measures calculated under Generally Accepted Accounting Principles:

EBITDA from Continuing
Operations

(in millions)	Year Ended December 31,				
	2007	2006	2005	2004	2003
Net income from continuing operations	\$ 600.5	\$ 475.4	\$ 399.5	\$ 278.2	\$ 250.6
Income taxes	344.4	266.8	214.3	172.4	154.7
Depreciation and amortization	97.5	99.8	84.3	70.1	54.1
Interest expense, net	96.2	82.0	26.0	37.9	38.0
Undistributed loss from joint venture	1.3	1.6	2.4	4.5	5.8
Non-operating charges, net	18.6	-	-	-	-
EBITDA from continuing operations	1,158.5	925.6	726.5	563.1	503.2
Current income taxes	(340.3)	(259.2)	(195.8)	(153.3)	(120.2)
Change in operating assets and liabilities (excluding effects of acquisitions)	77.2	49.7	223.4	80.9	84.1
Interest expense less amortization	(94.0)	(80.0)	(20.9)	(30.2)	(35.0)
Bad debt expense	36.7	13.5	17.8	6.2	(2.6)
Tax benefit from employee stock compensation	-	-	35.6	10.9	26.9
Amortization of unearned comp. under employee plans	31.6	27.6	11.5	11.8	8.3
Non-operating charges, net	(18.6)	-	-	-	-
Undistributed loss from joint venture	(1.3)	(1.6)	(2.4)	(4.5)	(5.8)
Other	(1.7)	(2.1)	-	11.3	(1.0)
Net cash provided by operating activities—continuing operations	\$ 848.1	\$ 673.5	\$ 795.7	\$ 496.2	\$ 457.9

Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

As one of the largest full-service pharmacy benefit management (“PBM”) companies we provide health care management and administration services on behalf of our clients, which include health maintenance organizations, health insurers, third-party administrators, employers, union-sponsored benefit plans, workers compensation plans, and government health programs. Our integrated PBM services include network claims processing, home delivery services, benefit design consultation, drug utilization review, formulary management, and drug data analysis services.

Through our Specialty and Ancillary Services (“SAAS”) segment, we provide specialty services, including patient care and direct specialty home delivery to patients; distribution of injectable drugs to patient homes and physician offices; distribution of pharmaceuticals and medical supplies to providers and clinics; third party logistics services for

contracted pharmaceutical manufacturer clients; fertility services to providers and patients; and bio-pharmaceutical services including marketing, reimbursement and customized logistics solutions. SAAS does not include the fulfillment of specialty prescriptions at retail pharmacies participating in our networks; these prescriptions are reflected in PBM network revenues. We also provide services which include distribution of specialty pharmaceuticals requiring special handling or packaging where we have been selected by the pharmaceutical manufacturer as part of a limited distribution network; distribution of pharmaceuticals to low-income patients through manufacturer-sponsored patient assistance programs and company-sponsored generic patient assistance programs, and distribution of sample units to physicians and verification of practitioner licensure.

We report two segments: PBM and SAAS (see “—Results of Operations”). Revenue generated by our segments can be classified as either tangible product revenue or service revenue. We earn tangible product revenue from the sale of prescription drugs by retail pharmacies in our retail pharmacy networks and from dispensing prescription drugs from our home delivery and specialty pharmacies. Service revenue includes administrative fees associated with the administration of retail pharmacy networks contracted by certain clients, market research programs, medication counseling services, certain specialty distribution services, and sample fulfillment and accountability services. Tangible product revenue generated by our PBM and SAAS segments represented 98.4% of revenues for the year ended December 31, 2007, respectively, as compared to 98.3% and 98.2% for the years ended December 31, 2006 and 2005, respectively.

RECENT DEVELOPMENTS

During the fourth quarter of 2007, we identified our CuraScript Infusion Pharmacy, Inc. line of business (“IP”) as available for sale as we considered it non-core to our future operations. As a result, IP is classified as a discontinued operation. IP is headquartered in Louisville, Kentucky and operates twelve infusion pharmacies in six states. IP offers a broad range of infused therapies in the home to patients with acute or chronic conditions.

Prior to being classified as a discontinued operation, IP was included in our SAAS segment. The results of operations for IP are reported as discontinued operations for all periods presented in the accompanying Consolidated Statements of Operations in accordance with FAS 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”. Additionally, for all periods presented, assets and liabilities of the discontinued operations are segregated in the accompanying Consolidated Balance Sheets, and cash flows of our discontinued operations are segregated in our accompanying Consolidated Statement of Cash Flows.

In connection with the classification of IP as a discontinued operation, we recorded a charge of \$34.0 million in the fourth quarter of 2007, the majority of which reflects the IP goodwill and intangible asset impairment losses and the subsequent write-down of IP assets to fair market value (see—“Critical Accounting Policies—Asset Impairment”).

EXECUTIVE SUMMARY AND TREND FACTORS AFFECTING THE BUSINESS

Our results in 2007 reflect the successful execution of our business model which emphasizes the alignment of our financial interests with those of our clients through greater use of generics, home delivery and specialty pharmacy. In 2007 we benefited from higher generic utilization (61.8% in 2007 compared to 57.6% in 2006) and better management of ingredient costs through renegotiation of supplier contracts, increased competition among generic manufacturers and other actions which helped to reduce ingredient costs. We expect certain activities within our SAAS segment including specialty pharmacy fulfillment to our PBM clients to deliver solid results, which recently have been offset by margin declines in various other lines of business within our SAAS segment. As noted above, we classified IP as a discontinued operation in the fourth quarter of 2007.

We believe the positive trends we see in 2007, including increased generic usage and lower drug purchasing costs, will continue to generate improvements in our results of operations in the future.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Our estimates and assumptions are based upon a combination of historical information and various other assumptions believed to be reasonable under the particular circumstances. Actual results may differ from our estimates. Certain of the accounting policies which most impact our consolidated financial statements and that require our management to make difficult, subjective or complex judgments are described below. This should be read in conjunction with Note 1, "Summary of Significant Accounting Policies" and with the other notes to the consolidated financial statements.

REBATE ACCOUNTING

ACCOUNTING POLICY

We administer a rebate program through which we receive rebates and administrative fees from pharmaceutical manufacturers. The portion of rebates payable to clients is estimated based on historical and/or anticipated sharing percentages. These estimates are adjusted to actual when amounts are paid to clients.

FACTORS AFFECTING ESTIMATE

The factors that could impact our estimates of rebates, rebates receivable and rebates payable are as follows:

- Differences between estimated aggregate allocation percentages and actual rebate allocation percentages calculated on a client-by-client basis;
 - Drug patent expirations; and
 - Changes in drug utilization patterns.

Historically, adjustments to our original estimates have been relatively immaterial.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

ACCOUNTING POLICY

We provide an allowance for doubtful accounts equal to estimated uncollectible receivables. This estimate is based on the current status of each customer's receivable balance.

FACTORS AFFECTING ESTIMATE

We record allowances for doubtful accounts based on a variety of factors including the length of time the receivables are past due, the financial health of the customer and historical experience. Our estimate could be impacted by changes in economic and market conditions as well as changes to our customers' financial condition.

SELF-INSURANCE RESERVES

ACCOUNTING POLICY

We accrue self-insurance reserves based upon estimates of the aggregate liability of claim costs in excess of our insurance coverage which are probable and estimable. Reserves are estimated using certain actuarial assumptions followed in the insurance industry and our historical experience. The majority of these claims are legal claims and our liability estimate is primarily related to the cost to defend these claims. We do not accrue for settlements, judgments, monetary fines or penalties until such amounts are probable and estimable, in compliance with Financial Accounting Standard ("FAS") No. 5, "Accounting for Contingencies." Under FAS 5, if the range of possible loss is broad, and no amount within the range is more likely than any other, the liability accrual is based on the lower end of the range.

FACTORS AFFECTING ESTIMATE

Self-insurance reserves are based on management's estimates of the costs to defend legal claims. We do not have significant experience with certain of these types of cases. As such, differences between actual costs and management's estimates could be significant. Actuaries do not have a significant history with the PBM industry. Therefore, changes to assumptions used in the development of these reserves can affect net income in a given period. In addition, changes in the legal environment and the number and nature of claims could impact our estimate.

ASSET IMPAIRMENT

ACCOUNTING POLICY

Goodwill is evaluated for impairment annually or when events or circumstances occur indicating that goodwill might be impaired in accordance with FAS 142, "Goodwill and Other Intangible Assets". In addition, we evaluate whether events or circumstances have occurred that may indicate an impairment in goodwill. The measurement of possible impairment is based on the ability to recover the balance of assets from expected future operating cash flows on an undiscounted basis. Impairment losses, if any, would be determined based on the present value of the cash flows using discount rates that reflect the inherent risk of the underlying business.

We evaluate goodwill separately for the domestic PBM operations and Canadian PBM operations. No such impairment existed for our domestic PBM operations or Canadian PBM operations at December 31, 2007 or 2006.

As noted above, we identified IP as available for sale during the fourth quarter of 2007. As a result, IP is classified as a discontinued operation. Prior to being classified as a discontinued operation, IP was included in our SAAS segment. As a result of this triggering event, we evaluated goodwill separately for IP and for our continuing SAAS segment. No impairment existed for our continuing SAAS segment; however, impairment charges of \$7.0 million were recorded for IP. See Note 7 for more information on FAS 142 and accounting for goodwill as well as the impairment charges.

Other intangible assets include, but are not limited to, customer contracts and relationships, non-compete agreements, deferred financing fees, trade names and certain advance discounts paid to clients under contractual agreements. Other intangible assets, excluding customer contracts, customer relationships and trade names, are recorded at cost. Customer contracts and relationships are valued based on discounted cash flows over the expected life of the intangible asset. Excluding trade names which have an indefinite life, other intangible assets are amortized on a straight-line basis, which approximates the pattern of benefit, over periods from two to 20 years (see Note 7).

In connection with our evaluation of IP as a discontinued operation, we wrote-off intangible assets with a net book value of \$0.4 million (gross carrying value of \$0.7 million net of accumulated amortization of \$0.3 million), consisting of contractual relationships.

FACTORS AFFECTING ESTIMATE

The measurement of possible impairment is based on the ability to recover the balance of assets from expected future operating cash flows on an undiscounted basis. Impairment losses, if any, would be determined based on the present value of the cash flows using discount rates that reflect the inherent risk of the underlying business. Assessment of impairment requires assumptions about discount rates, inflation rates and earnings growth rates and could be impacted by other internal factors and external economic conditions.

OTHER ACCOUNTING POLICIES

We consider the following information about revenue recognition policies important for an understanding of our results of operations:

- Revenues from dispensing prescriptions from our home delivery pharmacies are recorded when prescriptions are shipped. These revenues include the co-payment received from members of the health plans we serve.
- Revenues from the sale of prescription drugs by retail pharmacies are recognized when the claim is processed. We do not include member co-payments to retail pharmacies in revenue or cost of revenue.
 - When we independently have a contractual obligation to pay our network pharmacy providers for benefits provided to our clients' member, we act as a principal in the arrangement and we include the total payments we have contracted to receive from these clients as revenue and the total payments we make to the network pharmacy providers as cost of revenue.
- When we merely administer a client's network pharmacy contracts to which we are not a party and under which we do not assume credit risk, we earn an administrative fee for collecting payments from the client and remitting the corresponding amount to the pharmacies in the client's network. In these transactions, drug ingredient cost is not included in our revenues or in our cost of revenues.
- Gross rebates and administrative fees earned for the administration of our rebate programs, performed in conjunction with claim processing services provided to clients, are recorded as a reduction of cost of revenue and the portion of the rebate payable to customers is treated as a reduction of revenue.
- When we earn rebates and administrative fees in conjunction with formulary management services, but do not process the underlying claims, we record rebates received from manufacturers, net of the portion payable to customers, in revenue.
- We distribute pharmaceuticals in connection with our management of patient assistance programs and earn a fee from the manufacturer for administrative and pharmacy services for the delivery of certain drugs free of charge to doctors for their low income patients.
- We earn a fee for the distribution of consigned pharmaceuticals requiring special handling or packaging where we have been selected by the pharmaceutical manufacturer as part of a limited distribution network.
- Discounts and contractual allowances related to our SAAS revenues are estimated based on historical collections over a recent period for the sales that are recorded at gross amounts. The percentage is applied to the applicable accounts receivable balance that contains gross amounts for each period. Any differences between the estimates and actual collections are reflected in operations in the year payment is received. Differences may result in the amount and timing of revenues for any period if actual performance varies from estimates. Allowances for returns are estimated based on historical return trends.
- Specialty revenues earned by our SAAS segment are recognized at the point of shipment. At the time of shipment, the Company has performed substantially all of its obligations under its customer contracts and does not experience a significant level of reshipments.
- SAAS product revenues include revenues earned through the distribution of specialty drugs to clients, and supplies provided through the distribution business, as well as administering sample card programs for certain manufacturers. We include ingredient cost of those drug samples dispensed from retail pharmacies in our SAAS revenues and the associated costs for these sample card programs in cost of revenues.
- SAAS service revenues include revenues earned through providing reimbursement solutions and product support to pharmaceutical manufacturers, biotechnology companies, and medical device companies, revenues derived from our group purchasing organization, and administrative fees for the verification of practitioner licensure and the

distribution of consigned drug samples to doctors based on orders received from pharmaceutical sales representatives.

RESULTS OF OPERATIONS

We maintain a PBM segment, consisting of our domestic and Canadian PBM operations, and a SAAS segment, which consists of our specialty operations of CuraScript and our Specialty Distribution Services (“SDS”) and Phoenix Marking Group LLC (“PMG”) lines of business.

PBM OPERATING INCOME

(in millions)	Year Ended December 31,		
	2007(1)	2006	2005
Product revenue			
Network revenues	\$ 9,468.8	\$ 8,797.4	\$ 9,164.7
Home delivery revenues	5,015.5	5,166.0	5,014.7
Service revenues	168.7	163.0	152.2
Total PBM revenues	14,653.0	14,126.4	14,331.6
Cost of PBM revenues	13,072.3	12,870.5	13,292.8
PBM gross profit	1,580.7	1,255.9	1,038.8
PBM SG&A expenses	543.2	511.5	477.0
PBM operating income	\$ 1,037.5	\$ 744.4	\$ 561.8
Total adjusted PBM Claims(2)	502.3	513.9	557.9

(1) Includes the acquisition of CYC effective October 10, 2007.

(2) PBM adjusted claims represent network claims plus mail claims, which are multiplied by 3, as mail claims are typically 90 day claims and network claims are generally 30 day claims.

Network claims decreased by 10.4 million, or 2.7%, in 2007 from 2006. These decreases are primarily due to the loss of lives resulting from the attrition of several clients, including the shift to the government funded benefit, Medicare Part D. Total unadjusted home delivery claims decreased by 0.4 million claims, or 1.0% in 2007 from 2006, primarily due to client attrition as described above. These decreases were offset by the increased usage of our home delivery pharmacies by members of new and existing clients. On an adjusted basis, total PBM claims decreased 2.3% in 2007 from 2006, and decreased 7.9% in 2006 over 2005.

PBM RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2007 vs. 2006

Network pharmacy revenues increased \$671.4 million, or 7.6%, in 2007 over 2006. There are two primary components to our change in network revenues, changes in volume and changes in price. Approximately \$906.5 million of the increase in network pharmacy revenues is attributable to changes in price. This increase was offset by a \$235.1 million decrease due to lower claim volumes, as described above.

Two factors affect changes in price: inflation and the mix of the prescriptions processed at network pharmacies. Average revenue per network claim increased 10.6% in 2007 over 2006 primarily as a result of a change in mix shifting away from lower revenue claims. As compared to 2006, we experienced a significant reduction in claim volume from members participating in discount card programs who began transitioning to Medicare Part D programs. For these discount programs, we do not include member co-payments to retail pharmacies in revenue or cost of revenue, and as such, we only report administrative fees as revenues. Excluding these claims, average revenue per network claim increased 3.4%, primarily as a result of inflation.

Additionally, our generic penetration rate affects our average revenue per network claim. As our penetration rate increased to 63.2% of total network claims in 2007 as compared to 59.1% in 2006, it offset the upward trend in price caused by inflation as generic drugs are less expensive than brand drugs.

The \$150.5 million, or 2.9%, decrease in home delivery revenues in 2007 from 2006 is primarily due to the impact of higher generic penetration on average revenue per home delivery claim and lower claim volumes. Our generic penetration rate increased to 50.5% of total home delivery claims in 2007 as compared to 45.7% in 2006 and decreased claims volume resulted in a \$44.2 million decrease in home delivery revenues. The impact of these items was partially offset by ingredient cost inflation.

Our home delivery generic fill rate is lower than the retail generic fill rate as fewer generic substitutions are available among maintenance medications (e.g. therapies for chronic conditions) commonly dispensed from home delivery pharmacies compared to acute medications that are dispensed primarily by pharmacies in our retail networks.

Cost of PBM revenues increased \$201.8 million, or 1.6% in 2007 from 2006 due to the following:

- We experienced an increase of 3.9% in the cost of revenue per adjusted claim in 2007 over 2006, primarily from ingredient cost inflation and a significant reduction of 100% co-payment claims as discussed above.
- This increase was partially offset by the 2.3% decrease in adjusted claims volume, as well as better management of ingredient costs resulting from renegotiation of certain supplier contracts and the increase in the aggregate generic fill rate, as discussed above.

Our PBM gross profit increased \$324.8 million, or 25.9%, in 2007 over 2006. Client cost savings from the increase in the aggregate generic fill rate and better management of ingredient costs resulting from renegotiation of certain supplier contracts were only partially offset by lower network claims volume and margin pressures arising from the current competitive environment.

Selling, general and administrative expense (“SG&A”) for our PBM segment increased \$31.7 million, or 6.2%, in 2007 over 2006 primarily as a result of the following factors:

- Increased spending of \$32.0 million partially consisting of increases in management incentive compensation in addition to the effect of inflation.
 - Increase of \$8.1 million related to our new headquarters.
 - Increased legal expenses of \$6.0 million due to changes in the status of existing cases.
- These increases were offset by a \$16.3 million decrease in professional fees, primarily due to a reduction of IT contractors and consultants.

PBM operating income increased \$293.1 million, or 39.4%, in 2007 over 2006, based on the various factors described above.

PBM RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2006 vs. 2005

Network pharmacy revenues decreased \$367.3 million, or 4.0%, in 2006 from 2005. There are two primary components to our change in network revenues, changes in volume and changes in price. Approximately \$985.1 million of the decrease in network pharmacy revenues is attributable to lower claim volumes.

Two factors affect changes in price: inflation and the mix of the prescriptions processed at network pharmacies. Average revenue per network claim increased 7.5% in 2006 from 2005 as a result of inflation and a significant reduction in claim volume from members participating in discount card programs with 100% co-payments who transitioned to Medicare Part D programs. For these discount programs, we do not include member co-payments to retail pharmacies in revenue or cost of revenue, and as such, only report administrative fees as revenues. A

reduction of these lower revenue claims from the previous year's results in a higher average revenue per network claim this year. Additionally, our generic penetration rate affects our average revenue per network claim. As our penetration rate increased to 59.1% of total network claims in 2006 as compared to 55.4% in 2005, it offset the upward trend in price caused by inflation as generic drugs are less expensive than brand drugs.

The \$151.3 million, or 3.0%, increase in home delivery revenues in 2006 over 2005 is primarily attributable to higher claim volumes, which accounted for an increase in revenues of approximately \$124.3 million. This is primarily due to the increased usage of our home delivery pharmacies by members of new and existing clients.

Average revenue per home delivery claim increased 0.5% in 2006 from 2005, primarily due to inflation and a significant reduction in claim volume from members participating in discount programs with 100% co-payments who transitioned to Medicare Part D programs, as described above. Partially offsetting this increase is our generic penetration rate which affects our average revenue per home delivery claim. Our penetration rate increased to 45.7% of total home delivery claims in 2006 as compared to 43.6% in 2005. Our home delivery generic fill rate is lower than the retail generic fill rate as fewer generic substitutions are available among maintenance medications (e.g. therapies for chronic conditions) commonly dispensed from home delivery pharmacies compared to acute medications that are dispensed primarily by pharmacies in our retail networks.

PBM service revenues include amounts received from clients for therapy management services such as prior authorization and step therapy protocols and administrative fees earned for processing claims for clients utilizing their own retail pharmacy networks. PBM service revenues increased \$10.8 million, or 7.1%, in 2006 over 2005 primarily due to growth in our Canadian PBM and growth in our step therapy programs, which help our clients save money by focusing the use of medications according to clinically developed algorithms.

Cost of PBM revenues decreased \$422.3 million, or 3.2% in 2006 from 2005 as a result of the 7.9% decrease in adjusted claims volume, as well as better management of ingredient costs resulting from renegotiation of certain supplier contracts. Offsetting these decreases was an increase in the cost of revenue per adjusted claim in 2006 of 5.1%, primarily from ingredient cost inflation and a significant reduction of 100% co-payment claims as discussed above.

Our PBM gross profit increased \$217.1 million, or 20.9%, in 2006 over 2005. This mainly resulted from client cost savings from the increase in the aggregate generic fill rate, better management of ingredient costs resulting from renegotiation of certain supplier contracts and higher home delivery volumes. The increase in gross profit related to the aggregate generic fill rate was partially offset by lower net rebates received from pharmaceutical manufacturers, net of amounts we share with our clients.

Selling, general and administrative expense ("SG&A") for our PBM segment increased \$34.5 million, or 7.2%, in 2006 as compared to 2005 primarily as a result of the following factors:

- Stock option expense of \$20.3 million recognized in 2006 due to the implementation of FAS 123R, "Share-Based Payment".
- Increased spending of \$22.5 million in 2006 over the same periods of 2005, on costs to improve the operation and the administrative functions supporting the management of the pharmacy benefit.
- Partially offsetting the increases noted above, prior year SG&A included bad debt expense of approximately \$8.9 million, primarily relating to an increase in the allowance for receivables from our clients' members.

PBM operating income increased \$182.6 million, or 32.5%, in 2006 over 2005, based on the various factors described above.

SAAS OPERATING INCOME

(in millions)	Year Ended December 31,		
	2007	2006	2005 (1)
Product revenues	\$ 3,493.2	\$ 3,295.0	\$ 1,711.9
Service revenues	127.4	132.6	144.9
Total SAAS revenues	3,620.6	3,427.6	1,856.8
Cost of SAAS revenues	3,434.7	3,207.3	1,704.5
SAAS gross profit	185.9	220.3	152.3
SAAS SG&A expenses	162.4	138.9	71.9
SAAS operating income from continuing operations(2)	\$ 23.5	\$ 81.4	\$ 80.4

(1) Includes the acquisition of Priority effective October 14, 2005.

(2) 2007 results include the impact of \$30.6 million of non-recurring charges as discussed below.

As previously noted, our SAAS results for 2007, 2006, and 2005 have been adjusted for the discontinued operations of IP, which was formerly part of our SAAS segment.

SAAS RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2007 vs. 2006

SAAS Continuing Operations. SAAS revenues increased \$193.0 million, or 5.6%, in 2007 over 2006. This is partially due to increased cross-selling of specialty services to our PBM clients in addition to sales of new drugs which became available for distribution through our Specialty Distribution line of business in late 2006, the full effect of which was not realized until 2007. The increase in revenues was partially offset by a \$5.0 million reduction of revenues related to a non-recurring contractual adjustment. In addition, the increase in revenues was offset by a reduction in sales of higher margin drugs through our Specialty Distribution and Specialty Pharmacy lines of business as well as lower Patient Assistance Programs (“PAP”) shipments and Rx Outreach membership reflecting the continuing shift of patients to Medicare Part D and other discount programs.

The increase in revenues was more than offset by an increase in SAAS cost of revenues of \$227.4 million, or 7.1%, in 2007 over 2006. The following factors contributed to the decrease in SAAS gross profit of \$34.4 million, or 15.6%, in 2007 from 2006:

- Changes in mix as sales of newer, low margin therapies replaced sales of higher margin drugs across multiple SAAS business units.
- We had inventory write-offs of \$9.1 million in the fourth quarter of 2007; the majority of which related to a write-off of flu vaccine inventory in our Specialty Distribution line of business due to an overstock of inventory resulting from a mild flu season.

SG&A for our SAAS segment increased \$23.5 million, or 16.9%, in 2007 from 2006. This is primarily caused by an increase in bad debt expense in 2007 over 2006, the majority of which is related to a \$13.5 million non-recurring charge to bad debt expense in the third quarter of 2007 in our Specialty Distribution line of business related to the insolvency of a client, as well as \$3.0 million of additional reserves taken in the fourth quarter of 2007 in order to adequately balance our collection risks in all SAAS business lines.

SAAS income from continuing operations decreased \$57.9 million, or 71.1%, in 2007 from 2006 based on the factors described above.

SAAS RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2006 vs. 2005

SAAS Continuing Operations. The acquisition of Priority in October 2005 was a primary driver of the increases in SAAS revenues, SAAS cost of revenues, and SAAS gross profit in 2006 over 2005. Partially offsetting the increases resulting from the acquisition of Priority is the decrease of \$20.6 million of operating income from our PAP in 2006 from 2005. This is mainly due to fewer PAP shipments and other activities as patients have left our system and shifted to the Medicare Part D program.

Other factors that impacted SAAS results of operations in 2006 from 2005:

- Changes in mix as sales of newer, low margin therapies replaced sales of higher margin drugs across multiple SAAS business units.
- General increases in distribution cost of sales as a result of a change in wholesale vendor. The new contract offers the possibility of better discounts based on a tiered pricing structure.
- Additional decreases in distribution gross margins due to changes in pricing offered by a manufacturer of certain oncology drugs.

SG&A for our SAAS segment increased \$67.0 million, or 93.2%, in 2006 over 2005 primarily due to the acquisition of Priority, and related integration costs.

SAAS income from continuing operations increased \$1.0 million, or 1.2%, in 2006 from 2005.

OTHER (EXPENSE) INCOME, NET

Net interest expense increased \$14.2 million, or 17.3%, in 2007 as compared to 2006, resulting from increased borrowings under our credit facility (see “Liquidity and Capital Resources—Bank Credit Facility”).

Net interest expense increased \$56.0 million, or 215.4%, in 2006 as compared to 2005, resulting from the refinancing of our entire credit facility during the fourth quarter of 2005 and additional borrowings under our revolver due to the acquisition of Priority.

On December 18, 2006, we announced a proposal to acquire all of the outstanding shares of Caremark Rx, Inc. (“Caremark”) common stock. On March 16, 2007, Caremark shareholders approved a merger agreement with CVS Corporation (“CVS”) and we subsequently withdrew our proposal to acquire Caremark. We incurred legal and other professional fees (which do not include internal costs) of \$27.2 million as a result of the proposed acquisition. These expenses were partially offset by a \$4.4 million special dividend paid by CVS/Caremark Corporation (“CVS/Caremark”) on Caremark stock we owned prior to the CVS/Caremark merger and by a non-operating gain of \$4.2 million resulting from the sale of our shares of CVS/Caremark stock in the second quarter of 2007. We recognized net non-operating charges in 2007 of \$18.6 million.

PROVISION FOR INCOME TAXES

Our effective tax rate increased to 36.4% for the year ended December 31, 2007, as compared to 35.9% for the year ended December 31, 2006. Our 2007 effective rate reflects a nondeductible penalty of \$10.5 million paid to the U.S. Attorney’s Office for the District of Massachusetts regarding settlement of a lawsuit. Our 2006 effective rate reflects non-recurring net tax benefits of \$7.3 million mainly related to the impact of changes in state effective rates on deferred tax assets and liabilities.

Our 2005 effective rate includes the impact of both non-recurring and recurring net tax benefits of approximately \$20.0 million resulting primarily from changes in the apportionment of our income for state income tax purposes as

well as the recognition of expected state tax benefits associated with prior year subsidiary losses and credits.

NET (LOSS) INCOME FROM DISCONTINUED OPERATIONS, NET OF TAX

Net loss from discontinued operations, net of tax, increased \$31.7 million from 2006 to 2007. This increase is primarily due to fourth quarter 2007 charges of \$34.0 million from IP goodwill and intangible asset impairment losses and the write-down of IP assets to fair market value (see—"Critical Accounting Policies—Asset Impairment"). In addition, IP incurred non-recurring charges of \$2.0 million relating to the closure of six IP pharmacy sites in the fourth quarter of 2007.

Results of discontinued operations, net of tax, trended downward by \$1.6 million from 2005 to 2006, primarily due to a charge to bad debt expense of \$4.0 million in the third quarter of 2006.

NET INCOME AND EARNINGS PER SHARE

Net income increased \$93.4 million, or 19.7%, for the year ended December 31, 2007 over 2006 and increased \$74.3 million, or 18.6% for the year ended December 31, 2006 over 2005.

On May 23, 2007, we announced a two-for-one stock split for stockholders of record on June 8, 2007, effective June 22, 2007. On May 24, 2005, we announced a two-for-one stock split for stockholders of record on June 10, 2005, effective June 24, 2005. Both splits were effected in the form of a dividend by issuance of one additional share of common stock for each share of common stock outstanding. The earnings per share and the weighted average number of shares outstanding for basic and diluted earnings per share for each respective period have been adjusted for both stock splits.

Basic and diluted earnings per share increased 28.2% and 28.7%, respectively, for the year ended December 31, 2007 over 2006 and 25.0% and 24.6%, respectively, for the year ended December 31, 2006 over 2005. These increases are primarily due to improved operating results, as well as the decrease in the basic and diluted weighted average number of common shares, relating to the repurchase of 23.1 million and 24.0 million shares in the years ended December 31, 2007 and 2006, respectively (see—"Stock Repurchase Program").

LIQUIDITY AND CAPITAL RESOURCES

OPERATING CASH FLOW AND CAPITAL EXPENDITURES

In 2007, net cash provided by continuing operations increased \$174.6 million to \$848.1 million. Changes in operating cash flows from continuing operations in 2007 were positively impacted by the following factors:

- Net income from continuing operations increased \$125.1 million in 2007 over 2006.
- Inventory balances from continuing operations decreased by approximately \$25.3 million primarily due to a large purchase of generic inventory at a discounted rate made in 2006, as well as improved inventory management.
 - The impact on continuing operations accounts receivable of overall improvements in days outstanding.
 - Smaller payouts of management incentive bonuses in 2007 as compared to 2006.

In 2007, cash flows used by discontinued operations increased \$5.9 million to \$20.8 million.

In 2006, net cash provided by operations from continuing operations decreased \$122.2 million to \$673.5 million from \$795.7 million. This decrease is due to several factors:

- The \$104.2 million decrease in claims and rebates payable (which is a use of cash) was only partially offset by a \$35.7 million decrease in accounts receivable (which is a source of cash) resulting in a net \$68.6 million use of cash in 2006. This net decrease is partially due to the timing of collections and disbursements surrounding the end of 2005 which resulted in positive cash flows occurring in the fourth quarter of 2005 instead of 2006. In addition, there

was a decrease in claim volume and lower rebates due to certain formulary changes made in 2006. We manage our business to operate with negative net working capital. As a result, when we experience a reduction in claim volume, our negative net working capital position will decline as well, resulting in a use of cash.

- The decrease in other liabilities in 2006 reduced operating cash flows by approximately \$3.7 million, due to payout of management incentive bonuses in the first quarter of 2006, and timing of payments to vendors, partially offset by other various increases.
- As a result of the adoption of FAS 123R on January 1, 2006, tax benefits from the exercise of stock options are now classified as financing cash flows, rather than operating cash flows. In 2005, cash flow from operating activities included a cash inflow of \$35.6 million related to tax benefits from the exercise of stock options.
- These decreases were partially offset by increases in earnings and in depreciation and amortization, and other positive changes in certain working capital components. The primary component of the net positive working capital changes was a \$77.4 million decrease in inventory, which is a cash inflow. This was primarily as a result of the consolidation of specialty pharmacies as part of our efforts to integrate our Priority acquisition.

In 2006, cash flows used by discontinued operations increased \$12.1 million to \$14.9 million.

As a percent of accounts receivable, our allowance for doubtful accounts for continuing operations was 6.0% and 4.5% at December 31, 2007 and 2006, respectively. This increase is primarily due to an increase in the allowance for doubtful accounts in the second half of 2007, related to our legacy Priority operations, which is part of our SAAS segment.

Our capital expenditures increased \$8.4 million, or 12.6%, in 2007 as compared to 2006, and increased \$7.9 million, or 13.5%, in 2006 as compared to 2005. We intend to continue to invest in infrastructure and technology that we believe will provide efficiencies in operations and facilitate growth and enhance the service we provide to our clients. We expect future capital expenditures will be funded primarily from operating cash flow or, to the extent necessary, with borrowings under our revolving credit facility, discussed below.

STOCK REPURCHASE PROGRAM (reflecting the two-for-one stock split effective June 22, 2007)

We have a stock repurchase program, originally announced on October 25, 1996. In 2007, our Board of Directors authorized total increases in the program of 24.0 million shares. Treasury shares are carried at first in, first out cost. There is no limit on the duration of the program. During 2007, we repurchased 23.1 million shares for \$1,140.3 million, leaving 13.2 million shares remaining under the program. Current year repurchases were funded through borrowings under an amendment to our credit facility and through internally generated cash. Additional share repurchases, if any, will be made in such amounts and at such times as we deem appropriate based upon prevailing market and business conditions.

ACQUISITIONS AND RELATED TRANSACTIONS

On October 10, 2007, we purchased Connect Your Care, LLC (“CYC”), a leading provider of consumer directed healthcare technology solutions to the employer, health plan and financial services markets. The purchase price was funded through internally generated cash. The purchase agreement includes an earnout provision, payable after three years based on the performance of the business. This acquisition is reported as part of our PBM segment, and will not have a material impact on earnings.

On October 14, 2005, we acquired the capital stock of Priority in a cash transaction for \$28 per share, or approximately \$1.3 billion. The acquisition was accomplished through the merger of one of our wholly-owned subsidiaries with and into Priority. The \$1.3 billion purchase price was financed with approximately \$167.0 million of cash on hand and the remainder by adding \$1.6 billion in Term A loans through a new credit facility which replaced our prior credit facility. As a result of this refinancing, we wrote-off approximately \$3.8 million in deferred financing fees relating to our prior credit facility in the fourth quarter of 2005.

We regularly review potential acquisitions and affiliation opportunities. We believe available cash resources, bank financing or the issuance of additional common stock could be used to finance future acquisitions or affiliations. There can be no assurance we will make new acquisitions or establish new affiliations in 2008 or thereafter.

BANK CREDIT FACILITY

At December 31, 2007, our credit facility includes \$1.6 billion of Term A loans, \$800.0 million of Term-1 loans and a \$600.0 million revolving credit facility. The revolving credit facility (none of which was outstanding as of December 31, 2007) is available for general corporate purposes. During 2007, we made scheduled payments of \$180.0 million on our Term A loan. The maturity dates of our credit facility are October 14, 2010.

During the year, we amended our credit facility to provide additional borrowing under the Term-1 loans. As a result of this amendment, we added approximately \$1.4 million of deferred financing fees in the second quarter of 2007.

Our credit facility requires us to pay interest periodically on the London Interbank Offered Rates (“LIBOR”) or base rate options, plus a margin. The margin over LIBOR will range from 0.50% to 1.125%, depending on our consolidated leverage ratio or our credit rating. Under our credit facility we are required to pay commitment fees on the unused portion of the \$600.0 million revolving credit facility. The commitment fee will range from 0.10% to 0.25% depending on our consolidated leverage ratio or our credit rating.

At December 31, 2007, the weighted average interest rate on the facility was 5.6%. Our credit facility contains covenants that limit the indebtedness we may incur, the common shares we may repurchase, and dividends we may pay. The repurchase and dividend covenant applies if certain leverage thresholds are exceeded. The covenants also include a minimum interest coverage ratio and a maximum leverage ratio. At December 31, 2007, we believe we are

in compliance with all covenants associated with our credit facility.

CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following table sets forth our schedule of current maturities of our long-term debt as of December 31, 2007, and future minimum lease payments due under noncancellable operating leases of our continuing operations (in millions):

Contractual obligations	Payments Due by Period as of December 31, 2007				
	Total	2008	2009 – 2010	2011 – 2012	After 2013
Long-term debt (1)	\$ 2,020.4	\$ 260.1	\$ 1,760.0	\$ 0.2	\$ 0.1
Future minimum lease payments (2)					
(3) (4)	179.7	28.9	52.0	36.6	62.2
Purchase commitments (5)	49.0	29.7	18.3	1.0	-
Total contractual cash obligations	\$ 2,249.1	\$ 318.7	\$ 1,830.3	\$ 37.8	