

PharMerica CORP
Form 10-Q
May 07, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2015

or

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

For the transition period from _____ to _____ .

Commission File Number: 001-33380

PHARMERICA CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

87-0792558

(I.R.S. Employer Identification No.)

1901 Campus Place

Louisville, KY

(Address of Principal Executive Offices)

40299

(Zip Code)

(502) 627-7000

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

Smaller reporting company

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(Do not check if a smaller reporting company)

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

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class of Common Stock	Outstanding at May 1, 2015
Common stock, \$0.01 par value	30,387,961 shares

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PHARMERICA CORPORATION

CONDENSED CONSOLIDATED INCOME STATEMENTS

For the Three Months Ended March 31, 2014 and 2015

(Unaudited)

(In millions, except share and per share amounts)

	Three Months Ended March 31,	
	2014	2015
Revenues	\$452.2	\$511.6
Cost of goods sold	372.2	423.0
Gross profit	80.0	88.6
Selling, general and administrative expenses	57.2	59.0
Amortization expense	4.4	6.6
Merger, acquisition, integration costs and other charges	5.0	3.8
Settlement, litigation and other related charges	1.2	2.3
Restructuring and impairment charges	1.9	0.1
Operating income	10.3	16.8
Interest expense, net	2.5	1.4
Income before income taxes	7.8	15.4
Provision for income taxes	3.0	5.8
Net income	\$4.8	\$9.6
Earnings per common share:		
Basic	\$0.16	\$0.32
Diluted	\$0.16	\$0.31
Shares used in computing earnings per common share:		
Basic	29,753,024	30,185,230
Diluted	30,354,067	30,733,381

See accompanying Notes to Condensed Consolidated Financial Statements

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PHARMERICA CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

As of December 31, 2014 and March 31, 2015

(Unaudited)

(In millions, except share and per share amounts)

	(As Adjusted) December 31, 2014	March 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 33.3	\$ 25.2
Accounts receivable, net	195.8	199.5
Inventory	135.7	122.6
Deferred tax assets, net	42.2	39.9
Income taxes receivable	-	0.5
Prepays and other assets	90.4	62.0
	497.4	449.7
Equipment and leasehold improvements	196.4	198.6
Accumulated depreciation	(125.0)	(128.5)
	71.4	70.1
Goodwill	318.0	336.3
Intangible assets, net	177.6	179.2
Other	4.1	4.1
	\$ 1,068.5	\$ 1,039.4
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 96.0	\$ 81.6
Salaries, wages and other compensation	35.1	32.7
Current portion of long-term debt	6.4	8.9
Income taxes payable	2.3	-
Other accrued liabilities	36.4	31.6
	176.2	154.8
Long-term debt	344.9	317.1
Other long-term liabilities	57.7	68.6
Deferred tax liabilities	11.6	11.8
Commitments and contingencies (See Note 5)		
Stockholders' equity:		
Preferred stock, \$0.01 par value per share; 1,000,000 shares authorized and no shares issued, December 31, 2014 and March 31, 2015	-	-
Common stock, \$0.01 par value per share; 175,000,000 shares authorized; 32,725,786 and 33,137,201 shares issued as of December 31, 2014 and March 31, 2015, respectively	0.3	0.3
Capital in excess of par value	394.1	397.9
Retained earnings	117.0	126.6
	(33.3)	(37.7)

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Treasury stock at cost, 2,617,305 and 2,760,633 shares at December 31, 2014 and March 31, 2015, respectively

478.1	487.1
\$ 1,068.5	\$ 1,039.4

See accompanying Notes to Condensed Consolidated Financial Statements

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PHARMERICA CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Three Months Ended March 31, 2014 and 2015

(Unaudited)

(In millions)

	Three Months Ended March 31,	
	2014	2015
Cash flows provided by (used in) operating activities:		
Net income	\$4.8	\$9.6
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	4.8	5.8
Amortization	4.4	6.6
Merger, acquisition, integration costs and other charges	2.5	-
Stock-based compensation and deferred compensation	2.1	2.0
Amortization of deferred financing fees	0.7	0.1
Deferred income taxes	4.0	2.3
(Gain) Loss on disposition of equipment	(0.1)	0.1
Gain on acquisition/disposition	(0.3)	-
Other	0.1	-
Change in operating assets and liabilities:		
Accounts receivable, net	13.1	(2.3)
Inventory	2.8	13.2
Prepays and other assets	(2.1)	27.4
Accounts payable	(21.8)	(14.1)
Salaries, wages and other compensation	(4.7)	(2.4)
Other accrued liabilities	(1.9)	(2.2)
Change in income taxes payable	(1.3)	0.1
Excess tax benefit from stock-based compensation	(2.7)	(1.9)
Net cash provided by operating activities	4.4	44.3
Cash flows provided by (used in) investing activities:		
Purchase of equipment and leasehold improvements	(6.0)	(4.6)
Acquisitions, net of cash acquired	(10.7)	(20.5)
Cash proceeds from dispositions	0.4	0.1
Net cash used in investing activities	(16.3)	(25.0)
Cash flows provided by (used in) financing activities:		
Repayments of long-term debt	(3.1)	-
Net activity of long-term revolving credit facility	2.8	(25.0)
Issuance of common stock	2.5	0.3
Treasury stock at cost	(4.5)	(4.4)
Excess tax benefit from stock-based compensation	2.7	1.9
Repayments of capital lease obligations	-	(0.2)
Net cash provided by (used in) financing activities	0.4	(27.4)
Change in cash and cash equivalents	(11.5)	(8.1)

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Cash and cash equivalents at beginning of period	24.2	33.3
Cash and cash equivalents at end of period	\$12.7	\$25.2
Supplemental information:		
Cash paid for interest	\$1.8	\$2.1
Cash paid for taxes	\$0.4	\$4.7

See accompanying Notes to Condensed Consolidated Financial Statements

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PHARMERICA CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

For the Three Months Ended March 31, 2015

(Unaudited)

(In millions, except share amounts)

	Common Stock		Capital in Excess of Par	Retained Earnings	Treasury Stock	Total
	Shares	Amount	Value			
Balance at December 31, 2014	30,108,481	\$ 0.3	\$ 394.1	\$ 117.0	\$ (33.3)	\$ 478.1
Net income				9.6		9.6
Exercise of stock options and tax components of stock-based awards, net	105,314	-	2.1	-	-	2.1
Vested restricted stock units	163,281	-	-	-	-	-
Vested performance stock units	142,820	-	-	-	-	-
Treasury stock at cost	(143,328)	-	-	-	(4.4)	(4.4)
Stock-based compensation - non-vested restricted stock	-	-	1.6	-	-	1.6
Stock-based compensation - stock options	-	-	0.1	-	-	0.1
Balance at March 31, 2015	30,376,568	\$ 0.3	\$ 397.9	\$ 126.6	\$ (37.7)	\$ 487.1

See accompanying Notes to Condensed Consolidated Financial Statements

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

PharMerica Corporation together with its subsidiaries (the "Corporation"), is a leading provider of pharmacy services. The Corporation serves the long-term care, hospital pharmacy management services, specialty home infusion and specialty oncology pharmacy markets. The Corporation operates 97 institutional pharmacies, 15 specialty home infusion pharmacies, and 5 specialty oncology pharmacies in 45 states. The Corporation's customers are institutional healthcare providers, such as skilled nursing facilities, assisted living facilities, hospitals, individuals receiving in-home care and patients with cancer.

Operating Segments

The Corporation consists of three operating segments: institutional pharmacy, specialty infusion services and specialty oncology pharmacy. Management believes the nature of the products and services are similar, the payers for the products and services are common among the segments and all segments operate in the healthcare regulatory environment. In addition, the segments are economically similar. Accordingly, management has aggregated the three operating segments into one reporting segment.

Principles of Consolidation

All intercompany transactions have been eliminated.

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information and disclosures required by generally accepted accounting principles in the United States ("U.S. GAAP") for complete financial statements. Accordingly, the accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements of the Corporation and related footnotes for the year ended December 31, 2014, included in the Corporation's Annual Report on Form 10-K. The balance sheet as of December 31, 2014 has been derived from the audited consolidated financial statements adjusted for acquisition related measurement period adjustments.

The results of operations for the interim periods are not necessarily indicative of results of operations for a full year. It is the opinion of management that all necessary adjustments for a fair presentation of the condensed consolidated financial statements for the interim periods have been made and are of a normal recurring nature.

Use of Estimates

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. GAAP which requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosure of contingent liabilities as of the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates are involved in

collectability of accounts receivable, revenue recognition, inventory valuation, supplier rebates, the valuation of long-lived assets and goodwill, and accounting for income taxes. Actual amounts may differ from these estimates.

Fair Value of Financial Instruments

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

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

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

Level 1: Observable inputs such as quoted prices in active markets;

Level 2: Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and

Level 3: Unobservable inputs for which there is little or no market data, which require the Corporation to develop its own assumptions.

Assets and liabilities measured at fair value are based on one or more of the following three valuation techniques:

A. Market approach: Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

B. Cost approach: Amount that would be required to replace the service capacity of an asset (replacement cost).

C. Income approach: Techniques to convert future amounts to a single present amount based upon market expectations (including present value techniques, option-pricing and excess earnings models).

The financial liabilities recorded at fair value at December 31, 2014 and March 31, 2015 are set forth in the tables below (dollars in millions):

	Asset (Liability)	Level 1	Level 2	Level 3	Valuation Technique
As of December 31, 2014					
Financial Liability					
Deferred Compensation Plan	\$ (8.0)	\$ -	\$ (8.0)	\$-	A
Contingent Consideration	(1.1)	-	-	(1.1)	C
Mandatorily Redeemable Interest	(8.3)	-	-	(8.3)	C
As of March 31, 2015					
Financial Liability					
Deferred Compensation Plan	\$ (8.1)	\$ -	\$ (8.1)	\$-	A
Contingent Considerations	(9.0)	-	-	(9.0)	C
Mandatorily Redeemable Interest	(7.4)	-	-	(7.4)	C

The deferred compensation plan liability represents an unfunded obligation associated with the deferred compensation plan offered to eligible employees and members of the Board of Directors of the Corporation. The fair value of the liability associated with the deferred compensation plan is derived using pricing and other relevant information for investments in phantom shares of certain available investment options, primarily mutual funds. This liability is classified as other long-term liabilities in the accompanying condensed consolidated balance sheets.

The contingent consideration represents future earn-outs associated with the Corporation's acquisition of an institutional pharmacy business purchased in 2013 and two infusion businesses purchased in 2014 and 2015. The fair

values of the liabilities associated with the contingent consideration were derived using the income approach with unobservable inputs, which included future gross profit forecasts and present value assumptions, and there was little or no market data. The Corporation assessed the fair values of the liabilities as of the acquisition date and will assess quarterly thereafter until settlement. These liabilities are classified as current and other long-term liabilities in the accompanying condensed consolidated balance sheets.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

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

The mandatorily redeemable interest represents a future obligation associated with the Corporation's acquisition of a specialty pharmacy business, OncoMed Specialty, LLC (“Onco”), purchased on December 6, 2013. The mandatorily redeemable interest is classified as a long-term liability and measured at fair value. The fair value was derived using the income approach with unobservable inputs, which included a future gross profit forecast and present value assumptions, and there was little or no market data. The Corporation assessed and adjusted the mandatorily redeemable interest’s fair value of the liability at March 31, 2015.

For the year ended December 31, 2014 and the quarter ended March 31, 2015, there were no transfers between the valuation hierarchy Levels 1, 2, and 3. The following table summarizes the change in fair value of the Corporation’s contingent consideration and mandatorily redeemable interest identified as Level 3 for the year ended December 31, 2014 and the three months ended March 31, 2015 (in millions):

	Contingent Consideration	Mandatorily Redeemable Interest
Beginning balance, December 31, 2013	\$ 0.7	\$ 8.2
Additions from business acquisitions	1.1	-
Change in fair value	(0.7)	0.1
Balance, December 31, 2014	1.1	8.3
Additions from business acquisitions	7.9	-
Change in fair value	-	(0.9)
Balance, March 31, 2015	\$ 9.0	\$ 7.4

The carrying amounts reported in the accompanying condensed consolidated balance sheets for cash and cash equivalents, accounts receivable, inventory and accounts payable approximate fair value because of the short-term maturity of these instruments. The carrying amount of the Corporation’s debt approximates fair value due to the interest being set at variable market interest rates (Level 2).

Accounts Receivable and Allowance for Doubtful Accounts

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

The Corporation has an established a process to determine the adequacy of the allowance for doubtful accounts, which relies on analytical tools, specific identification, and benchmarks to arrive at a reasonable allowance. No single statistic or measurement determines the adequacy of the allowance for doubtful accounts. The Corporation monitors and reviews trends by payer classification along with the composition of the Corporation's aging accounts receivable.

This review is focused primarily on trends in private and other payers, PDP's, dual eligible co-payments, historic payment patterns of long-term care institutions, and monitoring respective credit risks. In addition, the Corporation analyzes other factors such as revenue days in accounts receivables, denial trends by payer types, payment patterns by payer types, subsequent cash collections, and current events that may impact payment patterns of the Corporation's long-term care institution customers. Accounts receivable are written off after collection efforts have been completed in accordance with the Corporation's policies.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

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

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

	December 31, 2014		March 31, 2015	
Institutional healthcare providers	\$ 153.6		\$ 157.0	
Medicare Part D	30.5		29.8	
Private payer and other	30.6		30.3	
Insured	24.5		25.9	
Medicaid	11.7		12.7	
Medicare	3.0		3.5	
Allowance for doubtful accounts	(58.1)	(59.7)
	\$ 195.8		\$ 199.5	
0 to 60 days	58.8	%	61.4	%
61 to 120 days	17.2	%	15.8	%
Over 120 days	24.0	%	22.8	%
	100.0	%	100.0	%

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

	Beginning Balance	Charges to Costs and Expenses	Write-offs	Ending Balance
Allowance for doubtful accounts:				
Year ended December 31, 2014	\$ 56.7	\$ 23.2	\$ (21.8) \$ 58.1
Three months ended March 31, 2015	\$ 58.1	\$ 5.0	\$ (3.4) \$ 59.7

Goodwill and Other Intangibles

The Corporation's policy is to perform a quantitative assessment of its institutional pharmacy and specialty infusion reporting units to determine whether it is more likely than not (defined as having a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount. The Corporation performed a quantitative assessment as of December 31, 2014. The institutional pharmacy and specialty infusion reporting unit's fair values as calculated for the analysis were approximately 48.2% and 13.1%, respectively, greater than book value as of December 31, 2014. The Corporation also performed a qualitative assessment of its specialty oncology reporting unit as of December 31, 2014 and did not find it necessary to perform the first step of the two-step impairment test based on that analysis.

There were no impairment triggering events during the three months ended March 31, 2015.

The Corporation's finite-lived intangible assets are comprised primarily of trade names, customer relationship assets, limited distributor relationships, doctor and insurer relationships and non-compete agreements. Finite-lived intangible assets are amortized on a straight-line basis over the course of their lives ranging from 5 to 20 years. For impairment reviews, intangible assets are reviewed on a specific pharmacy basis or as a group of pharmacies depending on the intangible assets under review. The Corporation's goodwill and intangible assets are further described in Note 3.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

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

Restructuring and Impairment Charges

Restructuring and impairment charges in the condensed consolidated financial statements represent amounts expended for purposes of realigning corporate and pharmacy locations.

Mandatorily Redeemable Interest

The Corporation acquired 37.5% of the membership interests of Onco while also obtaining control of the business. The subsidiary is consolidated in the Corporation's condensed consolidated financial statements and the mandatorily redeemable interest is classified as debt within other long-term liabilities in the condensed consolidated balance sheets.

Measurement Period Adjustments

For the three months ended March 31, 2015, the Corporation has adjusted certain amounts on the condensed consolidated balance sheet as of December 31, 2014 as a result of measurement period adjustments related to acquisitions completed in the prior year (See Note 2).

NOTE 2—ACQUISITIONS

2015 Acquisition

The Corporation through its wholly owned subsidiary, Amerita, acquired Coastal Pharmaceutical Services Corporation (“InfusionRx Acquisition”) on January 28, 2015. The InfusionRx Acquisition had an estimated purchase price of \$27.9 million, comprised of a net cash payment of \$20.0 million and an estimated fair value of contingent consideration of \$7.9 million. The resulting amount of goodwill and identifiable intangibles related to this transaction in the aggregate were \$18.3 million and \$8.2 million, respectively. The Corporation believes the resulting amount of goodwill reflects its expectation of synergistic benefits of the acquisition. Tax deductible goodwill associated with the acquisition was \$18.3 million as of March 31, 2015. The net assets and operating results of the acquisition have been included in the Corporation’s condensed consolidated financial statements from the date of acquisition.

Amounts contingently payable related to the InfusionRx Acquisition, representing potential payments originating from an earn-out provision were \$7.9 million as of March 31, 2015.

2014 Acquisitions

During the year ended December 31, 2014, the Corporation completed acquisitions of four long-term care businesses and one infusion business (collectively the "2014 Acquisitions"), none of which were individually significant to the Corporation. The 2014 Acquisitions required cash payments of approximately \$114.9 million in the aggregate. The resulting amount of goodwill and identifiable intangibles related to these transactions in the aggregate were \$35.2 million and \$61.4 million, respectively. The Corporation believes the resulting amount of goodwill reflects its expectation of synergistic benefits of the acquisitions. Tax deductible goodwill associated with the 2014 Acquisitions

was \$29.8 million as of March 31, 2015. The net assets and operating results of the 2014 Acquisitions have been included in the Corporation's condensed consolidated financial statements from their respective dates of acquisition.

Amounts contingently payable related to the 2014 Acquisitions, representing payments originating from an earn-out provision of the infusion acquisition, were \$1.1 million as of December 31, 2014 and March 31, 2015.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

NOTE 2—ACQUISITIONS (Continued)

The amounts recognized as of the acquisition dates for the 2014 Acquisitions, on a combined basis, for assets acquired and liabilities assumed are as follows (dollars in millions):

	Amounts Recognized as of Acquisition Date	Measurement Period Adjustments	As Adjusted
Accounts receivable	\$ 24.7	\$ 0.1	\$ 24.8
Inventory	8.8	-	8.8
Deferred tax assets - current	1.8	-	1.8
Other current assets	3.1	-	3.1
Equipment and leasehold improvements	4.8	-	4.8
Deferred tax assets	8.2	-	8.2
Identifiable intangibles	61.4	-	61.4
Goodwill	34.9	0.3	35.2
Total Assets	147.7	0.4	148.1
Current liabilities*	26.4	(0.1)	26.3
Other long-term liabilities*	6.9	-	6.9
Total Liabilities	33.3	(0.1)	33.2
Total purchase price, less cash acquired	\$ 114.4	\$ 0.5	\$ 114.9

* Included in current liabilities and other long-term liabilities are \$0.8 million and \$0.5 million, respectively, of capital lease obligations acquired as a part of the 2014 Acquisitions.

Pro forma financial statements are not presented on the 2014 and 2015 acquisitions as the results are not material to the Corporation's condensed consolidated financial statements.

Other

For the three months ended March 31, 2014 and March 31, 2015, the Corporation incurred \$4.9 million and \$3.7 million, respectively, of acquisition-related costs, which have been classified as a component of merger, acquisition, integration costs and other charges.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

NOTE 3—GOODWILL AND INTANGIBLES

As of December 31, 2014 and March 31, 2015 the carrying amount of goodwill was \$318.0 million and \$336.3 million, respectively.

The following table presents the components of the Corporation's finite lived intangible assets (dollars in millions):

	Balance at December 31, 2014	Additions	Balance at March 31, 2015
Finite Lived Intangible Assets			
Customer relationships	\$ 177.5	\$ 7.0	\$ 184.5
Trade name	62.2	0.6	62.8
Non-compete agreements	19.9	0.6	20.5
Sub Total	259.6	8.2	267.8
Accumulated amortization	(82.0)	(6.6)	(88.6)
Net intangible assets	\$ 177.6	\$ 1.6	\$ 179.2

Amortization expense relating to finite-lived intangible assets was \$4.4 million and \$6.6 million for the three months ended March 31, 2014 and 2015, respectively.

NOTE 4—CREDIT AGREEMENT

On September 17, 2014, the Corporation entered into a credit agreement by and among the Corporation, the lenders named therein (the "Lenders"), Bank of America, N.A., as administrative agent, JP Morgan Chase Bank N.A., as syndication agent, and U.S. Bank, National Association, Citibank, N.A., MUFG Union Bank, N.A., BBVA Compass Bank and SunTrust Bank as co-documentation agents (the "Credit Agreement"). The Credit Agreement consists of a \$225.0 million term loan facility and a \$310.0 million revolving credit facility. The terms and conditions of the Credit Agreement are customary to facilities of this nature.

As of March 31, 2015, \$225.0 million was outstanding under the term loan facility and \$100.0 million was outstanding under the revolving credit facility. Indebtedness under the Credit Agreement matures on September 17, 2019, at which time the commitments of the Lenders to make revolving loans also expire.

The table below summarizes the term total outstanding debt of the Corporation (dollars in millions):

	December 31, 2014	March 31, 2015
Term Debt - payable to lenders at LIBOR plus applicable margin (2.17% as of March 31, 2015), matures September 17, 2019	\$ 225.0	\$ 225.0
Revolving Credit Facility payable to lenders, interest at LIBOR plus applicable margin (2.14% of March 31, 2015), matures September 17, 2019	125.0	100.0
Capital lease obligations	1.3	1.0
Total debt	351.3	326.0
Less: Current portion of long-term debt	6.4	8.9

Total long-term debt	\$ 344.9	\$ 317.1
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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

NOTE 4—CREDIT AGREEMENT (Continued)

The Corporation's indebtedness has the following maturities as of March 31, 2015 (dollars in millions):

Year Ending December 31,	Term Debt	Revolving Credit Facility	Capital Lease Obligations	Total Maturities
2015	\$5.6	\$ -	\$ 0.5	\$ 6.1
2016	11.3	-	0.1	11.4
2017	11.3	-	0.1	11.4
2018	11.3	-	0.3	11.6
2019	185.5	100.0	-	285.5
	\$225.0	\$ 100.0	\$ 1.0	\$ 326.0

The Credit Agreement provides for the issuance of letters of credit which, when issued, reduce availability under the revolving credit facility. The aggregate amount of letters of credit outstanding as of March 31, 2015 was \$2.5 million. After giving effect to the letters of credit, total availability under the revolving credit facility was \$207.5 million as of March 31, 2015.

The Corporation was compliant with all debt covenant requirements at March 31, 2015.

NOTE 5—COMMITMENTS AND CONTINGENCIES

Legal Action and Regulatory

The Corporation maintains liabilities for certain of its outstanding investigations and litigation. In accordance with the provisions of U.S. GAAP for contingencies, the Corporation accrues for a liability when it is probable that such a liability has been incurred and the amount of the loss can be reasonably estimated. The Corporation is the subject of certain investigations and is a defendant in a number of cases, including those discussed below.

On April 15, 2013, the U.S. Department of Justice, through the U.S. Attorney's Office for the Eastern District of Virginia, filed a complaint in the United States District Court for the Eastern District of Virginia against the Corporation's two pharmacies in Virginia Beach, Virginia and Fredericksburg, Virginia alleging that these two pharmacies failed to comply with the Controlled Substances Act ("CSA") by dispensing Schedule II drugs without a proper prescription. The parties reached a settlement in December 2013 and filed a stipulation for dismissal of the case in January 2014. Under the settlement, the Corporation paid a \$1.0 million fine and will enter into a Memorandum of Agreement ("MOA") with the DEA through which it will agree to certain CSA compliance obligations. The precise terms of the MOA are currently being negotiated between the parties. In connection with the settlement, the Corporation did not admit liability for the alleged CSA violations.

On June 10, 2013, the United States District Court for the Eastern District of Wisconsin unsealed two consolidated qui tam complaints filed in 2009 and 2011 by relators who are former employees of the Corporation and a company acquired by the Corporation. The United States, acting through the U.S. Attorney's Office in Wisconsin, intervened in part and declined to intervene in part and filed its complaint in intervention on August 9, 2013, when the matter was

formally brought to the Corporation's attention. The Government's complaint seeks statutory fines for the Corporation's alleged dispensing of Schedule II controlled substances without a valid prescription in violation of the CSA. It also seeks monetary damages and equitable relief alleging that this conduct caused false claims to be submitted in violation of the Federal False Claims Act (the "FCA"). The Corporation moved to dismiss the Government's complaint for failure to state a claim upon which relief may be granted but the Court denied the Corporation's motion on September 3, 2014. With regard to the portion of the relators' complaint on which the Government did not intervene, on November 15, 2013, the relators dismissed their claims against the Corporation alleging that the Corporation submitted false claims to Medicare Part D and to Medicaid for drugs in connection with which the Corporation allegedly received kickbacks from the manufacturer in the form of market share rebates and other remuneration, all in violation of the Federal Anti Kickback Statute. The United States stipulated to the dismissal of those and other non-intervened counts and the Court approved the dismissal without prejudice of those counts on November 20, 2013. The relators pursued their claim under the retaliatory termination provisions of the FCA. On September 3, 2014, the Court denied the Corporation's motion to dismiss the relators' retaliatory termination claim. The Corporation intends to vigorously defend itself in both matters.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

NOTE 5—COMMITMENTS AND CONTINGENCIES (Continued)

On October 29, 2013, a complaint was filed in the United States District Court for the Southern District of Florida by Pines Nursing Homes (77), Inc. as a putative class action against the Corporation. The complaint alleged that the Corporation sent unsolicited advertisements promoting the Corporation's goods or services by facsimile to individuals or entities, and that such communications did not include an opt-out clause, all in violation of the federal Telephone Consumer Protection Act ("TCPA"). The Complaint did not specify the amount of damages sought, but the TCPA provides a statutory remedy of \$500 per facsimile communication sent in violation of the statute, which may be trebled in the event of a willful violation. On August 18, 2014, the Corporation entered into a Settlement Agreement with the putative class and class counsel resolving all claims raised in the complaint. The parties moved on September 8, 2014 for, among other things, certification of the putative class for the purposes of effectuating the settlement and preliminary approval of the parties' settlement, and have requested a hearing on that motion. No hearing has yet been set on that motion and the Corporation awaits a decision on the motion for preliminary approval of the settlement.

On November 20, 2013 a complaint filed by a relator, Robert Gadbois, on behalf of the U.S. Government and various state governments, was unsealed by the United States District for the District of Rhode Island against the Corporation alleging that the Corporation dispensed controlled and non-controlled substances in violation of the CSA and that, as a result, the dispenses were not eligible for payment and that the claims the Corporation submitted to the Government were false within the meaning of the FCA. The U.S. Government and the various state governments declined to intervene in this case. On October 3, 2014, the Corporation's motion to dismiss was granted by the court. The relator has appealed the court's decision. The Corporation intends to continue to defend the case vigorously.

On March 4, 2011, a relator, Mark Silver, on behalf of the U.S. Government and various state governments, filed a complaint in the United States District Court for the District of New Jersey against the Corporation alleging that the Corporation violated the FCA and Federal Anti-Kickback Statute through its agreements to provide prescription drugs to nursing homes under certain Medicare and Medicaid programs. On February 19, 2013, the U.S. Government declined to intervene in the case. The complaint has been amended several times, most recently on November 12, 2013, and thereafter served upon the Corporation. On December 6, 2013, the Corporation moved to dismiss the amended complaint for failure to state a claim upon which relief may be granted and on September 29, 2014, the court declined to dismiss the case, but limited the relevant time period for which claims could be brought against the Corporation. The Corporation intends to vigorously defend itself against these allegations.

On January 31, 2014, a relator, Frank Kurnik, on behalf of the U.S. Government and various state governments served its complaint filed in the United States District for the District of South Carolina alleging that the Corporation solicited and received remuneration in violation of the Federal Anti-Kickback Statute from drug manufacturer Amgen in exchange for preferring and promoting Amgen's drug Aranesp over a competing drug called Procrit. The U.S. Government and the various states declined to intervene in the case. On April 7, 2014, the Corporation moved to dismiss the complaint and on July 23, 2014, the motion was denied. On January 13, 2015, the Corporation again moved to dismiss the complaint and on March 23, 2015, the second motion was denied. On April 2, 2015, the Corporation moved the court to reconsider its denial of the second motion to dismiss. That motion is pending. The Corporation intends to vigorously defend itself against these allegations.

The U.S. Department of Justice, through the U.S. Attorney's Office for the Western District of Virginia, is investigating whether the Corporation's activities in connection with the agreements it had with the manufacturer of the pharmaceutical Depakote violated the Anti-Kickback Statute and, hence, that certain claims for Depakote that the Corporation submitted to federal health care programs violated the Federal False Claims Act. The Corporation is cooperating with this investigation and believes it has complied with all applicable laws and regulations. On May 29, 2014, the United States District Court for the Western District of Virginia entered an order (the "May 29 Order") unsealing two previously partially sealed qui tam complaints, entitled United States, et al., ex rel. Spetter v. Abbott Laboratories, Inc., Omnicare, Inc., and PharMerica Corp., No. 1:07-cv-00006 and United States, et al., ex rel. McCoyd v. Abbott Laboratories, Omnicare, Inc., PharMerica Corp., and Miles White, No. 1:07-cv-00008. The May 29 Order also unsealed the government's notice of intervention and granted the Government 120 days to serve its Complaint in Intervention. That deadline has since been extended to March 23, 2015 as to PharMerica only. As was indicated during the investigation, the complaints allege that certain agreements that the Corporation had with the manufacturer of Depakote violated the Anti-Kickback Statute and, hence, those certain claims for Depakote that the Corporation submitted to federal health care programs violated the Federal False Claims Act and the analogous statutes of 27 states. The Corporation intends to vigorously defend itself.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

NOTE 5—COMMITMENTS AND CONTINGENCIES (Continued)

On September 10, 2014, the Corporation filed a Complaint in Jefferson Circuit Court in Louisville, Kentucky against AmerisourceBergen Drug Corporation (“ABDC”) for failure of ABDC to comply with certain pricing and rebate provisions of the Amended Prime Vendor Agreement (“Amended PVA”). The Corporation subsequently filed a First Amended Verified Complaint on September 26, 2014 asserting additional breaches of the Amended PVA.

As a result of ABDC’s failure to comply with certain pricing and rebate provisions, the Corporation had recorded a receivable of \$40.8 million related to these disputes at December 31, 2014. Separately, as of December 31, 2014, the Corporation had recorded \$12.2 million for additional rebates owing from ABDC which at that time the Corporation believed were not in dispute and had previously been paid by ABDC in all the prior quarters. All these receivables totaled \$53.0 million and were included in prepaids and other assets in the accompanying condensed consolidated balance sheet as of December 31, 2014. During the period of January 1, 2015 through March 31, 2015, an additional \$18.5 million, net of payments received, of certain rebates and guarantees owed by ABDC under the Amended PVA were recognized which brought the total receivable to \$71.5 million at March 31, 2015.

On March, 2, 2015, the Corporation notified ABDC of its intent to terminate the Amended PVA effective April 1, 2015. The Corporation also announced that it had entered into a Prime Vendor Agreement with Cardinal Health (“Cardinal”) effective April 1, 2015. On March 3, 2015, the Corporation received a letter from ABDC terminating the Amended PVA effective immediately based upon the Corporation’s alleged failure to pay certain disputed miscellaneous charges and the Corporation’s signing of the Cardinal PVA. The Corporation believes ABDC did not have the right to immediately terminate the contract pursuant to the terms of the Amended PVA. On March 6 and March 13, 2015, the Corporation withheld from ABDC normal recurring payments for drug purchases of approximately \$50.0 million.

The following table represents all receivables, whether previously disputed or not, due and owing from ABDC at March 31, 2015 and the related amounts allegedly payable to ABDC, which have been offset resulting in a net receivable at March 31, 2015 of \$21.5 million. This net receivable is included in prepaids and other assets in the accompanying condensed consolidated balance sheet as of March 31, 2015.

Presented in the condensed consolidated balance sheet, the following amounts are offset as of March 31, 2015 (in millions):

Description	Gross Amount of Recognized Asset	Gross Liability Offset in the Condensed Consolidated Balance Sheet	Net Amount of Asset Presented in the Condensed Consolidated Balance Sheet
Rebates & Other Receivables	\$ 71.5	\$ (50.0) \$ 21.5

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Total \$ 71.5 \$ (50.0) \$ 21.5

The Corporation will have claims for additional damages resulting from ABDC's breaches of the Amended PVA. The Corporation intends to vigorously pursue its claims. At this time, the Corporation is unable to determine the ultimate impact of these litigation proceedings on its consolidated financial condition, results of operations, or liquidity. The litigation with ABDC could continue for an extended period of time, likely longer than 12 months. The Corporation cannot provide any assurances about the outcome of the litigation.

In addition, the Corporation is involved in certain legal actions and regulatory investigations arising in the ordinary course of business.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

NOTE 5—COMMITMENTS AND CONTINGENCIES (Continued)

At March 31, 2015, the Corporation had accrued approximately \$45.5 million related to the legal actions and investigations.

California Medicaid

On August 14, 2013, the California Department of Health Care Service ("DHCS") announced its intent to implement a ten (10) percent reimbursement reduction for numerous healthcare providers, including long term care pharmacies.

The DHCS implemented the reduction prospectively beginning in the first quarter of 2014. In addition, the DHCS is expected to begin recouping a percentage of provider payments representing a ten percent (10%) reduction on certain drug reimbursements retroactive to June 1, 2011. The Corporation has previously recorded a \$3.3 million liability and reduction of revenue for the expected amount of recoveries from June 1, 2011 through December 31, 2013.

FUL and AMP Changes

The reimbursement rates for pharmacy services under Medicaid are determined on a state-by-state basis subject to review by Centers for Medicare and Medicaid Services ("CMS") and applicable federal law. Although Medicaid programs vary from state to state, they generally provide for the payment of certain pharmacy services, up to the established limits, at rates determined in accordance with each state's regulations. Federal regulations and the regulations of certain states establish "upper limits" for reimbursement of certain prescription drugs under Medicaid (these upper limits being the "FUL").

The 2010 Health Care Reform Legislation amended the Deficit Reduction Act of 2005 ("DRA") to change the definition of the FUL by requiring the calculation of the FUL as no less than 175% of the weighted average, based on utilization, of the most recently reported monthly Average Manufacturer's Price ("AMP") for pharmaceutically and therapeutically equivalent multi-source drugs available through retail community pharmacies nationally. In addition, the definition of AMP changed to reflect net sales only to drug wholesalers that distribute to retail community pharmacies and to retail community pharmacies that directly purchase from drug manufacturers. Further, the 2010 Health Care Reform Legislation continues the current statutory exclusion of prompt pay discounts offered to wholesalers and adds three (3) other exclusions to the AMP definition: i) bona fide services fees; ii) reimbursement for unsalable returned goods (recalled, expired, damaged, etc.); and iii) payments from and rebates/discounts to certain entities not conducting business as a wholesaler or retail community pharmacy. In addition to reporting monthly, the manufacturers are required to report the total number of units used to calculate each monthly AMP. CMS will use this information when it establishes FULs as a result of the new volume-weighted requirements pursuant to the 2010 Health Care Reform Legislation.

In September 2011, CMS issued the first draft FUL reimbursement files for multiple source drugs, including the draft methodology used to calculate the FULs in accordance with the Health Care Legislation. CMS continues to release monthly data and a three-month rolling average and is expected to do so going forward. CMS has not posted monthly AMPs for individual drugs, but only posted the weighted average of monthly AMPs in a FUL group and the calculation methodology.

CMS has stated that AMP-based FULs will be published at or about the same time that CMS publishes the Medicaid Covered Outpatient Drug final rule, which, according to the latest unified agenda, is expected in June 2015. CMS will continue to post draft monthly FULs. The Corporation will continue to analyze the draft monthly FULs, including the relationship of those FULs to the National Average Drug Acquisition pricing.

Medicare Part D Changes

In a May 23, 2014 Final Rule entitled "Medicare Program: Contract Year 2015 Policy and Technical Changes to the Medicare Advantage and the Medicare Prescription Drug Benefit Programs," CMS finalized a requirement that effective June 1, 2015 and enforceable December 1, 2015, all prescribers of Part D covered drugs must be enrolled as Medicare providers (or be granted a valid opt-out affidavit on file with a Part A or Part B Medicare Administrative Contractor) in order for a claim to be covered under Medicare Part D. CMS also finalized several specific requirements to reduce prescriber fraud, waste, and abuse. The Corporation is unable to evaluate the full impact of these changes on its business at this time.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

NOTE 5—COMMITMENTS AND CONTINGENCIES (Continued)

In a February 12, 2015 Final Rule entitled "Medicare Program: Contract Year 2016 Policy and Technical Changes to the Medicare Advantage and the Medicare Prescription Drug Benefit Programs", CMS finalized a regulation, effective January 1, 2016, prohibiting financial arrangements that penalize more efficient long-term care dispensing techniques (e.g., dispensing a three day supply over a 14 day supply) through pro-rated dispensing fees based on a day's supply or quantity dispensed. CMS also finalized a requirement that, effective January 1, 2016, any differences in payment methodologies among long-term care pharmacies incentivize more efficient dispensing techniques. The Corporation is unable to evaluate the full impact of these changes on its business at this time.

Acquisitions

The Corporation has historically acquired the stock or assets of businesses with prior operating histories. Acquired companies may have unknown or contingent liabilities, including liabilities for failure to comply with healthcare laws and regulations, medical and general professional liabilities, workers' compensation liabilities, previous tax liabilities, and unacceptable business practices. Although the Corporation institutes policies designed to conform practices to its standards following completion of acquisitions, there can be no assurance the Corporation will not become liable for past activities that may later be asserted to be improper by private plaintiffs or government agencies. While the Corporation generally seeks to obtain indemnification from prospective sellers covering such matters, there can be no assurance that any such matter will be covered by indemnification, or if covered, that such indemnification will be adequate to cover potential losses and fines. In the ordinary course of business, the Corporation enters into contracts containing standard indemnification provisions and indemnifications specific to a transaction such as business acquisitions and disposals of an operating facility. These indemnifications may cover claims against employment-related matters, governmental regulations, environmental issues, tax matters, as well as customer, third party payer, supplier, and contractual relationships. Obligations under these indemnities generally would be initiated by a breach of the terms of the contract or by a third party claim or event.

Employment Agreements

The Corporation has entered into employment agreements with certain of its executive officers. During the employment period, certain executive officers will be eligible to (i) participate in any short-term and long-term incentive programs established or maintained by the Corporation, (ii) participate in all incentive, savings and retirement plans and programs of the Corporation, (iii) participate, along with their dependents, in all welfare benefit plans and programs provided by the Corporation, and (iv) receive four weeks of paid vacation per calendar year.

The type of compensation due to each of the executive officers in the event of the termination of their employment period varies depending on the nature of the termination. The employment agreements generally do not entitle the executive officers to any additional payment or benefits solely upon the occurrence of a change in control but do provide additional payments or benefits or both upon a termination of employment in connection with a change in control. Additionally, the vesting of certain equity based grants made to certain executive officers accelerates upon the occurrence of a change in control.

NOTE 6—MERGER, ACQUISITION, INTEGRATION COSTS AND OTHER CHARGES

Merger, acquisition, integration costs and other charges combined were \$5.0 million and \$3.8 million for the three months ended March 31, 2014 and 2015, respectively.

Merger, integration costs and other charges for the three months ended March 31, 2014 and 2015 were \$0.1 million.

Acquisition related costs for the three months ended March 31, 2014 and 2015 were \$4.9 million and \$3.7 million, respectively.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

NOTE 7—RESTRUCTURING COSTS AND OTHER CHARGES

In July 2013, the Corporation commenced the implementation of its restructuring plan as a result of the loss of two of the Corporation's significant customers, Kindred Healthcare ("Kindred") and Golden Living. The plan is a major initiative primarily designed to optimize operational efficiency while ensuring that the Corporation remains well-positioned to serve its clients and achieve sustainable, long-term growth. The Corporation's restructuring plan includes steps to right size its cost structure by adjusting its workforce and facility plans to reflect anticipated business needs.

The Corporation recorded restructuring costs and other related charges of approximately of \$1.9 million and \$0.1 million during the three months ended March 31, 2014 and 2015, respectively. The restructuring charges primarily included severance pay, the buy-out of employment agreements, lease terminations, and other exit-related asset disposals, professional fees and facility exit costs.

The following table presents the components of the Corporation's restructuring liability (dollars in millions):

	Balance at December 31, 2014	Accrual	Utilized Amounts	Balance At March 31, 2015
Employee Severance and related costs	\$ 0.3	\$ 0.1	\$ (0.2)	\$ 0.2
Facility costs	1.1	-	(0.2)	0.9
	\$ 1.4	\$ 0.1	\$ (0.4)	\$ 1.1

The liability at March 31, 2015 represents amounts not yet paid relating to actions taken in connection with the restructuring plan (primarily lease payments and severance costs).

NOTE 8—COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS

Treasury Stock Purchases

In August 2010, the Board of Directors authorized a share repurchase of up to \$25.0 million of the Corporation's common stock, of which \$10.5 million was used. On July 2, 2012 the Board of Directors authorized an increase to the remaining portion of the existing share repurchase program that allows the Corporation to again repurchase up to a maximum of \$25.0 million of the Corporation's common stock. Approximately \$19.7 million remained available under the program as of March 31, 2015. Share repurchases under this authorization may be made in the open market through unsolicited or solicited privately negotiated transactions, or in such other appropriate manner, and may be funded from available cash or the revolving credit facility. The amount and timing of the repurchases, if any, would be determined by the Corporation's management and would depend on a variety of factors including price, corporate and regulatory requirements, capital availability and other market conditions. Common stock acquired through the share repurchase program would be held as treasury shares and may be used for general corporate purposes, including reissuance in connection with acquisitions, employee stock option exercises or other employee stock plans. The share

repurchase program does not have an expiration date and may be limited, terminated or extended at any time without prior notice. During the three months ended March 31, 2015, the Corporation repurchased no shares of common stock.

The Corporation may redeem shares from employees upon the vesting of the Corporation's stock awards for minimum statutory tax withholding purposes and to cover option exercise costs. The Corporation redeemed 143,328 shares from the vesting of certain awards and exercise of certain stock options, for an aggregate price of approximately \$4.4 million during the three months ended March 31, 2015. These shares have also been designated by the Corporation as treasury stock.

As of March 31, 2015, the Corporation had a total of 2,760,633 shares held as treasury stock.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

NOTE 8—COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS (Continued)

Stock Option Activity

Stock options were not granted to officers and employees during 2014 or the three months ended March 31, 2015. The following table summarizes option activity for the periods presented:

	Number of Shares	Weighted- Average Exercise Price Per Share	Weighted- Average Remaining Term	Aggregate Intrinsic Value (in millions)
Outstanding shares at December 31, 2014	913,209	\$ 14.62	2.1 years	\$ 5.6
Exercised	(105,314)	15.34		
Canceled	(116,117)	10.84		
Expired	-	-		
Outstanding shares at March 31, 2015	691,778	\$ 14.39	2.04 years	\$ 9.5
Exercisable shares at March 31, 2015	690,750	\$ 14.40	2.04 years	\$ 9.5

Nonvested Shares

The following table summarizes nonvested share activity for the periods presented:

	Number of Shares	Weighted- Average Grant Date Fair Value
Outstanding shares at December 31, 2014	941,570	\$ 18.00
Granted - Restricted Stock Units	135,725	27.85
Granted - Performance Share Units	149,777	27.85
Forfeited	(2,163)	19.84
Vested	(306,101)	15.50
Outstanding shares at March 31, 2015	918,808	\$ 21.67

The weighted average remaining term and intrinsic value of non-vested shares as of March 31, 2015 was 2.9 years and \$18.2 million, respectively.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

NOTE 9—INCOME TAXES

The provision for income taxes is based upon the Corporation's estimate of annual taxable income or loss for each respective accounting period. The following table summarizes our provision for income taxes for the periods presented (dollars in millions):

	Three Months Ended March 31,	
	2014	2015
Provision for income taxes	\$3.0	\$5.8
Total provision as a percentage of pre-tax income	38.4%	37.9%

The decrease in our provision for income taxes as a percentage of pre-tax income for the three months ended March 31, 2015 compared to the comparable 2014 period was due primarily to a decrease in state and local taxes. The effective tax rates in 2015 and 2014 are higher than the federal statutory rate largely as a result of the combined impact of state and local taxes and various non-deductible expenses.

The Corporation derives a current federal and state income tax benefit from the impact of deductions associated with the amortization of tax deductible goodwill acquired through business combinations. The tax basis of the Corporation's tax deductible goodwill was approximately \$145.3 million and \$141.6 million at December 31, 2014 and March 31, 2015, respectively.

The Corporation recognizes an asset or liability for the deferred tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets are recovered or liabilities are settled. The Corporation also recognizes as deferred tax assets the future tax benefits from net operating loss carryforwards. As of March 31, 2015, the Corporation has \$5.2 million (\$1.8 million tax benefit) of federal net operating loss carryforwards available related to a 2013 acquisition and \$31.4 million (\$11.0 million deferred tax benefit) related to a 2014 acquisition. These net operating losses are subject to limitations under Internal Revenue Code Section 382; however, the Corporation expects that it will be able to use the recorded amount which takes into account the limitations of the carryforwards. Accordingly, the Corporation has not recorded any valuation allowance for the associated deferred tax asset. The deferred tax asset for state net operating loss carryforwards is \$3.0 million, net of valuation allowances. The net operating losses have carryforward periods ranging from 1 to 20 years depending on the taxing jurisdiction.

A valuation allowance is provided for the Corporation's deferred tax assets if it is more likely than not that some portion or all of the net deferred tax assets will not be realized. The Corporation recognized net deferred tax assets totaling \$30.6 million at December 31, 2014 and \$28.1 million at March 31, 2015, net of state valuation allowances of \$4.1 million.

As of December 31, 2014 and March 31, 2015, the Corporation had no reserves recorded for unrecognized tax benefits for U.S. federal and state tax jurisdictions.

The federal statute of limitations remains open for tax years 2012 through 2014. The IRS completed its audit of the Corporation's consolidated U.S. income tax return for the 2011 tax year in February 2014.

State tax jurisdictions generally have statutes of limitation ranging from three to five years. The Corporation is generally no longer subject to state and local income tax examinations by tax authorities for years before 2009. The state income tax impact of federal income tax changes remains subject to examination by various states for a period of up to one year after formal notification of IRS settlement to the states.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

NOTE 10—EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share (dollars in millions, except per share amounts):

	Three Months ended March 31,	
	2014	2015
Numerator:		
Numerator for basic and earnings per diluted share - net income	\$4.8	\$9.6
Denominator:		
Denominator for basic earnings per share - weighted average shares	29,753,024	30,185,230
Effect of dilutive securities (stock options, restricted stock units and performance share units)	601,043	548,151
Denominator for earnings per diluted share - adjusted weighted average shares	30,354,067	30,733,381
Basic earnings per share	\$0.16	\$0.32
Earnings per diluted share	\$0.16	\$0.31
Unexercised employee stock options and unvested restricted shares excluded from the effect of dilutive securities above (a)	1,677	56

(a) These unexercised employee stock options, unvested restricted shares and performance shares that have not yet met performance conditions are not included in the computation of diluted earnings per share because to do so would be anti-dilutive for the periods presented.

Stock options and restricted shares and units granted by the Corporation are treated as potential common shares outstanding in computing earnings per diluted share. Performance share units are treated as potential common shares outstanding in computing earnings per diluted share only when the performance conditions are met.

Common shares repurchased by the Corporation reduce the number of basic shares used in the denominator for basic and diluted earnings per share.

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which reflect the Corporation's current estimates, expectations and projections about the Corporation's future results, performance, prospects and opportunities. Forward looking statements include, among other things, the information concerning the Corporation's possible future results of operations including revenues, costs of goods sold, and gross margin, business and growth strategies, financing plans, the Corporation's competitive position and the effects of competition, the projected growth of the industries in which we operate, and the Corporation's ability to consummate strategic acquisitions. Forward-looking statements include statements that are not historical facts and can be identified by forward-looking words such as "anticipate," "believe," "could," "estimate," "expect," "intend," "plan," "may," "should," "will," "would," "project," and similar expressions. These forward-looking statements are based upon information currently available to the Corporation and are subject to a number of risks, uncertainties and other factors that could cause the Corporation's actual results, performance, prospects or opportunities to differ materially from those expressed in, or implied by, these forward-looking statements. Important factors that could cause the Corporation's actual results to differ materially from the results referred to in the forward-looking statements the Corporation makes in this report include:

- the Corporation's access to capital, credit ratings, indebtedness, and ability to raise additional financings and operate under the terms of the Corporation's debt obligations;
- anti-takeover provisions of the Delaware General Corporation Law, which in concert with our certificate of incorporation and our by-laws could delay or deter a change in control;
- the effects of adverse economic trends or intense competition in the markets in which we operate;
- the Corporation's risk of loss of revenues due to a customer or owner of skilled nursing facility entering the institutional pharmacy business;
- the effects of the loss of a large customer and the Corporation's ability to adequately restructure its operations to offset the loss;
- the demand for the Corporation's products and services;
- the risk of retaining existing customers and service contracts and the Corporation's ability to attract new customers for growth of the Corporation's business;
- the effects of renegotiating contract pricing relating to significant customers and suppliers, including the hospital pharmacy business which is substantially dependent on service provided to one customer;
- the impacts of cyber security risks and/or incidents;
- the effects of a failure in the security or stability of our technology infrastructure, or the infrastructure of one or more of our key vendors, or a significant failure or disruption in service;
- the effects of an increase in credit risk, loss or bankruptcy of or default by any significant customer, supplier, or other entity relevant to the Corporation's operations;
- the Corporation's ability to successfully pursue the Corporation's development and acquisition activities and successfully integrate new operations and systems, including the realization of anticipated revenues, economies of scale, cost savings, and productivity gains associated with such operations;
- the Corporation's ability to control costs, particularly labor and employee benefit costs, rising pharmaceutical costs, and regulatory compliance costs;
- the effects of healthcare reform and government regulations, including interpretation of regulations and changes in the nature and enforcement of regulations governing the healthcare and institutional pharmacy services industries including the dispensing of antipsychotic prescriptions;
- changes in the reimbursement rates or methods of payment from Medicare and Medicaid and other third party payers to both us and our customers;
-

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

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

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

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

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

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

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

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

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

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

the outcome of litigation to which the Corporation is a party from time to time, including adverse results in material litigation or governmental inquiries including the possible insufficiency of any accruals established by the Corporation from time to time;

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

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

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

the uncertainty as to the long-term value of the Corporation's common stock;

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

the effect on prescription volumes and the Corporation's net revenues and profitability if the safety risk profiles of drugs increase or if drugs are withdrawn from the market, including as a result of manufacturing issues, or if prescription drugs transition to over-the-counter products;

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

the potential impact of the litigation proceedings with ABDC regarding the Amended PVA;

changes in tax laws and regulations;

the effects of changes to critical accounting estimates; and

other factors, risks and uncertainties referenced in the Corporation's filings with the Commission, including the "Risk Factors" set forth in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2014.

YOU ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON ANY FORWARD-LOOKING STATEMENTS, ALL OF WHICH SPEAK ONLY AS OF THE DATE OF THIS QUARTERLY REPORT. EXCEPT AS REQUIRED BY LAW, WE UNDERTAKE NO OBLIGATION TO PUBLICLY UPDATE OR RELEASE ANY REVISIONS TO THESE FORWARD-LOOKING STATEMENTS TO REFLECT ANY EVENTS OR CIRCUMSTANCES AFTER THE DATE OF THIS QUARTERLY REPORT OR TO REFLECT THE OCCURRENCE OF UNANTICIPATED EVENTS. ALL SUBSEQUENT WRITTEN AND ORAL FORWARD-LOOKING STATEMENTS ATTRIBUTABLE TO US OR ANY PERSON ACTING ON THE CORPORATION'S BEHALF ARE EXPRESSLY QUALIFIED IN THEIR ENTIRETY BY THE CAUTIONARY STATEMENTS CONTAINED OR REFERRED TO IN THIS SECTION AND IN OUR RISK FACTORS SET FORTH IN PART I, ITEM 1A OF THE CORPORATION'S ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2014 AND IN OTHER REPORTS FILED WITH THE SEC BY THE CORPORATION.

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General

The condensed consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in this quarterly report on Form 10-Q as of and for the three months ended March 31, 2015, reflect the financial position, results of operations, and cash flows of the Corporation.

Unless the context otherwise requires, all references to "we," "us," "our," and "Corporation" refer to PharMerica Corporation and its subsidiaries.

Institutional Pharmacy Business

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

We offer prescription and non-prescription pharmaceuticals to our customers through unit dose or modified unit dose packaging, dispensing, and delivery systems, typically in a 14 to 30 day supply. Unit dose medications are packaged for dispensing in individual doses as compared to bulk packaging used by most retail pharmacies. The customers we serve prefer the unit dose delivery system over the bulk delivery system employed by retail pharmacies because it improves control over the storage and ordering of drugs and reduces errors in drug administration in healthcare facilities. Nursing staff in our customers' facilities administer the pharmaceuticals to individual patients and residents. The Corporation also utilizes an on-site dispensing system, with real time data transfer between the system and the Corporation, which provides timely medication administration in emergency and first dose situations. We also offer clinical pharmacy programs that encompass a wide range of drug therapy and disease management protocols, including protocols for anemia treatment, infectious diseases, wound care, nutritional support, renal dosing, and therapeutic substitution.

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

Hospital Pharmacy Management Services

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

("Kindred") hospitals.

Consultant Pharmacist Services

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

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We provide consultant pharmacist services to approximately 65% of our patients serviced. The services offered by our consultant pharmacists include:

- Monthly reviews of each resident's drug regimen to assess the appropriateness and efficiency of drug therapies, including the review of medical records, monitoring drug interactions with other drugs or food, monitoring laboratory test results, and recommending alternative therapies;
- Participation on quality assurance and other committees of our customers, as required or requested by such customers;
- Monitoring and reporting on facility-wide drug utilization;
- Development and maintenance of pharmaceutical policy and procedure manuals; and
- Assistance with federal and state regulatory compliance pertaining to resident care.

Medical Records

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

- Real-time access to medication and treatment administration records, physician order sheets and psychotropic drug monitoring sheets;
- Online ordering to save time and resources;
- A customized database with the medication profiles of each resident's medication safety, efficiency and regulatory compliance;
- Web-based individual patient records detailing each prescribed medicine; and
- Electronic medical records to improve information to make it more legible and instantaneous.

Specialty Infusion Services

The Corporation provides specialty infusion services focused on providing complex pharmaceutical products and clinical services to patients in client facilities, hospice, and outside of hospital or nursing home settings. We offer high-touch clinical services to patients with acute or chronic conditions. The delivery of specialty infusion therapy requires comprehensive planning and monitoring which is provided through our registered nursing staff. Our nursing staff performs an initial patient assessment, provides therapy specific training and education, administers therapy and monitors for potential side effects. We also provide extensive clinical monitoring and patient follow-up to ensure patient therapy adherence and proactively manage patients' conditions. An in-network strategy facilitates easier decision-making for referral sources and provides us with the ability to pre-authorize patients, auto adjudicate, and bill electronically, enabling faster prescription turnaround.

Specialty Oncology Pharmacy

We provide dispensing of oncology drugs, care management and other related services to patients, oncology practices, and hospitals. These services encompass clinical coordination and review, compliance to appropriate oncology protocols, patient assistance with outside funding, and timely delivery of medication. We coordinate the administration of medications to the physician's office or directly to the patient at the appropriate point of treatment. We work directly with the payers to bill insurance companies for the medication provided, ensuring all prior authorizations and approvals are obtained. These services offer physicians an alternative to the traditional buy-and-bill distribution model, allowing them to outsource drug procurement, inventory management, and prescription administration.

Suppliers/Inventory

We obtain pharmaceutical and other products from Cardinal Health (“Cardinal”) and other contracts negotiated directly with pharmaceutical manufacturers for discounted prices. The Corporation entered into a Prime Vendor Agreement with Cardinal effective April 1, 2015. The loss of a supplier could adversely affect our business if alternate sources of supply are unavailable.

We seek to maintain an on-site inventory of pharmaceuticals and supplies to ensure prompt delivery to our customers. Cardinal maintains local distribution facilities in most major geographic markets in which we operate. In addition, beginning in the fourth quarter of 2013, we began supplying many of our pharmacies with select products from a distribution center operated by a third-party logistics company.

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Brand to Generic Conversions

The following table summarizes the material brand-to-generic conversions expected to occur in 2015 through 2018:

2015	2016	2017	2018
Colcrys (Q1)	Nuedexta (Q1)	Seroquel XR (Q4)	Nasonex (Q2)
Abilify (Q2)*	Combivent (Q2)		
Renagel (Q2)	Crestor (Q2)		
Renvela(Q2)	Cubicin (Q2)		
Zyvox (Q2)*	Tamiflu (Q3)		
Aggrenox (Q3)	Azilect(Q4)		
Copaxone (Q3)	Zetia (Q4)		
Gleevec (Q3)			
Invega (Q3)			
Namenda IR (Q3)*			
Avodart (Q4)			
Exelon Patch (Q4)*			
Patanol (Q4)			

* These represent the most significant brand-to-generic conversions
(Number in parentheses refers to the expected quarter of conversion)

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

Supplier and Manufacturer Rebates

We currently receive rebates from certain manufacturers and distributors of pharmaceutical products for achieving targets of market share or purchase volumes. Rebates are designed to prefer, protect, or maintain a manufacturer's products that are dispensed by the pharmacy under its formulary. Rebates for brand name products are generally based upon achieving a defined market share tier within a therapeutic class and can be based on either purchasing volumes or actual prescriptions dispensed. Rebates for generic products are more likely to be based on achieving purchasing volume requirements.

2010 Health Care Reform Legislation

The Patient Protection and Affordable Care Act and the reconciliation law known as Health Care and Education Affordability Reconciliation Act (combined we refer to both Acts as the "2010 Health Care Reform Legislation") were enacted in March 2010. State participation in the expansion of Medicaid under the 2010 Health Care Reform

Legislation is voluntary. Three key provisions of the 2010 Health Care Reform Legislation that are relevant to the Corporation are: (i) the gradual modification to the calculation of the Federal Upper Limit (“FUL”) for drug prices and the definition of Average Manufacturer’s Price (“AMP”), (ii) the closure, over time, of the Medicare Part D coverage gap, which is otherwise known as the “Donut Hole,” and (iii) short cycle dispensing. Regulations under the 2010 Health Care Reform Legislation are expected to continue being drafted, released, and finalized throughout the next several years.

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FUL and AMP Changes

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

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

In September 2011, CMS issued the first draft FUL reimbursement files for multiple source drugs, including the draft methodology used to calculate the FULs in accordance with the Health Care Legislation. CMS continues to release this monthly data and a three-month rolling average and is expected to do so going forward. CMS has not posted monthly AMPs for individual drugs, but only posted the weighted average of monthly AMPs in a FUL group and the calculation methodology.

The Office of Information and Regulatory Affairs website states that the final AMP was expected June 2014, but to date has not been released. Further, CMS has stated that AMP-based FULs will be published at or about the same time that CMS publishes the Medicaid Covered Outpatient Drug final rule, which, according to the latest unified agenda, is expected in April 2015. CMS will continue to post draft monthly FULs. The Corporation will continue to analyze the draft monthly FULs, including the relationship of those FULs to the National Average Drug Acquisition pricing.

Part D Coverage Gap

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

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

Short Cycle Dispensing and Dispensing Fees

Pursuant to the 2010 Health Care Reform Legislation, Prescription Drug Plans ("PDPs") are required, under Medicare Part D and Medicare Advantage prescription drug plans ("Medicare Advantage" or "MAPDs") to utilize specific, uniform dispensing techniques, such as weekly, daily, or automated dose dispensing, when dispensing covered Medicare Part D drugs to beneficiaries who reside in a long-term care facility to reduce waste associated with 30 to 90 day prescriptions for such beneficiaries. Pursuant to CMS issued regulation, beginning January 1, 2013, pharmacies dispensing to long-term care facilities must dispense no more than 14-day supplies of brand-name oral solid medications covered by Medicare Part D. The Corporation fully implemented short cycle dispensing on January 1, 2013. The impact of short cycle dispensing has not had a material adverse impact on the Corporation's results of

operations.

In a February 12, 2015 Final Rule entitled "Medicare Program: Contract Year 2016 Policy and Technical Changes to the Medicare Advantage and the Medicare Prescription Drug Benefit Programs", CMS finalized a regulation, effective January 1, 2016, prohibiting financial arrangements that penalize more efficient long-term care dispensing techniques (e.g., dispensing a three day supply over a 14 day supply) through pro-rated dispensing fees based on a day's supply or quantity dispensed. CMS also finalized a requirement that, effective January 1, 2016, any differences in payment methodologies among long-term care pharmacies incentivize more efficient dispensing techniques. The Corporation is unable to evaluate the full impact of these changes on its business at this time.

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Medicare Part D Changes

In a May 23, 2014 Final Rule entitled "Medicare Program: Contract Year 2015 Policy and Technical Changes to the Medicare Advantage and the Medicare Prescription Drug Benefit Programs," CMS finalized a requirement that, effective June 1, 2015 and enforceable December 1, 2015, all prescribers of Part D covered drugs must be enrolled as Medicare providers (or be granted a valid opt-out affidavit on file with a Part A or Part B Medicare Administrative Contractor) in order for a claim to be covered under Medicare Part D. CMS also finalized several specific requirements to reduce prescriber fraud, waste, and abuse. The Corporation is unable to evaluate the full impact of these changes on its business at this time.

Critical Accounting Estimates

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

- It requires assumptions to be made that were uncertain at the time the estimate was made; and
- Changes in the estimate or different estimates could have a material impact on our condensed consolidated results of operations or financial condition.

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

Allowance for doubtful accounts and provision for doubtful accounts

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

Our quarterly provision for doubtful accounts included in our condensed consolidated statements of operations is as follows (dollars in millions):

	2014		2015		
	Amount	% of Revenues	Amount	% of Revenues	
First Quarter	\$5.6	1.2	% First Quarter	\$5.0	1.0
Second Quarter	5.7	1.3			
Third Quarter	5.3	1.1			
Fourth Quarter	6.6	1.3			

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

	2014	2015
First Quarter	37.7	34.0
Second Quarter	37.0	
Third Quarter	36.7	
Fourth Quarter	34.9	

The following table shows our summarized aging categories by quarter:

	2014				2015	
	First	Second	Third	Fourth	First	
0 to 60 days	56.7%	53.9 %	57.3 %	58.8 %	61.4%	
61 to 120 days	17.7	17.3	16.9	17.2	15.8	
Over 120 days	25.6	28.8	25.8	24.0	22.8	

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The following table shows our allowance for doubtful accounts as a percent of gross accounts receivable (dollars in millions):

	2014				2015		
	Allowance	Gross Accounts Receivable	% of Gross Accounts Receivable		Allowance	Gross Accounts Receivable	% of Gross Accounts Receivable
First Quarter	\$57.7	\$ 242.2	23.8	% First Quarter	\$59.7	\$ 259.2	23.0
Second Quarter	60.3	246.5	24.5				
Third Quarter	57.4	272.4	21.1				
Fourth Quarter	58.1	253.9	22.9				

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

A summary of revenues by payer type follows (dollars in millions):

	Three Months Ended March 31,					
	2014		2015			
	Amount	% of Revenues	Amount	% of Revenues	Amount	% of Revenues
Medicare Part D	\$202.5	44.8	% \$237.2	46.3		%
Institutional healthcare providers	114.8	25.3	121.9	23.9		
Medicaid	42.9	9.5	41.2	8.1		
Private and other	20.8	4.6	23.1	4.5		
Insured	51.8	11.5	67.6	13.2		
Medicare	4.9	1.1	5.1	1.0		
Hospital management fees	14.5	3.2	15.5	3.0		
Total	\$452.2	100.0	% \$511.6	100.0		%

Inventory and cost of drugs dispensed

We have inventory located at each of our institutional pharmacy, specialty infusion, and specialty oncology locations as well as our drug distribution center. Our inventory is valued at the lower of first-in, first-out cost or market. The inventory consists of prescription drugs, over the counter products and intravenous solutions. Our inventory relating to controlled substances is maintained on a manually prepared perpetual system to the extent required by the Drug Enforcement Agency and state board of pharmacies. All other inventory is maintained on a periodic system, through the performance of, at a minimum, quarterly physical inventory at the end of each quarter. All inventory counts are reconciled to the balance sheet account and differences are adjusted through cost of goods sold. In addition, we record an amount of potential returns of prescription drugs based on historical rates of returns and record an estimate for rebates associated with inventory remaining at the end of each period.

As of December 31, 2014 and March 31, 2015, our inventories were \$135.7 million and \$122.6 million, respectively.

The inventory days on hand were as follows for the periods presented:

	2014	2015
First Quarter	26.0	26.1
Second Quarter	35.1	
Third Quarter	31.7	
Fourth Quarter	29.1	

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Goodwill and other intangible assets

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

Our goodwill as of December 31, 2014 and March 31, 2015 was \$318.0 million and \$336.3 million, respectively.

The Corporation's policy is to perform a quantitative assessment of its institutional pharmacy and specialty infusion reporting units to determine whether it is more likely than not (defined as having a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount. The Corporation performed a quantitative assessment as of December 31, 2014. The institutional pharmacy and specialty infusion reporting unit's fair value as calculated for the analysis were approximately 48.2% and 13.1%, respectively, greater than book value at December 31, 2014. While the excess on the specialty infusion reporting unit was not significantly in excess of book value, the business was acquired in the fourth quarter 2012 and is performing to our expectations. In addition, if we were to assume a 100 basis point change in the key assumption, a reduction in the long-term growth rate or an increase in the discount rate used, to determine the fair value of the specialty infusion reporting unit as of December 31, 2014, the quantitative assessment of the specialty infusion reporting unit would still result in fair value in excess of the carrying value. The specialty infusion reporting unit has goodwill with a carrying value of \$57.7 million. The Corporation also performed a qualitative assessment of its specialty oncology reporting unit as of December 31, 2014 and did not find it necessary to perform the first step of the two-step impairment test based on that analysis.

There were no impairment triggering events during the three months ended March 31, 2015.

Accounting for income taxes

We assess the likelihood that deferred tax assets will be realized from future taxable income. A valuation allowance is provided for deferred tax assets if it is more-likely-than-not that some portion or all of the net deferred tax assets will not be realized. Our deferred tax asset balances as of December 31, 2014 and March 31, 2015 were \$30.6 million and \$28.1 million, respectively. Our valuation allowances for state deferred tax assets in our condensed consolidated balance sheets as of December 31, 2014 and March 31, 2015 were \$4.1 million.

Definitions

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

Gross profit per prescription dispensed: Represents the gross profit divided by the total prescriptions dispensed.

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

Prescriptions dispensed: Represents a prescription filled for an individual patient. A prescription will usually be for a 14 or 30 day period and will include only one drug type.

Revenue per prescription dispensed: Represents the revenue divided by the total prescriptions dispensed.

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Results of Operations

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

	Quarter Ended		Increase (Decrease)		March 31,		
	March 31, 2014	% of Amount Revenues			March 31, 2015	% of Amount Revenues	
Revenues	\$452.2	100.0	% \$59.4	13.1 %	\$511.6	100.0	%
Cost of goods sold	372.2	82.3	50.8	13.6 %	423.0	82.7	
Gross profit	\$80.0	17.7	% \$8.6	10.8 %	\$88.6	17.3	%

Pharmacy (in whole numbers except where indicated)

Financial data

Prescriptions dispensed (in thousands)	8,608		445	5.2 %	9,053		
Revenue per prescription dispensed	\$52.53		\$3.98	7.6 %	\$56.51		
Gross profit per prescription dispensed	\$9.29		\$0.50	5.4 %	\$9.79		
Gross profit margin	17.7 %		(0.4) %	(2.3) %	17.3 %		
Generic dispensing rate	84.5 %		0.8 %	0.9 %	85.3 %		

Revenues

Revenues increased \$59.4 million for the three months ended March 31, 2015 compared to the three months ended March 31, 2014 due to the 2014 and 2015 acquisitions. The increase of \$59.4 million is comprised of a favorable rate variance of approximately \$36.0 million or \$3.98 increase per prescription dispensed, along with a favorable volume variance of approximately \$23.4 million or 445,000 more prescriptions dispensed. The increase is driven by 2014 acquisitions, growth in both specialty oncology and specialty infusion, and branded drug inflation. The revenue per prescription dispensed increase is due to the increased volume in both specialty oncology and specialty infusion, which carries higher revenue per script and branded drug inflation.

Gross Profit

Gross profit for the three months ended March 31, 2015 was \$88.6 million or \$9.79 per prescription dispensed compared to \$80.0 million or \$9.29 per prescription dispensed for the three months ended March 31, 2014. The increase in gross profit was driven by 2014 acquisitions, growth in both specialty oncology and specialty infusion, and branded drug inflation. The gross profit per prescription increase is due to the increased volume in both specialty oncology and specialty infusion, which carries higher revenue per script and branded drug inflation.

Gross profit margin for the three months ended March 31, 2015 was 17.3% compared to 17.7% for the three months ended March 31, 2014. The gross profit margin was adversely impacted by the increased volume in both specialty oncology and specialty infusion, which carries lower profit margins.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$59.0 million, or 11.5% of revenues, for the three months ended March 31, 2015 compared to \$57.2 million, or 12.6% of revenues, for the three months ended March 31, 2014. The increase of \$1.8 million is due to the 2014 Acquisitions, primarily labor costs.

Depreciation and Amortization

Depreciation expense was \$5.8 million and \$4.8 million for the three months ended March 31, 2015 and 2014. Depreciation expense increased \$1.0 million due depreciation expense recognized on the assets acquired through the 2014 Acquisitions.

Amortization expense was \$6.6 million for the three months ended March 31, 2015 compared to \$4.4 million for the three months ended March 31, 2014. The increase of \$2.2 million is due primarily to the amortization expense recognized on intangibles acquired through the 2014 Acquisitions.

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Settlement, Litigation and Other Related Charges

Settlement, litigation and other related charges were \$2.3 million for the three months ended March 31, 2015 compared to \$1.2 million for the three months ended March 31, 2014. These costs relate to the Corporation's defense and settlement of certain governmental investigations and litigations.

Restructuring and Impairment Charges

Restructuring and impairment charges were \$0.1 million for the three months ended March 31, 2015 compared to \$1.9 million for the three months ended March 31, 2014. These costs are part of the Corporation's initiative to realign the organization in connection with the loss of two significant customers, which were primarily recognized in 2014.

Merger, Acquisition, Integration Costs and Other Charges

Merger, acquisition, integration costs and other charges were \$3.8 million and \$5.0 million for the three months ended March 31, 2015 and 2014, respectively. The decrease is primarily related to post acquisition bonus payments made in 2014, with no such costs in 2015.

Interest Expense

Interest expense was \$1.4 million for the three months ended March 31, 2015 compared to \$2.5 million for the three months ended March 31, 2014. The decrease was due to lower interest rates as a result of the new credit agreement signed in 2014, along with lower amortization of deferred financing costs.

Tax Provision

The effective tax rate for the three months ended March 31, 2015 was 37.9%, comprised of the 35% federal statutory rate, 3.0% for the state rate, and (0.1)% for permanent differences. There were no discrete items for the three months ended March 31, 2015 that impacted the effective tax rate. The effective tax rate for the three months ended March 31, 2014 was 38.4% comprised of the 35% federal statutory rate, 4.0% for the state rate, and (0.6)% for permanent differences and other discrete items. The effective tax rate excluding the impact of the discrete items was 37.4% for the three months ended March 31, 2014. The increase in the effective tax rate excluding the impact of the discrete items between the two periods was the result of an increase in certain non-deductible employee compensation costs.

Liquidity and Capital Resources

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

	Three Months Ended March 31,	
	2014	2015
Net cash provided by operating activities	\$4.4	\$44.3
Net cash used in investing activities	(16.3)	(25.0)
Net cash provided by (used in) financing activities	0.4	(27.4)
Net change in cash and cash equivalents	(11.5)	(8.1)
Cash and cash equivalents at beginning of period	24.2	33.3
Cash and cash equivalents at end of period	\$12.7	\$25.2

Operating Activities – Cash provided by operating activities aggregated \$44.3 million for the three months ended March 31, 2015 compared to cash provided by operating activities of \$4.4 million for the three months ended March 31, 2014. The increase in cash from operating activities is due primarily to the \$50.0 million in ABDC drug purchase payments withheld, the Corporation's inventory purchasing strategy, and an increase in net income which were partially offset by an increase in ABDC rebates receivable.

Investing Activities – Cash used in investing activities aggregated \$25.0 million for the three months ended March 31, 2015 compared to \$16.3 million for the three months ended March 31, 2014. The increase is due to the acquisition completed by the Corporation in the first quarter of 2015.

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Financing Activities – Cash used in financing activities aggregated \$27.4 million for the three months ended March 31, 2015 compared to cash provided by financing activities of \$0.4 million for the three months ended March 31, 2014. The increase in cash used in financing activities is due primarily to the increase in revolving credit facility repayments during 2015.

Credit Agreement

On September 17, 2014, the Corporation entered into a Credit Agreement by and among the Corporation, the lenders named therein, Bank of America, N.A., as administrative agent, JP Morgan Chase Bank N.A., as syndication agent, and U.S. Bank, National Association, Citibank, N.A., MUFG Union Bank, N.A., BBVA Compass Bank and SunTrust Bank as co-documentation agents (the "Credit Agreement"). The Credit Agreement consists of a \$225.0 million term loan facility and a \$310.0 million revolving credit facility. The terms and conditions of the Credit Agreement are customary to facilities of this nature. Unless terminated earlier, the Credit Agreement will mature on September 17, 2019, and the principal amount outstanding thereunder, together with all accrued unpaid interest and other amounts owed thereunder, if any, will be payable in full on such date.

The Credit Agreement requires term loan principal payments by the Corporation in an amount of \$2.8 million on the each quarter beginning September 2015 through September 2019. The final principal repayment installment of term loans shall be repaid on the term maturity date, September 17, 2019. In addition, the term loan is subject to certain prepayment obligations relating to certain asset sales, certain casualty losses and the incurrence of certain indebtedness.

The Corporation had a total of \$225.0 million outstanding of term debt under the Credit Agreement and \$100.0 million outstanding under the revolving portion of the Credit Agreement as of March 31, 2015. The Credit Agreement provides for the issuance of letters of credit which, when issued, constitute usage and reduce availability on the revolving portion of the Credit Agreement. The amount of letters of credit outstanding as of March 31, 2015 was \$2.5 million. After giving effect to the letters of credit and amounts outstanding under the revolving credit agreement, total availability under the revolving credit facility was \$207.5 million as of March 31, 2015.

The Corporation was compliant with all debt covenant requirements at March 31, 2015.

Drug Wholesaler Agreement

We obtain pharmaceutical and other products from Cardinal pursuant to a Prime Vendor Agreement with Cardinal effective April 1, 2015. The Corporation also obtains pharmaceutical and other products for discounted prices directly from pharmaceutical manufacturers. While the loss of a supplier could adversely affect our business if alternate sources of supply are unavailable, numerous sources of supply are generally available to us and we have not experienced any difficulty in obtaining pharmaceuticals or other products and supplies to conduct our business.

The Corporation seeks to maintain an on-site inventory of pharmaceuticals and supplies to ensure prompt delivery to our customers. Cardinal maintains local distribution facilities in most geographic markets in which we operate.

Treasury Stock

In August 2010, the Board of Directors authorized a share repurchase of up to \$25.0 million of the Corporation's common stock, of which \$10.5 million was used. On July 2, 2012 the Board of Directors authorized an increase to the remaining portion of the existing stock repurchase program that allows the Corporation to again repurchase up to a maximum of \$25.0 million of the Corporation's common stock. Approximately \$19.7 million remained available under the program as of March 31, 2015. Share repurchases under this authorization may be made in the open market through unsolicited or solicited privately negotiated transactions, or in such other appropriate manner, and may be

funded from available cash or the revolving credit facility. The amount and timing of the repurchases, if any, would be determined by the Corporation's management and would depend on a variety of factors including price, corporate and regulatory requirements, capital availability and other market conditions. Common stock acquired through the share repurchase program would be held as treasury shares and may be used for general corporate purposes, including reissuance in connection with acquisitions, employee stock option exercises or other employee stock plans. The share repurchase program does not have an expiration date and may be limited, terminated or extended at any time without prior notice. During the three months ended March 31, 2015, the Corporation repurchased no shares of common stock.

The Corporation may redeem shares from employees upon the vesting of the Corporation's stock awards for minimum statutory tax withholding purposes and to cover option exercise costs. The Corporation redeemed 143,328 shares from the vesting of certain awards and the exercise of certain stock options, for an aggregate price of approximately \$4.4 million during the three months ended March 31, 2015. These shares have also been designated by the Corporation as treasury stock.

As of March 31, 2015, the Corporation had a total of 2,760,633 shares held as treasury stock.

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Supplemental Quarterly Information

The following tables represent the results of the Corporation's quarterly operations for the year ended December 31, 2014 and for the first quarter of 2015 (in millions, except where indicated):

	2014 Quarters				2015
	First	Second	Third	Fourth	Quarter
Revenues	\$452.2	\$448.6	\$470.2	\$523.5	\$511.6
Cost of goods sold	372.2	366.7	387.2	429.1	423.0
Gross profit	80.0	81.9	83.0	94.4	88.6
Selling, general and administrative	57.2	57.9	56.0	65.2	59.0
Amortization expense	4.4	4.3	4.9	6.5	6.6
Merger, acquisition, integration costs, and other charges	5.0	1.5	3.8	3.3	3.8
Settlement, litigation and other related charges	1.2	26.6	1.1	8.4	2.3
Restructuring and impairment charges	1.9	1.2	0.1	0.1	0.1
Hurricane Sandy disaster costs	-	0.1	-	(1.8)	-
Operating income	10.3	(9.7)	17.1	12.7	16.8
Interest expense, net	2.5	2.3	2.1	3.0	1.4
Loss on debt extinguishment	-	-	4.3	-	-
Income (loss) before income taxes	7.8	(12.0)	10.7	9.7	15.4
Provision (benefit) for income taxes	3.0	(2.3)	2.2	6.5	5.8
Net income (loss)	\$4.8	\$(9.7)	\$8.5	\$3.2	\$9.6
Earnings (loss) per share (1):					
Basic	\$0.16	\$(0.32)	\$0.28	\$0.11	\$0.32
Diluted	\$0.16	\$(0.32)	\$0.28	\$0.10	\$0.31
Adjusted diluted earnings per diluted share (1)(2):	\$0.37	\$0.40	\$0.45	\$0.45	\$0.48
Shares used in computing earnings (loss) per share:					
Basic	29.8	30.0	30.1	30.1	30.2
Diluted	30.4	30.0	30.6	30.7	30.7
Balance sheet data:					
Cash and cash equivalents	\$12.7	\$11.1	\$7.1	\$33.3	\$25.2
Working capital (3)	\$273.4	\$310.3	\$335.1	\$321.2	\$294.9
Goodwill (3)	\$282.7	\$286.9	\$319.5	\$318.0	