MCKESSON CORP
Form 10-Q
January 30, 2007

Table of Contents

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For quarter ended December 31, 2006

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

For the transition period from __________ to __________

Commission file number 1-13252

McKESSON CORPORATION
(Exact name of Registrant as specified in its charter)

Delaware	**94-3207296**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**
One Post Street, San Francisco, California	**94104**
(Address of principal executive offices)	**(Zip Code)**

(415) 983-8300
(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 þ No o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

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

Class	Outstanding at December 31, 2006
Common stock, $0.01 par value	**295,397,045 shares**

McKESSON CORPORATION
TABLE OF CONTENTS

McKESSON CORPORATION
PART I. FINANCIAL INFORMATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions, except per share amounts)
(Unaudited)

	December 31, 2006	March 31, 2006
ASSETS		
Current Assets		
Cash and cash equivalents	$ 2,013	$ 2,139
Restricted cash	962	962
Receivables, net	6,427	6,247
Inventories	8,616	7,127
Prepaid expenses and other	286	522
Total	18,304	16,997
Property, Plant and Equipment, Net	616	663
Capitalized Software Held for Sale, Net	156	139
Goodwill	1,694	1,637
Intangible Assets, Net	132	116
Other Assets	1,588	1,409
Total Assets	$ 22,490	$ 20,961
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Drafts and accounts payable	$ 10,859	$ 9,944
Deferred revenue	1,048	827
Current portion of long-term debt	25	26
Securities Litigation	984	1,014
Other	1,810	1,659
Total	14,726	13,470
Postretirement Obligations and Other Noncurrent Liabilities	709	619
Long-Term Debt	957	965
Other Commitments and Contingent Liabilities (Note 14)		
Stockholders Equity		
Preferred stock, $0.01 par value, 100 shares authorized, no shares issued or outstanding		
Common stock, $0.01 par value Shares authorized: December 31, 2006 and March 31, 2006 800		
Shares issued: December 31, 2006 336 and March 31, 2006 330	3	3

Additional paid-in capital		3,508		3,238
Other capital		(32)		(75)
Retained earnings		4,473		3,871
Accumulated other comprehensive income		76		55
ESOP notes and guarantees		(15)		(25)
Treasury shares, at cost, December 31, 2006 41 and March 31, 2006 26		(1,915)		(1,160)
Total Stockholders Equity		6,098		5,907
Total Liabilities and Stockholders Equity	$	22,490	$	20,961

See Financial Notes

3

McKESSON CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except per share amounts)
(Unaudited)

	Quarter Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
Revenues	$ 23,111	$ 22,240	$ 68,812	$ 64,193
Cost of Sales	22,050	21,266	65,731	61,455
Gross Profit	1,061	974	3,081	2,738
Operating Expenses	743	665	2,191	1,897
Securities Litigation Charge (Credit), Net		1	(6)	53
Total Operating Expenses	743	666	2,185	1,950
Operating Income	318	308	896	788
Other Income, Net	39	35	106	97
Interest Expense	(23)	(22)	(68)	(69)
Income from Continuing Operations Before Income Taxes	334	321	934	816
Income Tax Provision	(94)	(117)	(223)	(294)
Income from Continuing Operations	240	204	711	522
Discontinued Operations, net	3	(11)	(3)	(4)
Discontinued Operations gain (loss) on sales, net			(52)	13
Total Discontinued Operations	3	(11)	(55)	9
Net Income	$ 243	$ 193	$ 656	$ 531
Earnings Per Common Share				
Diluted				
Continuing operations	$ 0.79	$ 0.64	$ 2.33	$ 1.66
Discontinued operations	0.01	(0.03)	(0.01)	(0.01)
Discontinued operations gain (loss) on sales, net			(0.17)	0.04
Total	$ 0.80	$ 0.61	$ 2.15	$ 1.69
Basic				
Continuing operations	$ 0.81	$ 0.66	$ 2.38	$ 1.71

Discontinued operations	0.01	(0.03)	(0.01)	(0.01)
Discontinued operations gain (loss) on sales, net			(0.17)	0.04
Total	$ 0.82	$ 0.63	$ 2.20	$ 1.74
Dividends Declared Per Common Share	$ 0.06	$ 0.06	$ 0.18	$ 0.18
Weighted Average Shares				
Diluted	302	316	305	315
Basic	296	307	299	306

See Financial Notes

Table of Contents

McKESSON CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Unaudited)

	Nine Months Ended December 31,	
	2006	**2005**
Operating Activities		
Net income	$ 656	$ 531
Discontinued operations, net of income taxes	55	(9)
Adjustments to reconcile to net cash provided by (used in) operating activities:		
Depreciation and amortization	208	194
Securities Litigation charge (credit), net	(6)	53
Deferred taxes	77	226
Other non-cash items	(29)	(15)
Total	961	980
Changes in operating assets and liabilities, net of business acquisitions:		
Receivables	(132)	(438)
Inventories	(1,464)	(350)
Drafts and accounts payable	914	1,221
Deferred revenue	240	307
Taxes	35	2
Securities Litigation settlement payments	(25)	(227)
Proceeds from sale of notes receivable		28
Other	26	(57)
Total	(406)	486
Net cash provided by operating activities	555	1,466
Investing Activities		
Property acquisitions	(76)	(138)
Capitalized software expenditures	(119)	(127)
Acquisitions of businesses, less cash and cash equivalents acquired	(106)	(560)
Proceeds from sale of businesses	175	63
Other	(26)	(6)
Net cash used in investing activities	(152)	(768)
Financing Activities		
Repayment of debt	(11)	(23)
Capital stock transactions:		
Issuances	239	435
Share repurchases	(756)	(579)

ESOP notes and guarantees	10	12
Dividends paid	(54)	(55)
Other	43	(107)
Net cash used in financing activities	(529)	(317)
Net increase (decrease) in cash and cash equivalents	(126)	381
Cash and cash equivalents at beginning of period	2,139	1,800
Cash and cash equivalents at end of period	$ 2,013	$ 2,181

See Financial Notes

5

Table of Contents

McKESSON CORPORATION
FINANCIAL NOTES
(Unaudited)

1. Significant Accounting Policies

Basis of Presentation. The condensed consolidated financial statements of McKesson Corporation (McKesson, the Company, or we and other similar pronouns) include the financial statements of all majority-owned or controlled companies. Significant intercompany transactions and balances have been eliminated. In our opinion, these unaudited condensed consolidated financial statements include all adjustments necessary for a fair presentation of the Company s financial position as of December 31, 2006, and the results of operations for the quarters and nine months ended December 31, 2006 and 2005 and cash flows for the nine months ended December 31, 2006 and 2005.

The results of operations for the quarters and nine months ended December 31, 2006 and 2005 are not necessarily indicative of the results that may be expected for the entire year. These interim financial statements should be read in conjunction with the annual audited financial statements, accounting policies and financial notes included in our 2006 consolidated financial statements previously filed with the Securities and Exchange Commission (SEC).

The Company s fiscal year begins on April 1 and ends on March 31. Unless otherwise noted, all references to a particular year shall mean the Company s fiscal year. Certain prior year amounts have been reclassified to conform to the current year presentation.

New Accounting Pronouncements. On April 1, 2006, we adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment, which requires the recognition of expense resulting from transactions in which we acquire goods and services by issuing our shares, share options, or other equity instruments. This standard requires a fair-value based measurement method in accounting for share-based payment transactions. The share-based compensation expense is recognized for the portion of the awards that is ultimately expected to vest. This standard replaced SFAS No. 123, Accounting for Stock-Based Compensation, and superseded Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. Accordingly, the use of the intrinsic value method as provided under APB Opinion No. 25, which was utilized by the Company, was eliminated. We adopted SFAS No. 123(R) using the modified prospective method of transition. See Financial Note 4, Share-Based Payment, for further details.

As a result of the provisions of SFAS No. 123(R), in 2007, we expect share-based compensation charges to approximate $0.10 to $0.12 per diluted share. These charges are expected to be approximately $0.07 to $0.09 per diluted share more than the share-based compensation expense recognized in our net income in 2006. Our assessments of estimated compensation charges are affected by our stock price as well as assumptions regarding a number of complex and subjective variables and the related tax impact. These variables include, but are not limited to, the volatility of our stock price, employee stock option exercise behaviors, timing, level and types of our grants of annual share-based awards and the attainment of performance goals. As a result, the actual share-based compensation expense in 2007 may differ from the Company s current estimate.

In July 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN No. 48 provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. This interpretation also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 will become effective for us in 2008. We are currently assessing the impact of FIN No. 48 on our consolidated financial statements.

Table of Contents

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This standard applies under other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements. SFAS No. 157 will become effective for us in 2009. We are currently assessing the impact of SFAS No. 157; however, we do not believe the adoption of this standard will have a material effect on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, which requires us to recognize the funded status of our defined benefit plans in the consolidated balance sheets and changes in the funded status in comprehensive income. This standard also requires us to recognize the gains/losses, prior year service costs and transition assets/obligations as a component of other comprehensive income upon adoption, and provide additional annual disclosure. SFAS No.158 does not affect the computation of benefit expense recognized in our consolidated statements of operations. The recognition and disclosure provisions are effective in 2007. In addition, SFAS No. 158 requires us to measure plan assets and benefit obligations as of the year-end balance sheet date effective in 2009. We are required to apply the provisions of this standard prospectively. We are currently assessing the impact of SFAS No. 158 on our consolidated financial statements.

In September 2006, the SEC staff issued Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. This guidance indicates that the materiality of a misstatement must be evaluated using both the rollover and iron curtain approaches. The iron curtain approach quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, while the rollover approach quantifies a misstatement based on the amount of the error originating in the current year income statement. SAB No. 108 is effective for our 2007 annual consolidated financial statements. We are currently assessing the impact of SAB No. 108; however, we do not believe its adoption will have a material effect on our consolidated financial statements.

2. Acquisitions and Investments

On November 5, 2006, we entered into a definitive agreement to acquire all of the outstanding shares of Per-Se Technologies, Inc. (Per-Se) of Alpharetta, Georgia for $28.00 per share in cash, or approximately $1.8 billion in aggregate including the assumption of Per-Se s debt. Per-Se is a leading provider of financial and administrative healthcare solutions for hospitals, physicians and retail pharmacies. On January 26, 2007, we acquired Per-Se. The acquisition was funded with cash on hand and through the use of a new interim credit facility (refer to Financial Note 9, Financing Activities). Financial results for Per-Se will primarily be included within our Provider Technologies segment.

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

In the first quarter of 2007, we acquired the following three entities for a total cost of $92 million, which was paid in cash:

Sterling Medical Services LLC (Sterling), based in Moorestown, New Jersey, a national provider and distributor of disposable medical supplies, health management services and quality management programs to the home care market. Financial results for Sterling are included in our Medical-Surgical Solutions segment;

HealthCom Partners LLC (HealthCom), based in Mt. Prospect, Illinois, a leading provider of patient billing solutions designed to simplify and enhance healthcare providers financial interactions with their patients; and

RelayHealth Corporation (RelayHealth), based in Emeryville, California, a provider of secure online healthcare communication services linking patients, healthcare professionals, payors and pharmacies. Financial results for HealthCom and RelayHealth are included in our Provider Technologies segment.

Goodwill recognized in these transactions amounted to $61 million.

In addition, in the first quarter of 2007, we contributed $36 million in cash and $45 million in net assets primarily from our Automated Prescription Systems business to Parata Systems, LLC (Parata), in exchange for a significant minority interest in Parata. In connection with the investment, we abandoned certain assets which resulted in a $15 million charge to cost of sales and we incurred $6 million of other expenses related to the transaction which were recorded within operating expenses. We did not recognize any additional gains or losses as a result of this transaction as we believe the fair value of our investment in Parata, as determined by a third-party valuation, approximates the carrying value of consideration contributed to Parata. Our investment in Parata is accounted for under the equity method of accounting within our Pharmaceutical Solutions segment.

In 2006, we made the following acquisitions:

In the second quarter of 2006, we acquired all of the issued and outstanding stock of D&K Healthcare Resources, Inc. (D&K) of St. Louis, Missouri for an aggregate cash purchase price of $479 million, including the assumption of D&K s debt. D&K is primarily a wholesale distributor of branded and generic pharmaceuticals and over-the-counter health and beauty products to independent and regional pharmacies, primarily in the Midwest. Approximately $158 million of the purchase price has been assigned to goodwill. Included in the purchase price were acquired identifiable intangibles of $43 million primarily representing customer lists and not-to-compete covenants which have an estimated weighted-average useful life of nine years. Financial results for D&K are included in our Pharmaceutical Solutions segment.

Also in the second quarter of 2006, we acquired all of the issued and outstanding shares of Medcon, Ltd. (Medcon), an Israeli company, for an aggregate purchase price of $82 million. Medcon provides web-based cardiac image and information management services to healthcare providers. Approximately $60 million of the purchase price was assigned to goodwill and $20 million was assigned to intangibles which represent technology assets and customer lists which have an estimated weighted-average useful life of four years. Financial results for Medcon are included in our Provider Technologies segment.

During the last two years, we also completed a number of other acquisitions and investments within all three of our operating segments. Financial results for our business acquisitions have been included in our consolidated financial statements since their respective acquisition dates. Purchase prices for our business acquisitions have been allocated based on estimated fair values at the date of acquisition and, for certain recent acquisitions, may be subject to change. Goodwill recognized for our business acquisitions is not expected to be deductible for tax purposes. Pro forma results of operations for our business acquisitions have not been presented because the effects were not material to the consolidated financial statements on either an individual or an aggregate basis.

Table of Contents

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

3. Discontinued Operations

Results from discontinued operations were as follows:

(In millions)	Quarter Ended December 31, 2006	Quarter Ended December 31, 2005	Nine Months Ended December 31, 2006	Nine Months Ended December 31, 2005
Income (loss) from discontinued operations				
Acute Care	$ 5	$ (18)	$ (5)	$ (8)
BioServices				2
Income taxes	(2)	7	2	2
Total	$ 3	$ (11)	$ (3)	$ (4)
Gain (loss) on sale of discontinued operations				
Acute Care	$	$	$ (49)	$
BioServices				22
Other			6	
Income taxes			(9)	(9)
Total	$	$	$ (52)	$ 13
Discontinued operations, net of taxes				
Acute Care	$ 3	$ (11)	$ (64)	$ (5)
PBI			5	
BioServices				14
Other			4	
Total	$ 3	$ (11)	$ (55)	$ 9

In the second quarter of 2007, we sold our Medical-Surgical Solutions segment s Acute Care supply business to Owens & Minor, Inc. (OMI) for net cash proceeds of approximately $160 million. In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the financial results of this business are classified as a discontinued operation for all periods presented in the accompanying condensed consolidated financial statements. Such presentation includes the classification of all applicable assets of the disposed business under the caption Prepaid expenses and other and all applicable liabilities under the caption Other under Current Liabilities within our condensed consolidated balance sheets for all periods presented. Revenues associated with the Acute Care business prior to its disposition were $269 million and $797 million for the third quarter and first nine months of 2006 and $573 million for the first half of 2007.

Financial results for the nine months ended December 31, 2006 for this discontinued operation include an after-tax loss of $64 million, which primarily consists of an after-tax loss of $61 million for the business disposition and $3 million of after-tax losses associated with operations, other asset impairment charges and employee severance costs. The after-tax loss of $61 million for the business disposition includes a $79 million non-tax deductible write-off of goodwill, as further described below.

9

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

In connection with this divestiture, we allocated a portion of our Medical-Surgical Solutions segment s goodwill to the Acute Care business as required by SFAS No. 142, Goodwill and Other Intangible Assets. The allocation was based on the relative fair values of the Acute Care business and the continuing businesses that are being retained by the Company. The fair value of the Acute Care business was determined based on the net cash proceeds resulting from the divestiture and the fair value of the continuing businesses was determined by a third-party valuation. As a result, we allocated $79 million of the segment s goodwill to the Acute Care business.

Additionally, as part of the divestiture, we entered into a transition services agreement (TSA) with OMI under which we continue to provide certain services to the Acute Care business during a transition period of approximately nine months. We also anticipate incurring approximately $5 million of pre-tax employee severance charges over the transition period. These charges, as well as the financial results from the TSA, are recorded as part of discontinued operations. The continuing cash flows generated from the TSA are not material to our condensed consolidated financial statements.

In 2005, our Acute Care business entered into an agreement with a third party vendor to sell the vendor s proprietary software and services. The terms of the contract required us to prepay certain royalties. During the third quarter of 2006, we ended marketing and sale of the software under the contract. As a result of this decision, we recorded a $15 million pre-tax charge in the third quarter of 2006 to write-off the remaining balance of the prepaid royalties.

In the second quarter of 2007, we also sold a wholly-owned subsidiary, Pharmaceutical Buyers Inc. (PBI), for net cash proceeds of $10 million. The divestiture resulted in an after-tax gain of $5 million resulting from the tax basis of the subsidiary exceeding its carrying value. Financial results of this business, which were previously included in our Pharmaceutical Solutions segment, have been presented as a discontinued operation for all periods presented in the accompanying condensed consolidated financial statements. These results were not material to our condensed consolidated financial statements.

Results for discontinued operations for the nine months ended December 31, 2006 also include an after-tax gain of $4 million associated with the collection of a note receivable from a business sold in 2003.

In the second quarter of 2006, we sold our wholly-owned subsidiary, McKesson BioServices Corporation (BioServices), for net cash proceeds of $63 million. The divestiture resulted in an after-tax gain of $13 million. Financial results for this business, which were previously included in our Pharmaceutical Solutions segment, have been presented as a discontinued operation for all periods presented in the accompanying condensed consolidated financial statements. These results were not material to our condensed consolidated financial statements.

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

4. Share-Based Payment

We provide various share-based compensation for our employees, officers and non-employee directors, including stock options, an employee stock purchase plan, restricted stock (RS), restricted stock units (RSUs) and performance-based restricted stock units (PeRSUs) (collectively, share-based awards.) On April 1, 2006, we adopted SFAS No. 123(R), as discussed in Financial Note 1, Significant Accounting Policies. Accordingly, we began to recognize compensation expense for the fair value of share-based awards granted, modified, repurchased or cancelled from April 1, 2006 forward. For the unvested portion of awards issued prior to and outstanding as of April 1, 2006, the expense is recognized at the grant-date fair value as the remaining requisite service is rendered. We recognize compensation expense on a straight-line basis over the requisite service period for those awards with graded vesting and service conditions. For the awards with performance conditions, we recognize the expense on a straight-line basis, treating each vesting tranche as a separate award. In 2006, 2005 and 2004, we reduced the vesting period of substantially all of the then outstanding stock options for employee retention purposes and in anticipation of the requirements of SFAS No. 123(R), either through acceleration or shortened vesting schedules at grant. We adopted SFAS No. 123(R) using the modified prospective method and therefore have not restated prior period financial statements. Prior to adopting SFAS No. 123(R), we accounted for our employee share-based compensation plans using the intrinsic value method under APB Opinion No. 25. This standard generally did not require recognition of compensation expense for the majority of our share-based awards except for RS and RSUs. In addition, as required under APB Opinion No. 25, we previously recognized forfeitures as they occurred.

The compensation expense recognized under SFAS No. 123(R) has been classified in the income statement or capitalized on the balance sheet in the same manner as cash compensation paid to our employees. There was no material share-based compensation expense capitalized as part of the balance sheet at December 31, 2006. In addition, SFAS No. 123(R) requires that the benefits of realized tax deductions in excess of previously recognized tax benefits on compensation expense be reported as a financing cash flow rather than an operating cash flow, as was done under APB Opinion No. 25. For the quarter and nine months ended December 31, 2006, $7 million and $43 million of excess tax benefits were recognized.

In conjunction with the adoption of SFAS No. 123(R), in the first quarter of 2007, we elected the short-cut method for calculating the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of share-based compensation. Under this method, a simplified calculation is applied in establishing the beginning APIC pool balance as well as determining the future impact on the APIC pool and our consolidated statements of cash flows relating to the tax effects of share-based compensation. The election of this accounting policy did not have a material impact on our consolidated financial statements.

I. Impact on Net Income

During the third quarter and first nine months of 2007, we recorded $15 million and $39 million of pre-tax share-based compensation expense, compared to $39 million and $71 million pre-tax pro forma expense for the comparable prior year periods. The share-based compensation expense for the third quarter and first nine months of 2007 was comprised of RS, RSUs and PeRSUs expense of $12 million and $29 million, stock option expense of $2 million and $5 million, and employee stock purchase plan expense of $1 million and $5 million. We recognized tax benefits related to the share-based compensation of $5 million and $13 million in the third quarter and first nine months of 2007.

Table of Contents

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

The following table illustrates the impact of share-based compensation on reported amounts:

	Quarter Ended December 31, 2006		Nine Months Ended December 31, 2006	
(In millions, except per share data)	As Reported	Impact of Share-Based Compensation	As Reported	Impact of Share-Based Compensation
Income from continuing operations before income taxes	$ 334	$ 15	$ 934	$ 39
Net income	243	10	656	26
Earnings per share:				
Diluted	$0.80	$ 0.03	$2.15	$ 0.08
Basic	0.82	0.03	2.20	0.08

II. SFAS No. 123 Pro Forma Information for 2006

As noted above, prior to April 1, 2006 we accounted for our employee share-based compensation plans using the intrinsic value method under APB Opinion No. 25. Had compensation expense for our employee share-based compensation been recognized based on the fair value method, consistent with the provisions of SFAS No. 123, net income and earnings per share would have been as follows:

(In millions, except per share data)	Quarter Ended December 31, 2005	Nine Months Ended December 31, 2005
Net income, as reported	$ 193	$ 531
Share-based compensation expense included in reported net income, net of income taxes	3	7
Share-based compensation expense determined under the fair value method, net of income taxes	(24)	(43)
Pro forma net income	$ 172	$ 495
Earnings per common share:		
Diluted as reported	$0.61	$ 1.69
Diluted pro forma	0.54	1.57
Basic as reported	0.63	1.74
Basic pro forma	0.56	1.62

III. Stock Plans

The 2005 Stock Plan (the 2005 Plan) provides our employees, officers and non-employee directors share-based long-term incentives. The 2005 Plan permits the granting of stock options, RS, RSUs, PeRSUs and other share-based awards. Under the 2005 Plan, 13 million shares were authorized for issuance, and as of December 31, 2006, 5 million shares remain available for future grant. The 2005 Plan replaced the following three plans in advance of their expirations: 1999 Stock Option and Restricted Stock Plan, the 1997 Directors Equity Compensation and Deferral Plan and the 1998 Canadian Incentive Plan (collectively, the Legacy Plans). The aggregate remaining 11 million authorized shares under the Legacy Plans were cancelled, although awards under those plans remain outstanding. The 2005 Plan is now the Company s only plan for providing share-based incentive compensation to employees and non-employee directors of the Company and its affiliates.

In anticipation of the requirements of SFAS No. 123(R), the Compensation Committee of the Company s Board of Directors (Compensation Committee) reviewed our long-term compensation program for key employees across the Company. As a result, beginning in 2006, reliance on options was reduced with more long-term incentive value delivered by grants of PeRSUs and performance-based cash compensation.

Table of Contents

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

IV. Stock Options

Stock options are granted at not less than fair market value and those options granted under the 2005 Plan have a contractual term of seven years. Prior to 2004, stock options typically vested over a four-year period and had a contractual term of ten years. As noted above, in 2006, 2005 and 2004, we reduced the vesting period of substantially all of the then outstanding unvested stock options, either through acceleration or shortened vesting schedules at grant. It is expected that options granted in 2007 and future years will have a seven-year contractual life and generally follow the four-year vesting schedule. Stock options under the Legacy Plans, which are substantially vested, generally have a ten-year contractual life.

Compensation expense for stock options is recognized on a straight-line basis over the requisite service period and is based on the grant-date fair value for the portion of the awards that is ultimately expected to vest. We continue to use the Black-Scholes model to estimate the fair value of our stock options. Once the fair value of an employee stock option value is determined, current accounting practices do not permit it to be changed, even if the estimates used are different from actual. The option pricing model requires the use of various estimates and assumptions, as follows:

Expected stock price volatility is based on a combination of historical volatility of our common stock and implied market volatility. We believe that this market-based input provides a better estimate of our future stock price movements and is consistent with emerging employee stock option valuation considerations. Our expected stock price volatility assumption continues to reflect a constant dividend yield during the expected term of the option.

Expected dividend yield is based on historical experience and investors current expectations.

The risk-free interest rate for periods within the expected life of the option is based on the constant maturity U.S. Treasury rate in effect at the time of grant.

The expected life of the options is determined based on historical option exercise behavior data, and also reflects the impact of changes in contractual life of current option grants compared to our historical grants.

Weighted-average assumptions used to estimate the fair value of employee stock options were as follows:

	2007	**2006**
Expected stock price volatility	27%	36%
Expected dividend yield	0.5%	0.5%
Risk-free interest rate	5%	4%
Expected life (in years)	5	6

The estimated forfeiture rate, which reduces all share-based awards expense, is based on historical experience. The estimated forfeiture rate at grant is re-assessed periodically and revised if actual forfeitures differ materially from those estimates. In addition, the forfeiture estimates will be adjusted to reflect actual forfeitures when an award vests. In the Company s pro forma information required under SFAS No. 123 for the periods prior to 2007, we accounted for forfeitures as they occurred. The weighted-average forfeiture rate is approximately 9%. The actual forfeitures in the future reporting periods could be materially higher or lower than our current estimates. As a result, the share-based compensation expense in 2007 may differ from the Company s current estimate.

Table of Contents

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

The following table summarizes stock option activity during the first nine months of 2007:

(In millions, except per share data)	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value [(2)]
Outstanding, April 1, 2006	46	$ 43.38		
Granted	1	48.12		
Exercised	(6)	33.19		
Outstanding, December 31, 2006	41	45.03	4	$468
Vested and expected to vest [(1)], December 31, 2006	40	45.06	4	465
Exercisable, December 31, 2006	39	45.10	4	455

(1) The number of options expected to vest takes into account an estimate of expected forfeitures.

(2) The aggregate intrinsic value is calculated as the difference between the period-end market price of the Company s stock and the option exercise price, times the number of in-the-money option shares.

The total intrinsic value of stock options exercised during the third quarters and first nine months of 2007 and 2006 was $19 million and $73 million and $111 million and $182 million. The total fair value of stock options vested in the third quarter and first nine months of 2007 was $1 million and $2 million. The weighted average grant-date fair value of stock options granted during the first nine months of 2007 and the third quarter and first nine months of 2006 was $15.43 and $17.79 and $18.23. Cash received from the exercise of stock options in the third quarters and first nine months of 2007 and 2006 was $38 million and $145 million and $205 million and $413 million, and the related tax benefits realized were $7 million and $23 million and $42 million and $71 million. Total compensation expense, net of estimated forfeitures, related to unvested stock options not yet recognized at December 31, 2006 was approximately $20 million, and the weighted-average period over which the cost is expected to be recognized is 3 years.

V. RS, RSUs and PeRSUs

RS and RSUs, which entitle the holder to receive, at the end of a vesting term, a specified number of shares of the Company s common stock, are accounted for at fair value at the date of grant. The fair value of RS and RSUs under our stock plans is determined by the product of the number of shares that are expected to vest and the grant date market price of the Company s common stock. The Compensation Committee determines the vesting terms at the time of grant. These awards generally vest in full after three years. The fair value of RS and RSUs with graded vesting and service conditions is expensed on a straight-line basis over the requisite service period. RS contains certain restrictions on transferability and may not be transferred until such restrictions lapse.

Each non-employee director currently receives 2,500 RSUs annually, which vest immediately, and which are expensed upon grant. However, issuance of any shares is delayed until the director is no longer performing services for the Company. At December 31, 2006, 40,000 RSUs for our directors are vested, but shares have not been issued.

PeRSUs are RSUs for which the number of RSUs awarded may be conditional upon the attainment of one or more performance objectives over a specified period. Vesting of such awards ranges from one to three-year periods following the end of the performance period and may follow the graded or cliff method of vesting.

PeRSUs are accounted for as variable awards until the performance goals are reached and the grant date is established. The fair value of PeRSUs is determined by the product of the number of shares eligible to be awarded and expected to vest, and the market price of the Company s common stock, commencing at the inception of the requisite service period. During the performance period, the PeRSUs are re-valued using the market price and the performance modifier at the end of a reporting period. At the end of the performance period, if the goals are attained, the award is classified as a RSU and is accounted for on that basis. The fair value of PeRSUs is expensed

14

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

on a straight-line basis, treating each vesting tranche as a separate award, over the requisite service period of four years. For RS and RSUs with service conditions, we have elected to amortize the expense on a straight-line basis.

The following table summarizes RS and RSU activity during the first nine months of 2007:

(In millions, except per share data)	**Shares**	**Weighted-Average Grant Date Fair Value Per Share**
Nonvested, April 1, 2006	1	$ 37.09
Granted	1	48.22
Nonvested, December 31, 2006	2	44.01

The total fair value of shares vested during the third quarter and first nine months of 2007 was nil and $4 million. As of December 31, 2006, the total compensation cost, net of estimated forfeitures, related to nonvested RS and RSU awards not yet recognized was approximately $32 million, pre-tax, and the weighted-average period over which the cost is expected to be recognized is 3 years.

In May 2006, the Compensation Committee approved 1 million PeRSU target share units representing the base number of awards that could be granted, if goals are attained, and would be granted in the first quarter of 2008 (the 2007 PeRSU). These target share units are not included in the table above as they have not been granted in the form of a RSU. As of December 31, 2006, the total compensation cost, net of estimated forfeitures, related to nonvested 2007 PeRSUs not yet recognized was approximately $43 million, pre-tax (based on the period-end market price of the Company s common stock), and the weighted-average period over which the cost is expected to be recognized is 2 years.

In accordance with the provisions of SFAS No. 128, Earnings per Share, the 2007 PeRSUs are not included in the calculation of diluted weighted average shares until the performance goals have been achieved.

VI. Employee Stock Purchase Plan (ESPP)

The ESPP allows eligible employees to purchase shares of our common stock through payroll deductions. The deductions occur over three-month purchase periods and the shares are then purchased at 85% of the market price at the end of each purchase period. Employees are allowed to terminate their participation in the ESPP at any time during the purchase period prior to the purchase of the shares, and any amounts accumulated during that period are refunded.

The 15% discount provided to employees on these shares is included in compensation expense. The funds outstanding at the end of a quarter are included in the calculation of diluted weighted average shares outstanding. These amounts have not been significant.

5. Income Taxes

During the third quarter of 2007, we decreased our estimated effective tax rate from 35.0% to 34.0% primarily due to a higher proportion of income attributed to foreign countries that have lower income tax rates. This decrease required a $6 million cumulative catch-up benefit to income taxes in the third quarter of 2007 for income associated with the first half of 2007. Also, during the third quarter of 2007, we recorded an $8 million income tax benefit arising primarily from settlements and adjustments with various taxing authorities and a $6 million income tax benefit due to research and development investment tax credits from our Canadian operations.

During the second quarter of 2007, we recorded a credit to income tax expense of $83 million which primarily pertains to our receipt of a private letter ruling from the U.S. Internal Revenue Service (IRS) holding that our payment of approximately $960 million to settle our Securities Litigation Consolidated Action is fully tax-

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

deductible. We previously established tax reserves to reflect the lack of certainty regarding the tax deductibility of settlement amounts paid in the Consolidated Action and related litigation. Income tax expense for the nine months ended December 31, 2005 includes a $7 million charge which primarily relates to tax settlements and adjustments with various taxing authorities.

6. Restructuring Activities

(In millions)	Pharmaceutical Solutions Severance	Pharmaceutical Solutions Exit-Related	Provider Technologies Severance	Total
Balance, March 31, 2006	$ 6	$ 29	$ 1	$ 36
Expenses	1	(1)	5	5
Cash expenditures	(5)	(7)	(5)	(17)
Adjustment to liabilities related to the acquisition of D&K		(14)		(14)
Balance, December 31, 2006	$ 2	$ 7	$ 1	$ 10

During the first nine months of 2007, we recorded pre-tax restructuring expense of $5 million, which primarily reflected employee termination costs within our Provider Technologies segment. This segment s restructuring plan was intended to realign product development and marketing resources. Approximately 125 employees were terminated as part of this plan.

In connection with the D&K acquisition, in 2006 we recorded $10 million of liabilities relating to employee severance costs and $28 million for facility exit and contract termination costs. Approximately 260 employees, consisting primarily of distribution, general and administrative staff, were terminated as part of this restructuring plan. To date, $8 million of severance and $9 million of exit costs have been paid. In connection with the Company s investment in Parata, $13 million of contract termination costs that were initially estimated as part of the D&K acquisition were extinguished and, as a result, the Company decreased goodwill and decreased its restructuring liability during the first nine months of 2007. At December 31, 2006, the remaining severance liability for this plan was $2 million, which is anticipated to be paid by the end of 2007, and the remaining facility exit liability was $5 million, which is anticipated to be paid at various dates through 2015.

7. Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the reporting period. Diluted earnings per share is computed similarly except that it reflects the potential dilution that could occur if dilutive securities or other obligations to issue common stock were exercised or converted into common stock.

Table of Contents

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

The computations for basic and diluted earnings per share are as follows:

	Quarter Ended December 31,		Nine Months Ended December 31,	
(In millions, except per share data)	**2006**	**2005**	**2006**	**2005**
Income from continuing operations	$ 240	$ 204	$ 711	$ 522
Interest expense on convertible junior subordinated debentures, net of tax				1
Income from continuing operations diluted	240	204	711	523
Discontinued operations	3	(11)	(3)	(4)
Discontinued operations gain (loss) on sales, net			(52)	13
Net income diluted	$ 243	$ 193	$ 656	$ 532
Weighted average common shares outstanding:				
Basic	296	307	299	306
Effect of dilutive securities:				
Options to purchase common stock	6	8	6	8
Convertible junior subordinated debentures				1
Restricted stock		1		
Diluted	302	316	305	315
Earnings Per Common Share: (1)				
Diluted				
Continuing operations	$0.79	$ 0.64	$ 2.33	$ 1.66
Discontinued operations, net	0.01	(0.03)	(0.01)	(0.01)
Discontinued operations gain (loss) on sales, net			(0.17)	0.04
Total	$0.80	$ 0.61	$ 2.15	$ 1.69
Basic				
Continuing operations	$0.81	$ 0.66	$ 2.38	$ 1.71
Discontinued operations, net	0.01	(0.03)	(0.01)	(0.01)
Discontinued operations gain (loss) on sales, net			(0.17)	0.04
Total	$0.82	$ 0.63	$ 2.20	$ 1.74

(1) Certain computations may reflect rounding adjustments.

Approximately 12 million stock options were excluded from the computations of diluted net earnings per share for the quarters ended December 31, 2006 and 2005 as their exercise price was higher than the Company s average stock price. For the nine months ended December 31, 2006 and 2005, the number of stock options excluded was approximately 12 million and 17 million.

17

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

8. Goodwill and Intangible Assets, Net

Changes in the carrying amount of goodwill for the nine months ended December 31, 2006 are as follows:

(In millions)	**Pharmaceutical Solutions**	**Medical-Surgical Solutions**	**Provider Technologies**	**Total**
Balance, March 31, 2006	$495	$ 672	$ 470	$1,637
Goodwill acquired, net of purchase price adjustments	(26)	29	43	46
Translation adjustments	1		10	11
Balance, December 31, 2006	$470	$ 701	$ 523	$1,694

Information regarding intangible assets is as follows:

(In millions)	**December 31, 2006**	**March 31, 2006**
Customer lists	$ 164	$ 139
Technology	98	83
Trademarks and other	43	40
Gross intangibles	305	262
Accumulated amortization	(173)	(146)
Intangible assets, net	$ 132	$ 116

Amortization expense of other intangibles was $10 million and $29 million for the quarter and nine months ended December 31, 2006 and $8 million and $20 million for the quarter and nine months ended December 31, 2005. The weighted average remaining amortization periods for customer lists, technology and trademarks and other intangible assets at December 31, 2006 were: 8 years, 4 years and 4 years. Estimated future annual amortization expense of these assets is as follows: $9 million, $31 million, $22 million, $12 million and $10 million for 2007 through 2011, and $28 million thereafter. At December 31, 2006, there was $20 million of other intangibles not subject to amortization.

9. Financing Activities

In June 2006, we renewed our committed accounts receivable sales facility. The facility was renewed under substantially similar terms to those previously in place with the exception that the facility amount was reduced to $700 million from $1.4 billion. The renewed facility expires in June 2007. At December 31, 2006 and March 31, 2006, there were no amounts outstanding under any of our borrowing facilities.

In connection with our purchase of Per-Se in January 2007, we entered into a new $1.8 billion interim credit facility. The interim credit facility is a 364-day unsecured facility which has terms substantially similar to those contained in the Company s existing revolving credit facility. We anticipate replacing the interim credit facility with a permanent bond financing in an amount up to $1.2 billion by the end of the fourth quarter of 2007.

10. Convertible Junior Subordinated Debentures

In February 1997, we issued 5% Convertible Junior Subordinated Debentures (the Debentures) in an aggregate principal amount of $206 million. The Debentures were purchased by McKesson Financing Trust (the Trust) with proceeds from its issuance of four million shares of preferred securities to the public and 123,720 common securities to us. The Debentures represented the sole assets of the Trust and bore interest at an annual rate of 5%, payable quarterly. These preferred securities of the Trust were convertible into our common stock at the holder s option.

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

Holders of the preferred securities were entitled to cumulative cash distributions at an annual rate of 5% of the liquidation amount of $50 per security. Each preferred security was convertible at the rate of 1.3418 shares of our common stock, subject to adjustment in certain circumstances. The preferred securities were to be redeemed upon repayment of the Debentures and were callable by us on or after March 4, 2000, in whole or in part, initially at 103.5% of the liquidation preference per share, and thereafter at prices declining at 0.5% per annum to 100% of the liquidation preference on and after March 4, 2007 plus, in each case, accumulated, accrued and unpaid distributions, if any, to the redemption date.

During the first quarter of 2006, we called for the redemption of the Debentures, which resulted in the exchange of the preferred securities for 5 million shares of our newly issued common stock.

11. Pension and Other Postretirement Benefit Plans

Net expense for the Company s defined benefit pension and postretirement plans was $12 million and $35 million for the third quarter and first nine months of 2007 compared to $10 million and $32 million for the comparable prior year periods. The third quarter of 2007 expense reflects a $2 million curtailment and special termination benefit charge in accordance with SFAS No. 88, Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits. In July 2006, we made a lump sum cash payment of $7 million from an unfunded U.S. pension plan. In accordance with SFAS No. 88, a $2 million settlement charge was recorded in the second quarter of 2007 associated with the payment.

12. Financial Guarantees and Warranties

Financial Guarantees

We have agreements with certain of our customers financial institutions under which we have guaranteed the repurchase of inventory (primarily for our Canadian businesses), at a discount, in the event these customers are unable to meet certain obligations to those financial institutions. Among other limitations, these inventories must be in resalable condition. We have also guaranteed loans and the payment of leases for some customers; and we are a secured lender for substantially all of these guarantees. Customer guarantees range from one to ten years and were primarily provided to facilitate financing for certain strategic customers. At December 31, 2006, the maximum amounts of inventory repurchase guarantees and other customer guarantees were approximately $100 million and $7 million of which a nominal amount has been accrued.

At December 31, 2006, we had commitments of $2 million of cash contributions to our equity-held investments, for which no amounts had been accrued.

In addition, our banks and insurance companies have issued $103 million of standby letters of credit and surety bonds on our behalf in order to meet the security requirements for statutory licenses and permits, court and fiduciary obligations, and our workers compensation and automotive liability programs.

Our software license agreements generally include certain provisions for indemnifying customers against liabilities if our software products infringe a third party s intellectual property rights. To date, we have not incurred any material costs as a result of such indemnification agreements and have not accrued any liabilities related to such obligations.

In conjunction with certain transactions, primarily divestitures, we may provide routine indemnification agreements (such as retention of previously existing environmental, tax and employee liabilities) whose terms vary in duration and often are not explicitly defined. Where appropriate, obligations for such indemnifications are recorded as liabilities. Because the amounts of these indemnification obligations often are not explicitly stated, the overall maximum amount of these commitments cannot be reasonably estimated. Other than obligations recorded as liabilities at the time of divestiture, we have historically not made significant payments as a result of these indemnification provisions.

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

Warranties

In the normal course of business, we provide certain warranties and indemnification protection for our products and services. For example, we provide warranties that the pharmaceutical and medical-surgical products we distribute are in compliance with the Food, Drug and Cosmetic Act and other applicable laws and regulations. We have received the same warranties from our suppliers, who customarily are the manufacturers of the products. In addition, we have indemnity obligations to our customers for these products, which have also been provided to us from our suppliers, either through express agreement or by operation of law.

We also provide warranties regarding the performance of software and automation products we sell. Our liability under these warranties is to bring the product into compliance with previously agreed upon specifications. For software products, this may result in additional project costs which are reflected in our estimates used for the percentage-of-completion method of accounting for software installation services within these contracts. In addition, most of our customers who purchase our software and automation products also purchase annual maintenance agreements. Revenue from these maintenance agreements is recognized on a straight-line basis over the contract period and the cost of servicing product warranties is charged to expense when claims become estimable. Accrued warranty costs were not material to the condensed consolidated balance sheets.

13. Contract Settlement

During the second quarter of 2007, we entered into an agreement (the Settlement Agreement) that settled a patent infringement litigation we filed against TriZetto Group, Inc. (TriZetto) on September 13, 2004, *McKesson Information Solutions LLC v. The TriZetto Group, Inc.* (No. 04-1258-SLR). In the lawsuit, we alleged that clinical editing functionality included in TriZetto s Facets®, QicLink™ and ClaimFacts® software products infringed one of our patents. As part of the Settlement Agreement, TriZetto agreed to pay us a one-time royalty fee of $15 million (payable in two equal installments in October 2006 and September 2007) for a license for the relevant patent that covers past and future use of TriZetto products and services by all of their existing customers. TriZetto continues to include its clinical editing functionality in versions of Facets® sold to new health plan customers with 100,000 or fewer members and in versions of QicLink™ sold to any new customers. TriZetto also agreed to pay us a royalty fee of 5% of the net licensing revenue received from new sales of Facets® and QicLink™ containing its clinical editing functionality. Additionally, as part of the Settlement Agreement, TriZetto no longer includes its clinical editing functionality in versions of Facets® sold to new customers with more than 100,000 members, effective November 1, 2006. In these cases, new customers may choose their clinical editing solution from available third-party providers, including McKesson. The Company started amortizing the $15 million settlement over the four-year term of the contract, commencing in the third quarter of 2007.

14. Other Commitments and Contingent Liabilities

I. Securities Litigation

In our annual report on Form 10-K for the year ended March 31, 2006 and in our Form 10-Q for the quarters ended June 30, 2006, and September 30, 2006, we reported on numerous legal proceedings, including those arising out of our 1999 announcement of accounting improprieties at HBO & Company (HBOC), now known as McKesson Information Solutions LLC (the Securities Litigation). Although most of the Securities Litigation matters have been resolved, as reported previously, certain matters remain pending. Significant developments in the Securities Litigation and significant developments relating to other litigation and claims since the earlier referenced reports, are as follows:

The previously reported action, *James Gilbert v. McKesson Corporation, et al.,* (Georgia State Court, Fulton County, Case No. 02VS032502C), was settled in January of 2007 for approximately the same amount accrued for this action at December 31, 2006.

In 2005, as previously reported, we recorded a $1,200 million pre-tax ($810 million after-tax) charge with respect to the Company s Securities Litigation. The charge consisted of $960 million for the previously reported

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

action in the Northern District of California captioned, *In re McKesson HBOC, Inc. Securities Litigation*, (No. C-99-20743 RMW) (the Consolidated Action) and $240 million for other Securities Litigation proceedings. During 2006, we settled many of the other Securities Litigation proceedings and paid $243 million pursuant to those settlements. Based on the payments made in the Consolidated Action and the other Securities Litigation proceedings, settlements reached in certain of the other Securities Litigation proceedings and our assessment of the remaining cases, the estimated accrual was increased by net pre-tax charges of $52 million and $1 million during the first and third quarters of 2006 and a total net pre-tax charge of $45 million for fiscal 2006. Additionally, on February 24, 2006, the Court gave final approval to the settlement of the Consolidated Action, and as a result, we paid approximately $960 million into an escrow account established by the lead plaintiff in connection with the settlement of the Consolidated Action. As of March 31, 2006, the Securities Litigation accrual was $1,014 million. The timing of any distribution of escrowed funds is uncertain in that it is conditioned on completion of the class claims administration process and also, the Company believes, on the final resolution of the pending Bear Stearns & Co. appeal.

As previously reported, in March 2006, we reached an agreement to settle all claims brought under the Employee Retirement Income Security Act of 1974 (ERISA) on behalf of a class of certain participants in the McKesson Profit-Sharing Investment Plan, *In re McKesson HBOC, Inc. ERISA Litigation,* (No. C-00-20030 RMW). Such settlement called for the payment of $19 million, plus certain accrued interest, minus certain costs and expenses such as plaintiffs attorneys fees. On September 1, 2006, the Honorable Ronald M. Whyte entered an order granting final approval to the proposed settlement. The net cash proceeds of the settlement were distributed in October 2006. That order of final approval, and the expiration of the time in which an appeal could have been taken from that order, concludes this matter.

During the first nine months of 2007, the Securities Litigation accrual decreased $30 million primarily reflecting a net pre-tax credit of $6 million representing the settlement of the ERISA claims and a reassessment of another case in the second quarter of 2007, and $25 million of cash payments made in connection with the ERISA and another settlement. As of December 31, 2006, the Securities Litigation accrual was $984 million. We believe the Securities Litigation reserves are adequate to address our remaining potential exposure with respect to the Securities Litigation. However, in light of the uncertainties of the timing and outcome of this type of litigation, and the substantial amounts involved, it is possible that the ultimate cost of these matters could impact our earnings, either negatively or positively, in the quarter of their resolution. We do not believe that the resolution of these matters will have a material adverse effect on our results of operations, liquidity or financial position taken as a whole.

II. Other Litigation and Claims

As previously reported, a civil class action entitled *New England Carpenters Health Benefits Fund et al., v. First DataBank and McKesson Corporation* (Civil Action No. 05-11148) has been filed against the Company in the United States District Court, District of Massachusetts based on allegations that the Company, in concert with co-defendant First DataBank, Inc. (FDB), took certain actions to increase the Average Wholesale Prices (AWPs) of certain branded drugs in violation of the federal Racketeer Influenced and Corrupt Organizations Act and in violation of other statutory and common law requirements. On November 22, 2006, the trial court granted plaintiffs leave to amend their complaint to assert claims on behalf of a purported class of consumers, in addition to the original class of third party payors. On December 20, 2006, plaintiffs filed an amended motion seeking class certification of classes for both third party payor and consumer class members. The Company filed its opposition to that motion on January 24, 2007. The hearing on plaintiffs motion for class certification is scheduled for April 12, 2007. On October 4, 2006, the *New England Carpenters Health Benefits Fund* plaintiffs and defendant FDB announced a proposed settlement, as to the defendant FDB only. The proposed settlement calls for downward adjustments to certain FDB published AWPs, a prohibition against all future changes to such AWPs and a prescribed timetable for the cessation of all publication of AWPs by FDB. On November 22, 2006, immediately following its order allowing plaintiffs to amend the complaint to add allegations regarding a consumer class, the trial court granted preliminary approval of the FDB settlement. The court has not yet set any schedule for class notice, the filling of objections to the settlement, or for a hearing on final approval of the settlement.

In the previously disclosed matter, *Roby v. McKesson HBOC, Inc. et al.,* (Superior Court of Yolo County, California, Case No. CV01-573), oral argument in the Company s appeal from judgments in favor of plaintiff Roby

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

was held on December 12, 2006. On December 26, 2006, the California Court of Appeals issued its opinion (Opinion) in the matter, reducing Roby s compensatory award from $3 million to $2 million and the punitive damages award from $15 million to $2 million. Roby s petition for reconsideration of the Opinion was denied by the Court of Appeals on January 25,2007.

The United States Attorney s Office (USAO) for the Northern District of Mississippi is conducting an investigation into whether it will intervene in a civil qui tam action filed in the Northern District by an unknown private relator against the Company and other defendants. The Company is informed that the action attempts to allege violations of the anti-kickback statute in connection with the Company s provision of Medicare claims billing services to an affiliate of a multi-facility nursing home customer. The Company has not seen the civil complaint that is the subject of the investigation, but does not believe there have been any violations of the anti-kickback statute in connection with its relationships or dealings with the customer. The Company has provided documents to the USAO and is fully cooperating with the investigation.

As indicated in our previous periodic reports, the health care industry is highly regulated, and government agencies continue to increase their scrutiny over certain practices affecting government programs. From time to time, the Company receives subpoenas or requests for information from various government agencies. The Company generally responds to such subpoenas and requests in a cooperative, thorough and timely manner. These responses sometimes require considerable time and effort, and can result in considerable costs to the Company.

15. Stockholders Equity

Comprehensive income is as follows:

	Quarter Ended December 31,		Nine Months Ended December 31,	
(In millions)	**2006**	**2005**	**2006**	**2005**
Net income	$243	$193	$656	$531
Foreign currency translation adjustments and other	(18)	(1)	21	18
Comprehensive income	$225	$192	$677	$549

On January 4, 2007, the Company s Board of Directors (the Board) amended the Company s common stock rights plan to provide for the termination of the rights plan effective January 31, 2007. The common stock rights plan was structured to have certain antitakeover effects that would cause substantial dilution to the ownership interest of a person or group that attempted to acquire the Company on terms not approved by the Board.

The Board approved share repurchase plans in October 2003, August 2005, December 2005 and January 2006 which permitted the Company to repurchase up to a total of $1 billion ($250 million per plan) of the Company s common stock. Under these plans, we repurchased 19 million shares for $958 million during 2006 and as of March 31, 2006, less than $1 million remained available for future repurchases under these plans.

In April and July 2006, the Board approved share repurchase plans which permitted the Company to repurchase up to an additional $1 billion ($500 million per plan) of the Company s common stock. In the third quarter and the first nine months of 2007, we repurchased a total of 2 million and 15 million shares for $98 million and $753 million, and $247 million remains available for future repurchases as of December 31, 2006. Repurchased shares will be used to support our stock-based employee compensation plans and for other general corporate purposes. Stock repurchases may be made from time to time in open market or private transactions.

As previously discussed, during the first quarter of 2006, we called for the redemption of the Debentures, which resulted in the exchange of the preferred securities for 5 million shares of our newly issued common stock.

Table of Contents

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

16. Segment Information

Our operating segments consist of Pharmaceutical Solutions, Medical-Surgical Solutions and Provider Technologies. We evaluate the performance of our operating segments based on operating profit before interest expense, income taxes and results from discontinued operations. Our Corporate segment includes expenses associated with corporate functions and projects, certain employee benefits, and the results of certain joint venture investments. Corporate expenses are allocated to the operating segments to the extent that these items can be directly attributable to the segment.

The Pharmaceutical Solutions segment distributes ethical and proprietary drugs, and health and beauty care products throughout North America. This segment also provides medical management and specialty pharmaceutical solutions for biotech and pharmaceutical manufacturers, patient and other services for payors, software and consulting and outsourcing services to pharmacies, and, through its investment in Parata, sells automated pharmaceutical dispensing systems for retail pharmacies.

The Medical-Surgical Solutions segment distributes medical-surgical supplies, first-aid products and equipment, and provides logistics and other services within the United States and Canada.

The Provider Technologies segment delivers enterprise-wide patient care, clinical, financial, supply chain, managed care and strategic management software solutions, automated pharmaceutical dispensing systems for hospitals, as well as outsourcing and other services to healthcare organizations throughout North America, the United Kingdom and other European countries.

Financial information relating to our segments is as follows:

	Quarter Ended December 31,		Nine Months Ended December 31,	
(In millions)	**2006**	**2005**	**2006**	**2005**
Revenues				
Pharmaceutical Solutions	$22,028	$21,295	$65,715	$61,553
Medical-Surgical Solutions	632	544	1,789	1,529
Provider Technologies				
Services	322	269	930	782
Software and software systems	91	90	263	218
Hardware	38	42	115	111
Total Provider Technologies	451	401	1,308	1,111
Total	$23,111	$22,240	$68,812	$64,193
Operating profit				
Pharmaceutical Solutions (1) (2)	$ 338	$ 305	$ 954	$ 859
Medical-Surgical Solutions	25	26	70	67
Provider Technologies	40	38	108	95
Total	403	369	1,132	1,021
Corporate	(46)	(25)	(136)	(83)
Securities Litigation (charge) credit, net		(1)	6	(53)
Interest Expense	(23)	(22)	(68)	(69)

Income from continuing operations before income taxes	$ 334	$ 321	$ 934	$ 816

(1) During the first nine months of 2007 and the third quarter and first nine months of 2006, we received $10 million, $37 million and $88 million as our share of settlements of antitrust class action lawsuits brought against drug manufacturers. These settlements were recorded as a credit in cost of sales within our Pharmaceutical Solutions segment in our condensed consolidated statements of operations.

(2) During the first nine months of 2007, we recorded $21 million of charges within our Pharmaceutical Solutions segment as a result of our transaction with Parata. Refer to Financial Note 2, Acquisitions and Investments.

Table of Contents

McKESSON CORPORATION
FINANCIAL NOTES (Concluded)
(Unaudited)

(In millions)	**December 31, 2006**	**March 31, 2006**
Segment assets		
Pharmaceutical Solutions	$15,162	$13,737
Medical-Surgical Solutions	1,385	1,268
Provider Technologies	1,920	1,602
Total	18,467	16,607
Corporate		
Cash and cash equivalents	2,013	2,139
Other	2,010	2,215
Total	$22,490	$20,961

McKESSON CORPORATION
FINANCIAL REVIEW
(Unaudited)

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

	Quarter Ended December 31,			Nine Months Ended December 31,		
(In millions, except per share data)	2006	2005	Change	2006	2005	Change
Revenues	$23,111	$22,240	4%	$68,812	$64,193	7%
Securities Litigation pre-tax charge (credit), net		1	NM	(6)	53	NM
Income from Continuing Operations Before Income Taxes	334	321	4	934	816	14
Discontinued Operations, net	3	(11)	NM	(55)	9	NM
Net Income	243	193	26	656	531	24
Diluted Earnings Per Share:						
Continuing Operations	$ 0.79	$ 0.64	23%	$ 2.33	$ 1.66	40%
Discontinued Operations	0.01	(0.03)	NM	(0.18)	0.03	NM
Total	$ 0.80	$ 0.61	31	$ 2.15	$ 1.69	27

NM not meaningful

Revenues for the quarter ended December 31, 2006 grew 4% to $23.1 billion, net income increased 26% to $243 million and diluted earnings per share increased 31% to $0.80 compared to the same period a year ago. For the nine months ended December 31, 2006, revenue increased 7% to $68.8 billion, net income increased 24% to $656 million and diluted earnings per share increased 27% to $2.15 compared to the same period a year ago.

Increases in net income and diluted earnings per share for the third quarter and first nine months of 2007 compared to the same period a year ago primarily reflect:

- higher operating profit in our Pharmaceutical Solutions segment, and

- a decrease in our reported tax rate.

Net income and diluted earnings per share for the first nine months of 2007 were also impacted by:

- a $59 million decrease in pre-tax charges relating to our Securities Litigation,

- an $83 million credit to our income tax provision relating to the reversal of income tax reserves for our Securities Litigation, and

- $55 million of after-tax losses associated with our discontinued operations. In the second quarter of 2007, we sold our Medical-Surgical Solutions segment s Acute Care business for net cash proceeds of $160 million. Financial results for this business for the first nine months of 2007 reflect an after-tax loss of $64 million, which includes a $79 million non-tax deductible write-off of goodwill. The financial results for the Acute Care business have been reclassified as a discontinued operation for all periods presented.

Table of Contents

McKESSON CORPORATION
FINANCIAL REVIEW (Continued)
(Unaudited)

Results of Operations

Revenues:

(In millions)	Quarter Ended December 31, 2006	2005	Change	Nine Months Ended December 31, 2006	2005	Change
Pharmaceutical Solutions						
U.S. Healthcare direct distribution & services	$ 13,507	$ 13,242	2%	$ 40,216	$ 38,270	5%
U.S. Healthcare sales to customers warehouses	6,836	6,523	5	20,413	18,799	9
Subtotal	20,343	19,765	3	60,629	57,069	6
Canada distribution & services	1,685	1,530	10	5,086	4,484	13
Total Pharmaceutical Solutions	22,028	21,295	3	65,715	61,553	7
Medical-Surgical Solutions	632	544	16	1,789	1,529	17
Provider Technologies Services	322	269	20	930	782	19
Software and software systems	91	90	1	263	218	21
Hardware	38	42	(10)	115	111	4
Total Provider Technologies	451	401	12	1,308	1,111	18
Total Revenues	$ 23,111	$ 22,240	4	$ 68,812	$ 64,193	7

Revenues increased by 4% and 7% to $23.1 billion and $68.8 billion during the quarter and nine months ended December 31, 2006 compared to the same periods a year ago. The increase primarily reflects growth in our Pharmaceutical Solutions segment, which accounted for over 95% of consolidated revenues.

U.S. Healthcare pharmaceutical direct distribution and services revenues increased primarily reflecting market growth rates, which was partially offset by the loss of a large customer. For the nine months ended December 31, 2006, these revenues also reflect our acquisition of D&K Healthcare Resources, Inc. (D&K) during the second quarter of 2006 and expanded agreements with customers. U.S. Healthcare sales to customers warehouses increased primarily as a result of new and expanded agreements with customers, offset in part by a decrease in volume from a large customer.

Canadian pharmaceutical distribution revenues increased reflecting favorable foreign exchange rates and market growth rates. Had the same U.S. and Canadian dollar exchange rates applied in 2007 as in 2006, revenues for the third quarter and first nine months of 2007 from our Canadian operations would have increased approximately 7% and 6% compared to the same periods a year ago.

Medical-Surgical Solutions segment distribution revenues increased primarily reflecting stronger than average market growth rates as well as the acquisition of Sterling Medical Services LLC (Sterling) during the first quarter of 2007. Sterling is based in Moorestown, New Jersey, and is a national provider and distributor of disposable medical supplies, health management services and quality management programs to the home care market. Additionally, revenues for the third quarter of 2007 benefited from increased sales of flu vaccines and revenues for the first nine months of 2007 include an extra week of sales compared to the same period a year ago.

Provider Technologies segment revenues increased reflecting greater implementations of clinical, imaging, revenue cycle and resource management software solutions domestically and continued progress on software solution implementations in international operations. Partially offsetting these increases, 2006 revenues for this segment benefited from a lower software deferral rate. Growth in this segment s revenues was not materially impacted by business acquisitions.

McKESSON CORPORATION
FINANCIAL REVIEW (Continued)
(Unaudited)

Gross Profit:

(Dollars in millions)	Quarter Ended December 31, 2006	2005	Change	Nine Months Ended December 31, 2006	2005	Change
Gross Profit						
Pharmaceutical Solutions	$ 671	$ 642	5%	$1,963	$1,801	9%
Medical-Surgical Solutions	174	143	22	505	425	19
Provider Technologies	216	189	14	613	512	20
Total	$1,061	$ 974	9	$3,081	$2,738	13
Gross Profit Margin						
Pharmaceutical Solutions	3.05%	3.01%	4bp	2.99%	2.93%	6bp
Medical-Surgical Solutions	27.53	26.29	124	28.23	27.80	43
Provider Technologies	47.89	47.13	76	46.87	46.08	79
Total	4.59	4.38	21	4.48	4.27	21

Gross profit for the third quarter and first nine months of 2007 increased 9% and 13% to $1,061 million and $3,081 million. As a percentage of revenues, gross profit margin increased 21 basis points to 4.59% for the third quarter of 2007 and 21 basis points to 4.48% for the first nine months of 2007. Gross profit margin increased due to an increase in our gross profit margins in all three of our segments.

Gross profit margin for our Pharmaceutical Solutions segment increased during the third quarter of 2007 compared to the same period a year ago primarily as a result of:

the benefit of increased sales of generic drugs with higher margins,

a last-in, first-out (LIFO) inventory credit of $18 million in the third quarter of 2007 compared to $10 million for the same period a year ago. LIFO credits reflect our expectation of a LIFO benefit for the full fiscal year. Our Pharmaceutical Solutions segment uses the LIFO method of accounting for the majority of its inventories, which results in cost of sales that more closely reflects replacement cost than do other accounting methods, thereby mitigating the effects of inflation and deflation on gross profit. The practice in the Pharmaceutical Solutions distribution business is to pass on to customers published price changes from suppliers. Manufacturers generally provide us with price protection, which prevents inventory losses. Price declines on many generic pharmaceutical products in this segment over the last few years have moderated the effects of inflation in other product categories, which resulted in minimal overall price changes in those years, and

improved buy profit margin.

These increases were partially offset by:

a decrease in amounts of antitrust settlements. Results for the third quarter of 2006 include $37 million of cash proceeds representing our share of a settlement of an antitrust class action lawsuit, and a decrease associated with a greater proportion of revenues within the segment attributed to sales to customers warehouses, which have lower gross profit margins relative to other revenues within the segment.

Table of Contents

McKESSON CORPORATION
FINANCIAL REVIEW (Continued)
(Unaudited)

Gross profit margin for our Pharmaceutical Solutions segment also increased during the first nine months of 2007 compared to the same period a year ago primarily as a result of:

the benefit of increased sales of generic drugs with higher margins,

improved buy profit margin, and

a last-in, first-out (LIFO) inventory credit of $38 million in the first nine months of 2007 compared to $20 million for the same prior year period.

These increases were partially offset by:

a decrease in amounts of antitrust settlements. Results for the first nine months of 2007 and 2006 include $10 million and $88 million of cash proceeds representing our share of various settlements of antitrust class action lawsuits,

a decrease associated with a greater proportion of revenues within the segment attributed to sales to customers warehouses, which have lower gross profit margins relative to other revenues within the segment, and

a $15 million charge in 2007 pertaining to the write-down of certain abandoned assets within our retail automation group. During the first quarter of 2007, we contributed $36 million in cash and $45 million in net assets primarily from our Automated Prescription Systems business to Parata Systems, LLC (Parata), in exchange for a significant minority interest in Parata. In connection with the investment, we abandoned certain assets which resulted in a $15 million charge to cost of sales and we incurred $6 million of other expenses related to the transaction which were recorded within operating expenses. We did not recognize any additional gains or losses as a result of this transaction as we believe the fair value of our investment in Parata, as determined by a third-party valuation, approximates the carrying value of consideration contributed to Parata. Our investment in Parata is accounted for under the equity method of accounting within our Pharmaceutical Solutions segment.

In addition, gross profit margin for our U.S. pharmaceutical distribution business benefited from a relatively stable sell side margin in 2007.

Gross profit margins increased in our Medical-Surgical Solutions segment during the third quarter and first nine months of 2007 compared to the same periods a year ago primarily reflecting favorable product mix and buy side margins. Provider Technologies segment s gross profit margin increased primarily due to a change in product mix.

McKESSON CORPORATION
FINANCIAL REVIEW (Continued)
(Unaudited)

Operating Expenses and Other Income:

(Dollars in millions)	**Quarter Ended December 31,** 2006	2005	**Change**	**Nine Months Ended December 31,** 2006	2005	**Change**
Operating Expenses						
Pharmaceutical Solutions	$ 343	$ 346	(1)%	$1,039	$ 967	7%
Medical-Surgical Solutions	150	118	27	437	360	21
Provider Technologies	179	153	17	512	426	20
Corporate	71	48	48	203	144	41
Subtotal	743	665	12	2,191	1,897	15
Securities Litigation charge (credit), net		1	NM	(6)	53	NM
Total	$ 743	$ 666	12	$2,185	$1,950	12
Operating Expenses as a Percentage of Revenues						
Pharmaceutical Solutions	1.56%	1.62%	(6)bp	1.58	1.57%	1bp
Medical-Surgical Solutions	23.73	21.69	204	24.43	23.54	89
Provider Technologies	39.69	38.15	154	39.14	38.34	80
Total	3.21	2.99	22	3.18	3.04	14
Other Income						
Pharmaceutical Solutions	$ 10	$ 9	11%	$ 30	$ 25	20%
Medical-Surgical Solutions	1	1		2	2	
Provider Technologies	3	2	50	7	9	(22)
Corporate	25	23	9	67	61	10
Total	$ 39	$ 35	11	$ 106	$ 97	9

Operating expenses increased 12% to $743 million in the third quarter of 2007 and to $2.2 billion for the first nine months of 2007 (or 15% excluding the Securities Litigation charges and credits). As a percentage of revenues, operating expenses increased 22 and 14 basis points to 3.21% and 3.18% for the third quarter and first nine months of 2007. Excluding the Securities Litigation charges and credits, operating expenses as a percentage of revenues increased 22 basis points to 3.18% for the first nine months of 2007. Operating expense dollars, excluding the Securities Litigation, increased primarily due to additional costs to support our sales volume growth, our business acquisitions, and employee compensation costs associated with the requirement to expense all share-based compensation. Results for the first nine months of 2007 and 2006 include a pre-tax Securities Litigation credit of $6 million and a pre-tax charge of $53 million. Other income increased slightly in the third quarter and first nine months of 2007 compared to the same periods a year ago.

During the first quarter of 2007, we adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment, which requires the recognition of expense resulting from transactions in which we acquire goods and services by issuing our shares, share options, or other equity instruments. As a result of the implementation, included in our third quarter and first nine months 2007 operating expenses, we recorded $15 million and $39 million of pre-tax share-based compensation expense, or $10 million and $28 million more than the same periods a year ago.

We expect share-based compensation charges to approximate $0.10 to $0.12 per diluted share. These charges are expected to be approximately $0.07 to $0.09 per diluted share more than the share-based compensation expense recognized in our net income in 2006. 2006 net income includes $0.03 per diluted share of compensation expense associated with restricted stock whose intrinsic value as of the grant date is being amortized over the vesting period. Our assessments of estimated compensation charges are affected by our stock price as well as assumptions regarding a number of complex and subjective variables and the related tax impact. These variables include, but are not limited to, the volatility of our stock price, employee stock option exercise behaviors, timing, level and types of our grants of annual share-based awards, and the attainment of performance goals. As a result, the actual share-based compensation expense in 2007 may differ from the Company s current estimate.

McKESSON CORPORATION
FINANCIAL REVIEW (Continued)
(Unaudited)

Refer to Financial Notes 1 and 4, Significant Accounting Policies and Share-Based Payment, to the accompanying condensed consolidated financial statements for further discussions regarding our share-based compensation.

Segment Operating Profit and Corporate Expenses:

	Quarter Ended December 31,			Nine Months Ended December 31,		
(Dollars in millions)	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Segment Operating Profit [1]						
Pharmaceutical Solutions [2] [3]	$ 338	$ 305	11%	$ 954	$ 859	11%
Medical-Surgical Solutions	25	26	(4)	70	67	4
Provider Technologies	40	38	5	108	95	14
Subtotal	403	369	9	1,132	1,021	11
Corporate Expenses, net	(46)	(25)	84	(136)	(83)	64
Securities Litigation (charge) credit, net		(1)	NM	6	(53)	NM
Interest Expense	(23)	(22)	5	(68)	(69)	(1)
Income from Continuing Operations, Before Income Taxes	$ 334	$ 321	4	$ 934	$ 816	14
Segment Operating Profit Margin						
Pharmaceutical Solutions	1.53%	1.43%	10bp	1.45%	1.40%	5bp
Medical-Surgical Solutions	3.96	4.78	(82)	3.91	4.38	(47)
Provider Technologies	8.87	9.48	(61)	8.26	8.55	(29)

(1) Segment operating profit includes gross profit, net of operating expenses plus other income for our three business segments.

(2) During the first nine months of 2007 and the third quarter and first nine months of 2006, we received $10 million and $37 million and $88 million as our share of settlements of antitrust class action lawsuits brought against drug manufacturers.

(3) During the first nine months of 2007, we recorded $21 million of charges within our Pharmaceutical Solutions segment as a result of our transaction with Parata.

Operating profit as a percentage of revenues increased in our Pharmaceutical Solutions segment largely as a result of an increase in the segment s gross profit margin. Additionally, the segment s operating profit for the third quarter of 2007 benefited from expense control and efficiency programs. Operating expenses increased in the first nine months of 2007 primarily reflecting additional costs to support the segment s sales volume growth, our D&K acquisition, and employee share-based compensation costs.

Medical-Surgical Solutions segment s operating profit as a percentage of revenues decreased for the third quarter and first nine months of 2007 as increases in operating expenses as a percentage of revenues exceeded the increase in gross profit margin. Operating expenses for the segment increased primarily reflecting additional costs to support the segment s sales volume growth, the acquisition of Sterling and an increase in bad debt expense. Additionally, operating expenses in 2006 benefited from a settlement with a vendor. As part of this segment s divestiture of its Acute Care business, we expect to incur total restructuring charges of approximately $5 million in order to align the segment s remaining operations. We anticipate incurring these charges during the first quarter of 2008.

Provider Technologies segment s operating profit as a percentage of revenues decreased primarily reflecting an increase in operating expenses as a percentage of revenues partially offset by an increase in gross profit margins. Operating expenses for the segment increased primarily as a result of investments in research and development activities and sales and marketing functions to support the segment s revenue growth, the segment s business acquisitions, and increases in employee share-based compensation costs, partially offset by a decrease in bad debt expense. Operating expenses for the first nine months of 2007 also include $5 million of restructuring charges as a result of a plan intended to reallocate product development and marketing resources. Operating expenses for the

McKESSON CORPORATION
FINANCIAL REVIEW (Continued)
(Unaudited)

first nine months of 2006 include a $3 million write-off of acquired in-process research and development costs resulting from the Medcon, Ltd. (Medcon) acquisition.

Corporate expenses, net of other income, increased primarily reflecting additional costs incurred to support various initiatives and revenue growth, an increase in employee share-based compensation costs, a loss on the disposition of an asset, and an increase in reserves for notes on stock loans. These unfavorable variances were partially offset by a favorable legal settlement. Corporate expenses, net of other income, for the first nine months of 2006 benefited from a change in estimate for certain compensation and benefits plans.

Securities Litigation Charges, Net: In 2005, we recorded a $1,200 million pre-tax ($810 million after-tax) charge with respect to the Company s Securities Litigation. The charge consisted of $960 million for the previously reported action in the Northern District of California captioned, *In re McKesson HBOC, Inc. Securities Litigation*, (No. C-99-20743 RMW) (the Consolidated Action) and $240 million for other Securities Litigation proceedings. During 2006, we settled many of the other Securities Litigation proceedings and paid $243 million pursuant to those settlements. Based on the payments made in the Consolidated Action and the other Securities Litigation proceedings, settlements reached in certain of the other Securities Litigation proceedings and our assessment of the remaining cases, the estimated accrual was increased by pre-tax charges of $52 million and $1 million during the first and third quarters of 2006 and a total net pre-tax charge of $45 million for fiscal 2006. Additionally, on February 24, 2006, the Court gave final approval to the settlement of the Consolidated Action, and as a result, we paid approximately $960 million into an escrow account established by the lead plaintiff in connection with the settlement of the Consolidated Action. As of March 31, 2006, the Securities Litigation accrual was $1,014 million. The timing of any distribution of escrowed funds is uncertain in that it is conditioned on completion of the class claims administration process and also, the Company believes, on the final resolution of the pending Bear Stearns & Co. appeal.

As previously reported, in March 2006, we reached an agreement to settle all claims brought under the Employee Retirement Income Security Act of 1974 (ERISA) on behalf of a class of certain participants in the McKesson Profit-Sharing Investment Plan, *In re McKesson HBOC, Inc. ERISA Litigation,* (No. C-00-20030 RMW). Such settlement called for the payment of $19 million, plus certain accrued interest, minus certain costs and expenses such as plaintiffs attorneys fees. On September 1, 2006, the Honorable Ronald M. Whyte entered an order granting final approval to the proposed settlement. The net cash proceeds of the settlement were distributed in October 2006. That order of final approval, and the expiration of the time in which an appeal could have been taken from that order, concludes this matter.

The previously reported action, *James Gilbert v. McKesson Corporation, et al.,* (Georgia State Court, Fulton County, Case No. 02VS032502C), was settled in January of 2007 for approximately the same amount accrued for this action at December 31, 2006.

During the first nine months of 2007, the Securities Litigation accrual decreased $30 million primarily reflecting a net pre-tax credit of $6 million representing the settlement of the ERISA claims and a reassessment of another case in the second quarter of 2007, and $25 million of cash payments made in connection with the ERISA and another settlement. As of December 31, 2006, the Securities Litigation accrual was $984 million. We believe the Securities Litigation reserves are adequate to address our remaining potential exposure with respect to the Securities Litigation. However, in light of the uncertainties of the timing and outcome of this type of litigation, and the substantial amounts involved, it is possible that the ultimate cost of these matters could impact our earnings, either negatively or positively, in the quarter of their resolution. We do not believe that the resolution of these matters will have a material adverse effect on our results of operations, liquidity or financial position taken as a whole.

McKESSON CORPORATION
FINANCIAL REVIEW (Continued)
(Unaudited)

Interest Expense: Interest expense for 2007 approximated that of the prior year comparable periods.

Income Taxes: The Company s reported income tax rates for the quarters ended December 31, 2006 and 2005 were 28.1% and 36.4%, and 23.9% and 36.0% for the first nine months of 2007 and 2006.

During the third quarter of 2007, we decreased our estimated effective tax rate from 35.0% to 34.0% primarily due to a higher proportion of income attributed to foreign countries that have lower income tax rates. This decrease required a $6 million cumulative catch-up benefit to income taxes in the third quarter of 2007 for income associated with the first half of 2007. Also, during the third quarter of 2007, we recorded an $8 million income tax benefit arising primarily from settlements and adjustments with various taxing authorities and a $6 million income tax benefit due to research and development investment tax credits from our Canadian operations.

During the second quarter of 2007, we recorded a credit to income tax expense of $83 million which primarily pertains to our receipt of a private letter ruling from the U.S. Internal Revenue Service (IRS) holding that our payment of approximately $960 million to settle our Securities Litigation Consolidated Action is fully tax-deductible. We previously established tax reserves to reflect the lack of certainty regarding the tax deductibility of settlement amounts paid in the Consolidated Action and related litigation. Income tax expense for the nine months ended December 31, 2005 includes a $7 million charge which primarily relates to tax settlements and adjustments with various taxing authorities.

Discontinued Operations:

Results from discontinued operations were as follows:

	Quarter Ended December 31,		Nine Months Ended December 31,	
(In millions)	2006	2005	2006	2005
Discontinued operations, net of taxes				
Acute Care	$3	$(11)	$(64)	$ (5)
PBI			5	
BioServices				14
Other			4	
Total	$3	$(11)	$(55)	$ 9

In the second quarter of 2007, we sold our Medical-Surgical Solutions segment s Acute Care supply business to Owens & Minor, Inc. (OMI) for net cash proceeds of approximately $160 million. In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the financial results of this business are classified as a discontinued operation for all periods presented in the accompanying condensed consolidated financial statements. Such presentation includes the classification of all applicable assets of the disposed business under the caption Prepaid expenses and other and all applicable liabilities under the caption Other under Current Liabilities within our condensed consolidated balance sheets for all periods presented. Revenues associated with the Acute Care business were $269 million and $797 million for the third quarter and first nine months of 2006, and $573 million for the first half of 2007.

Financial results for the nine months ended December 31, 2006 for this discontinued operation include an after-tax loss of $64 million, which primarily consists of an after-tax loss of $61 million for the business disposition and $3 million of after-tax losses associated with operations, other asset impairment charges and employee severance costs. The after-tax loss of $61 million for the business disposition includes a $79 million non-tax deductible write-off of goodwill, as further described below.

In connection with this divestiture, we allocated a portion of our Medical-Surgical Solutions segment s goodwill to the Acute Care business as required by SFAS No. 142, Goodwill and Other Intangible Assets. The allocation was based on the relative fair values of the Acute Care business and the continuing businesses that are

32

Table of Contents

McKESSON CORPORATION
FINANCIAL REVIEW (Continued)
(Unaudited)

being retained by the Company. The fair value of the Acute Care business was determined based on the net cash proceeds resulting from the divestiture and the fair value of the continuing businesses was determined by a third-party valuation. As a result, we allocated $79 million of the segment s goodwill to the Acute Care business.

Additionally, as part of the divestiture, we entered into a transition services agreement (TSA) with OMI under which we continue to provide certain services to the Acute Care business during a transition period of approximately nine months. We also anticipate incurring approximately $5 million of pre-tax employee severance charges over the transition period. These charges, as well as the financial results from the TSA, are recorded as part of discontinued operations. The continuing cash flows generated from the TSA are not anticipated to be material to our condensed consolidated financial statements.

In 2005, our Acute Care business entered into an agreement with a third party vendor to sell the vendor s proprietary software and services. The terms of the contract required us to prepay certain royalties. During the third quarter of 2006, we ended marketing and sale of the software under the contract. As a result of this decision, we recorded a $15 million pre-tax charge in the third quarter of 2006 to write-off the remaining balance of the prepaid royalties.

In the second quarter of 2007, we also sold a wholly-owned subsidiary, Pharmaceutical Buyers Inc. (PBI), for net cash proceeds of $10 million. The divestiture resulted in an after-tax gain of $5 million resulting from the tax basis of the subsidiary exceeding its carrying value. Financial results of this business, which were previously included in our Pharmaceutical Solutions segment, have been presented as a discontinued operation for all periods presented in the accompanying condensed consolidated financial statements. These results were not material to our condensed consolidated financial statements.

Results for discontinued operations for the nine months ended December 31, 2006 also include an after-tax gain of $4 million associated with the collection of a note receivable from a business sold in 2003.

In the second quarter of 2006, we sold our wholly-owned subsidiary, McKesson BioServices Corporation (BioServices), for net cash proceeds of $63 million. The divestiture resulted in an after-tax gain of $13 million. Financial results for this business, which were previously included in our Pharmaceutical Solutions segment, have been presented as a discontinued operation for all periods presented in the accompanying condensed consolidated financial statements. These results were not material to our condensed consolidated financial statements.

Refer to Financial Note 3, Discontinued Operations, to the accompanying condensed consolidated financial statements for further discussions regarding our divestitures.

Net Income: Net income was $243 million and $193 million for the third quarters of 2007 and 2006, or $0.80 and $0.61 per diluted share. Net income was $656 million and $531 million for the first nine months of 2007 and 2006, or $2.15 and $1.69 per diluted share. Net income for the first nine months of 2007 includes an $87 million after-tax credit, or $0.28 per diluted share, relating to our Securities Litigation. Net income for the first nine months of 2006 includes a $35 million after-tax Securities Litigation charge, or ($0.11) per diluted share. Net income for the first nine months of 2007 also includes $55 million of after-tax losses for our discontinued operations primarily pertaining to the disposition of our Acute Care business.

Table of Contents

McKESSON CORPORATION
FINANCIAL REVIEW (Continued)
(Unaudited)

A reconciliation between our net income per share reported in conformity with generally accepted accounting principles in the United States of America (U.S. GAAP) and our earnings per diluted share, excluding charges for the Securities Litigation for the third quarters and first nine months of 2007 and 2006 is as follows:

	Quarter Ended December 31,		Nine Months Ended December 31,	
(In millions except per share amounts)	**2006**	**2005**	**2006**	**2005**
Net income, as reported	$ 243	$ 193	$ 656	$ 531
Exclude:				
Securities Litigation charge (credit), net		1	(6)	53
Income taxes		(1)	2	(18)
Income tax reserve reversals			(83)	
Securities Litigation charge (credit), net of tax			(87)	35
Net income, excluding Securities Litigation charges	$ 243	$ 193	$ 569	$ 566
Diluted earnings per common share, as reported (1) (2)	$0.80	$0.61	$2.15	$1.69
Diluted earnings per common share, excluding Securities Litigation charge (credit) (1) (2)	$0.80	$0.61	$1.87	$1.80
Shares on which diluted earnings per common share, excluding the Securities Litigation charge (credit), were based	302	316	305	315

(1) For the nine months ended December 31, 2005, interest expense, net of related income taxes, of $1 million, has been added to net income, excluding the Securities Litigation net charges, for purpose of calculating diluted earnings per share. This

calculation also includes the impact of dilutive securities (stock options, convertible junior subordinated debentures and restricted stock).

(2) Certain computations may reflect rounding adjustments.

These pro forma amounts are non-GAAP financial measures. We use these measures internally and consider these results to be useful to investors as they provide the most relevant benchmarks of core operating performance.

Weighted Average Diluted Shares Outstanding: Diluted earnings per share were calculated based on an average number of diluted shares outstanding of 302 million and 316 million for the third quarters of 2007 and 2006 and 305 million and 315 million for the nine months ended December 31, 2006 and 2005. The decrease in the number of weighted average diluted shares outstanding reflects a decrease in the number of common shares outstanding as a result of repurchased stock, partially offset by exercised stock options, as well as an increase in the common stock equivalents from stock options due to the increase in the Company s common stock price.

34

McKESSON CORPORATION
FINANCIAL REVIEW (Continued)
(Unaudited)

Business Acquisitions

On November 5, 2006, we entered into a definitive agreement to acquire all of the outstanding shares of Per-Se Technologies, Inc. (Per-Se) of Alpharetta, Georgia for $28.00 per share in cash, or approximately $1.8 billion in aggregate including the assumption of Per-Se s debt. Per-Se is a leading provider of financial and administrative healthcare solutions for hospitals, physicians and retail pharmacies. On January 26, 2007, we acquired Per-Se. The acquisition was funded with cash on hand and through the use of a new interim credit facility (refer to Credit Resources). Financial results for Per-Se will primarily be included within our Provider Technologies segment.

In the first quarter of 2007, we acquired the following three entities for a total cost of $92 million, which was paid in cash:

Sterling, based in Moorestown, New Jersey, a national provider and distributor of disposable medical supplies, health management services and quality management programs to the home care market. Financial results for Sterling are included in our Medical-Surgical Solutions segment;

HealthCom Partners LLC (HealthCom), based in Mt. Prospect, Illinois, a leading provider of patient billing solutions designed to simplify and enhance healthcare providers financial interactions with their patients; and

RelayHealth Corporation (RelayHealth), based in Emeryville, California, a provider of secure online healthcare communication services linking patients, healthcare professionals, payors and pharmacies. Financial results for HealthCom and RelayHealth are included in our Provider Technologies segment.

Goodwill recognized in these transactions amounted to $61 million.

In addition, in the first quarter of 2007, we contributed $36 million in cash and $45 million in net assets primarily from our Automated Prescription Systems business to Parata, in exchange for a significant minority interest in Parata. In connection with the investment, we abandoned certain assets which resulted in a $15 million charge to cost of sales and we incurred $6 million of other expenses related to the transaction which were recorded within operating expenses. We did not recognize any additional gains or losses as a result of this transaction as we believe the fair value of our investment in Parata, as determined by a third-party valuation, approximates the carrying value of consideration contributed to Parata. Our investment in Parata is accounted for under the equity method of accounting within our Pharmaceutical Solutions segment.

In 2006, we made the following acquisitions:

In the second quarter of 2006, we acquired all of the issued and outstanding stock of D&K of St. Louis, Missouri for an aggregate cash purchase price of $479 million, including the assumption of D&K s debt. D&K is primarily a wholesale distributor of branded and generic pharmaceuticals and over-the-counter health and beauty products to independent and regional pharmacies, primarily in the Midwest. Approximately $158 million of the purchase price has been assigned to goodwill. Included in the purchase price were acquired identifiable intangibles of $43 million primarily representing customer lists and not-to-compete covenants which have an estimated weighted-average useful life of nine years. Financial results for D&K are included in our Pharmaceutical Solutions segment.

Also in the second quarter of 2006, we acquired all of the issued and outstanding shares of Medcon, an Israeli company, for an aggregate purchase price of $82 million. Medcon provides web-based cardiac image and information management services to healthcare providers. Approximately $60 million of the purchase price was assigned to goodwill and $20 million was assigned to intangibles which represent technology assets and customer lists which have an estimated weighted-average useful life of four years. Financial results for Medcon are included in our Provider Technologies segment.

McKESSON CORPORATION
FINANCIAL REVIEW (Continued)
(Unaudited)

During the last two years, we also completed a number of other acquisitions and investments within all three of our operating segments. Financial results for our business acquisitions have been included in our consolidated financial statements since their respective acquisition dates. Purchase prices for our business acquisitions have been allocated based on estimated fair values at the date of acquisition and, for certain recent acquisitions, may be subject to change. Goodwill recognized for our business acquisitions is not expected to be deductible for tax purposes. Pro forma results of operations for our business acquisitions have not been presented because the effects were not material to the consolidated financial statements on either an individual or an aggregate basis.

Refer to Financial Note 2, Acquisitions and Investments, to the accompanying condensed consolidated financial statements for further discussions regarding our business acquisitions.

Financial Condition, Liquidity, and Capital Resources

Operating activities provided cash of $555 million and $1,466 million during the first nine months of 2007 and 2006. Operating activities for 2007 benefited from improved accounts receivable management, reflecting changes in our customer mix, our termination of a customer contract and an increase in accounts payable associated with improved payment terms. These benefits were fully offset by increases in inventory needed to support our growth and timing of inventory receipts. Operating activities for 2007 also reflect payments of $25 million for the settlements of Securities Litigation cases. Cash flows from operations in 2006 benefited from improved working capital balances for our U.S. pharmaceutical distribution business as purchases from certain of our suppliers were better aligned with customer demand and as a result, net financial inventory (inventory net of accounts payable) decreased. Operating activities for 2006 also benefited from better inventory management. Cash flows from operations can be significantly impacted by factors such as the timing of receipts from customers and payments to vendors. Operating activities for 2006 also include a $143 million cash receipt in connection with an amended agreement entered into with a customer and cash settlement payments of $227 million for certain Securities Litigation cases.

Investing activities utilized cash of $152 million and $768 million during the first nine months of 2007 and 2006. Investing activities for 2007 reflect payments of $106 million for our business acquisitions and $36 million for our investment in Parata. Investing activities for 2007 also reflect $175 million of cash proceeds from the sale of our businesses, including $164 million for the sale of our Acute Care business. Investing activities for 2006 include increases in property acquisitions and capitalized software expenditures which primarily reflect our investment in our U.S. pharmaceutical distribution center network and our Provider Technologies segment s investment in software for a contract with the British government s National Health Services Information Authority organization. Investing activities for 2006 also include $560 million of expenditures for our business acquisitions, including D&K and Medcon. Partially offsetting these increases were cash proceeds of $63 million pertaining to the sale of BioServices.

Financing activities utilized cash of $529 million and $317 million in the first nine months of 2007 and 2006. Financing activities for 2007 include an incremental use of cash of $177 million for stock repurchases and $196 million less cash receipts primarily resulting from employees exercises of stock options. Financing activities for 2006 include $102 million of cash paid for the repayment of life insurance policy loans.

The Company s Board of Directors (the Board) approved share repurchase plans in October 2003, August 2005, December 2005 and January 2006 which permitted the Company to repurchase up to a total of $1 billion ($250 million per plan) of the Company s common stock. Under these plans, we repurchased 19 million shares for $958 million during 2006 and as of March 31, 2006, less than $1 million remained available for future repurchases under these plans.

In April and July 2006, the Board approved share repurchases plans which permitted the Company to repurchase up to an additional $1 billion ($500 million per plan) of the Company s common stock. In the third quarter and the first nine months of 2007, we repurchased a total of 2 million and 15 million shares for $98 million and $753 million, and $247 million remains available for future repurchases as of December 31, 2006. Repurchased shares will be used to support our stock-based employee compensation plans and for other general corporate purposes. Stock repurchases may be made from time to time in open market or private transactions.

Table of Contents

McKESSON CORPORATION
FINANCIAL REVIEW (Continued)
(Unaudited)

Selected Measures of Liquidity and Capital Resources

(Dollars in millions)	**December 31, 2006**	**March 31, 2006**
Cash and cash equivalents	$ 2,013	$ 2,139
Working capital	3,578	3,527
Debt, net of cash and cash equivalents	(1,031)	(1,148)
Debt to capital ratio (1)	13.9%	14.4%
Return on stockholders equity(2)	14.7	13.1

(1) Ratio is computed as total debt divided by total debt and stockholders equity.

(2) Ratio is computed as net income (loss) over the past four quarters, divided by a five-quarter average of stockholders equity.

Working capital primarily includes cash and cash equivalents, receivables, inventories, drafts and accounts payable, and deferred revenue. Our Pharmaceutical Solutions segment requires a substantial investment in working capital that is susceptible to large variations during the year that are a result of a number of factors, including inventory purchase activities, seasonal demands, customer and supplier mix and the timing of receipts from customers and payments to suppliers. Inventory purchase activities are a function of sales volume, product mix, new customer build-up requirements and a level of investment inventory. As of December 31, 2006, consolidated working capital increased slightly from March 31, 2006.

During the first quarter of 2006, we called for the redemption of the Company s convertible junior subordinated debentures, which resulted in the exchange of preferred securities for 5 million shares of our newly issued common stock.

Credit Resources

We fund our working capital requirements primarily with cash, short-term borrowings and our receivables sale facility. We have a $1.3 billion five-year, senior unsecured revolving credit facility that expires in September 2009. Borrowings under this credit facility bear interest at a fixed base rate, a floating rate based on the London Interbank Offering Rate (LIBOR) rate or a Eurodollar rate. In June 2006, we renewed our committed accounts receivable sales facility. The facility was renewed under substantially similar terms to those previously in place with the exception that the facility was reduced to $700 million from $1.4 billion. The renewed facility expires in June 2007. No amounts were outstanding under any of these facilities at December 31, 2006.

In connection with our purchase of Per-Se in January 2007, we entered into a new $1.8 billion interim credit facility. The interim credit facility is a 364-day unsecured facility which has terms substantially similar to those contained in the Company s existing revolving credit facility. We anticipate replacing the interim credit facility with a permanent bond financing in an amount up to $1.2 billion by the end of the fourth quarter of 2007.

Our various borrowing facilities and long-term debt are subject to certain covenants. Our principal debt covenant is our debt to capital ratio, which cannot exceed 56.5%. If we exceed this ratio, repayment of debt outstanding under the revolving credit facility and $235 million of term debt could be accelerated. At December 31, 2006, this ratio was 13.9% and we were in compliance with our other financial covenants. A reduction in our credit ratings or the lack of compliance with our covenants could negatively impact our ability to finance operations through our credit facilities, or issue additional debt at the interest rates then currently available.

Funds necessary for the resolution of the Securities Litigation, future debt maturities and our other cash requirements are expected to be met by existing cash balances, cash flows from operations, existing credit sources and other capital market transactions.

Table of Contents

McKESSON CORPORATION
FINANCIAL REVIEW (Continued)
(Unaudited)

FACTORS AFFECTING FORWARD-LOOKING STATEMENTS

In addition to historical information, management s discussion and analysis includes certain 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. Some of the forward-looking statements can be identified by use of forward-looking words such as believes, expects, anticipates, may, will, should, seeks, approximates, or estimates, or the negative of these words, or other comparable terminology. The discussion of financial trends, strategy, plans or intentions may also include forward-looking statements. Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected. Although it is not possible to predict or identify all such risks and uncertainties, they may include, but are not limited to, the following factors. The readers should not consider this list to be a complete statement of all potential risks and uncertainties.

adverse resolution of pending shareholder litigation regarding the 1999 restatement of our historical financial statements;

the changing U.S. healthcare environment, including changes in government regulations and the impact of potential future mandated benefits;

competition;

changes in private and governmental reimbursement or in the delivery systems for healthcare products and services;

governmental and manufacturers efforts to regulate or control the pharmaceutical supply chain;

changes in pharmaceutical and medical-surgical manufacturers pricing, selling, inventory, distribution or supply policies or practices;

changes in the availability or pricing of generic drugs;

changes in customer mix;

substantial defaults in payment or a material reduction in purchases by large customers;

challenges in integrating and implementing the Company s internally used or externally sold software and software systems, or the slowing or deferral of demand or extension of the sales cycle for external software products;

continued access to third-party licenses for software and the patent positions of the Company s proprietary software;

the Company s ability to meet performance requirements in its disease management programs;

the adequacy of insurance to cover liability or loss claims;

new or revised tax legislation;

foreign currency fluctuations or disruptions to foreign operations;

the Company s ability to successfully identify, consummate and integrate strategic acquisitions;

changes in generally accepted accounting principles (GAAP); and

general economic conditions.

These and other risks and uncertainties are described herein or in our Forms 10-K, 10-Q, 8-K and other public documents filed with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly release the result of any revisions to these forward-looking statements to reflect events or circumstances after this date or to reflect the occurrence of unanticipated events.

Table of Contents

McKESSON CORPORATION

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We believe there has been no material change in our exposure to risks associated with fluctuations in interest and foreign currency exchange rates discussed in our 2006 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Our Chief Executive Officer and our Chief Financial Officer, after evaluating the effectiveness of the Company s disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) or 15d-15(e)) as of the end of the period covered by this quarterly report, have concluded that our disclosure controls and procedures are effective based on their evaluation of these controls and procedures required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15.

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See Financial Note 14, Other Commitments and Contingent Liabilities, of our unaudited condensed consolidated financial statements contained in Part I of this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors

There have been no material changes from the risk factors disclosed in Part 1, Item 1A, of our 2006 Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information on the Company s share repurchases during the third quarter of 2007.

	Share Repurchases			
(In millions, except price per share)	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Programs(1)
October 1, 2006 October 31, 2006		$		$ 345
November 1, 2006 November 30, 2006				345
December 1, 2006 December 31, 2006	2	50.85	2	247
Total	2		2	247

(1) In April and July 2006, the Company s Board of Directors approved plans to repurchase up

to a total of $1 billion ($500 million per plan) of the Company s common stock. These plans have no expiration date. This table does not include shares tendered to satisfy the exercise price in connection with cashless exercises of employee stock options or shares tendered to satisfy tax withholding obligations in connection with employee equity awards.

Item 3. Defaults Upon Senior Securities

None

Table of Contents

McKESSON CORPORATION

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

None

Item 5. Other Information

None

Item 6. Exhibits

Exhibits identified in parentheses below are on file with the Securities and Exchange Commission and are incorporated by reference as exhibits hereto.

Exhibit Number	Description
3.3	Amended and Restated By-Laws of the Company, dated as of January 4, 2007 (Exhibit 3.1 to the Company s Current Report on Form 8-K, Date of Report January 4, 2007, File No. 1-13252).
4.2	Amendment No. 1 to Rights Agreement, dated as of January 4, 2007, between the Company and The Bank of New York, as Rights Agent (Exhibit 4.1 to the Company s Current Report on Form 8-K, Date of Report January 4, 2007, File No. 1-13252).
10.31	Amended and Restated Employment Agreement, effective as of November 1, 2006, by and between the Company and its Executive Vice President and President, McKesson Provider Technologies.
10.32	Amended and Restated Employment Agreement, effective as of November 1, 2006, by and between the Company and its Executive Vice President and Group President.
31.1	Certification Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

McKesson Corporation

Dated: January 30, 2007

/s/ Jeffrey C. Campbell
Jeffrey C. Campbell
Executive Vice President and Chief Financial Officer

/s/ Nigel A. Rees
Nigel A. Rees
Vice President and Controller