Express Scripts Holding Co.
Form 10-Q
November 06, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2012.

¨ **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: 1-35490

EXPRESS SCRIPTS HOLDING COMPANY

(Exact name of registrant as specified in its charter)

Delaware	**45-2884094**
(State or other jurisdiction of **incorporation or organization)**	**(I.R.S. Employer** **Identification No.)**
One Express Way, St. Louis, MO	**63121**
(Address of principal executive offices)	**(Zip Code)**

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

Common stock outstanding as of October 31, 2012:	816,400,000	Shares

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

EXPRESS SCRIPTS HOLDING COMPANY

Unaudited Consolidated Balance Sheet

(in millions)	**September 30, 2012**	**December 31, 2011**
Assets		
Current assets:		
Cash and cash equivalents	$ 1,248.4	$ 5,620.1
Restricted cash and investments	47.3	17.8
Receivables, net	5,720.3	1,915.7
Inventories	1,561.4	374.4
Deferred taxes	417.3	45.8
Prepaid expenses and other current assets	437.8	84.2
Total current assets	9,432.5	8,058.0
Property and equipment, net	1,710.2	416.2
Goodwill	29,367.5	5,485.7
Other intangible assets, net	16,735.9	1,620.9
Other assets	61.6	26.2
Total assets	$ 57,307.7	$ 15,607.0
Liabilities and Stockholders Equity		
Current liabilities:		
Claims and rebates payable	$ 6,710.0	$ 2,874.1
Accounts payable	2,139.4	928.1
Accrued expenses	1,964.9	656.0
Short-term loan payable	40.0	
Current maturities of long-term debt	938.6	999.9
Total current liabilities	11,792.9	5,458.1
Long-term debt	16,146.3	7,076.4
Other liabilities	6,623.6	598.8
Total liabilities	34,562.8	13,133.3
Commitments and contingencies (Note 13)		
Stockholders Equity:		
Preferred stock, 15.0 shares authorized, $0.01 par value per share; and no shares issued and outstanding		
Common stock, 2,985.0 shares authorized, $0.01 par value per share; shares issued: 809.6 and 690.7, respectively; shares outstanding: 809.6 and 484.6, respectively	8.1	6.9
Additional paid-in capital	21,156.1	2,438.2
Accumulated other comprehensive income	16.6	17.0
Retained earnings	1,564.1	6,645.6
	22,744.9	9,107.7

Common stock in treasury at cost, zero and 206.1 shares, respectively		(6,634.0)
Total stockholders equity	22,744.9	2,473.7
Total liabilities and stockholders equity	$ 57,307.7	$ 15,607.0

See accompanying Notes to Unaudited Consolidated Financial Statements

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EXPRESS SCRIPTS HOLDING COMPANY

Unaudited Consolidated Statement of Operations

(in millions, except per share data)	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Revenues [1]	$ 26,999.4	$ 11,571.0	$ 66,824.5	$ 34,026.9
Cost of revenues [1]	24,864.9	10,735.2	61,745.1	31,661.5
Gross profit	2,134.5	835.8	5,079.4	2,365.4
Selling, general and administrative	1,336.0	230.7	3,220.7	628.6
Operating income	798.5	605.1	1,858.7	1,736.8
Other (expense) income:				
Undistributed gain from joint venture	5.1		9.4	
Interest income	1.4	5.9	6.0	7.8
Interest expense and other	(155.9)	(94.3)	(463.1)	(184.3)
	(149.4)	(88.4)	(447.7)	(176.5)
Income before income taxes	649.1	516.7	1,411.0	1,560.3
Provision for income taxes	257.7	192.0	602.2	574.9
Net income	$ 391.4	$ 324.7	$ 808.8	$ 985.4
Weighted average number of common shares outstanding during the period:				
Basic	812.9	487.2	702.4	506.1
Diluted	829.6	490.8	718.9	510.3
Basic earnings per share	$ 0.48	$ 0.67	$ 1.15	$ 1.95
Diluted earnings per share	$ 0.47	$ 0.66	$ 1.13	$ 1.93

[1] *Includes retail pharmacy co-payments of $3,348.9 million and $1,390.4 million for the three months ended September 30, 2012 and 2011, respectively, and $8,364.6 million and $4,374.0 million for the nine months ended September 30, 2012 and 2011, respectively.*

See accompanying Notes to Unaudited Consolidated Financial Statements

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EXPRESS SCRIPTS HOLDING COMPANY

Unaudited Consolidated Statement of Comprehensive Income

(in millions)	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Net income	$ 391.4	$ 324.7	$ 808.8	$ 985.4
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment	8.5	(5.1)	(0.4)	(4.2)
Comprehensive income	$ 399.9	$ 319.6	$ 808.4	$ 981.2

See accompanying Notes to Unaudited Consolidated Financial Statements

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EXPRESS SCRIPTS HOLDING COMPANY

Unaudited Consolidated Statement of Changes in Stockholders Equity

	Number of Shares	Amount					
(in millions)	Common Stock	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2011	690.7	$ 6.9	$ 2,438.2	$ 17.0	$ 6,645.6	$ (6,634.0)	$ 2,473.7
Net income					808.8		808.8
Other comprehensive income				(0.4)			(0.4)
Cancellation of treasury shares in connection with Merger activity	(204.7)	(2.0)	(728.5)		(5,890.3)	6,620.8	
Issuance of common shares in connection with Merger activity	318.0	3.2	18,841.6				18,844.8
Changes in stockholders equity related to employee stock plans	5.6		604.8			13.2	618.0
Balance at September 30, 2012	809.6	$ 8.1	$ 21,156.1	$ 16.6	$ 1,564.1	$	$ 22,744.9

See accompanying Notes to Unaudited Consolidated Financial Statements

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EXPRESS SCRIPTS HOLDING COMPANY

Unaudited Consolidated Statement of Cash Flows

(in millions)	Nine Months Ended September 30, 2012	2011
Cash flows from operating activities:		
Net income	$ 808.8	$ 985.4
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,292.0	187.5
Non-cash adjustments to net income	37.8	152.9
Deferred financing fees	32.1	44.9
Changes in operating assets and liabilities, net of effects of acquisition:		
Accounts receivable	382.6	(58.1)
Claims and rebates payable	(647.2)	44.4
Other net changes in operating assets and liabilities	143.3	302.9
Net cash flows provided by operating activities	2,049.4	1,659.9
Cash flows from investing activities:		
Acquisition of business, net of cash acquired	(10,283.6)	
Purchases of property and equipment	(106.0)	(98.1)
Proceeds from sale of business	31.5	
Other	(16.2)	8.5
Net cash used in investing activities	(10,374.3)	(89.6)
Cash flows from financing activities:		
Proceeds from long-term debt, net of discounts	7,458.9	1,494.0
Repayment of long-term debt	(2,710.6)	(0.1)
Proceeds (repayment) of revolving credit line, net	(1,000.0)	
Proceeds from accounts receivable financing facility	600.0	
Repayment of accounts receivable financing facility	(601.3)	
Excess tax benefit relating to employee stock compensation	30.4	27.3
Net proceeds from employee stock plans	276.5	28.9
Deferred financing fees	(103.2)	(62.7)
Treasury stock acquired		(2,515.7)
Net cash provided by (used in) financing activities	3,950.7	(1,028.3)
Effect of foreign currency translation adjustment	2.5	(3.1)
Net (decrease) increase in cash and cash equivalents	(4,371.7)	538.9
Cash and cash equivalents at beginning of period	5,620.1	523.7
Cash and cash equivalents at end of period	$ 1,248.4	$ 1,062.6

See accompanying Notes to Unaudited Consolidated Financial Statements

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EXPRESS SCRIPTS HOLDING COMPANY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Summary of significant accounting policies

On July 20, 2011, Express Scripts, Inc. (ESI) entered into a definitive merger agreement (the Merger Agreement) with Medco Health Solutions, Inc. (Medco), which was amended by Amendment No. 1 thereto on November 7, 2011, providing for the combination of ESI and Medco under a new holding company named Aristotle Holding, Inc. The transactions contemplated by the Merger Agreement (the Merger) were consummated on April 2, 2012. Aristotle Holding, Inc. was renamed Express Scripts Holding Company (the Company or Express Scripts) concurrently with the consummation of the Merger. We, our or us refers to Express Scripts Holding Company and its subsidiaries. For financial reporting and accounting purposes, ESI was the acquirer of Medco. The consolidated financial statements reflect the results of operations and financial position of ESI for 2011 periods and through April 1, 2012. However, references to amounts for periods after the closing of the Merger on April 2, 2012 relate to Express Scripts.

Express Scripts significant accounting policies, normally included in financial statements prepared in conformity with generally accepted accounting principles, have been omitted from this Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Express Scripts believes the disclosures contained in this Form 10-Q are adequate to fairly state the information when read in conjunction with the Notes to the Consolidated Financial Statements included in ESI s Annual Report on Form 10-K for the year ended December 31, 2011. Upon consummation of the Merger on April 2, 2012, Medco s significant accounting policies were conformed to ESI s significant accounting policies. However, two Medco historical accounting policies have been adopted related to the Medicare prescription drug program and the Cash balance pension plans.

Medicare Prescription Drug Program. Express Scripts revenues include premiums associated with our Medicare prescription drug program (PDP) risk-based product offerings. These products involve prescription dispensing for beneficiaries enrolled in the Centers for Medicare & Medicaid Services (CMS)-sponsored Medicare Part D Prescription Drug Program (Medicare Part D) prescription drug benefit. We also offer numerous customized benefit plan designs to employer group retiree plans under the Medicare Part D prescription drug benefit.

The PDP premiums are determined based on our annual bid and related contractual arrangements with CMS. The PDP premiums are primarily comprised of amounts received from CMS as part of a direct subsidy and an additional subsidy from CMS for low-income member premiums, as well as premium payments received from members. These premiums are recognized ratably to revenues over the period in which members are entitled to receive benefits. Premiums received in advance of the applicable benefit period are deferred and recorded in accrued expenses on the consolidated balance sheet. There is a possibility that the annual costs of drugs may be higher or lower than premium revenues. As a result, CMS provides a risk corridor adjustment for the standard drug benefit that compares our actual annual drug costs incurred to the targeted premiums in our CMS-approved bid. Based on specific collars in the risk corridor, we will receive from CMS additional premium amounts or be required to refund to CMS previously received premium amounts. We calculate the risk corridor adjustment on a quarterly basis based on drug cost experience to date and record an adjustment to revenues with a corresponding receivable from or payable to CMS reflected on the consolidated balance sheet.

In addition to PDP premiums, there are certain co-payments and deductibles (the cost share) due from members based on prescription orders by those members, some of which are subsidized by CMS in cases of low-income membership. Beginning in 2011, non-low-income members received a cost share benefit under the coverage gap discount program with brand pharmaceutical manufacturers. For subsidies received in advance, the amount is deferred and recorded in accrued expenses on the consolidated balance sheet. If there is cost share due from members, pharmaceutical manufacturers or CMS, or premiums due from members, the amount is accrued and recorded in receivables, net, on the consolidated balance sheet. After the end of the contract year and based on actual annual drug costs incurred, cost share amounts are reconciled with CMS and the corresponding receivable or payable is settled. The cost share is treated consistently as other co-payments derived from providing Pharmacy Benefit Management (PBM) services, as a component of revenues on the consolidated statement of operations.

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Express Scripts cost of revenues includes the cost of drugs dispensed by our mail-order pharmacies or retail network for members covered under our Medicare PDP product offerings and is recorded at cost as incurred. We receive a catastrophic reinsurance subsidy from CMS for approximately 80% of costs incurred by individual members in excess of the individual annual out-of-pocket maximum. The subsidy is reflected as an offsetting credit in cost of revenues to the extent that catastrophic costs are incurred. Catastrophic reinsurance subsidy amounts received in advance are deferred and recorded in accrued expenses on the consolidated balance sheet. If there are catastrophic reinsurance subsidies due from CMS, the amount is accrued and recorded in receivables, net, on the consolidated balance sheet. After the end of the contract year and based on actual annual drug costs incurred, catastrophic reinsurance amounts are reconciled with CMS and the corresponding receivable or payable is settled.

Pension Plans. Express Scripts has elected to determine the projected benefit obligation for cash balance pension plans as the value of the benefits to which employees participating in the plans would be entitled if they separated from service immediately. The amount by which the projected benefit obligation exceeds the fair value of the pension plan assets is recorded in other liabilities on the consolidated balance sheet.

The determination of our expense for pension plans is based on management s assumptions, which are developed with the assistance of actuaries. We reassess the plan assumptions on a regular basis. The expected rate of return for the pension plan represents the average rate of return to be earned on the plan assets over the period the benefits included in the benefit obligation are to be paid. The expected return on plan assets is determined by multiplying the expected long-term rate of return by the fair value of the plan assets and contributions, offset by expected return on expected benefit payments. In developing the expected rate of return we consider long-term compounded annualized returns of historical market data, as well as historical actual returns on our plan assets. Using this reference information, we develop forward-looking return expectations for each asset class and a weighted average expected long-term rate of return for a targeted portfolio allocated across these investment categories. As a result of this analysis, for 2012, the expected rate of return assumption is 7.5% for the pension plans.

Transaction Expense Adjustment. In September of 2012, the Company identified $36.4 million of transaction expenses related to the Merger which occurred subsequent to consummation of the Merger and were inadvertently excluded in the filed Form 10-Q for the three and six months ended June 30, 2012. These costs should have been accrued as of June 30, 2012. In accordance with Staff Accounting Bulletin No. 99 the Company assessed the materiality of the error and concluded that the error was not material to our financial statements for the three and six months ended June 30, 2012, but that the June 30, 2012 financial statements would be revised. The Company has revised these transaction expenses, which are reported within the Selling, general, and administrative (SG&A) line item of the accompanying unaudited consolidated statement of operations for the nine months ended September 30, 2012. These costs are not included in the accompanying unaudited consolidated statement of operations for the three months ended September 30, 2012.

We reported SG&A for the three and six months ended June 30, 2012 of $1,580.8 million and $1,848.3 million, respectively. The result of this adjustment revises SG&A for the three and six months ended June 30, 2012 to $1,617.2 million and $1,884.7 million, respectively. We reported net income for the three and six months ended June 30, 2012 of $170.9 million and $438.7 million, respectively. The result of this adjustment revises net income for the three and six months ended June 30, 2012 to $149.6 million and $417.4 million, respectively. These amounts will be revised in our next filing which includes June 30, 2012 amounts.

This revision in net income for the three months ended June 30, 2012 reduces basic earnings per share from 0.21 to 0.19 and reduces diluted earnings per share from 0.21 to 0.18. Furthermore, this revision reduces basic earnings per share for the six months ended June 30, 2012 from 0.68 to 0.65 and reduces diluted earnings per share from 0.66 to 0.63.

We believe the accompanying unaudited consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments, other than the transaction expenses discussed above) necessary to state fairly the unaudited consolidated balance sheet at September 30, 2012, the unaudited consolidated statement of operations and unaudited consolidated statement of comprehensive income for the three and nine months ended September 30, 2012 and 2011, the unaudited consolidated statement of changes in stockholders equity for the nine months ended September 30, 2012, and the unaudited consolidated statement of cash flows for the nine months ended September 30, 2012 and 2011. Operating results for the three and nine months ended September 30, 2012 include integration related expenses and are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

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Note 2 Fair value measurements

Accounting guidance regarding fair value measurement establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets for identical assets or liabilities; Level 2, defined as inputs other than quoted prices for similar assets and liabilities in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs for which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Financial assets accounted for at fair value on a recurring basis include cash equivalents of $878.0 million and $1,817.4 million, restricted cash and investments of $47.3 million and $17.8 million, and trading securities (included in other assets) of $7.5 million and $14.1 million at September 30, 2012 and December 31, 2011, respectively. These assets are carried at fair value based on quoted prices in active markets for identical securities (Level 1 inputs). Cash equivalents include investments in AAA-rated money market mutual funds with maturities of less than 90 days.

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The carrying value of cash and cash equivalents (Level 1), accounts receivable, claims and rebates payable, and accounts payable approximated fair values due to the short-term maturities of these instruments. The fair value, which approximates the carrying value, of our bank credit facility (Level 2) was estimated using either quoted market prices or the current rates offered to us for debt with similar maturities. The carrying values and the fair values of our senior notes are shown, net of unamortized discount, in the following table:

	September 30, 2012		December 31, 2011	
(in millions)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
March 2008 Senior Notes (acquired)				
7.125% senior notes due 2018	$ 1,426.9	$ 1,524.7	$	$
6.125% senior notes due 2013	306.9	306.9		
	1,733.8	1,831.6		
June 2009 Senior Notes				
6.250% senior notes due 2014	998.4	1,089.2	997.8	1,085.0
7.250% senior notes due 2019	497.5	640.3	497.3	593.1
5.250% senior notes due 2012			999.9	1,017.5
	1,495.9	1,729.5	2,495.0	2,695.6
September 2010 Senior Notes (acquired)				
2.75% senior notes due 2015	511.9	523.6		
4.125% senior notes due 2020	507.8	549.1		
	1,019.7	1,072.7		
May 2011 Senior Notes				
3.125% senior notes due 2016	1,495.5	1,598.0	1,494.6	1,493.7
November 2011 Senior Notes				
3.500% senior notes due 2016	1,249.7	1,353.5	1,249.7	1,265.3
4.750% senior notes due 2021	1,240.1	1,440.1	1,239.4	1,295.8
2.750% senior notes due 2014	899.3	933.1	899.0	907.8
6.125% senior notes due 2041	698.4	906.5	698.4	755.3
	4,087.5	4,633.2	4,086.5	4,224.2
February 2012 Senior Notes				
2.650% senior notes due 2017	1,487.2	1,574.1		
2.100% senior notes due 2015	996.1	1,025.2		
3.900% senior notes due 2022	979.6	1,086.4		
	3,462.9	3,685.7		
Total	$ 13,295.3	$ 14,550.7	$ 8,076.1	$ 8,413.5

The fair values of our senior notes were estimated based on observable market information (Level 2 inputs). In determining the fair value of liabilities, we took into consideration the risk of nonperformance. Nonperformance risk refers to the risk that the obligation will not be fulfilled and affects the value at which the liability would be transferred to a market participant. This risk did not have a material impact on the fair value of our liabilities.

Note 3 Changes in business

As a result of the Merger on April 2, 2012, Medco and ESI each became 100% owned subsidiaries of Express Scripts and former Medco and ESI stockholders became owners of stock in Express Scripts, which is listed for trading on the NASDAQ stock exchange. Upon closing of the Merger, former ESI stockholders owned approximately 59% of Express Scripts and former Medco stockholders owned approximately 41%. Per the terms of the Merger Agreement, upon consummation of the Merger on April 2, 2012, each share of Medco common stock was converted into

(i) the right to receive $28.80 in cash, without interest and (ii) 0.81 shares of Express Scripts stock. Holders of Medco stock options, restricted stock units, and deferred stock units received replacement awards at an exchange ratio of 1.3474 Express Scripts stock awards for each Medco award owned, which is equal to the sum of (i) 0.81 and (ii) the quotient obtained by dividing (1) $28.80 (the cash component of the Merger consideration) by (2) an amount equal to the average of the closing prices of ESI common stock on the NASDAQ for each of the 15 consecutive trading days ending with the fourth complete trading day prior to the completion of the Merger.

Based on the opening price of Express Scripts stock on April 2, 2012, the purchase price was comprised of the following:

(in millions)	
Cash paid to Medco stockholders[1]	$ 11,309.6
Value of shares of common stock issued to Medco stockholders[2]	17,963.8
Value of stock options issued to holders of Medco stock options[3] [4]	706.1
Value of restricted stock units issued to holders of Medco restricted stock units[3]	174.9
Total consideration	$ 30,154.4

(1) Equals Medco outstanding shares multiplied by $28.80 per share.
(2) Equals Medco outstanding shares immediately prior to the Merger multiplied by the exchange ratio of 0.81, multiplied by the Express Scripts opening share price on April 2, 2012 of $56.49.
(3) In accordance with applicable accounting guidance, the fair value of replacement awards attributable to precombination service is recorded as part of the consideration transferred in the Merger, while the fair value of replacement awards attributable to postcombination service is recorded separately from the business combination and recognized as compensation cost in the post-acquisition period over the remaining service period.
(4) The fair value of the Company s equivalent stock options was estimated using the Black-Scholes valuation model utilizing various assumptions. The expected volatility of the Company s common stock price is a blended rate based on the average historical volatility over the expected term based on daily closing stock prices of ESI and Medco common stock. The expected term of the option is based on Medco historical employee stock option exercise behavior as well as the remaining contractual exercise term.

The unaudited consolidated statement of operations for Express Scripts for the three months and nine months ended September 30, 2012 following consummation of the Merger on April 2, 2012 includes Medco s total revenues of $15,175.5 million and $30,847.9 million, respectively, and net income of $82.1 million and $46.9 million, respectively, which includes integration expense and amortization.

The following unaudited pro forma information presents a summary of Express Scripts combined results of operations for the three and nine months ended September 30, 2012 and 2011 as if the Merger and related financing transactions had occurred at January 1, 2011. The following pro forma financial information is not necessarily indicative of the results of operations as it would have been had the transactions been effected on the assumed date, nor is it necessarily an indication of trends in future results for a number of reasons, including, but not limited to, differences between the assumptions used to prepare the pro forma information, basic shares outstanding and dilutive equivalents, cost savings from operating efficiencies, potential synergies, and the impact of incremental costs incurred in integrating the businesses:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(in millions, except per share data)	**2012**	**2011**	**2012**	**2011**
Total revenues	$ 26,999.4	$ 28,499.1	$ 82,804.0	$ 85,006.3
Net income	391.4	279.1	837.7	516.5
Basic earnings per share	0.48	0.35	1.03	0.62
Diluted earnings per share	$ 0.47	$ 0.35	$ 1.01	$ 0.62

Pro forma net income for the three and nine months ended September 30, 2011 includes total non-recurring amounts of $180.7 million and $1,045.0 million, respectively, related to estimated severance payments, accelerated stock-based compensation, and transaction and integration costs incurred in connection with the Merger. These amounts represent the best available estimates as of the date of issuance. Actual costs recorded in the year ended December 31, 2012 may differ materially from estimates utilized for pro forma purposes.

The Merger is accounted for under the acquisition method of accounting with ESI treated as the acquirer for accounting purposes. The purchase price has been allocated based on the estimated fair value of net assets acquired and liabilities assumed at the date of the acquisition. Express Scripts retained third-party valuation advisors to conduct analyses of the assets acquired and liabilities assumed in order to assist in the determination of the preliminary purchase price allocation. The preliminary purchase price allocation may be subject to further refinement and may result in significant changes. These changes will primarily relate to the fair value of obligations acquired.

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During the third quarter ended September 30, 2012, the Company recorded fair value adjustments of approximately $104.0 million to its preliminary allocation of purchase price related to intangible assets, which had the effect of increasing intangible assets and reducing goodwill. In connection with the adjustment to fair value, the Company recorded a cumulative adjustment to amortization expense of $4.8 million. The adjustments to fair value resulted in an increase in deferred tax liabilities of $37.2 million and deferred tax assets of $58.7 million.

Also during the third quarter ended September 30, 2012, the Company made other adjustments to its preliminary allocation of purchase price related to accounts receivable, allowance for doubtful accounts, and contingent liabilities. These adjustments had the effect of increasing goodwill and reducing accounts receivable, increasing allowance for doubtful accounts and increasing current liabilities.

Express Scripts expects that if any further refinements become necessary, they will be completed by April 2013. There can be no assurance that such finalization will not result in material changes. The following table summarizes Express Scripts preliminary estimates of the fair values of the assets acquired and liabilities assumed in the Medco acquisition:

(in millions)	**Amounts Recognized as of Acquisition Date**
Current assets	$ 6,917.3
Property and equipment	1,390.6
Goodwill	23,897.2
Acquired intangible assets	16,216.7
Other noncurrent assets	48.3
Current liabilities	(9,033.1)
Long-term debt	(3,008.3)
Deferred income taxes	(5,924.0)
Other noncurrent liabilities	(350.3)
Total	$ 30,154.4

A portion of the excess of purchase price over tangible net assets acquired has been allocated to intangible assets consisting of customer contracts in the amount of $15,935.0 million with an estimated weighted average amortization period of 16 years. Additional intangible assets consist of trade names in the amount of $273.0 million with an estimated weighted average amortization period of 10 years and miscellaneous intangible assets of $8.7 million with an estimated weighted average amortization period of 5 years. The acquired intangible assets have been preliminarily valued using an income approach and are being amortized on a basis that approximates the pattern of benefit.

The excess of purchase price over tangible net assets and identified intangible assets acquired has been preliminarily allocated to goodwill in the amount of $23,897.2 million. The majority of the goodwill recognized as part of the Medco acquisition is reported under our PBM segment and reflects our expected synergies from combining operations, such as improved economies of scale and cost savings. None of the goodwill recognized is expected to be deductible for income tax purposes and is not amortized.

As a result of the Merger on April 2, 2012, we acquired the receivables of Medco. The gross contractual amounts receivable and fair value of these receivables as of the acquisition date are shown below. Of the gross amounts due under the contracts as of the date of acquisition, we estimated $20.6 million related to client accounts receivables to be uncollectible.

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(in millions)	Gross Contractual Amounts Receivable	Fair Value
Manufacturer Accounts Receivables	$ 1,895.2	$ 1,895.2
Client Accounts Receivables	2,432.2	2,389.0
Total	$ 4,327.4	$ 4,284.2

ESI and Medco each retain a one-sixth ownership in SureScripts. As a result of the Merger, the combined companies in total retain a one-third ownership in SureScripts. Due to the increased ownership percentage, we now account for the investment in SureScripts using the equity method and have recorded an undistributed gain of $5.1 million and $9.4 million, respectively, for the three months and nine months ended September 30, 2012.

Note 4 Dispositions

In the third quarter of 2012, we completed the sale of our ConnectYourCare (CYC) line of business, which is included within our Other Business Operations segment. During the third quarter of 2012, we recognized a gain on the sale of this business, net of the sale of its assets, which totaled $14.3 million. The gain is included in the Selling, general, and administrative (SG&A) line item in the accompanying unaudited consolidated statement of operations for the three and nine months ended September 30, 2012.

We determined that the results of operations for CYC for both 2012 and 2011 were immaterial to both consolidated and segment results of operations, and we have therefore not presented these results separately as discontinued operations for the current or prior periods. Operating income (loss), including the gain associated with the sale, totaled $14.4 million and $(0.1) million for the three months ended September 30, 2012 and 2011, respectively, and $14.7 million and $(0.5) million for the nine months ended September 30, 2012 and 2011, respectively. Total assets for CYC prior to the sale were $38.9 million. The majority of these assets represented goodwill of $12.0 million, restricted cash of $14.9 million and cash of $2.0 million. As these amounts represented less than 0.1% of total consolidated assets, the assets were not classified as held for sale within the consolidated balance sheet.

During the third quarter of 2012, we determined that our diabetic testing supply and related businesses under the Liberty brand (Liberty), which are included within our Other Business Operations, were not core to our future operations and committed to a plan to dispose of the business. As a result, Liberty has been classified as held for sale as of September 30, 2012. The Company expects to retain cash flows associated with Liberty which precludes classification of this business as a discontinued operation. Express Scripts anticipates working as a back end pharmacy supplier for portions of the Liberty business.

Operating loss for Liberty totaled $29.9 million and $35.5 million for the three and nine months ended September 30, 2012. Since Liberty was acquired through the Merger, periods prior to April 2, 2012 do not include any results associated with Liberty. Total assets for this line of business totaled $280.1 million as of September 30, 2012. The majority of these assets represented accounts receivable, net of $111.5 million, property and equipment, net of $45.3 million and inventories, net of $41.3 million. As a result of our plan to dispose of this line of business, an impairment charge totaling $23.0 million was recorded against intangible assets to reflect fair value. This charge is included in the SG&A line item in the accompanying unaudited consolidated statement of operations for the three and nine months ended September 30, 2012. The write-down was comprised of customer relationships with a carrying value of $24.2 million, net of accumulated amortization of $10.8 million, and trade names with a carrying value of $6.6 million, net of accumulated amortization of $0.4 million. This charge has been allocated to these assets on a pro rata basis using the carrying values as of September 30, 2012.

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Note 5 Property and equipment

Property and equipment, at cost, consists of the following:

(in millions)	September 30, 2012	December 31, 2011
Land and buildings	$ 240.6	$ 11.3
Furniture	71.2	36.7
Equipment	552.3	345.4
Computer software	1,330.7	398.0
Leasehold improvements	188.2	107.7
Total property and equipment	2,383.0	899.1
Less accumulated depreciation	(672.8)	(482.9)
Property and equipment, net	$ 1,710.2	$ 416.2

Depreciation expense for the three and nine months ended September 30, 2012 was $87.4 million and $198.2 million, respectively, and for the three and nine months ended September 30, 2011 was $22.5 million and $71.3 million, respectively. Internally developed software, net of accumulated depreciation was $733.3 million and $71.4 million at September 30, 2012 and December 31, 2011, respectively. We capitalized $33.2 million and $63.6 million of internally developed software during the three and nine months ended September 30, 2012, respectively.

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Note 6 Goodwill and other intangible assets

During the second quarter of 2012, we reorganized our segments to better reflect our structure following the Merger. Our new segment structure is composed of our domestic and Canadian PBM segment and our Other Business Operations segment. See Note 14 Segment information for further description of the services performed by each segment. Historical segment information has been retrospectively adjusted to reflect the effect of these changes. The following is a summary of our goodwill and other intangible assets for our two reportable segments PBM and Other Business Operations:

	September 30, 2012			December 31, 2011		
(in millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Goodwill						
PBM[1]	$ 29,268.8	$ (107.5)	$ 29,161.3	$ 5,512.6	$ (107.4)	$ 5,405.2
Other Business Operations[1][2]	206.2		206.2	80.5		80.5
	$ 29,475.0	$ (107.5)	$ 29,367.5	$ 5,593.1	$ (107.4)	$ 5,485.7
Other intangible assets						
PBM						
Customer contracts	$ 17,672.8	$ (1,532.7)	$ 16,140.1	$ 2,018.5	$ (494.7)	$ 1,523.8
Trade names	226.7	(11.2)	215.5	3.6		3.6
Miscellaneous	121.6	(24.1)	97.5	123.0	(60.1)	62.9
	18,021.1	(1,568.0)	16,453.1	2,145.1	(554.8)	1,590.3
Other Business Operations						
Customer relationships[3]	322.0	(75.4)	246.6	68.4	(38.5)	29.9
Trade names[4]	38.7	(2.5)	36.2	0.7		0.7
	360.7	(77.9)	282.8	69.1	(38.5)	30.6
Total other intangible assets	$ 18,381.8	$ (1,645.9)	$ 16,735.9	$ 2,214.2	$ (593.3)	$ 1,620.9

(1) Goodwill associated with the Medco acquisition has been reallocated between the PBM and the Other Business Operations segments due to refinement of purchase price valuation assumptions. $1,233.6 million previously allocated to the Other Business Operations segment as of June 30, 2012 was reallocated to the PBM as of September 30, 2012.

(2) Gross carrying amounts as of September 30, 2012 reflect the disposition of $12.0 million associated with CYC and impairment of $2.0 million associated with Europa Apotheek (EAV).

(3) Gross carrying amounts as of September 30, 2012 reflect the disposition of $0.7 million associated with CYC, impairment of $18.0 million associated with Liberty, and impairment of $3.6 million associated with EAV.

(4) Gross carrying amounts as of September 30, 2012 reflect the impairment of $5.0 million associated with Liberty and impairment of $5.9 million associated with EAV.

The aggregate amount of amortization expense of other intangible assets for our operations was $535.5 million and $55.3 million for the three months ended September 30, 2012 and 2011, respectively, and $1,121.7 million and $135.0 million for the nine months ended September 30, 2012 and 2011, respectively. In accordance with applicable accounting guidance, amortization for customer contracts related to our agreement to provide PBM services to members of the affiliated health plans of WellPoint has been included as an offset to revenues in the amount of $28.5 million for the three months ended September 30, 2012 and 2011 and $85.5 million for the nine months ended September 30, 2012 and 2011. The aggregate amount of amortization expense of other intangible assets for our operations is expected to be approximately $1,654.4 million for 2012, $2,082.5 million for 2013, $1,808.4 million for 2014, $1,785.3 million for 2015 and $1,766.4 million for 2016. These estimates may be revised once preliminary valuation procedures are completed for intangible assets acquired in connection with the Merger as discussed in Note 3 Changes in business. The weighted average amortization period of intangible assets subject to amortization is 15 years in total, and by major

intangible class is 2 to 20 years for customer-related intangibles, 10 years for trade name intangibles and 5 to 30 years for miscellaneous intangible assets.

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A summary of the change in the net carrying value of goodwill by business segment is shown in the following table:

(in millions)	PBM	Other Business Operations	Total
Balance at December 31, 2011	$ 5,405.2	$ 80.5	$ 5,485.7
Acquisitions[(1)(2)]	23,755.1	142.1	23,897.2
Dispositions[(3)]		(14.0)	(14.0)
Foreign currency translation	1.0	(2.4)	(1.4)
Balance at September 30, 2012	$ 29,161.3	$ 206.2	$ 29,367.5

(1) Represents the acquisition of Medco in April 2012.

(2) Goodwill associated with the Medco acquisition has been reallocated between the PBM and the Other Business Operations segments due to refinement of purchase price valuation assumptions. $1,233.6 million previously allocated to the Other Business Operations segment as of June 30, 2012 was reallocated to the PBM as of September 30, 2012.

(3) Represents the write-off of $12.0 million of goodwill associated with CYC and the impairment of $2.0 million associated with Europa Apotheek (EAV).

During the third quarter of 2012, we determined that our Europa Apotheek line of business, which primarily provides mail-order pharmacy services in Germany, which is included within our Other Business Operations, was not core to our future operations and it was more likely than not that we would dispose of this business. The Company determined it was necessary to reassess carrying values of assets and liabilities in this business in the third quarter of 2012 based on a change in business environment related to an adverse court ruling by the German high court in August 2012 and the expected disposal. Based on the assessment, we recorded impairment charges associated with this line of business totaling $11.5 million to reflect the write-down of $2.0 million of goodwill and $9.5 million of intangible assets. These charges are included in the SG&A line item in the accompanying unaudited consolidated statement of operations for the three and nine months ended September 30, 2012. The write-down of intangible assets was comprised of customer relationships with a carrying value of $3.6 million, net of accumulated amortization of $1.4 million, and trade names with a carrying value of $5.9 million, net of accumulated amortization of $1.1 million.

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Note 7 Earnings per share

Basic earnings per share (EPS) is computed using the weighted average number of common shares outstanding during the period. Diluted EPS is computed in the same manner as basic earnings per share but adds the number of additional common shares that would have been outstanding for the period if the dilutive potential common shares had been issued. All shares are calculated under the treasury stock method. The following is the reconciliation between the number of weighted average shares used in the basic and diluted EPS calculations for all periods:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions)	2012[1]	2011	2012[1]	2011
Weighted average number of common shares outstanding during the period Basic EPS	812.9	487.2	702.4	506.1
Dilutive common stock equivalents:				
Outstanding stock options, stock-settled stock appreciation rights, restricted stock units, and executive deferred compensation units	16.7	3.6	16.5	4.2
Weighted average number of common shares outstanding during the period Diluted EPS[2]	829.6	490.8	718.9	510.3

(1) The increase in the weighted average number of common shares outstanding for the three and nine months ended September 30, 2012 for Basic and Diluted EPS resulted primarily from the issuance of 318.0 million shares in connection with the Merger.

(2) Excludes awards of 3.5 million and 4.6 million for the three months ended September 30, 2012 and 2011, respectively, and 5.9 million and 3.0 million for the nine months ended September 30, 2012 and 2011, respectively. These were excluded because their effect was anti-dilutive.

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Note 8 Financing

The Company s debt, net of unamortized discounts and premiums, consists of:

(in millions)	September 30, 2012	December 31, 2011
Short-term debt:		
Other short-term loans payable	$ 40.0	$
Long-term debt:		
March 2008 Senior Notes (acquired)		
7.125% senior notes due 2018	1,426.9	
6.125% senior notes due 2013	306.9	
	1,733.8	
June 2009 Senior Notes		
6.250% senior notes due 2014	998.4	997.8
7.250% senior notes due 2019	497.5	497.3
5.250% senior notes due 2012		999.9
	1,495.9	2,495.0
September 2010 Senior Notes (acquired)		
2.750% senior notes due 2015	511.9	
4.125% senior notes due 2020	507.8	
	1,019.7	
May 2011 Senior Notes		
3.125% senior notes due 2016	1,495.5	1,494.6
November 2011 Senior Notes		
3.500% senior notes due 2016	1,249.7	1,249.7
4.750% senior notes due 2021	1,240.1	1,239.4
2.750% senior notes due 2014	899.3	899.0
6.125% senior notes due 2041	698.4	698.4
	4,087.5	4,086.5
February 2012 Senior Notes		
2.650% senior notes due 2017	1,487.2	
2.100% senior notes due 2015	996.1	
3.900% senior notes due 2022	979.6	
	3,462.9	
Term facility due August 29, 2016 with an average interest rate of 2.2% at September 30, 2012	3,789.5	
Other	0.1	0.2
Less: Current maturities of long-term debt	938.6	999.9
Total long-term debt	16,146.3	7,076.4
Total debt	$ 17,124.9	$ 8,076.3

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BANK CREDIT FACILITIES

On August 29, 2011, ESI entered into a credit agreement (the new credit agreement) with a commercial bank syndicate providing for a five-year $4.0 billion term loan facility (the term facility) and a $1.5 billion revolving loan facility (the new revolving facility). The term facility was used to pay a portion of the cash consideration paid in connection with the Merger, as discussed in Note 3 Changes in business, to repay existing indebtedness, and to pay related fees and expenses. Subsequent to consummation of the Merger on April 2, 2012, the new revolving facility is available for general corporate purposes and replaced our $750.0 million credit facility upon funding of the term facility on April 2, 2012. The term facility and the new revolving facility both mature on August 29, 2016. As of September 30, 2012, no balance was outstanding under the new revolving facility. The Company makes quarterly principal payments on the term facility. As of September 30, 2012, $631.6 million of this facility is considered current maturities of long-term debt. Upon consummation of the Merger, Express Scripts assumed the obligations of ESI and became the borrower under the new credit agreement and new revolving facility.

The new credit agreement requires interest to be paid at the LIBOR or adjusted base rate options, plus a margin. The margin over LIBOR ranges from 1.25% to 1.75% for the term facility and 1.10% to 1.55% for the new revolving facility, and the margin over the base rate options ranges from 0.25% to 0.75% for the term facility and 0.10% to 0.55% for the new revolving facility, depending on our consolidated leverage ratio. Under the new credit agreement, we are required to pay commitment fees on the $1.5 billion new revolving facility. The commitment fee ranges from 0.15% to 0.20% depending on the Express Scripts consolidated leverage ratio.

On August 13, 2010, ESI entered into a credit agreement with a commercial bank syndicate providing for a three-year revolving credit facility of $750.0 million (the 2010 credit facility). The 2010 credit facility was terminated and replaced by the new revolving facility on April 2, 2012, as described above.

BRIDGE FACILITY

On August 5, 2011, ESI entered into a credit agreement with Credit Suisse AG, Cayman Islands Branch, as administrative agent, Citibank, N.A., as syndication agent, and the other lenders and agents named within the agreement. The credit agreement provided for a one-year unsecured $14.0 billion bridge term loan facility (the bridge facility) to be used to pay a portion of the cash consideration in connection with the Merger in the event that more favorable financing arrangements could not be secured. No amounts were withdrawn under the bridge facility, and subsequent to consummation of the Merger on April 2, 2012, ESI terminated the bridge facility.

FIVE-YEAR CREDIT FACILITY

On April 30, 2007, Medco entered into a senior unsecured credit agreement, which was available for general working capital requirements. The facility consisted of a $1.0 billion, 5-year senior unsecured term loan and a $2.0 billion, 5-year senior unsecured revolving credit facility. The facility was due to mature on April 30, 2012. Medco refinanced the $2.0 billion senior unsecured revolving credit facility on January 23, 2012. Upon completion of the Merger, the $1.0 billion senior unsecured term loan and all associated interest, and the $1.0 billion then outstanding under the senior unsecured revolving credit facility, were repaid in full and terminated.

ACCOUNTS RECEIVABLE FINANCING FACILITY

Upon consummation of the Merger, Express Scripts assumed a $600 million, 364-day renewable accounts receivable financing facility that was collateralized by Medco s pharmaceutical manufacturer rebates accounts receivable. On September 21, 2012, Express Scripts terminated the facility and repaid all amounts drawn down.

INTEREST RATE SWAP

Medco entered into five interest rate swap agreements in 2004. These swap agreements, in effect, converted $200 million of Medco s $500 million of 7.250% senior notes due 2013 to variable interest rate debt. Under the terms of these swap agreements, Medco received a fixed rate of interest of 7.25% on $200 million and paid variable interest rates based on the six-month LIBOR plus a weighted average spread of 3.05%. The payment dates under the agreements coincided with the interest payment dates on the hedged debt instruments and the difference between the amounts paid and received is included in interest expense. These swaps were settled on May 7, 2012. Express Scripts received $10.1 million for settlement of the swaps and the associated accrued interest receivable through May 7, 2012, and recorded a loss of $1.5 million related to the carrying amount of the swaps and bank fees.

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SENIOR NOTES

On February 6, 2012, Express Scripts issued $3.5 billion of Senior Notes (the February 2012 Senior Notes) in a private placement with registration rights, including:

- $1.0 billion aggregate principal amount of 2.100% Senior Notes due 2015 (February 2015 Senior Notes)
- $1.5 billion aggregate principal amount of 2.650% Senior Notes due 2017 (February 2017 Senior Notes)
- $1.0 billion aggregate principal amount of 3.900% Senior Notes due 2022 (February 2022 Senior Notes)

The net proceeds were used to pay a portion of the cash consideration paid in the Merger and to pay related fees and expenses.

We may redeem some or all of each series of February 2012 Senior Notes prior to maturity at a price equal to the greater of (1) 100% of the aggregate principal amount of any notes being redeemed, plus accrued and unpaid interest; or (2) the sum of the present values of the remaining scheduled payments of principal and interest on the notes being redeemed, not including unpaid interest accrued to the redemption date, discounted to the redemption date on a semiannual basis at the treasury rate plus 30 basis points with respect to any February 2015 Senior Notes being redeemed, 35 basis points with respect to any February 2017 Senior Notes being redeemed, or 40 basis points with respect to any February 2022 Senior Notes being redeemed plus, in each case, unpaid interest on the notes being redeemed, accrued to the redemption date. The February 2012 Senior Notes, issued by Express Scripts, are jointly and severally and fully and unconditionally (subject to certain customary release provisions, including sale, exchange, transfer or liquidation of the guarantor subsidiary) guaranteed on a senior unsecured basis by ESI and most of our current 100% owned domestic subsidiaries, including, following the consummation of the Merger, Medco and certain of Medco s 100% owned domestic subsidiaries.

Following the consummation of the Merger on April 2, 2012, several series of senior notes issued by Medco are reported as debt obligations of Express Scripts on a consolidated basis:

- $500.0 million aggregate principal amount of 7.250% senior notes due 2013
- $300.0 million aggregate principal amount of 6.125% senior notes due 2013
- $500.0 million aggregate principal amount of 2.750% senior notes due 2015
- $1,200.0 million aggregate principal amount of 7.125% senior notes due 2018
- $500.0 million aggregate principal amount of 4.125% senior notes due 2020

On May 7, 2012, the Company redeemed Medco s $500.0 million aggregate principal amount of 7.250% senior notes due 2013. These notes were redeemable at a redemption price equal to the greater of (i) 100% of the principal amount of the notes being redeemed, or (ii) the sum of the present values of 107.25% of the principal amount of these notes being redeemed, plus all scheduled payments of interest on the notes discounted to the redemption date at a semi-annual equivalent yield to a comparable U.S. Treasury security for such redemption date plus 50 basis points. Total cash payments related to these notes were $549.4 million comprised of principal, redemption costs and interest.

On June 15, 2012, $1.0 billion aggregate principal amount of 5.250% senior notes due 2012, issued by ESI, matured and were redeemed.

COVENANTS

Our bank financing arrangements contain covenants that restrict our ability to incur additional indebtedness, create or permit liens on assets and engage in mergers or consolidations (other than the Merger with Medco). The covenants also include minimum interest coverage ratios and maximum leverage ratios. The 6.125% senior notes due 2013 and the 7.125% senior notes due 2018 issued by Medco are also subject to an interest rate adjustment in the event of a downgrade in the ratings to below investment grade. At September 30, 2012, we believe we were in compliance in all material respects with all covenants associated with our debt instruments (including credit agreements and terms of our senior notes).

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Note 9 Income taxes

As a result of the Merger, we recognized additional income tax contingencies and unfavorable impacts to our effective tax rate. Our effective tax rate increased to 39.7% and 42.7% for the three and nine months ended September 30, 2012, respectively, as compared to 37.2% and 36.8% for the same periods in 2011 due to both recurring and nonrecurring events. The state apportionment and income tax filing positions of the combined organization has increased our recurring effective tax rate by approximately 1.9%. Certain charges, described below, decreased our effective tax rate for the three months ended September 30, 2012 by 0.2% and increased our effective tax rate for the nine months ended September 30, 2012 by 3.1%.

For the nine months ended September 30, 2012, we recorded a charge of $14.2 million resulting from the reversal of the deferred tax asset previously established for transaction-related costs that became nondeductible upon the consummation of the Merger. In addition, due to the adoption of common income tax return filing methods between ESI and Medco, we recorded a $23.6 million income tax contingency related to prior year income tax return filings. We also recorded a charge of $0.5 million related to the impairment of goodwill for EAV. Lastly, unrelated to the Merger, we recorded a charge of $5.2 million in the first quarter of 2012 due to changes in our unrecognized tax benefits.

As of September 30, 2012, our gross income tax contingencies increased to $368.5 million primarily due to the acquisition of Medco. A reconciliation of our beginning and ending amount of unrecognized tax benefits is as follows:

(in millions)	September 30, 2012
Balance at January 1, 2012	$ 32.3
Additions for tax positions related to prior years[1]	313.5
Reductions for tax positions related to prior years	(0.3)
Additions for tax positions related to the current year	26.2
Reductions as a result of a lapse of the applicable statute of limitations	(3.2)
Ending Balance	$ 368.5

(1) Includes an aggregate $282.6 million of Medco income tax contingencies recorded through the allocation of Medco s purchase price. Included in our unrecognized tax benefits are $215.3 million of net uncertain tax positions that would impact our effective tax rate if recognized.

For the nine months ended September 30, 2012, we recorded $9.5 million of interest and penalties in our unaudited consolidated statement of operations and $41.3 million of interest and penalties recorded through the allocation of Medco s purchase price resulting in a $54.4 million cumulative balance of accrued interest and penalties in our unaudited consolidated balance sheet. Interest was computed on the difference between the tax position recognized in accordance with accounting guidance and the amount previously taken or expected to be taken in our tax returns.

The Internal Revenue Service (IRS) is examining the consolidated 2008 and 2009 U.S. federal income tax returns for both ESI and Medco. In addition, during the third quarter, the IRS commenced an examination of Medco s 2010 U.S. Federal income tax return. All of these audits are anticipated to be concluded in 2013. The majority of the income tax contingencies are subject to statutes of limitations that are scheduled to expire by the end of 2016.

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Note 10 Common stock

On May 27, 2011, ESI entered into agreements to repurchase shares of its common stock for an aggregate purchase price of $1,750.0 million under an Accelerated Share Repurchase (ASR) arrangement. During 2011, ESI settled $1,725.0 million of the ASR agreement and received 33.4 million shares. On April 27, 2012, we settled the remaining portion of the ASR agreement and received 0.1 million additional shares, resulting in a total of 33.5 million shares received under the agreement.

Upon consummation of the Merger on April 2, 2012, all ESI shares held in treasury were no longer outstanding and were cancelled and retired and ceased to exist. Express Scripts eliminated the value of treasury shares, at cost, recorded on the unaudited consolidated balance sheet immediately prior to the Merger as a reduction to retained earnings and paid-in capital.

The Board of Directors of Express Scripts has not yet adopted a stock repurchase program to allow for the repurchase of shares of Express Scripts.

Note 11 Stock-based compensation plans

In March 2011, ESI s Board of Directors adopted the ESI 2011 Long-Term Incentive Plan (the 2011 LTIP), which provides for the grant of various equity awards with various terms to our officers, directors and key employees selected by the Compensation Committee of the Board of Directors. The 2011 LTIP was approved by ESI s stockholders in May 2011 and became effective June 1, 2011. Upon consummation of the Merger, the Company assumed sponsorship of the 2011 LTIP. Under the 2011 LTIP, we may issue stock options, stock-settled stock appreciation rights (SSRs), restricted stock units, restricted stock awards, performance share awards, and other types of awards. The maximum number of shares available for awards under the 2011 LTIP is 30 million. The maximum term of stock options, SSRs, restricted stock and performance shares granted under the 2011 LTIP is 10 years. Subsequent to the effective date of the 2011 LTIP, no additional awards will be granted under the 2000 Long-Term Incentive Plan (2000 LTIP), which provided for the grant of various equity awards with various terms to our officers, directors and key employees selected by the Compensation Committee of the Board of Directors.

Effective upon the closing of the Merger, the Company assumed the sponsorship of the Medco Health Solutions, Inc. 2002 Stock Incentive Plan, originally adopted by Medco, allowing Express Scripts to issue awards under this plan. As of September 30, 2012, 14.5 million shares are available under this plan. Under the Medco Health Solutions, Inc. 2002 Stock Incentive Plan, Medco granted, and Express Scripts may grant, stock options, restricted stock units, and other types of awards to employees and directors. Medco s awards granted under the 2002 Stock Incentive Plan are subject to accelerated vesting upon change in control and termination.

As part of the consideration transferred in the Merger, Express Scripts issued 41.5 million replacement stock options to holders of Medco stock options, valued at $706.1 million, and 7.2 million replacement restricted stock units to holders of Medco restricted stock units, valued at $174.9 million. See Note 3 Changes in business, for further discussion of valuation.

STOCK OPTIONS AND SSRs

Express Scripts grants stock options and SSRs to certain officers, directors and employees to purchase shares of Express Scripts Holding Company common stock at the fair market value on the date of grant. ESI s SSRs and stock options granted under both the 2000 LTIP and 2011 LTIP have three-year graded vesting. Medco s options granted under the 2002 Stock Incentive Plan generally vest over three years. Due to the nature of the awards, we use the same valuation methods and accounting treatments for SSRs and stock options.

A summary of the status of stock options and SSRs as of September 30, 2012, and changes during the nine months ended September 30, 2012, is presented below:

(share data in millions)	**Shares**	**Weighted-Average Exercise Price**
ESI outstanding at January 1, 2012	13.7	$ 34.54
Medco outstanding converted at April 2, 2012	41.5	38.61
Granted	3.6	53.06
Exercised	(10.4)	29.90
Forfeited/Cancelled	(0.8)	48.72
Express Scripts outstanding at September 30, 2012	47.6	$ 40.26
Express Scripts exercisable at September 30, 2012	32.0	$ 36.03

The fair value of options and SSRs granted is estimated on the date of grant using a Black-Scholes multiple option-pricing model with the following weighted average assumptions:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2012	**2011**	**2012**	**2011**
Expected life of option	3-5 years	3-5 years	2-5 years	3-5 years
Risk-free interest rate	0.3%-0.6%	0.3%-2.1%	0.3%-0.9%	0.3%-2.2%
Expected volatility of stock	29%-38%	35%-39%	29%-38%	35%-39%
Expected dividend yield	None	None	None	None

The fair value of Medco converted grants was estimated on the date of the Merger using a Black-Scholes multiple option-pricing model with the following weighted average assumptions:

	At April 2, 2012 Medco Converted Grants
Expected life of option	2 years
Risk-free interest rate	0.4%
Expected volatility of stock	32.9%
Expected dividend yield	None

The Black-Scholes model requires subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values. The expected term and forfeiture rate of options granted is derived from historical data on employee exercises and post-vesting employment termination behavior, as well as expected behavior on outstanding options. The risk-free rate is based on the U.S. Treasury rates in effect during the corresponding period of grant. The expected volatility is based on the historical volatility of our stock price. These factors could change in the future, which would affect the stock-based compensation expense in future periods.

At September 30, 2012, the weighted-average remaining contractual lives of stock options and SSRs outstanding and stock options and SSRs exercisable were 6.2 years and 5.6 years, respectively, and the aggregate intrinsic value (the amount by which the market value of the underlying stock exceeds the exercise price of the option) of shares outstanding and shares exercisable was $1,064.8 million and $851.0 million, respectively.

The total grant date fair value of stock options and SSRs vested in 2012 was $164.7 million. Express Scripts expects the majority of outstanding non-vested options and SSRs to vest. The activity related to non-vested options is as follows:

(share data in millions)	**Shares**	**Weighted-Average Exercise Price**
ESI non-vested at January 1, 2012	5.8	$ 13.35
Medco non-vested converted at April 2, 2012	16.9	17.99
Granted	3.6	15.08
Vested	(10.0)	16.41
Forfeited	(0.7)	16.35
Express Scripts non-vested at September 30, 2012	15.6	$ 16.67

RESTRICTED STOCK UNITS AND PERFORMANCE SHARES

Express Scripts grants restricted stock units to certain officers, directors and employees and performance shares to certain officers and employees. ESI s restricted stock units granted under both the 2000 LTIP and the 2011 LTIP have a three-year graded vesting and the performance shares cliff vest at the end of the three years. The number of performance shares that ultimately vest is dependent upon achieving specific performance targets. Prior to vesting, these shares are subject to forfeiture to us without consideration upon termination of employment under certain circumstances. The original amount of performance share grants is subject to a multiplier of 2.5 based on certain performance metrics. Medco s restricted stock units and performance shares granted under the 2002 Stock Incentive Plan generally vest over three years (director options vest in one year). During the first nine months of 2012, approximately 0.2 million additional performance shares were granted to certain officers for exceeding certain performance metrics.

A summary of the status of restricted stock and performance shares as of September 30, 2012, and changes during the nine months ended September 30, 2012, is presented below:

(share data in millions)	**Shares**	**Weighted-Average Grant Date Fair Value**
ESI outstanding at January 1, 2012	1.3	$ 41.92
Medco outstanding converted at April 2, 2012	7.2	56.49
Granted	0.3	53.03
Other[(1)]	0.2	52.04
Released	(2.7)	50.14
Forfeited/Cancelled	(0.2)	53.97
Express Scripts outstanding at September 30, 2012	6.1	$ 54.24
Express Scripts vested and deferred at September 30, 2012	0.9	$ 56.49

(1) Represents additional performance shares issued above the original value for exceeding certain performance metrics.

Summarized information related to non-vested restricted stock units held by Express Scripts employees and directors is as follows:

(share data in millions)	Shares	Weighted-Average Grant Date Fair Value
ESI non-vested at January 1, 2012	1.3	$ 41.92
Medco non-vested converted at April 2, 2012	6.3	56.49
Granted	0.3	53.03
Other[1]	0.2	52.04
Vested	(2.7)	50.22
Forfeited	(0.2)	53.97
Express Scripts non-vested at September 30, 2012	5.2	$ 54.75

(1) Represents additional performance shares issued above the original value for exceeding certain performance metrics.

We recognized stock-based compensation expense of $95.3 million and $10.9 million in the three months ended September 30, 2012 and 2011, respectively, and $341.6 million and $36.2 million in the nine months ended September 30, 2012 and 2011, respectively. The increases for the three months and nine months ended September, 2012 include stock-based compensation expense acceleration associated with the termination of certain Medco employees. Unamortized stock-based compensation as of September 30, 2012 was $107.7 million for stock options and SSRs and $125.8 million for restricted stock and performance shares.

Note 12 Pension and other post-retirement benefits

In connection with the Merger, Express Scripts acquired Medco s pension and other post-retirement benefit obligations, which were re-measured and recorded at fair value on the acquisition date.

For the pension plans, Express Scripts has elected to determine the projected benefit obligation as the value of the benefits to which employees would be entitled if they separated from service immediately. Under this approach, the liability is equal to the employee s account value as of the measurement date. After re-measurement upon the acquisition, the fair value of the projected benefit obligation was $291.5 million and the plan assets at fair value totaled $217.0 million, representing an unfunded status and resulting in a balance sheet liability of $74.5 million.

In January 2011, Medco amended its pension plans, freezing the benefit for all participants effective in the first quarter of 2011. After the plan freeze, participants did not accrue any benefits under the plans, and the plans have been closed to new entrants since February 28, 2011. For the three and nine months ended September 30, 2012, the net benefit for Express Scripts pension plans consisted of the following components:

(in millions)	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012
Interest cost	2.1	4.2
Expected return on plan assets	(4.1)	(8.2)
Net pension benefit	$ (2.0)	$ (4.0)

Medco s unfunded postretirement healthcare benefit plan was discontinued for all active non-retirement eligible employees in January 2011. The elimination of the post-retirement healthcare benefit for all active nonretirement-eligible employees was accounted for as a curtailment of the plan. For the three and nine months ended September 30, 2012, the net cost for these post-retirement benefits consisted of interest cost of less than $0.1 million.

The Company paid $2.3 million and $4.6 million, respectively, for the three and nine months ended September 30, 2012. Contributions by the Company are calculated based upon actuarial assumptions. Under the current actuarial assumptions, there is no minimum contribution required for the 2011 or 2012 plan years.

Note 13 Commitments and contingencies

We have entered into noncancellable agreements to lease certain office and distribution facilities with remaining terms from one to ten years. The majority of our lease agreements include renewal options which would extend the agreements from one to five years. The future minimum lease payments due under noncancellable operating leases are shown below:

(in millions)	**Minimum Lease Payments**	
2012[(1)]	$	24.0
2013		81.1
2014		65.5
2015		44.0
2016		34.7
Thereafter		62.5
	$	311.8

(1) Represents remaining fourth quarter of 2012.

As of September 30, 2012, we have certain required future purchase commitments for prescription products, supplies, services and fixed assets related to the normal course of business. We do not expect potential payments under these provisions to materially affect results of operations or financial condition based upon reasonably likely outcomes derived by reference to historical experience and current business plans. These future purchase commitments are summarized below:

(in millions)	**Future Purchase Commitments**	
2012[(1)]	$	176.5
2013		367.6
2014		357.0
2015		2.0
2016		1.1
Thereafter		1.1
	$	905.3

(1) Represents remaining fourth quarter of 2012.

In the ordinary course of business there have arisen various legal proceedings, investigations, recoupment demands or claims now pending against us or our subsidiaries. In accordance with applicable accounting guidance, we record accruals for certain of our outstanding legal proceedings, investigations or claims when it is probable that a liability will be incurred and the amount of loss can be reasonably estimated. We evaluate, on a quarterly basis, developments in legal proceedings, investigations or claims that could affect the amount of any accrual, as well as any developments that would make a loss contingency both probable and reasonably estimable. We disclose the amount of the accrual if the financial statements would be otherwise misleading, which was not the case for the nine months ending September 30, 2012 or 2011.

We record self-insurance accruals based upon estimates of the aggregate liability of claim costs in excess of our insurance coverage. Accruals are estimated using certain actuarial assumptions followed in the insurance industry and our historical experience. The majority of these claims are legal claims and our liability estimate is primarily related to the cost to defend these claims. We do not accrue for settlements, judgments,

monetary fines or penalties until such amounts are probable and estimable. Under authoritative accounting guidance, if the range of probable loss is broad, the liability accrued should be based on the lower end of the range.

When a loss contingency is not both probable and estimable, we do not establish an accrued liability. However, if the loss (or an additional loss in excess of the accrual) is at least a reasonable possibility and material, then we disclose an estimate of the possible loss or range of loss, if such estimate can be made, or disclose that an estimate cannot be made.

The assessments of whether a loss is probable or a reasonable possibility, and whether the loss or a range of loss is estimable, often involve a series of complex judgments about future events. We are often unable to estimate a range of reasonably possible losses, particularly where (i) the damages sought are substantial or indeterminate, (ii) the proceedings are in the early stages, or (iii) the matters involve novel or unsettled legal theories or a large number of parties. In such cases, there is considerable uncertainty regarding the timing or ultimate resolution of such matters, including a possible eventual loss, fine, penalty or business impact, if any. Accordingly, for many proceedings, we are currently unable to estimate the loss or a range of possible loss. For a limited number of proceedings, we may be able to reasonably estimate the possible range of loss in excess of any accruals. However, we believe that such matters, individually and in the aggregate, when finally resolved, are not reasonably likely to have a material adverse effect on our consolidated cash flow or financial condition. We also believe that any amount that could be reasonably estimated in excess of accruals, if any, for such proceedings is not material. However, an adverse resolution of one or more of such matters could have a material adverse effect on our results of operations in a particular quarter or fiscal year.

While we believe our services and business practices are in compliance with applicable laws, rules and regulations in all material respects, we cannot predict the outcome of these claims at this time. An unfavorable outcome in one or more of these matters could result in the imposition of judgments, monetary fines or penalties, or injunctive or administrative remedies. We can give no assurance that such judgments, fines and remedies, and future costs associated with any such matters, would not have a material adverse effect on our financial condition, our consolidated results of operations or our consolidated cash flows.

We previously disclosed an accrual of $30.0 million related to a client contractual dispute. The accrual was reflected as an offset to revenue in the consolidated statement of operations for the year ended December 31, 2011. This dispute has since been resolved and the impact of the resolution is not material.

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Note 14 Segment information

During the second quarter of 2012, we reorganized our segments to better reflect our structure following the Merger. Our new segment structure is composed of our domestic and Canadian PBM segment and our Other Business Operations segment.

The PBM segment engages in the following services for which it collects revenues and incurs expenses:

- Domestic and Canadian retail network pharmacy management
- home delivery pharmacy services
- benefit design consultation
- drug utilization review
- drug formulary management programs
- compliance and therapy management programs for our clients
- a flexible array of Medicare Part D products to support clients benefits
- specialty pharmacy, including the distribution of fertility pharmaceuticals requiring special handling or packaging
- guidance and decision support for genomic medicine to patients, providers, payors and employees and comprehensive clinical programs

The Other Business Operations segment currently engages in the following services for which it collects revenues and incurs expenses:

- distribution of pharmaceuticals and medical supplies to providers and clinics
- other international retail network pharmacy management
- home delivery pharmacy services in Germany
- scientific evidence to guide the safe, effective and affordable use of medicines

diabetes prescriptions and testing supplies

Prior to the second quarter of 2012, our other international retail network pharmacy management business was included in the PBM segment. Historical segment information has been retrospectively adjusted to reflect the effect of these changes. Our PBM segment includes ESI s and Medco s integrated PBM operations in the United States and ESI s PBM operations in Canada. Our Other Business Operations segment includes our other international operations, our Specialty Distribution lines of business, and other service operations.

As described in Note 4 Dispositions, it was determined that our CYC line of business was immaterial to both consolidated and segment results of operations, and we have therefore not presented these results separately for the current or prior period.

Operating income is the measure used by our chief operating decision maker to assess the performance of each of our operating segments. The following table presents information about our reportable segments for the three and nine months ended September 30, 2012 and 2011.

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(in millions)	**PBM**	**Other Business Operations**	**Total**
For the three months ended September 30, 2012			
Product revenues:			
Network revenues[1]	$ 16,341.9	$	$ 16,341.9
Home delivery and specialty revenues[2]	9,580.4		9,580.4
Other revenues		727.6	727.6
Service revenues	233.7	115.8	349.5
Total revenues	26,156.0	843.4	26,999.4
Depreciation and amortization expense	599.9	21.9	621.8