

PharMerica CORP
Form 10-Q
August 02, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

or

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

For the transition period from _____ to _____ .

Commission File Number: 001-33380

PHARMERICA CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

87-0792558

(State or Other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification No.)

1901 Campus Place

40299

Louisville, KY

(Address of Principal Executive Offices)

(Zip Code)

(502) 627-7000

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

Smaller reporting
company

Emerging growth
company

(Do not check if a smaller reporting
company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

Class of Common Stock	Outstanding at July 28, 2017
Common stock, \$0.01 par value	31,121,162 shares

PHARMERICA CORPORATION
 FORM 10-Q
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PHARMERICA CORPORATION

CONDENSED CONSOLIDATED INCOME STATEMENTS

For the Three and Six Months Ended June 30, 2016 and 2017

(Unaudited)

(In millions, except share and per share amounts)

	Three Months Ended June		Six Months Ended June 30,	
	30, 2016	2017	2016	2017
Revenues	\$519.6	\$592.0	\$1,044.1	\$1,158.8
Cost of goods sold	437.8	502.4	880.3	981.4
Gross profit	81.8	89.6	163.8	177.4
Selling, general and administrative expenses	55.7	61.8	112.7	125.2
Amortization expense	8.2	9.9	16.4	19.0
Merger, acquisition, integration costs and other charges	4.4	3.6	8.8	7.1
Settlement, litigation and other related charges	4.9	2.7	8.0	5.2
Restructuring and impairment charges	1.1	-	2.5	0.1
Operating income	7.5	11.6	15.4	20.8
Interest expense, net	3.3	4.1	6.3	7.8
Income before income taxes	4.2	7.5	9.1	13.0
Provision for income taxes	1.7	2.8	2.5	4.8
Net income	\$2.5	\$4.7	\$6.6	\$8.2
Earnings per common share:				
Basic	\$0.08	\$0.15	\$0.22	\$0.26
Diluted	\$0.08	\$0.15	\$0.21	\$0.26
Shares used in computing earnings per common share:				
Basic	30,728,592	31,440,495	30,628,145	31,141,560
Diluted	31,028,174	31,686,524	31,003,145	31,480,728

See accompanying Notes to Condensed Consolidated Financial Statements

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PHARMERICA CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

As of December 31, 2016 and June 30, 2017

(Unaudited)

(In millions, except share and per share amounts)

	December 31, 2016	June 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$5.4	\$13.5
Accounts receivable, net	235.4	246.6
Inventory	214.7	139.6
Income taxes receivable	4.7	6.6
Prepays and other assets	56.5	51.1
	516.7	457.4
Equipment and leasehold improvements	250.9	266.2
Accumulated depreciation	(165.1)	(177.9)
	85.8	88.3
Goodwill	392.3	422.9
Intangible assets, net	187.6	187.6
Deferred tax assets, net	9.2	1.8
Other long-term assets (See Note 5)	81.4	78.7
	\$1,273.0	\$1,236.7
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$107.1	\$104.5
Salaries, wages and other compensation	32.5	31.6
Current portion of long-term debt	15.6	15.5
Other accrued liabilities	27.1	26.2
	182.3	177.8
Long-term debt	457.8	417.4
Other long-term liabilities	88.7	84.7
Commitments and contingencies (See Note 5)		
Stockholders' equity:		
Preferred stock, \$0.01 par value per share; 1,000,000 shares authorized and no shares issued, December 31, 2016 and June 30, 2017	-	-
Common stock, \$0.01 par value per share; 175,000,000 shares authorized; 33,698,269 and 34,132,297 shares issued as of December 31, 2016 and June 30, 2017, respectively	0.3	0.3
Capital in excess of par value	411.1	417.7
Retained earnings	173.7	181.9
Treasury stock at cost, 2,916,906 and 3,011,599 shares at December 31, 2016 and June 30, 2017, respectively	(40.9)	(43.1)
	544.2	556.8
	\$1,273.0	\$1,236.7

See accompanying Notes to Condensed Consolidated Financial Statements

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PHARMERICA CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Three and Six Months Ended June 30, 2016 and 2017

(Unaudited)

(In millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2017	2016	2017
Cash flows provided by (used in) operating activities:				
Net income	\$2.5	\$4.7	\$6.6	\$8.2
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Depreciation	5.7	6.8	11.0	13.7
Amortization	8.2	9.9	16.4	19.0
Stock-based compensation and deferred compensation	2.7	2.5	4.1	5.0
Amortization of deferred financing fees	0.2	0.2	0.3	0.4
Deferred income taxes	4.7	4.3	7.8	7.2
Other	-	(0.1)	0.1	(0.1)
Change in operating assets and liabilities:				
Accounts receivable, net	(8.0)	1.2	(7.0)	(4.1)
Inventory	(42.3)	3.9	(7.4)	77.5
Prepays and other assets	0.2	6.2	(0.5)	8.5
Accounts payable	12.6	17.4	26.8	(8.4)
Salaries, wages and other compensation	4.0	(2.6)	(2.7)	(1.1)
Other accrued and long-term liabilities	(11.5)	(10.1)	(9.3)	(9.0)
Change in income taxes (receivable)	(2.9)	(1.8)	(3.8)	(2.0)
Excess tax benefit from stock-based compensation	(0.2)	-	(1.2)	(0.1)
Net cash (used in) provided by operating activities	(24.1)	42.5	41.2	114.7
Cash flows provided by (used in) investing activities:				
Purchase of equipment and leasehold improvements	(7.9)	(8.0)	(13.3)	(15.9)
Acquisitions, net of cash acquired	(0.2)	(2.5)	(6.9)	(50.7)
Net cash used in investing activities	(8.1)	(10.5)	(20.2)	(66.6)
Cash flows provided by (used in) financing activities:				
Repayments of long-term debt	(2.8)	(3.8)	(5.6)	(7.5)
Net activity of long-term revolving credit facility	37.0	(30.0)	(8.0)	(33.0)
Issuance of common stock	-	-	0.1	3.0
Treasury stock, for employee taxes on stock awards	-	-	(3.0)	(2.2)
Repayments of capital lease obligations	(0.1)	(0.1)	(0.2)	(0.3)
Net cash provided by (used in) financing activities	34.1	(33.9)	(16.7)	(40.0)
Change in cash and cash equivalents	1.9	(1.9)	4.3	8.1
Cash and cash equivalents at beginning of period	25.5	15.4	23.1	5.4
Cash and cash equivalents at end of period	\$27.4	\$13.5	\$27.4	\$13.5

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Supplemental information:

Cash paid for interest	\$2.6	\$3.9	\$5.2	\$7.4
Cash paid (received) for taxes	\$0.2	\$0.2	\$0.2	\$(0.2)

See accompanying Notes to Condensed Consolidated Financial Statements

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PHARMERICA CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

For the Six Months Ended June 30, 2017

(Unaudited)

(In millions, except share amounts)

	Common Stock		Capital in Excess of Par	Retained Earnings	Treasury Stock	Total
	Shares	Amount	Value			
Balance at December 31, 2016	30,781,363	\$ 0.3	\$411.1	\$ 173.7	\$(40.9)	\$544.2
Net income				8.2		8.2
Exercise of stock options and tax components of stock-based awards, net	179,124	-	3.2	-	-	3.2
Vested restricted stock units	180,475	-	(0.1)	-	-	(0.1)
Vested performance stock units	74,429	-	-	-	-	-
Treasury stock, for employees taxes on stock awards	(94,693)	-	-	-	(2.2)	(2.2)
Stock-based compensation - non-vested restricted stock	-	-	3.5	-	-	3.5
Balance at June 30, 2017	31,120,698	\$ 0.3	\$417.7	\$ 181.9	\$(43.1)	\$556.8

See accompanying Notes to Condensed Consolidated Financial Statements

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

PharMerica Corporation together with its subsidiaries, (the "Corporation"), is a pharmacy services company that services healthcare facilities, provides pharmacy management services to hospitals, provides specialty infusion services to patients outside a hospital setting, and offers the only national oncology pharmacy in the United States. The Corporation is the second largest institutional pharmacy services company in the United States based on revenues and customer licensed beds under contract, operating 96 institutional pharmacies, 20 specialty home infusion pharmacies, and 5 specialty oncology pharmacies in 45 states. The Corporation's customers are institutional healthcare providers, such as skilled nursing facilities, assisted living facilities, hospitals, individuals receiving in-home care and patients with cancer.

Operating Segments

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

Principles of Consolidation

All intercompany transactions have been eliminated.

The Corporation has an investment in a long-term care pharmacy business that is accounted for by the equity method. This entity is not a variable interest entity and the Corporation's lack of majority voting rights precludes the Corporation from controlling this affiliate. Accordingly, the Corporation does not consolidate this affiliate, but rather applies the equity method of accounting. The Corporation's share of the net income or loss of this unconsolidated affiliate is included in operating income.

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information and disclosures required by generally accepted accounting principles in the United States ("U.S. GAAP") for complete financial statements. Accordingly, the accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements of the Corporation and related footnotes for the year ended December 31, 2016, included in the Corporation's Annual Report on Form 10-K. The balance sheet as of December 31, 2016 has been derived from the audited consolidated financial statements.

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

Use of Estimates

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. GAAP which requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosure of contingent liabilities as of the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates are involved in collectability of accounts receivable, revenue recognition, inventory valuation, supplier rebates and the valuation of long-lived assets and goodwill. Actual amounts may differ from these estimates.

Fair Value of Financial Instruments

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

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

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

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

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

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

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

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

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

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

The financial liabilities recorded at fair value at December 31, 2016 and June 30, 2017 are set forth in the tables below (dollars in millions):

As of December 31, 2016	Liability	Level 1	Level 2	Level 3	Valuation Technique
Financial Liability					
Deferred Compensation Plan	\$ (8.8)	\$ -	\$(8.8)	\$-	A
Contingent Considerations	(8.1)	-	-	(8.1)	C
Mandatorily Redeemable Interest	(4.0)	-	-	(4.0)	C

As of June 30, 2017	Liability	Level 1	Level 2	Level 3	Valuation Technique
Financial Liability					
Deferred Compensation Plan	\$ (10.8)	\$ -	\$(10.8)	\$-	A
Contingent Considerations	(9.9)	-	-	(9.9)	C
Mandatorily Redeemable Interest	(4.0)	-	-	(4.0)	C

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

The contingent consideration represents future earn-outs associated with certain of the Corporation's acquisitions made in 2015, 2016 and 2017. The fair values of the liabilities associated with the contingent consideration were derived using the income approach with unobservable inputs, which included future gross profit forecasts and present value assumptions, and there was little or no market data. The Corporation assessed the fair values of the liabilities as of the acquisition date and will assess quarterly thereafter until settlement. These liabilities are classified as other current and long-term liabilities in the accompanying condensed consolidated balance sheets.

The mandatorily redeemable interest represents a future obligation associated with the Corporation's acquisition of a specialty pharmacy business, OncoMed Specialty, LLC ("Onco") in which the Corporation made its initial purchase of interests on December 6, 2013 and its purchase of additional interests in December 2016. The mandatorily redeemable

interest is classified as a long-term liability and measured at fair value. The fair value was derived using the income approach with unobservable inputs, which included a future gross profit forecast and present value assumptions, and there was little or no market data. The Corporation assessed and adjusted the mandatorily redeemable interest liability to estimated fair value at December 31, 2016. This liability is classified as other long-term liabilities in the accompanying condensed consolidated balance sheets.

For the year ended December 31, 2016 and the six months ended June 30, 2017, there were no transfers between the valuation hierarchy Levels 1, 2, and 3. The following table summarizes the change in fair value of the Corporation's contingent consideration and mandatorily redeemable interest identified as Level 3 for the year ended December 31, 2016 and the six months ended June 30, 2017 (in millions):

	Contingent Consideration	Mandatorily Redeemable Interest
Beginning balance, December 31, 2015	\$ 11.5	\$ 5.8
Additions from business acquisitions	1.4	-
Contingent consideration payment	(3.9)	-
Change in fair value	(0.9)	(1.8)
Balance at December 31, 2016	8.1	4.0
Additions from business acquisitions	5.9	-
Contingent consideration payment	(3.9)	-
Change in fair value	(0.2)	-
Balance, June 30, 2017	\$ 9.9	\$ 4.0

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

PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

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

Accounts Receivable and Allowance for Doubtful Accounts

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

The Corporation has an established process to determine the adequacy of the allowance for doubtful accounts, which relies on analytical tools, specific identification, and benchmarks to arrive at a reasonable allowance. No single statistic or measurement determines the adequacy of the allowance for doubtful accounts. The Corporation monitors and reviews trends by payer classification along with the composition of the Corporation's accounts receivable aging. This review is focused primarily on trends in private and other payers, PDPs, dual eligible co-payments, historic payment patterns of long-term care institutions, and monitoring respective credit risks. In addition, the Corporation analyzes other factors such as revenue days in accounts receivables, denial trends by payer types, payment patterns by payer types, subsequent cash collections, and current events that may impact payment patterns of the Corporation's long-term care institution customers. Accounts receivable are written off after collection efforts have been completed in accordance with the Corporation's policies.

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

	December 31, 2016	June 30, 2017
Institutional healthcare providers	\$ 138.2	\$ 138.5
Medicare Part D	42.5	51.8
Private payer and other	28.1	27.0
Insured	38.7	41.0
Medicaid	15.6	18.7
Medicare	3.4	2.4
Allowance for doubtful accounts	(31.1)	(32.8)
	\$ 235.4	\$ 246.6
0 to 60 days	62.9 %	64.5 %
61 to 120 days	15.7 %	14.8 %
Over 120 days	21.4 %	20.7 %
	100.0 %	100.0 %

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

Write-offs

	Beginning Balance	Charges Included in Selling, General & Administrative Expenses	Ending Balance
Allowance for doubtful accounts:			
Year Ended December 31, 2016	\$ 49.3	\$ 6.3	\$ (24.5) \$ 31.1
Six Months Ended June 30, 2017	\$ 31.1	\$ 6.6	\$ (4.9) \$ 32.8

Bad debt expense for the year ended December 31, 2016 was favorably impacted by approximately \$5.6 million related to collections of certain previously reserved receivables under note agreements and the settlement of a customer's trade receivable of \$3.2 million.

Restructuring and Impairment Charges

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

Mandatorily Redeemable Interest

On December 6, 2013, the Corporation acquired 37.5% of the membership interests of Onco while also obtaining control of the business. Following the Corporation's exercise of its rights to purchase additional interests of Onco in December 2016, the Corporation owns an aggregate of 81.5% of the membership interests of Onco as of June 30, 2017. The subsidiary is consolidated in the Corporation's condensed consolidated financial statements and the mandatorily redeemable interest is classified as debt within other long-term liabilities in the condensed consolidated balance sheets.

PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

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

Recently Issued Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-02, "Leases", which generally requires companies to recognize operating and financing lease liabilities and corresponding right-of-use assets on the balance sheet. This guidance will be adopted in the first quarter of 2019 on a modified retrospective basis. The Corporation is still evaluating the effect that this guidance will have on its condensed consolidated financial statements and related disclosures.

In November 2015, the FASB issued ASU No. 2015-17, "Balance Sheet Classification of Deferred Taxes" related to accounting for income taxes which changes the balance sheet classification of deferred taxes, requiring deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The new guidance is effective for the Corporation beginning with annual and interim periods in 2017, with early adoption permitted. The Corporation adopted this ASU beginning January 1, 2017. The Corporation no longer presents a current deferred tax asset and a noncurrent deferred tax liability. Instead those amounts are combined to a net noncurrent deferred tax asset on its condensed consolidated balance sheets as of December 31, 2016 and June 30, 2017.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers", which amends the existing accounting standards for revenue recognition. In August 2015, the FASB issued ASU No. 2015-14, which delayed the effective date of ASU 2014-09 by one year. In March 2016, the FASB issued Accounting Standards Update No. 2016-08, "Revenue from Contracts with Customers: Principal versus Agent Considerations" which clarifies the implementation guidance on principal versus agent considerations. The guidance includes indicators to assist an entity in determining whether it controls a specified good or service before it is transferred to the customers. The Corporation currently anticipates adopting the new standard effective January 1, 2018. The new standard also permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective method). The Corporation currently anticipates adopting the standard using the modified retrospective method. Since the Corporation is still in the process of completing its analysis on the impact this guidance will have on its condensed consolidated financial statements and related disclosures, the Corporation is not able to determine if it will have a material impact on its condensed consolidated financial statements.

NOTE 2—ACQUISITIONS

2017 Acquisitions

During the six months ended June 30, 2017, the Corporation completed the acquisition of one infusion business and one specialty and oncology business (collectively the "2017 Acquisitions"), neither of which were individually significant to the Corporation. The 2017 Acquisitions had an estimated purchase price of \$44.0 million. The Corporation has not yet finalized the purchase price allocation related to these acquisitions. The preliminary amount of goodwill and identifiable intangibles related to these transactions is estimated to be \$30.6 million and \$16.9 million, respectively. Tax deductible goodwill associated with the acquisitions was \$29.9 million as of June 30, 2017. The net assets and operating results of the 2017 Acquisitions have been included in the Corporation's condensed consolidated financial statements from the respective dates of acquisition.

2016 Acquisitions

During the year ended December 31, 2016, the Corporation completed acquisitions of four long-term care businesses and two infusion businesses (collectively the "2016 Acquisitions"), none of which were individually significant to the Corporation. The resulting amount of goodwill and identifiable intangibles related to these transactions in the aggregate were \$19.4 million and \$32.0 million, respectively. The Corporation believes the resulting amount of goodwill reflects the synergistic benefits of the acquisitions. Tax deductible goodwill associated with the 2016 Acquisitions was \$10.8 million as of June 30, 2017. The net assets and operating results of the 2016 Acquisitions have been included in the Corporation's condensed consolidated financial statements from the respective dates of acquisition.

Pro forma financial statements are not presented on the 2017 Acquisitions or 2016 Acquisitions as the results are not material to the Corporation's condensed consolidated financial statements.

Other

For the three months ended June 30, 2016 and 2017, the Corporation incurred \$4.4 million and \$3.6 million, respectively, and \$8.7 million and \$7.1 million for the six months ended June 30, 2016 and 2017, respectively, of acquisition-related costs, which have been classified as a component of merger, acquisition, integration costs and other charges.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

NOTE 3—GOODWILL AND INTANGIBLES

As of December 31, 2016 and June 30, 2017 the carrying amount of goodwill was \$392.3 million and \$422.9 million, respectively.

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

	Balance at December 31, 2016	Additions	Balance at June 30, 2017
Finite Lived Intangible Assets			
Customer relationships	\$ 245.7	\$ 13.9	\$259.6
Trade name	64.0	4.1	68.1
Non-compete agreements	22.2	1.0	23.2
Sub Total	331.9	19.0	350.9
Accumulated amortization	(144.3)	(19.0)	(163.3)
Net intangible assets	\$ 187.6	\$ -	\$ 187.6

Amortization expense relating to finite-lived intangible assets was \$8.2 million and \$9.9 million for the three months ended June 30, 2016 and 2017, respectively, and \$16.4 million and \$19.0 million for the six months ended June 30, 2016 and 2017, respectively.

NOTE 4—CREDIT AGREEMENT

On December 9, 2016, the Corporation entered into a First Amendment ("Amendment") to its existing Credit Agreement previously entered into in September 2014 by and among the Corporation, the lenders named therein (the "Lenders"), Bank of America, N.A., as administrative agent, JP Morgan Chase Bank N.A., as syndication agent, and U.S. Bank, National Association, Citibank, N.A., MUFG Union Bank, N.A., BBVA Compass Bank and SunTrust Bank as co-documentation agents (collectively, the "Credit Agreement"). The Credit Agreement originally consisted of a \$225.0 million term loan facility and a \$310.0 million revolving credit facility. Pursuant to the Amendment, among other things, (a) the revolving commitments to the revolving credit facility were increased to \$370.0 million, (b) an additional advance under the term loan was provided in an outstanding principal amount equal to \$89.1 million which, when combined with the \$210.9 million then outstanding under the term loan as of the date of the Amendment, equals \$300.0 million outstanding under the term loan, (c) the amount by which commitments may be increased after the initial closing was increased from \$190.0 million to \$200.0 million, and (d) The Huntington National Bank was added as a new lender to the Credit Agreement.

As of June 30, 2017, \$289.7 million was outstanding under the term loan facility and \$143.5 million was outstanding under the revolving credit facility. Indebtedness under the Credit Agreement matures on September 17, 2019, at which time the commitments of the Lenders to make revolving loans also expire.

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

	December 31, 2016	June 30, 2017
Term Debt - payable to lenders at LIBOR plus applicable margin (3.48% as of June 30, 2017), matures September 17, 2019	\$ 297.2	\$289.7
Revolving Credit Facility payable to lenders, interest at LIBOR plus applicable margin (3.45% as of June 30, 2017), matures September 17, 2019	176.5	143.5
Deferred financing costs, net	(1.9)	(1.6)
Capital lease obligations	1.6	1.3
Total debt	473.4	432.9
Less: Current portion of long-term debt	15.6	15.5
Total long-term debt	\$ 457.8	\$417.4

The Corporation's indebtedness has the following maturities as of June 30, 2017 (dollars in millions):

Year Ending December 31,	Term Debt	Revolving Credit Facility	Deferred Financing Costs	Capital Lease Obligations	Total Maturities
2017	\$7.5	\$ -	\$ (0.4)	\$ 0.3	\$ 7.4
2018	15.0	-	(0.7)	0.4	14.7
2019	267.2	143.5	(0.5)	0.4	410.6
2020	-	-	-	0.2	0.2
	\$289.7	\$ 143.5	\$ (1.6)	\$ 1.3	\$ 432.9

The Credit Agreement provides for the issuance of letters of credit which, when issued, reduce availability under the revolving credit facility. The aggregate amount of letters of credit outstanding as of June 30, 2017 was \$2.8 million. After giving effect to the letters of credit, total availability under the revolving credit facility was \$223.7 million as of June 30, 2017.

PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

NOTE 5—COMMITMENTS AND CONTINGENCIES

Legal Action and Regulatory

The Corporation maintains liabilities for certain of its outstanding investigations and litigation. In accordance with the provisions of U.S. GAAP for contingencies, the Corporation records a liability when it is probable that such a liability has been incurred and the amount of the loss can be reasonably estimated. To the extent that the resolution of contingencies results in actual losses that differ from the Corporation's recorded liabilities, earnings will be charged or credited accordingly. The Corporation cannot know the ultimate outcome of the pending matters described below, and there can be no assurance that the resolution of these matters will not have a material adverse impact on the Corporation's condensed consolidated results of operations, financial position or cash flows. As a part of its ongoing operations, the Corporation is subject to various inspections, audits, inquiries, investigations and similar actions by third parties, as well as by government/regulatory authorities responsible for enforcing the laws and regulations to which the Corporation is subject. Further, under the federal False Claims Act (the "FCA"), private parties have the right to bring qui tam, or "whistleblower," suits against companies that submit false claims for payments to, or improperly retain overpayments from, the government. The inherently unpredictable nature of legal proceedings may be impacted by various factors, including: (i) the damages sought in the proceedings are unsubstantiated or indeterminate; (ii) discovery is not complete; (iii) the proceeding is in its early stages; (iv) the matters present legal uncertainties; (v) significant facts are in dispute; (vi) a large number of parties are participating in the proceedings (including where it is uncertain how liability, if any, will be shared among defendants); or (vii) the proceedings present a wide range of potential outcomes.

The Corporation is the subject of certain investigations and is a defendant in a number of cases, including those discussed below.

On March 4, 2011, a relator, Mark Silver, on behalf of the U.S. Government and various state governments, filed a complaint in the United States District Court for the District of New Jersey against the Corporation. The complaint alleges that, in violation of the Federal Anti-Kickback Statute and of the FCA, the Corporation offered below cost or below fair market value prices on drugs for which nursing homes were at financial risk (e.g., Medicare Part A), in exchange for so-called preferred or exclusive provider status that would allow the Corporation to dispense drugs to patients for which the Corporation could bill federal health care program payers such as Medicare Part D and Medicaid. On February 19, 2013, the U.S. Government declined to intervene in the case. The complaint has been amended several times, most recently on November 12, 2013, and thereafter served upon the Corporation. On December 6, 2013, the Corporation moved to dismiss the amended complaint for failure to state a claim upon which relief may be granted and on September 29, 2014, the court declined to dismiss the case, but limited the relevant time period for which claims could be brought against the Corporation. On March 4, 2016 and April 1, 2016, the Corporation filed motions to dismiss and for summary judgment, respectively, for lack of subject matter jurisdiction under the FCA prior public disclosure bar. On May 9, 2016, the Court granted the joint motion of Silver and the Corporation and dismissed with prejudice all successor liability claims against the Corporation for or regarding the conduct of Chem Rx Corporation. On November 28, 2016, the Court ruled in favor of the Corporation's March and April motions and this case was dismissed. In December of 2016, Silver filed an appeal of the dismissal and summary judgment. The Corporation intends to continue to defend the case vigorously.

On November 20, 2013, the complaint filed against the Corporation by a relator, Robert Gadbois, on behalf of the U.S. Government and various state governments, was unsealed by the United States District Court for the District of

Rhode Island. The complaint alleges that the Corporation dispensed controlled and non-controlled substances in violation of the CSA and in violation of relevant state laws, and that as a result, the dispenses were not eligible for payment and that the claims the Corporation submitted to the Government were false within the meaning of the FCA. The U.S. Government and the various state governments declined to intervene in this case. On October 3, 2014, the Corporation's motion to dismiss was granted by the court. The relator appealed the court's decision and on December 16, 2015, the First Circuit Court of Appeals granted the relator its appeal and remanded the case to the District Court to allow the relator to file a motion to supplement his complaint and to allow the District Court to rule upon that motion. On December 30, 2015, the Corporation filed with the First Circuit Court of Appeals a petition for a re-hearing en banc, which was denied on January 25, 2016. The Corporation filed a petition for certiorari with the U.S. Supreme Court on April 22, 2016 asking the Supreme Court to review the First Circuit's decision. On June 27, 2016, the Supreme Court denied the petition. Thereafter, on June 28, 2016, the case was returned to the District Court through the issuance by the First Circuit of its Mandate. Subsequently, the relator passed away. The relator filed a motion to substitute the personal representative of the relator's estate as the plaintiff in the case, which was granted on January 23, 2017. The relator also filed a motion for leave to file a third amended complaint. The Corporation filed its opposition to that motion on March 6, 2017 on grounds that amendment of the complaint would be futile because the relator is barred by two provisions of the FCA from proceeding in the action. On March 23, 2017, the relator moved to strike the Corporation's opposition and to defer further briefing of the motion for leave to amend pending discovery. The Corporation filed its opposition on April 10, 2017, and the relator filed his reply thereto on April 20, 2017. By order of the court, a final round of briefing on the relator's motion for leave to file a third amended complaint was concluded on July 10, 2017. Oral argument is scheduled for August 31, 2017. The Corporation intends to continue to defend the case vigorously.

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

As a result of ABDC's failure to comply with certain pricing and rebate provisions, the Corporation had recorded a receivable of \$40.8 million related to these disputes at December 31, 2014. Separately, as of December 31, 2014, the Corporation had recorded \$12.2 million for additional rebates owing from ABDC which at that time the Corporation believed were not in dispute and had previously been paid by ABDC in all the prior quarters. These receivables totaled \$53.0 million and were included in prepaids and other assets in the consolidated balance sheet as of December 31, 2014. During the period of January 1, 2015 through March 31, 2015, an additional \$19.3 million, net of payments received, of certain rebates and guarantees owed by ABDC under the Previous PVA were recognized, which brought the total gross receivable to \$72.3 million at December 31, 2015.

PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

NOTE 5—COMMITMENTS AND CONTINGENCIES (Continued)

On March, 2, 2015, the Corporation notified ABDC of its intent to terminate the Previous PVA effective April 1, 2015. The Corporation also announced that it had entered into the Cardinal Health Prime Vendor Agreement ("Cardinal Health PVA") effective April 1, 2015. On March 3, 2015, the Corporation received a letter from ABDC terminating the Previous PVA effective immediately based upon the Corporation's alleged failure to pay certain disputed miscellaneous charges and the Corporation's signing of the Cardinal Health PVA. The Corporation believes ABDC did not have the right to immediately terminate the contract pursuant to the terms of the Previous PVA. On March 6 and March 13, 2015, the Corporation withheld from ABDC normal recurring payments for drug purchases of approximately \$48.9 million. On May 18, 2015, ABDC filed an Amended Counterclaim seeking additional financial damages against the Corporation and asserted claims against two counter-defendants. On November 23, 2015, the Corporation filed its Third Amended Complaint against ABDC for additional financial damages, amounts overcharged by ABDC, and for certain rebates not paid by ABDC under the Previous PVA.

On April 1, 2016, the Jefferson Circuit Court ruled that the Corporation could not set-off payment of the amounts that ABDC owed the Corporation against amounts that ABDC had invoiced the Corporation. Instead the Corporation must first pay ABDC and continue the litigation against ABDC to collect any amounts owed to the Corporation by ABDC upon the conclusion of the entire lawsuit. As a result, the Corporation owes approximately \$48.9 million of payments for drug purchases in the first quarter of 2015. The Corporation has continued the litigation in the Jefferson Circuit Court against ABDC. On April 11, 2016, the Corporation filed a Motion to Alter and Amend the April 1, 2016 order of the Jefferson Circuit Court asking the judge to reconsider the final and appealable aspect of the order. On August 8, 2016, the Jefferson County Circuit Court issued an order that granted the Corporation's April 11, 2016 Motion to Alter and Amend the Judgment entered on April 1, 2016. The Court granted the Corporation's motion to remove the final and appealable designation from the April 1, 2016 order; therefore, the Corporation does not presently have to post a bond, pay ABDC post-judgment interest, or appeal the order to the Kentucky Court of Appeals for further relief. The Jefferson Circuit Court's ruling on the right to set-off does not in any way adversely affect the Corporation's claims against ABDC and the Corporation's ability to pursue all of its claims against ABDC in the Jefferson Circuit Court. The Corporation and ABDC have fully briefed their respective Motions for Summary Judgment and the Jefferson Circuit Court will hear oral arguments on the motions on August 11, 2017.

Amounts owed to and from ABDC were previously offset resulting in a net receivable of \$23.4 million from ABDC in the consolidated balance sheet at December 31, 2015 classified as an other long-term asset. As a result of the ruling on the right to set-off during the first quarter of 2016, the Corporation recorded amounts related to this matter on a gross basis resulting in a receivable from ABDC of \$72.3 million and the payable to ABDC of \$48.9 million. Accordingly, the \$72.3 million receivable from ABDC is reflected in other long-term assets and the \$48.9 million payable is reflected in other long-term liabilities in the accompanying condensed consolidated balance sheets as of June 30, 2017.

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

In addition, the Corporation is involved in certain legal actions and regulatory investigations arising in the ordinary course of business. At June 30, 2017, the Corporation had accrued approximately \$8.0 million related to the pending and settled legal actions and investigations included in other current liabilities in the accompanying condensed consolidated balance sheets.

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

Merger, acquisition, integration costs and other charges combined were \$4.4 million and \$3.6 million for the three months ended June 30, 2016 and 2017, respectively, and \$8.8 million and \$7.1 million for the six months ended June 30, 2016 and 2017, respectively. These costs primarily relate to costs incurred prior to an acquisition such as professional advisory fees and the costs associated with integrating completed acquisitions into our business, such as IT transition and facility related costs.

NOTE 7—RESTRUCTURING COSTS AND OTHER CHARGES

The Corporation recorded restructuring costs and other related charges of \$1.1 million and less than \$0.1 million for the three months ended June 30, 2016 and 2017, respectively, and \$2.5 million and \$0.1 million for the six months ended June 30, 2016 and 2017, respectively. The restructuring charges primarily included severance pay, the buy-out of employment agreements, lease terminations, and other exit-related asset disposals, professional fees and facility exit costs.

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

	Balance at December 31, 2016	Accrual	Utilized Amounts	Balance at June 30, 2017
Employee Severance and related costs	\$ 0.2	\$ -	\$ (0.1)	\$ 0.1
Facility costs	0.4	0.1	(0.2)	0.3
	\$ 0.6	\$ 0.1	\$ (0.3)	\$ 0.4

The liability at June 30, 2017 represents amounts not yet paid relating to actions taken in connection with the restructuring plan (primarily lease payments and severance costs).

PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

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

Treasury Stock Purchases

In August 2010, the Board of Directors authorized a share repurchase of up to \$25.0 million of the Corporation's common stock, of which \$10.5 million has been used. On July 2, 2012, the Board of Directors authorized an increase to the remaining portion of the existing share repurchase program that allows the Corporation to again repurchase up to a maximum of \$25.0 million of the Corporation's common stock. Approximately \$19.7 million remained available under the program as of June 30, 2017. Share repurchases under this authorization may be made in the open market through unsolicited or solicited privately negotiated transactions, or in such other appropriate manner, and may be funded from available cash or the revolving credit facility. The amount and timing of the repurchases, if any, would be determined by the Corporation's management and would depend on a variety of factors including price, corporate and regulatory requirements, capital availability and other market conditions. Common stock acquired through the share repurchase program would be held as treasury shares and may be used for general corporate purposes, including reissuance in connection with acquisitions, employee stock option exercises or other employee stock plans. The share repurchase program does not have an expiration date and may be limited, terminated or extended at any time without prior notice. During the six months ended June 30, 2017, the Corporation repurchased no shares of common stock under this program.

The Corporation may redeem shares from employees upon the vesting of the Corporation's stock awards for tax withholding purposes and to cover option exercise costs. The Corporation redeemed 94,693 shares from the vesting of certain awards and exercise of certain stock options, for an aggregate price of approximately \$2.2 million during the six months ended June 30, 2017. These shares have also been designated by the Corporation as treasury stock.

Stock Option Activity

Stock options were not granted to officers and employees during the six months ended June 30, 2017. The following table summarizes option activity for the periods presented:

	Number of Shares	Weighted- Average Exercise Price Per Share	Weighted- Average Remaining Term	Aggregate Intrinsic Value (in millions)
Outstanding shares at December 31, 2016	413,346	\$ 13.99	0.8 years	\$ 4.6
Exercised	(179,124)	17.98		
Expired	(4,426)	16.66		
Outstanding shares at June 30, 2017	229,796	\$ 10.83	0.7 years	\$ 3.6
Exercisable at June 30, 2017	229,796	\$ 10.83	0.7 years	\$ 3.6

Nonvested Shares

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

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	Number of Shares	Weighted- Average Grant Date Fair Value
Outstanding shares at December 31, 2016	968,834	\$ 22.63
Granted - Restricted Stock Units	214,895	23.90
Granted - Performance Share Units	185,993	23.90
Forfeited	(93,752)	24.37
Vested	(254,904)	24.04
Outstanding shares at June 30, 2017	1,021,066	\$ 22.61

The weighted average remaining term and intrinsic value of non-vested shares as of June 30, 2017 was 1.8 years and \$26.8 million, respectively.

PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

NOTE 9—INCOME TAXES

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

	Three Months		Six Months	
	Ended June		Ended June	
	30,	30,	30,	2017
	2016	2017	2016	2017
Provision for income taxes	\$1.7	\$2.8	\$2.5	\$4.8
Total provision as a percentage of pre-tax income	40.1%	37.3%	27.2%	36.8%

The increase in our provision for income taxes as a percentage of pre-tax income for the six months ended June 30, 2017 compared to the comparable 2016 period was primarily due to increases in pre-tax income and lower excess tax benefits from employee share-based compensation. The effective tax rate for the three months and six months ended June 30, 2017 is higher than the federal statutory rate largely as a result of the impact of state and local taxes.

The Corporation derives a current federal and state income tax benefit from the impact of deductions associated with the amortization of tax deductible goodwill acquired through business combinations. The net tax basis of the Corporation's tax deductible goodwill was approximately \$162.7 million and \$184.5 million at December 31, 2016 and June 30, 2017, respectively. The future tax benefits of the tax-deductible goodwill are included in the Corporation's deferred tax assets.

The Corporation recognizes an asset or liability for the deferred tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets are recovered or liabilities are settled. The Corporation also recognizes as deferred tax assets the future tax benefits from net operating loss carryforwards. As of June 30, 2017, the Corporation had \$33.4 million (\$11.7 million tax benefit) of federal net operating loss carryforwards available. These net operating loss carryforwards resulted from the stock acquisitions the Corporation completed in 2013 and 2014 as well as net operating carryforwards generated by the Corporation. These net operating loss carryforwards are subject to limitations under Internal Revenue Code Section 382. However, the Corporation expects that it will be able to use the recorded amount which takes into account the limitations of the carryforwards. The Corporation has state net operating loss carryforwards representing a tax benefit of \$5.5 million, net of valuation allowances. The net operating losses have carryforward periods ranging from 1 to 20 years depending on the taxing jurisdiction.

A valuation allowance is provided for the Corporation's deferred tax assets if it is more likely than not that some portion or all of the net deferred tax assets will not be realized. The Corporation recognized net deferred tax assets totaling \$9.2 million and \$1.8 million at December 31, 2016 and June 30, 2017, respectively, net of state valuation allowances of \$2.6 million. The Corporation has presented all deferred tax assets and liabilities as noncurrent on the accompanying condensed consolidated balance sheets as of June 30, 2017.

As of December 31, 2016 and June 30, 2017, the Corporation had no reserves recorded for unrecognized tax benefits for U.S. federal and state tax jurisdictions.

The federal statute of limitations remains open for tax years 2013 through 2015.

State tax jurisdictions generally have statutes of limitation ranging from three to five years. The Corporation is generally no longer subject to state and local income tax examinations by tax authorities for years before 2011. The state income tax impact of federal income tax changes remains subject to examination by various states for a period of up to one year after formal notification of IRS settlement to the states.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

NOTE 10—EARNINGS PER SHARE

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

	Three Months Ended June		Six Months Ended June 30,	
	30, 2016	2017	2016	2017
Numerator:				
Numerator for basic and diluted earnings per share - net income	\$2.5	\$4.7	\$6.6	\$8.2
Denominator:				
Denominator for basic earnings per share - weighted average shares	30,728,592	31,440,495	30,628,145	31,141,560
Effect of dilutive securities (stock options, restricted stock units and performance share units)	299,582	246,029	375,000	339,168
Denominator for earnings per diluted share - adjusted weighted average shares	31,028,174	31,686,524	31,003,145	31,480,728
Basic earnings per share	\$0.08	\$0.15	\$0.22	\$0.26
Earnings per diluted share	\$0.08	\$0.15	\$0.21	\$0.26
Unexercised employee stock options and unvested restricted shares excluded from the effect of dilutive securities above (a)	892	-	-	-

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

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

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

PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

NOTE 11—SUBSEQUENT EVENT

On August 1, 2017, the Corporation entered into an Agreement and Plan of Merger (the "Merger Agreement") with Phoenix Parent Holdings Inc., a Delaware corporation ("Parent"), and Phoenix Merger Sub Inc., a Delaware corporation and a wholly owned subsidiary of Parent ("Merger Sub"), pursuant to which Merger Sub will be merged with and into the Corporation, with the Corporation continuing as the surviving corporation (the "Merger"). After the closing of the Merger, the Corporation will be a private company and a wholly-owned subsidiary of Parent. Parent and Merger Sub are affiliates of investment funds affiliated with Kohlberg Kravis Roberts & Co. L.P. and, at the closing of the Merger, affiliates of Walgreens Boots Alliance, Inc. will acquire a minority ownership interest in Parent. Subject to the terms and conditions of the Merger Agreement, at the effective time of the Merger, each share of common stock, \$0.01 par value, of the Corporation outstanding immediately prior to the effective time will be converted into the right to receive an amount in cash equal to \$29.25 per share, without interest. The Merger is subject to the approval of the Corporation's stockholders, regulatory approvals and other customary closing conditions as set forth in the Merger Agreement. The Merger is expected to be completed by early 2018. The Corporation cannot predict with certainty when, or if, the Merger will be completed because completion of the Merger is subject to conditions beyond the control of the Corporation.

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- the potential impact of the litigation proceedings with ABDC regarding the Previous PVA;
- the Corporation's ability to comply with the terms of its Memorandum of Agreement with the DEA and the Corporate Integrity Agreements with the OIG to which it is subject;
- the Corporation's ability to collect outstanding receivables;
- changes in tax laws and regulations;
- the effects of changes to critical accounting estimates; and
- other factors, risks and uncertainties referenced in the Corporation's filings with the Commission, including the "Risk Factors" set forth in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2016.

YOU ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON ANY FORWARD-LOOKING STATEMENTS, ALL OF WHICH SPEAK ONLY AS OF THE DATE OF THIS QUARTERLY REPORT. EXCEPT AS REQUIRED BY LAW, WE UNDERTAKE NO OBLIGATION TO PUBLICLY UPDATE OR RELEASE ANY REVISIONS TO THESE FORWARD-LOOKING STATEMENTS TO REFLECT ANY EVENTS OR CIRCUMSTANCES AFTER THE DATE OF THIS QUARTERLY REPORT OR TO REFLECT THE OCCURRENCE OF UNANTICIPATED EVENTS. ALL SUBSEQUENT WRITTEN AND ORAL FORWARD-LOOKING STATEMENTS ATTRIBUTABLE TO US OR ANY PERSON ACTING ON THE CORPORATION'S BEHALF ARE EXPRESSLY QUALIFIED IN THEIR ENTIRETY BY THE CAUTIONARY STATEMENTS CONTAINED OR REFERRED TO IN THIS SECTION AND IN OUR RISK FACTORS SET FORTH IN PART I, ITEM 1A OF THE CORPORATION'S ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2016 AND IN OTHER REPORTS FILED WITH THE SEC BY THE CORPORATION.

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General

The condensed consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in this quarterly report on Form 10-Q as of and for the three and six months ended June 30, 2017, reflect the financial position, results of operations, and cash flows of the Corporation.

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

Institutional Pharmacy Business

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

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

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

Hospital Pharmacy Management Services

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

Consultant Pharmacist Services

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

We provide consultant pharmacist services to approximately 67% of our patients serviced. The services offered by our consultant pharmacists include:

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

Medical Records

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

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

Specialty Infusion Services

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

Specialty Oncology Pharmacy

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

Suppliers/Inventory

We obtain pharmaceutical and other products from Cardinal Health ("Cardinal Health") and other contracts negotiated directly with pharmaceutical manufacturers for discounted prices. The Corporation entered into a Prime Vendor Agreement with Cardinal Health effective April 1, 2015 ("Cardinal Health PVA"). The initial term of the agreement is through June 30, 2018 and contains one year automatic renewal provisions. The Cardinal Health PVA requires the Corporation to purchase certain levels of brand and non-injectable generic drugs from Cardinal Health. The Cardinal Health PVA provides flexibility for the Corporation to contract with other suppliers. Under the agreement, the Corporation is entitled to certain rebates based on drug purchases. The loss of a supplier could adversely affect our business if alternate sources of supply are unavailable or if available are significantly more expensive.

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

logistics company.

Brand to Generic Conversions

The following table summarizes the material brand-to-generic conversions expected to occur in 2017 through 2019:

2017	2018	2019
Renvela (Q3)**	Sensipar (Q1)*	Ranexa (Q1)*
Reyataz (Q4)	Zytiga (Q1)	Lyrica (Q2)*
	ProAir (Q3)	Vesicare (Q2)*
	Advair (Q3)*	
	Invanz (Q4)	

* These represent the most significant brand-to-generic conversions

**Renvela went generic in July 2017

(Number in parentheses refers to the expected quarter of conversion)

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

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Supplier and Manufacturer Rebates

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

2010 Health Care Reform Legislation

The Patient Protection and Affordable Care Act and the reconciliation law known as Health Care and Education Affordability Reconciliation Act (combined we refer to both Acts as the "2010 Health Care Reform Legislation") were enacted in March 2010. State participation in the expansion of Medicaid under the 2010 Health Care Reform Legislation is voluntary. Two key provisions of the 2010 Health Care Reform Legislation that are relevant to the Corporation are: (i) the gradual modification to the calculation of the Federal Upper Limit ("FUL") for drug prices and the definition of Average Manufacturer's Price ("AMP") and (ii) short cycle dispensing.

It is not clear what impact, if any, the 2016 elections (including the new presidential administration) will have on the various provisions of the 2010 Health Care Reform Legislation. It is possible that parts of the 2010 Health Care Reform Legislation that impact our business may be repealed or otherwise amended. We will continue to monitor any developments that may impact our business.

FUL and AMP Changes

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

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

In addition, the definition of AMP changed to reflect net sales only to drug wholesalers that distribute to retail community pharmacies and to retail community pharmacies that directly purchase from drug manufacturers. Further, the 2010 Health Care Reform Legislation continues the current statutory exclusion of prompt pay discounts offered to wholesalers and adds three other exclusions to the AMP definition: (i) bona fide services fees; (ii) reimbursement for unsalable returned goods (recalled, expired, damaged, etc.); and (iii) payments from and rebates/discounts to certain entities not conducting business as a wholesaler or retail community pharmacy.

On February 1, 2016, CMS released a Final Rule titled Medicaid Program; Covered Outpatient Drugs. This Final Rule details the types of sales that are to be included and excluded in determining AMP. Moreover, consistent with the 2010 Health Care Reform Legislation, the Final Rule calculates the FULs at 175% of the weighted average, determined based on the basis of utilization, of the most recently reported monthly AMP. As an exception, however, if the AMP-based FUL is lower than the National Average Drug Acquisition Cost ("NADAC"), the FULs will be set at the drug's NADAC. This Final Rule became effective on April 1, 2016 and states had until May 1, 2016 to implement

the FULs. CMS updates the FULs on a monthly basis and the FULs become effective on the first date of the month following their publication. States have 30 days after the effective date of the monthly updates to implement the new FULs.

The Final Rule also changed how states reimburse pharmacies. The Final Rule now requires states to pay pharmacies based on the actual acquisition cost of the drug, as opposed to the estimated acquisition cost. Moreover, the Final Rule requires states to consider the sufficiency of both the ingredient cost reimbursement and dispensing fee reimbursement when proposing changes to either of these components of reimbursement for Medicaid covered drugs.

Due to the nature of our contracts, the Final Rule has not had a material impact on our business; however, the Corporation will continue to analyze the effect of these changes on its business, results of operations, and liquidity.

Short Cycle Dispensing and Dispensing Fees

Pursuant to the 2010 Health Care Reform Legislation, Prescription Drug Plans ("PDPs") are required, under Medicare Part D and Medicare Advantage prescription drug plans ("Medicare Advantage" or "MAPDs") to utilize specific, uniform dispensing techniques, such as weekly, daily, or automated dose dispensing, when dispensing covered Medicare Part D drugs to beneficiaries who reside in a long-term care facility to reduce waste associated with 30 to 90 day prescriptions for such beneficiaries. Pursuant to a CMS issued regulation, beginning January 1, 2013, pharmacies dispensing to long-term care facilities must dispense no more than 14-day supplies of brand-name oral solid medications covered by Medicare Part D.

Medicare Part D Changes

In a May 23, 2014 Final Rule titled "Medicare Program: Contract Year 2015 Policy and Technical Changes to the Medicare Advantage and the Medicare Prescription Drug Benefit Programs," CMS announced the Part D Prescriber Enrollment Requirement, which states that Medicare Part D prescription drug benefit plans may not cover drugs prescribed by providers who are not enrolled in (or have not validly opted out of) Medicare in an approved status, except in very limited circumstances. CMS previously has delayed enforcement of the Part D Enrollment Requirements. In November 2016, CMS announced that it would implement the new requirement in a multifaceted, phased approach, where full enforcement of the requirement would begin on January 1, 2019. However, in a May 30, 2017 letter to Medicare Part D sponsors, CMS announced that while it is still delaying enforcement of the Prescriber Enrollment Requirement until January 1, 2019, it is no longer planning to implement a phased approach. CMS noted that as such, there will not be any additional guidance regarding the phased approach before January 1, 2019.

In a February 12, 2015 Final Rule entitled "Medicare Program: Contract Year 2016 Policy and Technical Changes to the Medicare Advantage and the Medicare Prescription Drug Benefit Programs," CMS finalized a regulation, effective January 1, 2016, prohibiting financial arrangements that penalize more efficient long-term care dispensing techniques (e.g., dispensing a 3 day supply over a 14 day supply) through pro-rated dispensing fees based on a day's supply or quantity dispensed. CMS also finalized a requirement that, effective January 1, 2016, any differences in payment methodologies among long-term care pharmacies incentivize more efficient dispensing techniques. The Corporation has implemented these regulations in its operations and has amended its contracts with the Part D Plans so that there has been no material impact to the business, results of operations, or liquidity.

CIA and DEA MOA

In May 2015, the Corporation entered into a five-year Corporate Integrity Agreement ("CIA") with the United States Department of Health and Human Services Office of the Inspector General ("OIG") and a Memorandum of Agreement ("MOA") with the Drug Enforcement Agency ("DEA") concurrent with the execution of settlement agreements with the OIG and the DEA settling alleged Controlled Substance Act ("CSA") violations and associated False Claims Act allegations.

The CIA requires the Corporation, among other things to : (i) create procedures designed to ensure it complies with the CSA and related regulations; (ii) retain an independent review organization to review the Corporation's compliance with the terms of the CIA and report to the OIG regarding that compliance; and (iii) provide training for certain Corporation employees as to the Corporation's requirements under the CSA. If the Corporation fails to comply with the terms of the CIA, it may be required to pay certain monetary penalties. Furthermore, if the Corporation commits a material breach of the CIA, the OIG may exclude the Corporation from participating in federal healthcare programs. Any such exclusion would result in the revocation or termination of contracts and/or licenses and potentially have a material adverse effect on our financial condition, results of operations and business prospects.

The MOA requires the Corporation to comply with all requirements of the CSA, specifically relating to the dispensing of scheduled prescription drugs. If the Corporation fails to comply with the terms of the MOA, the DEA may suspend a Corporation's pharmacy DEA Certificate of Registration and begin an administrative hearing process pursuant to 21 U.S.C. Section 824. Any such suspension would prohibit the Corporation's pharmacy from dispensing scheduled prescription drugs and would lead to the revocation or termination of contracts and/or licenses and potentially have a materially adverse effect on our financial condition, results of operations and business prospects.

CareMed CIA

In connection with the acquisition of Sorokin's Rx Ltd. (d/b/a CareMed Pharmaceutical Services, Inc. and/or CareMed Specialty Pharmacy, Inc., and hereinafter referred to as "CareMed"), in March 2017, the Corporation notified the OIG that it would be accepting the terms of the five-year Corporate Integrity Agreement that CareMed entered into with

the OIG in December 2014 ("CareMed CIA"). CareMed entered into the CareMed CIA as part of settling an FCA lawsuit alleging that CareMed had made false statements in connection with prior authorization procedures, had allegedly re-stocked and re-sold products without issuing credits back to payers for payments already made, and had allegedly submitted false claims for refills that were not delivered to beneficiaries. The CareMed CIA is limited to the CareMed entities and does not apply to the remainder of the Corporation.

The CareMed CIA requires CareMed, among other things, to: maintain a compliance program in accordance with several specified elements; engage an independent review organization to conduct certain claim and restocking reviews; create internal risk assessments and work plans; screen for ineligible persons; notify the OIG of government investigations; repay overpayments in specified timeframes; notify the OIG of certain Reportable Events; and make certifications of compliance.

If CareMed fails to comply with the terms of the CareMed CIA, it may be required to pay certain monetary penalties. Furthermore, if CareMed commits a material breach of the CareMed CIA, the OIG may exclude CareMed from participating in federal healthcare programs. Any such exclusion would result in the revocation or termination of contracts and/or licenses and potentially have a material adverse impact on our financial condition, results of operations and business prospects.

21st Century Cures Act

The 21st Century Cures Act ("Cures Act"), enacted in December 2016, among other things implemented Average Sales Price ("ASP") pricing for Part B DME infusion drugs in January 2017 and delayed the start of any payments for the home infusion services necessary to administer these drugs until January 2021. The amount at which the services will be reimbursed in the future has not yet been determined by the United States Department of Health and Human Services. While several therapies are impacted by this change, the two most affected therapies of our specialty home infusion business are inotropic therapy for heart failure and subcutaneous immunoglobulin therapy for primary immunodeficiency diseases. Because of the delayed implementation of the reimbursement for home infusion therapy services and the unknowns with respect to the actual amount of reimbursement, the Corporation cannot determine the full impact of the Cures Act on the Corporation. The Corporation will continue to analyze the effect of this law on its business and results of operations.

Critical Accounting Estimates

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

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

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

Allowance for doubtful accounts and provision for doubtful accounts

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

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

	2016			2017			
	Amount	% of		Amount	% of		
		Revenues			Revenues		
First Quarter	\$3.2	0.6	%	First Quarter	\$3.9	0.7	%
Second Quarter	0.7	0.1		Second Quarter	2.7	0.5	
Third Quarter	0.1	0.0					
Fourth Quarter	2.3	0.4					

* Bad debt expense during the year ended December 31, 2016 was favorably impacted by approximately \$5.6 million related to collections of certain previously reserved receivables under note agreements and the full settlement of a customer's trade receivable of which \$3.2 million was reserved.

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

	2016	2017
First Quarter	34.7	37.9
Second Quarter	35.4	37.5
Third Quarter	37.4	
Fourth Quarter	38.0	

The following table shows our summarized aging categories by quarter:

	2016				2017	
	First	Second	Third	Fourth	First	Second
0 to 60 days	63.5%	61.9 %	61.0%	62.9 %	63.5%	64.5 %
61 to 120 days	14.7	16.3	14.4	15.7	14.5	14.8
Over 120 days	21.8	21.8	24.6	21.4	22.0	20.7

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

	2016				2017		
	Allowance	Gross Accounts Receivable	% of Gross Accounts Receivable		Allowance	Gross Accounts Receivable	% of Gross Accounts Receivable
First Quarter	\$44.9	\$ 244.4	18.4 %	First Quarter	\$32.9	\$ 280.7	11.7 %
Second Quarter	43.0	251.1	17.1	Second Quarter	32.8	279.4	11.7
Third Quarter	39.9	255.3	15.6				
Fourth Quarter	31.1	266.5	11.7				

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

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

	Three Months Ended June 30,					
	2016		2017			
	Amount	% of Revenues	Amount	% of Revenues		
Medicare Part D	\$244.7	47.1 %	\$308.5	52.1 %		
Institutional healthcare providers	114.0	21.9	106.9	18.1		
Medicaid	31.2	6.0	33.1	5.6		
Private and other	19.0	3.7	18.6	3.1		
Insured	82.1	15.8	100.6	17.0		
Medicare	9.0	1.7	4.0	0.7		
Hospital management fees	19.6	3.8	20.3	3.4		
Total	\$519.6	100.0 %	\$592.0	100.0 %		

	Six Months Ended June 30,					
	2016		2017			
	Amount	% of Revenues	Amount	% of Revenues		
Medicare Part D	\$489.4	46.9 %	\$587.5	50.7 %		
Institutional healthcare providers	232.3	22.2	220.9	19.1		
Medicaid	69.6	6.7	69.9	6.0		
Private and other	37.1	3.5	37.4	3.2		

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Insured	159.0	15.2	194.6	16.8
Medicare	17.4	1.7	7.7	0.7
Hospital management fees	39.3	3.8	40.8	3.5
Total	\$1,044.1	100.0	% \$1,158.8	100.0 %

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Inventory and cost of drugs dispensed

We have inventory located at each of our institutional pharmacy, specialty infusion, specialty oncology and distribution center locations. The Corporation's inventory is valued at the lower of first-in, first-out cost or market. The inventory consists of prescription drugs, over the counter products and intravenous solutions. The Corporation's inventory balances historically tend to be higher at June 30 and December 31 based on purchasing strategies associated with brand name drugs. Our inventory relating to controlled substances is maintained on a manually prepared perpetual system to the extent required by the Drug Enforcement Agency and state board of pharmacies. All other inventory is maintained on a periodic system, through the performance of, at a minimum, quarterly physical inventories at the end of each quarter. All inventory counts are reconciled to the balance sheet account and differences are adjusted through cost of goods sold. In addition, we record an amount of potential returns of prescription drugs based on historical rates of returns and record an estimate for rebates associated with inventory remaining at the end of each period.

As of December 31, 2016 and June 30, 2017, our inventories were \$214.7 million and \$139.6 million, respectively.

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

	2016	2017
First Quarter	24.4	26.6
Second Quarter	33.5	25.3
Third Quarter	25.2	-
Fourth Quarter	43.4	-

Goodwill and other intangible assets

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

Our goodwill as of December 31, 2016 and June 30, 2017 was \$392.3 million and \$422.9 million, respectively.

The Corporation's policy is to perform a qualitative assessment of its reporting units to determine whether it is more likely than not (defined as having a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount, unless events or circumstances warrant the need to perform a quantitative assessment. The Corporation performed the qualitative assessment of its institutional pharmacy and specialty oncology reporting units at December 31, 2016 and did not find it necessary to perform the first step of the two-step impairment analysis. The Corporation performed a quantitative assessment as of December 31, 2016 for its specialty infusion reporting unit. At that time the specialty infusion reporting unit's fair value as calculated was approximately 13.0% greater than book value.

There were no impairment triggering events during the six months ended June 30, 2017.

Definitions

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

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

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

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

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

Results of Operations

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

	Three Months Ended June 30,				Six Months Ended June 30,				
	2016	Increase (Decrease)		2017	2016	Increase (Decrease)		2017	
	Amount	% of Revenues		Amount	% of Revenues	Amount	% of Revenues	Amount	% of Revenues
Revenues	\$519.6	100.0%		\$592.0	100.0%	\$1,044.1	100.0%	\$1,158.8	100.0%
Cost of Goods sold	437.8	84.3	64.6	502.4	84.9	880.3	84.3	981.4	84.7
Gross profit	\$81.8	15.7 %	\$7.8	\$89.6	15.1 %	\$163.8	15.7 %	\$177.4	15.3 %
Pharmacy (in whole numbers except where indicated)									
Financial data									
Prescriptions dispensed (in thousands)	7,868		(290)	7,578		16,163		(701)	(4.3)%
Revenue per prescription dispensed	\$66.04		\$12.08	\$78.12		\$64.60		\$10.35	16.0%
Gross profit per prescription dispensed	\$10.40		\$1.42	\$11.82		\$10.13		\$1.34	13.2%
Gross profit margin	15.7 %		(0.6)%	15.1 %		15.7 %		(0.4)%	(2.5)%
Generic dispensing rate	85.5 %		0.2 %	85.7 %		85.7 %		(0.4)%	(0.5)%

Revenues

Revenues increased \$72.4 million for the three months ended June 30, 2017 compared to the three months ended June 30, 2016 which was driven by organic growth in the Corporation's specialty pharmacy businesses and the 2016 and 2017 Acquisitions, partially offset by a 4.1% reduction in prescription volume in the institutional pharmacy business. The increase of \$72.4 million is comprised of a favorable rate variance of approximately \$95.0 million or \$12.08 increase per prescription dispensed, partially offset by an unfavorable volume variance of approximately \$22.6 million or 290,000 fewer prescriptions dispensed. The revenue per prescription dispensed increase was due to the increased volume and recent acquisitions in the Corporation's specialty pharmacy businesses, which carries higher revenue per script, along with certain improved Part D contracts and branded drug inflation in the long-term care pharmacy business.

Revenues increased \$114.7 million for the six months ended June 30, 2017 compared to the six months ended June 30, 2016 which was driven by the 2016 and 2017 Acquisitions, organic growth in the Corporation's specialty pharmacy businesses and branded drug inflation, partially offset by a 4.6% reduction in prescription volume in the institutional pharmacy business. The increase of \$114.7 million is comprised of a favorable rate variance of approximately \$167.3 million or \$10.35 increase per prescription dispensed, partially offset by an unfavorable volume variance of approximately \$52.6 million or 701,000 fewer prescriptions dispensed. The revenue per prescription dispensed increase was due to the increased volume and recent acquisitions in the Corporation's specialty pharmacy businesses, which carry higher revenue per script, along with certain improved Part D contracts and branded drug inflation in the long-term care pharmacy business.

Gross Profit

Gross profit for the three months ended June 30, 2017 was \$89.6 million or \$11.82 per prescription dispensed compared to \$81.8 million or \$10.40 per prescription dispensed for the three months ended June 30, 2016. The increase in gross profit was due to improved purchasing strategies in the Corporation's long-term care pharmacy business along with higher gross profit associated with the Corporation's specialty pharmacy businesses as a result of organic growth and recent acquisitions, partially offset by lower prescription volume in the Corporation's long-term care pharmacy business.

Gross profit for the six months ended June 30, 2017 was \$177.4 million or \$11.47 per prescription dispensed compared to \$163.8 million or \$10.13 per prescription dispensed for the six months ended June 30, 2016. The increase in gross profit was due to improved purchasing strategies in the Corporation's long-term care pharmacy business along with higher gross profit associated with the Corporation's specialty pharmacy businesses as a result of organic growth and recent acquisitions, partially offset by lower prescription volume in the Corporation's long-term care pharmacy business.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$61.8 million, or 10.4% of revenues, for the three months ended June 30, 2017 compared to \$55.7 million, or 10.7% of revenues, for the three months ended June 30, 2016. The increase of \$6.1 million was due to an increase in labor costs associated with the 2016 and 2017 Acquisitions, an increase in bad debt expense and a reduction in an acquisition related earn-out recorded in the 2016 period.

Selling, general and administrative expenses were \$125.2 million, or 10.8% of revenues, for the six months ended June 30, 2017 compared to \$112.7 million, or 10.8% of revenues, for the six months ended June 30, 2016. The increase of \$12.5 million was due to an increase in labor costs associated with the 2016 and 2017 Acquisitions, an increase in bad debt expense due to a reduction in the previous period resulting from collections on previously reserved receivables and a reduction in an acquisition related earn-out recorded in the 2016 period.

Depreciation and Amortization

Depreciation expense was \$6.8 million for the three months ended June 30, 2017 and \$5.7 million for the three months ended June 30, 2016 and \$13.7 million for the six months ended June 30, 2017 and \$11.0 million for the six months ended June 30, 2016. The increase of \$1.1 million for the three months and \$2.7 million for the six months, was due to capitalization of internally developed software in 2016, along with current year fixed asset additions.

Amortization expense was \$9.9 million for the three months ended June 30, 2017 compared to \$8.2 million for the three months ended June 30, 2016 and \$19.0 million for the six months ended June 30, 2017 as compared to \$16.4 million for the six months ended June 30, 2016. The increase of \$1.7 million for the three months and \$2.6 million for the six months, was due primarily to the amortization expense recognized on intangibles acquired through the 2016 and 2017 Acquisitions.

Settlement, Litigation and Other Related Charges

Settlement, litigation and other related charges were \$2.7 million for the three months ended June 30, 2017 compared to \$4.9 million for the three months ended June 30, 2016 and were \$5.2 million for the six months ended June 30, 2017 as compared to \$8.0 million for the six months ended June 30, 2016. These costs relate to the Corporation's defense and settlement of certain governmental investigations and other litigation. These costs decreased compared to the prior year due to fewer litigation settlements in the current year.

Restructuring and Impairment Charges

Restructuring and impairment charges for the three months ended June 30, 2017 were less than \$0.1 million compared to \$1.1 million for the three months ended June 30, 2016 and were \$0.1 million for the six months ended June 30, 2017 compared to \$2.5 million for the six months ended June 30, 2016. These costs were part of the Corporation's restructuring and centralization initiative related to the specialty pharmacy business.

Merger, Acquisition, Integration Costs and Other Charges

Merger, acquisition, integration costs and other charges were \$3.6 million for the three months ended June 30, 2017 compared to \$4.4 million for the three months ended June 30, 2016 and were \$7.1 million for the six months ended June 30, 2017 compared to \$8.8 million for the six months ended June 30, 2016. The decrease was related to higher professional fees incurred in 2016 associated with future and current acquisitions.

Interest Expense

Interest expense was \$4.1 million for the three months ended June 30, 2017 compared to \$3.3 million for the three months ended June 30, 2016 and was \$7.8 million for the six months ended June 30, 2017 compared to \$6.3 million for the six months ended June 30, 2016. The increase was primarily due to increased interest rates on the credit facility along with a higher outstanding term loan balance in 2017, due to the credit agreement amendment on December 6, 2016, which increased the balance by \$89.1 million.

Tax Provision

The Corporation's effective tax rate for the six months ended June 30, 2017 was 36.8%, comprised of the 35% federal statutory rate, 3.4% for the state rate, (1.1)% for permanent differences, and (0.5)% for discrete events. Excluding the impact of discrete events and other nonrecurring items, the provision for income taxes as a percentage of pre-tax income would have been 37.0% and 36.6% for the six months ended June 30, 2017 and June 30, 2016, respectively. The increase in the effective tax rate excluding the impact of the discrete events and nonrecurring items between the two periods was primarily the result of an increase in state and local income taxes due to the earnings mix amongst the Corporation's subsidiaries and their varied state tax implications.

Liquidity and Capital Resources

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

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2016	2017	2016	2017
Net cash (used in) provided by operating activities	\$(24.1)	\$42.5	\$41.2	\$114.7
Net cash used in investing activities	(8.1)	(10.5)	(20.2)	(66.6)
Net cash provided by (used in) financing activities	34.1	(33.9)	(16.7)	(40.0)
Net change in cash and cash equivalents	1.9	(1.9)	4.3	8.1
Cash and cash equivalents at beginning of period	25.5	15.4	23.1	5.4
Cash and cash equivalents at end of period	\$27.4	\$13.5	\$27.4	\$13.5

Operating Activities – Cash provided by operating activities aggregated \$42.5 million for the three months ended June 30, 2017 compared to cash used in operating activities of \$24.1 million for the three months ended June 30, 2016. Cash provided by operating activities aggregated \$114.7 million for the six months ended June 30, 2017 as compared to \$41.2 million for the six months ended June 30, 2016. The increase in cash from operating activities for both the three and six month periods is due primarily to a decrease in inventory associated with the Corporation's inventory purchasing strategies. The six month period is partially offset by year over year reductions in cash provided by operations for accounts payable due to timing of the Cardinal PVA payment.

Investing Activities – Cash used in investing activities aggregated \$10.5 million and \$66.6 million for the three and six months ended June 30, 2017, respectively, compared to \$8.1 million and \$20.2 million for the three and six months ended June 30, 2016, respectively. The increase in cash used in investing activities is a result of cash paid for acquisitions during the respective periods and an increase in fixed asset purchases.

Financing Activities – Cash used in financing activities aggregated \$33.9 million and \$40.0 million for the three and six months ended June 30, 2017, respectively, compared to cash provided by financing activities of \$34.1 million and cash used in financing activities of \$16.7 million for the three and six months ended June 30, 2016, respectively. The increase in cash used in operating activities for both the three and six month periods is due the Corporation's net paydown on the revolving credit facility of \$30.0 million and \$33.0 million in the three months and six months ended June 30, 2017, respectively. In the second quarter of 2016, the Corporation had net borrowings on the revolving credit facility as a result of the Corporation's inventory purchasing strategy.

Credit Agreement

On December 9, 2016, the Corporation entered into a First Amendment ("Amendment") to its existing Credit Agreement previously entered into in September 2014 with Bank of America, N.A. as administrative agent (collectively, the "Credit Agreement"). The Credit Agreement originally consisted of a \$225.0 million term loan facility and a \$310.0 million revolving credit facility. Pursuant to the Amendment, among other things, (a) the revolving commitments to the revolving credit facility were increased to \$370.0 million, (b) an additional advance under the term loan was provided in an outstanding principal amount equal to \$89.1 million which, when combined with the \$210.9 million then outstanding under the term loan as of the date of the Amendment, equals \$300.0 million outstanding under the term loan, (c) the amount by which commitments may be increased after the initial closing was increased from \$190.0 million to \$200.0 million, and (d) The Huntington National Bank was added as a new lender to the Credit Agreement.

The Credit Agreement required quarterly term loan principal payments in an amount of \$2.8 million beginning September 2015 through September 2019. The Amendment replaced the quarterly term loan principal payment amount of \$2.8 million with \$3.8 million, beginning March 2017. The final principal repayment of the term loan shall be repaid on the term maturity date, September 17, 2019. In addition, the term loan is subject to certain prepayment obligations relating to certain asset sales, certain casualty losses and the incurrence of certain indebtedness.

The Corporation had a total of \$289.7 million of term debt outstanding under the term loan and \$143.5 million outstanding under the revolving portion of the Credit Agreement as of June 30, 2017. The Credit Agreement provides for the issuance of letters of credit which, when issued, constitute usage and reduce availability on the revolving portion of the Credit Agreement. The amount of letters of credit outstanding as of June 30, 2017 was \$2.8 million. After giving effect to the letters of credit and amounts outstanding under the revolving credit agreement, total availability under the revolving credit facility was \$223.7 million as of June 30, 2017.

The Credit Agreement also contains financial covenants that require us to satisfy certain financial tests and maintain certain financial ratios. The Corporation was compliant with all debt covenant requirements at June 30, 2017.

Drug Wholesaler Agreement

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

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

Treasury Stock

In August 2010, the Board of Directors authorized a share repurchase of up to \$25.0 million of the Corporation's common stock, of which \$10.5 million was used. On July 2, 2012 the Board of Directors authorized an increase to the remaining portion of the existing stock repurchase program that allows the Corporation to again repurchase up to a maximum of \$25.0 million of the Corporation's common stock. Approximately \$19.7 million remained available under the program as of June 30, 2017. Share repurchases under this authorization may be made in the open market through unsolicited or solicited privately negotiated transactions, or in such other appropriate manner, and may be funded from available cash or the revolving credit facility. The amount and timing of the repurchases, if any, would be determined by the Corporation's management and would depend on a variety of factors including price, corporate and regulatory requirements, capital availability and other market conditions. Common stock acquired through the share repurchase program would be held as treasury shares and may be used for general corporate purposes, including reissuances in connection with acquisitions, employee stock option exercises or other employee stock plans. The share repurchase program does not have an expiration date and may be limited, terminated or extended at any time without prior notice. During the six months ended June 30, 2017, the Corporation repurchased no shares of common stock under this program.

The Corporation may redeem shares from employees upon the vesting of the Corporation's stock awards for minimum statutory tax withholding purposes and to cover option exercise costs. The Corporation redeemed 94,693 shares from the vesting of certain awards and the exercise of certain stock options, for an aggregate price of approximately \$2.2 million during the six months ended June 30, 2017. These shares have also been designated by the Corporation as treasury stock.

As of June 30, 2017, the Corporation had a total of 3,011,599 shares held as treasury stock.

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Supplemental Quarterly Information

The following tables represent the results of the Corporation's quarterly operations for the year ended December 31, 2016 and for the first and second quarters of 2017 (in millions, except where indicated):

	2016 Quarters				2017 Quarters	
	First	Second	Third	Fourth	First	Second
Revenues	\$524.5	\$519.6	\$512.6	\$534.4	\$566.8	\$592.0
Cost of goods sold	442.5	437.8	434.1	450.7	478.9	502.4
Gross profit	82.0	81.8	78.5	83.7	87.9	89.6
Selling, general and administrative	57.0	55.7	53.1	54.8	63.5	61.8
Amortization expense	8.2	8.2	8.3	9.0	9.1	9.9
Merger, acquisition, integration costs, and other charges	4.4	4.4	5.3	6.7	3.5	3.6
Settlement, litigation and other related charges	3.1	4.9	(0.8)	2.4	2.6	2.7
Restructuring and impairment charges	1.4	1.1	0.6	(0.2)	-	-
Operating income	7.9	7.5	12.0	11.0	9.2	11.6
Interest expense, net	3.0	3.3	3.0	0.2	3.7	4.1
Income before income taxes	4.9	4.2	9.0	10.8	5.5	7.5
Provision for income taxes	0.8	1.7	1.7	3.1	2.0	2.8
Net income	\$4.1	\$2.5	\$7.3	\$7.7	\$3.5	\$4.7
Earnings per share (1):						
Basic	\$0.13	\$0.08	\$0.24	\$0.25	\$0.11	\$0.15
Diluted	\$0.13	\$0.08	\$0.23	\$0.25	\$0.11	\$0.15
Adjusted diluted earnings per share (1)(2):	\$0.45	\$0.47	\$0.44	\$0.58	\$0.42	\$0.47
Shares used in computing earnings per share:						
Basic	30.5	30.7	30.8	30.8	30.8	31.4
Diluted	30.9	31.0	31.1	31.2	31.2	31.7
Balance sheet data:						
Cash and cash equivalents	\$25.5	\$27.4	\$6.5	\$5.4	\$15.4	\$13.5
Working capital	\$303.9	\$325.8	\$291.5	\$334.4	\$307.6	\$279.6
Goodwill	\$372.1	\$372.2	\$388.1	\$392.3	\$431.6	\$422.9
Intangible assets, net	\$182.1	\$173.9	\$171.4	\$187.6	\$179.9	\$187.6
Total assets	\$1,166.6	\$1,201.1	\$1,157.5	\$1,273.0	\$1,252.3	\$1,236.7
Long-term debt	\$377.6	\$411.8	\$390.5	\$473.4	\$466.5	\$432.9
Total stockholders' equity	\$522.4	\$526.9	\$535.8	\$544.2	\$550.4	\$556.8
Supplemental information:						
Adjusted EBITDA(2)	\$30.3	\$31.8	\$31.5	35.6	\$31.3	\$34.6
Adjusted EBITDA Margin (2)	5.8	% 6.1	% 6.1	% 6.7	% 5.5	% 5.9
Adjusted EBITDA per prescription dispensed (2)	\$3.50	\$3.87	\$3.99	\$4.53	\$3.97	\$4.57
Net cash provided by (used in) operating activities	\$65.3	\$(24.1)	\$39.1	\$(49.5)	\$72.2	\$42.5

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Net cash used in investing activities	\$(12.1)	\$(8.1)	\$(37.3)	\$(34.2)	\$(56.1)	\$(10.5)
Net cash (used in) provided by financing activities	\$(50.8)	\$34.1	\$(22.7)	\$82.6	\$(6.1)	\$(33.9)

Statistical information (in whole numbers except where indicated)

Volume information

Prescriptions dispensed (in thousands) (3)	8,295	7,868	7,520	7,616	7,884	7,578
Revenue per prescription dispensed	\$63.23	\$66.04	\$68.16	\$70.17	\$71.89	\$78.12
Gross profit per prescription dispensed	\$9.89	\$10.40	\$10.44	\$10.99	\$11.15	\$11.82
Gross profit margin	15.6 %	15.7 %	15.3 %	15.7 %	15.5 %	15.1 %
Generic drug dispensing rate	85.9 %	85.5 %	84.7 %	84.7 %	85.0 %	85.7 %
Inventory days on hand	24.4	33.5	25.2	43.4	26.6	25.3
Revenue days outstanding	34.7	35.4	37.4	38.0	37.9	37.5

(1) The Corporation has never declared a cash dividend. Earnings per common share are in actual cents.

See "Use of Non-GAAP Measures for Measuring Quarterly Results" for a definition and Reconciliation of Diluted (2) Earnings Per Share to Adjusted Diluted Earnings Per Share, and for Reconciliation of Net Income to Adjusted EBITDA and Adjusted EBITDA Margin.

(3) The Corporation has made certain adjustments to historical prescriptions dispensed.

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Use of Non-GAAP Measures for Measuring Quarterly Results

The Corporation calculates Adjusted EBITDA as provided in the reconciliation below and calculates Adjusted EBITDA Margin by taking Adjusted EBITDA and dividing it by revenues. The Corporation calculates and uses Adjusted EBITDA as a performance measure. The measurement is used in concert with net income (loss) and cash flows from operating activities, which measure actual cash generated in the period. In addition, the Corporation believes that Adjusted EBITDA and Adjusted EBITDA Margin are supplemental measurement tools used by analysts and investors to help evaluate overall operating performance and the ability to incur and service debt and make capital expenditures. In addition, Adjusted EBITDA, as defined in the Credit Agreement, is used in conjunction with the Corporation's debt leverage ratio and this calculation sets the applicable margin for the quarterly interest charge. Adjusted EBITDA, as defined in the Credit Agreement, is not the same calculation as this Adjusted EBITDA table. Adjusted EBITDA presented herein does not represent funds available for the Corporation's discretionary use and is not intended to represent or to be used as a substitute for net income or cash flows from (used in) operating activities data as measured under U.S. GAAP. The items excluded from Adjusted EBITDA but included in the calculation of the Corporation's reported net income and cash flows from (used in) operating activities are significant components of the accompanying condensed consolidated income statements and condensed consolidated statements of cash flows and must be considered in performing a comprehensive assessment of overall financial performance. The Corporation's calculation of Adjusted EBITDA may not be consistent with calculations of EBITDA used by other companies. The following are reconciliations of Adjusted EBITDA to the Corporation's net income and net operating cash flows for the periods presented.

The Corporation calculates and uses adjusted diluted earnings per share, which is exclusive of the impact of merger, acquisition, integration costs and other charges, settlement, litigation and other related charges, Hurricane Sandy disaster costs (recoveries), restructuring and impairment charges, California Medicaid recoupment, amortization of intangible assets, and the tax impact of the adjustments on the tax provision ("the Excluded Items") as an indicator of its core operating results. The measurement is used in concert with net income and diluted earnings per share, which measure actual earnings per share generated in the period. The Corporation believes the exclusion of these charges in expressing earnings per share provides management with a useful measure to assess period to period comparability and is useful to investors in evaluating the Corporation's operating results from period to period. Adjusted diluted earnings per share after giving effect to the Excluded Items does not represent the amount that effectively accrues directly to stockholders (i.e., such costs are a reduction in earnings and stockholders' equity) and is not intended to represent or to be used as a substitute for diluted earnings per share as measured under U.S. GAAP. The Excluded Items are significant components of the accompanying condensed consolidated income statements and must be considered in performing a comprehensive assessment of overall financial performance. The following is a reconciliation of adjusted diluted earnings per share to the Corporation's U.S. GAAP earnings per diluted common share for the periods presented.

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Unaudited Reconciliation of Net Income to Adjusted EBITDA (dollars in millions)

	2016 Quarters				2017 Quarters	
	First	Second	Third	Fourth	First	Second
Net income	\$4.1	\$ 2.5	\$7.3	\$ 7.7	\$3.5	\$ 4.7
Add:						
Interest expense, net	3.0	3.3	3.0	0.2	3.7	4.1
Provision for income taxes	0.8	1.7	1.7	3.1	2.0	2.8
Depreciation and amortization expense	13.5	13.9	14.4	15.7	16.0	16.7
EBITDA	21.4	21.4	26.4	26.7	25.2	28.3
Merger, acquisition, integration costs and other charges	4.4	4.4	5.3	6.7	3.5	3.6
Settlement, litigation and other related charges	3.1	4.9	(0.8)	2.4	2.6	2.7
Restructuring and impairment charges	1.4	1.1	0.6	(0.2)	-	-
Adjusted EBITDA	\$30.3	\$ 31.8	\$31.5	\$ 35.6	\$31.3	\$ 34.6
Adjusted EBITDA Margin	5.8 %	6.1 %	6.1 %	6.7 %	5.5 %	5.9 %

Unaudited Reconciliation of Adjusted EBITDA to Net Operating Cash Flows (dollars in millions)

	2016 Quarters				2017 Quarters	
	First	Second	Third	Fourth	First	Second
Adjusted EBITDA	\$30.3	\$ 31.8	\$31.5	\$35.6	\$31.3	\$ 34.6
Interest expense, net	(3.0)	(3.3)	(3.0)	(0.2)	(3.7)	(4.1)
Merger, acquisition, integration costs and other charges	(8.9)	(10.4)	(5.3)	(8.7)	(6.1)	(6.3)
Provision for bad debt	3.2	0.7	0.1	2.3	3.9	2.7
Amortization of deferred financing fees	0.1	0.2	0.1	0.2	0.2	0.2
(Gain) loss on disposition of equipment	-	-	0.1	(0.1)	-	-
Gain on acquisition	-	-	-	(0.6)	-	-
Provision for income taxes	(0.8)	(1.7)	(1.7)	(3.1)	(2.0)	(2.8)
Deferred income taxes	3.1	4.7	0.2	1.0	2.9	4.3
Changes in federal and state income tax payable (receivable)	(0.9)	(2.9)	6.9	4.1	(0.2)	(1.8)
Stock-based compensation and deferred compensation	1.4	2.7	2.2	0.6	2.5	2.5
Excess tax benefit from stock-based compensation	(1.0)	(0.2)	(0.1)	(0.1)	(0.1)	-
Changes in assets and liabilities	41.7	(45.7)	8.1	(80.6)	43.5	13.3
Other	0.1	-	-	0.1	-	(0.1)
Net Cash Flows Provided by (Used in) Operating Activities	\$65.3	\$ (24.1)	\$39.1	\$ (49.5)	\$72.2	\$ 42.5

Unaudited Reconciliation of Diluted Earnings Per Share to Adjusted Diluted Earnings Per Share

	2016 Quarters				2017 Quarters	
	First	Second	Third	Fourth	First	Second
Diluted earnings per share	\$0.13	\$ 0.08	\$0.23	\$0.25	\$0.11	\$ 0.15
Add:						
Diluted earnings per share impact of:						
Merger, acquisition, integration costs and other charges	0.09	0.09	0.11	0.13	0.07	0.07
Settlement, litigation and other related charges	0.06	0.10	(0.02)	0.05	0.05	0.05
California Medicaid recoupment	-	-	-	-	-	-
Restructuring and impairment charges	0.03	0.02	0.01	-	-	-
Hurricane Sandy disaster recoveries	-	-	-	-	-	-
Amortization of intangible assets	0.17	0.17	0.17	0.18	0.18	0.20

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Tax impact of the above adjustment charges on tax provision	(0.03)	0.01	(0.06)	(0.03)	0.01	-
Adjusted diluted earnings per share	\$0.45	\$0.47	\$0.44	\$0.58	\$0.42	\$0.47

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

During the reporting period, there have been no material changes in the disclosures set forth in Part II, Item 7a in our Form 10-K for the year ended December 31, 2016.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Corporation has carried out an evaluation under the supervision and with the participation of management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Corporation's "disclosure controls and procedures" as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of the end of the period covered by this report. The Corporation's disclosure controls and procedures are designed so that information required to be disclosed in the Corporation's reports filed under the Exchange Act, such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. The Corporation's disclosure controls and procedures are also intended to ensure that such information is accumulated and communicated to the Corporation's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives, and management necessarily is required to use its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of June 30, 2017, the Corporation's disclosure controls and procedures were not effective due to the existence of a previously reported material weakness in internal control over financial reporting discussed below. The material weakness was identified and discussed in "Part II – Item 9A – Controls and Procedures" of our Annual Report on Form 10-K for the year ended December 31, 2016.

Notwithstanding the identified material weakness, management believes the condensed consolidated financial statements included in this Form 10-Q fairly represent in all material respects our financial condition, results of operations and liquidity at and for the periods presented, in accordance with U.S. GAAP.

Description of Material Weakness

As previously reported in our Annual Report on Form 10-K for the year ended December 31, 2016, the Corporation did not have effective controls over the completeness, existence, accuracy and valuation of the allowance for doubtful accounts for accounts receivable within the institutional pharmacy operating segment. This control deficiency resulted because management did not have a sufficient understanding of the required design elements for an effective management review control to address the assessed risks of material misstatements. In addition, the deficiency resulted because the Corporation did not have effective monitoring activities in place to determine the effective design and operation of internal controls over the allowance for doubtful accounts.

The control deficiency described above resulted in no misstatements in our condensed consolidated financial statements as of and for the six months ended June 30, 2017. However, the control deficiencies create a reasonable possibility that a material misstatement to the condensed consolidated financial statements will not be prevented or detected on a timely basis, and therefore we concluded that the deficiencies represent a material weakness in the Corporation's internal control over financial reporting and our internal control over financial reporting was not

effective as of June 30, 2017.

Remediation Efforts to Address Material Weakness

Management has been actively engaged in developing remediation plans to address the previously identified material weakness. We are in the process of reviewing our financial reporting processes and internal controls and written policies and procedures over the allowance for doubtful accounts. Further, management has provided and will continue to provide additional training regarding the required design elements for effective management review controls and monitoring activities to address the assessed risks of material misstatements as well as evidence standards for documenting the design and operating effectiveness of internal control over financial reporting.

Management is actively engaged in improving the efficiency and effectiveness of our internal control over financial reporting and as a part of this is currently performing a review of internal control over financial reporting across the organization to ensure that all aspects of the Committee of Sponsoring Organizations of the Treadway Commission's 2013 Internal Control Integrated 2013 Framework are appropriately addressed.

Management has developed the remediation plan and started implementing these changes. Management expects to begin testing those enhanced controls and procedures already implemented in the second quarter of 2017, and anticipates that the entire remediation plan will be implemented by the third quarter of 2017. The material weakness will not be considered remediated until the process-level controls and review controls effectively operate for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively. Management expects that the remediation of this material weakness will be completed prior to the end of fiscal year 2017.

Changes in Internal Control Over Financial Reporting

Other than the steps taken to work towards the remediation of the material weakness identified above there have been no changes in the Corporation's internal control over financial reporting during the quarter ended June 30, 2017 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information called for by this item is incorporated herein by reference to Note 5 included in Part I, Item 1, Financial Statements (Unaudited) - Notes to Condensed Consolidated Financial Statements.

Item 1A. Risk Factors

There have been no material changes in our risk factors from those disclosed in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2016 or the Corporation's Quarterly Report on Form 10-Q for the quarter ended March 31, 2017.

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

The Corporation may redeem shares from employees upon vesting of the Corporation's stock awards for minimum statutory tax withholding purposes and to cover option exercise costs. The Corporation redeemed 94,693 shares from the vesting of certain awards and the exercise of certain stock options, for an aggregate price of approximately \$2.2 million during the six months ended June 30, 2017. These shares have been designated by the Corporation as treasury stock.

The following table summarizes our share repurchase activity by month for the three months ended June 30, 2017:

Period	Total Number of Shares Purchased	Weighted Average Price Paid per Share	Total Number of Shares Purchased Publicly Announced Plans or Programs (2)	Approximate Dollar Value of Shares that may yet be Purchased under the Plans or Programs (in millions)
April 1, 2017 - April 30, 2017	41	(1) \$ 23.53	-	\$ 19.7
May 1, 2017 - May 31, 2017	684	(1) 23.76	-	19.7
June 1, 2017 - June 30, 2017	218	(1) 25.93	-	19.7

(1) The Corporation repurchased 943 shares of common stock in connection with the vesting of certain stock awards to cover minimum statutory withholding taxes.

(2) On August 24, 2010, the Board of Directors announced a share repurchase program whereby the Corporation is authorized to purchase up to \$25.0 million of the Corporation's common stock, of which \$10.5 million was used. On July 2, 2012, the Board of Directors authorized an increase to the remaining portion of the existing share repurchase program that allows the Corporation to again repurchase up to a maximum of \$25.0 million of the Corporation's common stock. The Corporation did not repurchase any common stock shares under this program

during the three months ended June 30, 2017.

Item 4. Mine Safety Disclosures

Not Applicable.

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Item 6. Exhibits

Exhibit

- No.
- 31.1* Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 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 of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1* Certification of Chief Executive Officer, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2* Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

*Furnished herewith.

SIGNATURES

Pursuant to the requirements 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.

PHARMERICA CORPORATION

Date: August 2, 2017 /s/ Gregory S. Weishar
Gregory S. Weishar
Chief Executive Officer and
Director

/s/ Robert E. Dries
Date: August 2, 2017 Robert E. Dries
Executive Vice President and Chief Financial Officer

/s/ Berard E. Tomassetti
Date: August 2, 2017 Berard E. Tomassetti
Senior Vice President and Chief Accounting Officer

Exhibit Index

Exhibit No.	Description
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