

PharMerica CORP  
Form 10-K  
February 28, 2014

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

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FORM 10-K  
(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the year ended December 31, 2013

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

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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  
Louisville, KY 40299  
(Address of Principal Executive Offices) (Zip Code)

(502) 627-7000  
(Registrant's Telephone Number, Including Area Code)  
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of exchange on which registered
Common stock \$0.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:  
N/A  
(Title of class)

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

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

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

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

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

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

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

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

The aggregate market value of the voting and non-voting common equity of the registrant held by non-affiliates as of June 28, 2013 was \$397,970,801.

<u>Class of Common Stock</u>	<u>Outstanding at February 21, 2014</u>
Common stock, \$0.01 par value	29,717,601

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Form 10-K incorporates certain information by reference from registrant's definitive proxy statement for the 2014 annual meeting of stockholders, which proxy statement will be filed no later than 120 days after the close of the registrant's fiscal year ended December 31, 2013.

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Part I

Item 1. Business

Overview

Formed in 2006, PharMerica Corporation (“the Corporation,” “we,” “us,” or “our”), a Delaware Corporation, is an institutional 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 and 12 specialty infusion centers and 5 specialty oncology pharmacies in 45 states. The Corporation’s customers are typically institutional healthcare providers, such as skilled nursing facilities, nursing centers, assisted living facilities, hospitals, individuals receiving in-home care and other long-term alternative care providers. The Corporation is generally the primary source of supply of pharmaceuticals to its customers. The Corporation also provides pharmacy management services to 83 hospitals in the United States.

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 a few customers, of which, our largest service is to the majority of the Kindred hospitals.

#### Consultant Pharmacist Services

Federal and state regulations mandate that long-term care facilities, in addition to providing a source of pharmaceuticals, retain consultant pharmacist services to monitor and report on prescription drug therapy in order to maintain and improve the quality of resident care. On September 30, 2008, the United States Department of Health and Human Services Office of Inspector General ("OIG") published OIG Supplemental Compliance Program Guidance for Nursing Homes. With quality of care being the first risk area identified, the supplemental guidance is part of a series of recent government efforts focused on improving quality of care at

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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 70% 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 customer's 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 home 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 drug procurement and delivery, inventory management, and prescription administration and coordination with the patient, oncology practice and payer. We procure oncology drugs from

manufacturers and wholesalers on behalf of oncologists and patients, handle administrative tasks related to prescription dispensing, distribute drugs directly to patients or to oncology practices, and are reimbursed by payers and patients. 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.

#### Our Business Focus

**Drive Scale Economies.** We will focus on consistently providing quality pharmaceutical services to our customers at competitive prices and delivery of prescriptions in a timely and effective manner. Our business seeks to implement innovative and cost-effective solutions to improve the provision of medication to our customers and the residents and patients that they serve.

**Focus on Organic Growth through New Sales and Client Retention.** We aim to grow our business through expansion in our existing markets and by servicing new customers. We believe our industry has underlying market growth potential attributable to both an increase in drug utilization as well as the general aging population of the United States.

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**Acquire Competitors.** We also intend to expand our market share through selected geographic expansion in markets not currently served by us and through strategic acquisitions in existing and underserved markets. The Corporation currently operates in 45 states. We believe that there are growth opportunities in several other markets. There are numerous businesses in our markets, mostly small or regional companies that lack the scale that we believe will be necessary to ultimately compete in a market that is national in scope. We intend to actively seek opportunities to acquire companies. Since its formation in 2007, the Corporation has acquired twelve institutional pharmacy businesses, one specialty infusion services business and one specialty oncology pharmacy.

## Sales and Marketing

We sell our products and services through a national sales force. Our sales force is organized along geographic lines to maximize coverage, manage costs, and align more effectively with our operating regions. Our sales representatives specialize in the products and services we offer and the markets in which we operate. Their knowledge permits us to meet the unique needs of our customers while maintaining profitable relationships.

## Customers

**Institutional Care Settings.** Our customers are typically institutional healthcare providers, such as skilled nursing facilities, nursing centers, assisted living facilities and other long-term alternative care settings. We are generally the primary source of pharmaceuticals for our customers.

Our customers depend on institutional pharmacies like us to provide the necessary pharmacy products and services and to play an integral role in monitoring patient medication regimens and safety. We dispense pharmaceuticals in patient specific packaging in accordance with physician instructions.

During 2013, revenues from Kindred's facilities represented approximately 9.2% of the Corporation's total revenues. Kindred Healthcare did not renew the Corporation's contract for pharmacy services and the contract expired on December 31, 2013. As of January 1, 2014, we no longer provide pharmacy services to Kindred Healthcare.

**Specialty Infusion Services.** At December 31, 2013, the Corporation provided specialty infusion services to patients in 14 states with acute or chronic conditions in a setting outside of a hospital or nursing home.

**Hospital Pharmacy Management Services.** At December 31, 2013, the Corporation provided hospital pharmacy management services to Kindred and other customers at 83 locations. For the year ended December 31, 2013, revenues under the Kindred hospital pharmacy management service contracts represented approximately 3.3% of the Corporation's total revenues.

## Suppliers/Inventory

We obtain pharmaceutical and other products from AmerisourceBergen Drug Corporation ("ABDC") and other contracts negotiated directly with pharmaceutical manufacturers for discounted prices. While the loss of a supplier could adversely affect our business if alternate sources of supply are unavailable, numerous sources of supply are generally available to us.

We seek to maintain an on-site inventory of pharmaceuticals and supplies to ensure prompt delivery to our customers. ABDC maintains local distribution facilities in most major geographic markets in which we operate. However, to take advantage of lower prices that can be realized by directly purchasing products from manufacturers, the Corporation implemented steps in 2013 to also establish our own distribution capabilities.

## Brand versus Generic



The following table summarizes the Corporation's generic drug dispensing rate:

2011	2012	2013
79.6%	83.3%	83.4%

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The following table summarizes the material brand-to-generic conversions expected to occur in 2014 through 2017:

2014	2015	2016	2017
Avelox (1Q)	Lovaza (1Q)	Adviar Diskus (3Q)	Tamiflu (2Q)
Detrol LA (1Q)	Namenda (1Q)	Crestor (3Q)	
Evista (1Q)	Abilify (2Q)	Seroquel XR (4Q)	
Nuedexta (1Q)	Celebrex (2Q)	Zetia (4Q)	
Renegel (1Q)	Diovan (2Q)		
Renvela (1Q)	Zyvox (2Q)		
Xeloda (1Q)	Aggrenox (3Q)		
Actonel (2Q)	Gleevec (3Q)		
Copaxone (2Q)	Avodart (4Q)		
Nexium (2Q)	Patanol (4Q)		
Restasis (2Q)	Combivent (4Q)		
Travatan Z (4Q)			

Number in parentheses refers to the quarter of conversion)

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

#### Supplier and Manufacturer Rebates

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

#### Information Technology

Computerized medical records and documentation are an integral part of our distribution system. We primarily utilize a proprietary information technology infrastructure that automates order entry of medications, dispensing of medications, invoicing, and payment processing. These systems provide consulting drug review, electronic medication management, medical records, and regulatory compliance information to help ensure patient safety. These systems also support verification of eligibility and electronic billing capabilities for the Corporation's pharmacies. They also provide order entry, shipment, billing, reimbursement and collection of service fees for medications, specialty services and other services rendered.

Based upon our electronic records, we are able to provide reports to our customers and management on patient care and quality assurance. These reports help to improve efficiency in patient care, reduce drug waste, and improve patient outcomes. We expect to continue to invest in technologies that help critical information access and system availability.

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## Sources of Pharmacy Revenues

We receive payment for our services from third party payers, including Medicare Part D Plans, government reimbursement programs under Medicare and Medicaid, and non-government sources such as institutional healthcare providers, commercial insurance companies, health maintenance organizations, preferred provider organizations, private payers, and contracted providers. The sources and amounts of our revenues will be determined by a number of factors, including the mix of our customers' patients, brand to generic conversions and the rates and changes of reimbursement among payers. Changes in our customers' censuses, the case mix of the patients, brand and generic dispensing rates, and the payer mix among private pay, Medicare Part D, institutional healthcare providers, and Medicaid, will affect our profitability.

A summary of revenue by payer type for the years ended December 31, are as follows (dollars in millions):

	2011		2012		2013		
	Amount	% of Revenues	Amount	% of Revenues	Amount	% of Revenues	
Medicare Part D	\$998.1	48.0	\$873.0	47.6	\$813.7	46.3	%
Institutional healthcare providers	616.2	29.6	561.4	30.6	519.2	29.5	
Medicaid	217.2	10.4	165.9	9.1	157.0	9.0	
Private and other	92.7	4.5	84.7	4.6	77.2	4.4	
Insured	90.0	4.3	79.5	4.3	113.0	6.4	
Medicare	4.4	0.2	4.2	0.3	15.5	0.9	
Hospital management fees	62.5	3.0	63.9	3.5	62.3	3.5	
Total	\$2,081.1	100.0	\$1,832.6	100.0	\$1,757.9	100.0	%

## Competition

We face a highly competitive environment in the institutional pharmacy market. In each geographic market, there are national, regional and local institutional pharmacies that provide services comparable to those offered by our pharmacies which may have greater financial and other resources than we do and may be more established in the markets they serve than we are. In addition, owners of skilled nursing facilities are also entering the institutional pharmacy market, particularly in areas of their geographic concentration. On a nationwide basis, there is one large competitor in the institutional pharmacy industry, Omnicare.

We believe that the competitive factors most important to our business are pricing, quality and the range of services offered, clinical expertise, ease of doing business with the provider and the ability to develop and maintain relationships with customers. Because relatively few barriers to entry exist in the local markets we serve, we have encountered and will continue to encounter substantial competition from local market entrants.

## Patents, Trademarks and Licenses

We use a number of trademarks and service marks. All of the principal trademarks and service marks used in the course of our business have been registered in the United States or are the subject of pending applications for registration.

We have various proprietary products, processes, software and other intellectual property that are used either to facilitate the conduct of our business or that are made available as products or services to customers. We generally seek to protect such intellectual property through a combination of trade secret, patent and copyright laws and through confidentiality and other contractually imposed protections.

Although we believe that our products and processes do not infringe upon the intellectual property rights of any third parties, third parties may assert infringement claims against us from time to time.

#### Seasonality

Our largest customers in institutional pharmacy services are skilled nursing facilities. Both prescription and non-prescription drug sales at skilled nursing facilities are affected by the timing and severity of the cold/flu season and other seasonality of the long-term care facilities industry, however seasonality does not have a material effect on the Corporation's financial results.

#### Working Capital

For information about the Corporation's practices relating to working capital items, see Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources".

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### Employees

As of December 31, 2013, we had approximately 5,800 employees which included approximately 1,100 part-time employees. The Corporation had approximately 400 employees that were covered by collective bargaining agreements as of December 31, 2013. These agreements expired on December 31, 2013, however the Corporation is awaiting determination from the National Labor Relations Board on certification of the union, once received we will proceed with negotiations. As of December 31, 2013, we employed approximately 1,700 licensed pharmacists. We believe that our relationships with our employees are good.

### Government Regulation

#### General

Extensive federal, state and local regulations govern institutional pharmacies and the healthcare facilities that they serve. These regulations cover licenses, staffing qualifications, conduct of operations, reimbursement, recordkeeping and documentation requirements and the confidentiality and security of health-related information. Our institutional pharmacies are also subject to federal and state laws that regulate financial arrangements between healthcare providers, including the federal anti-kickback statutes and the federal physician self-referral laws.

#### Licensure, Certification and Regulation

States generally require that the state board of pharmacy license a pharmacy operating within the state. Many states also regulate out-of-state pharmacies that deliver prescription products to patients or residents in their states. We have the necessary pharmacy state licenses, or pending applications, for each pharmacy we operate. Our pharmacies are also registered with the appropriate federal and state authorities pursuant to statutes governing the regulation of controlled substances. In addition, pharmacists, nurses and other healthcare professionals who provide services on our behalf are in most cases required to obtain and maintain professional licenses and are subject to state regulation regarding professional standards of conduct.

The Drug Enforcement Agency (the “DEA”), the U.S. Food and Drug Administration (the “FDA”), and various state regulatory authorities regulate the distribution of pharmaceutical products and controlled substances. These laws impose a host of requirements on the pharmaceutical supply channel, including providers of institutional pharmacy services. Under the Comprehensive Drug Abuse Prevention and Control Act of 1970, as a dispenser of controlled substances, we must register with the DEA, file reports of inventories and transactions and provide adequate security measures. In addition, we are required to comply with all the relevant requirements of the Controlled Substances Act for the transfer and shipment of pharmaceuticals. The FDA, DEA, and state regulatory authorities have broad enforcement powers, including the ability to seize or recall products and impose significant criminal, civil and administrative sanctions for violations of these laws and regulations. We have received all necessary regulatory approvals and believe that our pharmacy operations are in substantial compliance with applicable federal and state good manufacturing practice requirements.

Client long-term care facilities are separately required to be licensed in the states in which they operate and, if serving Medicaid or Medicare patients, must be certified to be in compliance with applicable program participation requirements. Client facilities are also subject to the nursing home reforms of the Omnibus Budget Reconciliation Act of 1987, as amended, which imposed strict compliance standards relating to quality of care for facility operations, including vastly increased documentation and reporting requirements.

#### Laws Affecting Referrals and Business Practices

We are subject to federal and state laws that govern financial and other arrangements between healthcare providers. These laws prohibit certain direct and indirect payments or fee-splitting arrangements between healthcare providers that are designed to induce or encourage the referral of patients to, or the recommendation of, a particular provider for medical products and services. These laws include:

the federal “anti-kickback” statute, which prohibits, among other things, knowingly or willfully soliciting, receiving, offering or paying remuneration “including any kickback, bribe or rebate” directly or indirectly in return for or to induce the referral of an individual to a person for the furnishing or arranging for the furnishing of any item or service for which payment may be made in whole or in part under Medicare, Medicaid or other federal healthcare programs; and the federal “Stark laws” which prohibit, with limited exceptions, the referral of patients by physicians for certain designated health services, to an entity with which the physician has a financial relationship.

These laws impact the relationships that we may have with potential referral sources. We have a variety of relationships with potential referral sources, including hospitals and skilled nursing facilities with which we have contracted to provide pharmacy services. With respect to the anti-kickback statute, the OIG has enacted safe harbor regulations that outline practices that are deemed protected from prosecution. While we endeavor to comply with the applicable safe harbors, certain of our current arrangements, none

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of which is material to us, may not qualify for safe harbor protection. Failure to meet a safe harbor does not mean that the arrangement necessarily violates the anti-kickback statute, but may subject the arrangement to greater scrutiny. In addition, as a means of providing guidance to healthcare providers, the OIG issues a variety of sub-regulatory guidance including Special Fraud Alerts, Special Advisory Bulletins, Advisory Opinions, and other compliance guidance documents. This guidance does not have the force of law, but identifies features of arrangements or transactions that may indicate that the arrangements or transactions violate the anti kickback statute or other federal health care laws. While we believe our practices comply with the anti-kickback statute, we cannot assure our practices that are outside of a safe harbor will not be found to violate the anti-kickback statute.

In addition to federal law, many states have enacted similar statutes that are not necessarily limited to items or services for which payment is made by federal healthcare programs. Violations of these laws may result in fines, imprisonment, denial of payment for services and exclusion from the Medicare and Medicaid programs and other state-funded programs.

Other provisions in the Social Security Act and in other federal and state laws authorize the imposition of penalties, including criminal and civil fines and exclusions from participation in Medicare, Medicaid and other federal healthcare programs for false claims, improper billing and other offenses. These laws include the federal False Claims Act, under which private parties have the right to bring “qui tam” whistleblower lawsuits against companies that submit false claims for payments to the government. Recent changes to the False Claims Act, expanding liability to certain additional parties and circumstances, may make these qui tam law lawsuits more prevalent. Some states have adopted similar state whistleblower and false claims laws.

In addition, a number of states have undertaken enforcement actions against pharmaceutical manufacturers involving pharmaceutical marketing programs, including looking at relationships with pharmacies and programs containing incentives for pharmacists to dispense one particular product rather than another. These enforcement actions arose under various state laws including fraud and abuse laws and consumer protection laws which generally prohibit false advertising, deceptive trade practices and the like.

In the ordinary course of business, we are regularly subject to inquiries, investigations and audits by federal and state agencies that oversee applicable healthcare program participation and payment regulations. We believe that the regulatory environment surrounding most segments of the healthcare industry remains intense. Federal and state governments continue to impose intensive enforcement policies resulting in a significant number of inspections, citations for regulatory deficiencies and other regulatory sanctions including demands for refund of overpayments, terminations from the Medicare and Medicaid programs, bars on Medicare and Medicaid payments and fines. Such sanctions could have a material adverse effect on our financial condition, results of operation and liquidity.

We believe our contract arrangements with other healthcare providers and our pharmaceutical suppliers and our pharmacy practices are in substantial compliance with applicable federal and state laws. These laws may, however, be interpreted in the future in a manner inconsistent with our interpretation and application.

### State Laws Affecting Access to Services

Some states have enacted “freedom of choice” or “any willing provider” requirements as part of their state Medicaid programs or in separate legislation. These laws may preclude a nursing center from requiring their patients and residents to purchase pharmacy or other ancillary medical services or supplies from particular providers that have a supplier relationship with the nursing center. Limitations such as these may increase the competition which we face in providing services to nursing center residents.

### HIPAA



The Federal Health Insurance Portability and Accountability Act of 1996, commonly known as “HIPAA,” mandates the adoption of regulations aimed at standardizing transaction formats and billing codes for documenting medical services, dealing with claims submissions and protecting the privacy and security of individually identifiable health information. HIPAA regulations that standardize transactions and code sets require standard formatting for healthcare providers, like us, that submit claims electronically.

The HIPAA privacy regulations apply to “protected health information,” or “PHI,” which is defined generally as individually identifiable health information transmitted or maintained in any form or medium, excluding certain education records and student medical records. The privacy regulations seek to limit the use and disclosure of most paper and oral communications, as well as those in electronic form, regarding an individual’s past, present or future physical or mental health or condition, or relating to the provision of healthcare to the individual or payment for that healthcare, if the individual can or may be identified by such information. HIPAA provides for the imposition of civil or criminal penalties if PHI is improperly disclosed.

HIPAA’s security regulations require us to ensure the confidentiality, integrity and availability of all electronic protected health information that we create, receive, maintain or transmit. We must protect against reasonably anticipated threats or hazards to the security of such information and the unauthorized use or disclosure of such information.

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In addition to HIPAA, we are subject to state privacy laws and other state privacy or health information requirements not preempted by HIPAA, including those which may furnish greater privacy protection for individuals than HIPAA.

The scope of our operations involving health information is broad and the nature of those operations is complex. Although we believe that our contract arrangements with healthcare payers and providers and our business practices are in compliance with applicable federal and state electronic transmissions, privacy and security of health information laws, the requirements of these laws, including HIPAA, are complicated and are subject to interpretation. In addition, state regulation of matters also covered by HIPAA, especially the privacy standards, is increasing, and determining which state laws are preempted by HIPAA is a matter of interpretation. Failure to comply with HIPAA or similar state laws could subject us to loss of customers, denial of the right to conduct business, civil damages, fines, criminal penalties and other enforcement actions.

The Health Information Technology for Economic and Clinical Health Act (“HITECH”), part of the American Recovery and Reinvestment Act of 2009, changed several aspects of HIPAA including, without limitation, the following: (i) applies HIPAA security provisions and penalties directly to business associates of covered entities; (ii) requires certain notifications in the event of a security breach involving PHI; (iii) restricts certain unauthorized disclosures; (iv) changes the treatment of certain marketing activities; and (v) strengthens enforcement activities. In addition, the Secretary issued an interim final rule on August 24, 2009 that requires notifications for certain unpermitted disclosures of PHI. The final rule was issued on January 17, 2013.

## 2010 Health Care Reform Legislation

The Patient Protection and Affordable Care Act and the reconciliation law known as Health Care and Education Affordability Reconciliation Act (combined we refer to both Acts as the “2010 Health Care Reform Legislation”) were enacted in March 2010. State participation in the expansion of Medicaid under the 2010 Health Care Reform Legislation is voluntary. Three key provisions of the 2010 Health Care Reform Legislation that are relevant to the Corporation are: (i) the gradual modification to the calculation of the Federal Upper Limit (“FUL”) for drug prices and the definition of Average Manufacturer’s Price (“AMP”), (ii) the closure, over time, of the Medicare Part D coverage gap, which is otherwise known as the “Donut Hole,” and (iii) short cycle dispensing. Regulations under the 2010 Health Care Reform Legislation are expected to continue being drafted, released, and finalized throughout the next several years. Pending the promulgation of these regulations, the Corporation is unable to fully evaluate the impact of the 2010 Health Care Reform Legislation.

## FUL and AMP Changes

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

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

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

On February 2, 2012, CMS issued proposed regulations further clarifying the AMP and FUL changes described above. CMS has since indicated that the final rule will be issued in July 2014.

Until CMS provides final guidance and the industry adapts to this now publicly available pricing information, the Corporation is unable to fully evaluate the impact of the changes in FUL and AMP to its business.

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### Part D Coverage Gap

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

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

### Short Cycle Dispensing

Pursuant to the 2010 Health Care Reform Legislation, Prescription Drug Plans (“PDPs”) are required, under Medicare Part D and Medicare Advantage prescription drug plans (“Medicare Advantage” or “MAPDs”) to utilize specific, uniform dispensing techniques, such as weekly, daily, or automated dose dispensing, when dispensing covered Medicare Part D drugs to beneficiaries who reside in a long-term care facility to reduce waste associated with 30 to 90 day prescriptions for such beneficiaries. Pursuant to CMS issued regulation, beginning January 1, 2013, pharmacies dispensing to long-term care facilities must dispense no more than 14-day supplies of brand-name oral solid medications covered by Medicare Part D. The Corporation fully implemented short cycle dispensing on January 1, 2013. Additionally, in January 2014, CMS issued a proposed rule entitled “Medicare Program; Contract Year 2015 Policy and Technical Changes to the Medicare Advantage and the Medicare Prescription Drug Benefit Programs” (the “Proposed Rule”). The Proposed Rule prohibits a Plan Sponsor from penalizing a long-term care pharmacy for selecting efficient dispensing techniques. For example, under the Proposed Rule, the Plan Sponsor could not prorate dispensing fees based on days' supply or quantity dispensed. The impact of short cycle dispensing has not had a material adverse impact on the Corporation's results of operations.

### Medicare Part D Proposed Changes

In the Proposed Rule, CMS clarifies the meaning of drug categories and classes of clinical concern for which all Part D drugs therein must be included on Part D sponsor formularies, subject to certain exceptions. CMS establishes criteria for determining which categories or classes of drugs are protected and states that anticonvulsants, antineoplastics, and antiretrovirals meet the criteria, while antidepressants, antipsychotics, and immunosuppressants do not. However, CMS defers any change in formulary requirements for the antipsychotic class and continues to require all drugs from within that class to be on Part D formularies in 2015.

In the Proposed Rule, CMS also proposes to require physicians and eligible professionals to enroll in the Medicare program in order to prescribe covered Part D drugs. CMS proposes that a prescriber or eligible professional of Part D drugs must have either an approved enrollment record in the Medicare fee-for-service program or a valid opt-out affidavit on file with a Part A or Part B Medicare Administrative Contractor for a prescription written by a prescriber to be eligible for coverage under the Part D program. Until CMS issues final guidance, the Corporation is unable to evaluate the full impact of these proposed changes to drug categories and classes and prescriber enrollment requirements on its business.

### Overview of Reimbursement

Medicare is a federal program that provides certain hospital and medical insurance benefits to persons age 65 and over and to certain disabled persons. Medicaid is a medical assistance program administered by each state that provides healthcare benefits to certain indigent patients. Within the Medicare and Medicaid statutory framework, there are substantial areas subject to administrative rulings, interpretations, and discretion that may affect payments made under

## Medicare and Medicaid.

We receive payment for our services from institutional healthcare providers, commercial Medicare Part D Plans, third party payer government reimbursement programs such as Medicare and Medicaid, and other non-government sources such as commercial insurance companies, health maintenance organizations, preferred provider organizations, and contracted providers. With respect to our skilled nursing facilities customers, their residents are covered by Medicare Part A, Part B and Part D Plans, Medicaid, insurance, and other private payers (including managed care).

## Medicare

The Medicare program consists of four parts: (i) Medicare Part A, which covers, among other things, in-patient hospital, skilled nursing facilities, home healthcare, and certain other types of healthcare services; (ii) Medicare Part B, which covers physicians' services, outpatient services, and certain items and services provided by medical suppliers such as intravenous therapy; (iii) Medicare Part C or Medicare Advantage, a managed care option for beneficiaries who are entitled to Medicare Part A and enrolled in Medicare Part B, and (iv) Medicare Part D, which provides coverage for prescription drugs that are not otherwise covered under Medicare Part A or Part B for those beneficiaries that enroll.

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Part A

The Balanced Budget Act of 1997 (the “BBA”) mandated the Prospective Payment System (“PPS”) for Medicare-eligible enrolled residents in skilled nursing facilities. Under PPS, Medicare pays skilled nursing facilities a fixed fee per patient per day for extended care services to patients, covering substantially all items and services furnished during such enrollee’s stay. Such services and items include pharmacy services and prescription drugs. We bill skilled nursing facilities based upon a negotiated fee schedule and are paid based on those contractual relationships. We do not receive direct payment from Medicare for patients covered under the Medicare Part A benefit. We classify the revenues recognized from these payers as Institutional Healthcare Providers.

Federal legislation continues to focus on reducing Medicare and Medicaid program expenditures. Such decreases may directly impact the Corporation’s customers and their Medicare reimbursement. Given the changing nature of these rules, we are unable at this time to fully evaluate the impact on our business. Any evaluation of budgeting, cost-cutting, and financing of health care must also consider the new federal administration and the impact its proposed health care policies could have on any future cost considerations.

Part B

The MMA also changed the Medicare payment methodology and conditions for coverage of certain items of durable medical equipment, prosthetics, orthotics, and supplies (“DMEPOS”) under Medicare Part B. The Corporation provides some of these products to its customers. The changes include, among other things, a new competitive bidding program for selected supplies, under which only suppliers that were winning bidders are eligible to provide services, at prices established as a result of the competitive bids, to Medicare beneficiaries. The competitive bidding is occurring for selected areas of the country in successive phases, with all areas of the country to be subject to either competitive bidding or rate adjustment using competitively bid rates by 2016. Enteral nutrients, equipment and supplies, oxygen equipment, hospital beds, walkers, negative pressure wound therapy pumps and supplies are among the 10 categories of DMEPOS included in the competitive bidding process. The Corporation submitted, and was awarded, competitive bids in certain geographic areas. Amounts paid under the competitive bidding program are expected to be significantly lower than the prior Medicare fee schedule rates. Medicare Part B is not material to the Corporation, representing 0.9% of revenues.

Part D

Medicare Part D provides coverage for prescription drugs that are not otherwise covered under Medicare Part A or Part B for those beneficiaries that enroll. Under Medicare Part D, beneficiaries may enroll in prescription drug plans offered by private commercial insurers who contract with CMS (or in a “fallback” plan offered on behalf of the government through a contractor, to the extent private entities fail to offer a plan in a given area), which provide coverage of outpatient prescription drugs (collectively, “Part D Plans”). Part D Plans include both plans providing the drug benefit on a standalone basis and Medicare Advantage plans providing drug coverage as a supplement to an existing medical benefit under that Medicare Advantage plan. Medicare beneficiaries generally have to pay a premium to enroll in a Part D Plan, with the premium amount varying from one Part D Plan to another, although CMS provides various federal subsidies to Part D Plans to reduce the cost to beneficiaries.

Part D Plans are required to make available certain drugs on their formularies. Dually-eligible residents in nursing centers generally are entitled to have their prescription drug costs covered by a Part D Plan, provided that the prescription drugs which they are taking are either on the Part D Plan’s formulary or an exception to the Part D Plan’s formulary is granted. CMS reviews the formularies of Part D Plans and requires these formularies to include the types of drugs most commonly used by Medicare beneficiaries. CMS also reviews the formulary exceptions criteria of the Part D Plans that provide for coverage of drugs determined by the Part D Plan to be medically appropriate for the enrollee; however there currently is not a separate formulary for long-term care residents.

We obtain reimbursement for drugs we provide to enrollees of the given Part D Plan in accordance with the terms of agreements negotiated between us and the Part D Plan. The Medicare Part D final rule prohibits Part D plans from paying for drugs and services not specifically called for by the BBA.

Medicare Part D does not alter federal reimbursement for residents of nursing centers whose stay at the nursing center is covered under Medicare Part A. Accordingly, Medicare's fixed per diem payments to nursing centers under PPS will continue to include a portion attributable to the expected cost of drugs provided to such residents. We will, therefore, continue to receive reimbursement for drugs provided to such residents from the nursing center in accordance with the terms of our agreements with each nursing center.

In addition, we receive rebates from pharmaceutical manufacturers for undertaking certain activities that the manufacturers believe may increase the likelihood that we will dispense their products. CMS continues to question whether institutional pharmacies should be permitted to receive these access/performance rebates from manufacturers with respect to prescriptions covered under Medicare Part D, but has not prohibited the receipt of such rebates. CMS defines these as rebates a manufacturer provides to long-term care pharmacies that are designed to "prefer, protect, or maintain" that manufacturer's product selection by the long-term care pharmacy or to increase the volume of that manufacturer's products that are dispensed by the pharmacy under its formulary. CMS, in 2007, required PDPs to have policies and systems in place as part of their drug utilization management programs to protect

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beneficiaries and reduce costs when long-term care pharmacies receive incentives to move market share through access/performance rebates. The elimination or substantial reduction of manufacturer rebates, if not offset by other reimbursement, would have a material adverse effect on our business.

### Medicaid

The reimbursement rate for pharmacy services under Medicaid is determined on a state-by-state basis subject to review by 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 established limits, at rates determined in accordance with each state's regulations. The federal Medicaid statute specifies a variety of requirements that a state plan must meet, including the requirements related to eligibility, coverage for services, payment, and admissions. For residents that are eligible for Medicaid only, and are not dual eligibles covered under Medicare Part D, we bill the individual state Medicaid program or in certain circumstances the state's designated managed care or other similar organizations. Federal regulations and the regulations of certain states establish "upper limits" for reimbursement of certain prescription drugs under Medicaid. In most states, pharmacy services are priced at the lower of "usual and customary" charges or cost, which generally is defined as a function of average wholesale price and may include a profit percentage plus a dispensing fee. Most states establish a fixed dispensing fee per prescription that is adjusted to reflect associated cost. Over the last several years, state Medicaid programs have lowered reimbursement through a variety of mechanisms, principally higher discounts off average wholesale price levels, expansion of the number of medications subject to federal upper limit pricing, and general reductions in contract payment methodology to pharmacies.

### Environmental Matters

In operating our facilities, historically we have not encountered any material difficulties effecting compliance with applicable pollution control laws. No material capital expenditures for environmental control facilities are expected. While we cannot predict the effect which any future legislation, regulations or interpretations may have upon our operations, we do not anticipate any changes regarding pollution control laws that would have a material adverse impact on the Corporation.

### Available Information

We make available free of charge on or through our web site, at [www.pharmerica.com](http://www.pharmerica.com), our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission ("SEC"). Additionally, the public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, D.C., 20549. Information regarding operation of the Public Reference Room is available by calling the SEC at 1-800-SEC-0330. Information that we file with the SEC is also available at the SEC's web site at [www.sec.gov](http://www.sec.gov).

Our SEC filings are available to the public through the New York Stock Exchange ("NYSE"), 20 Broad Street, New York, New York, 10005. Our Common Stock is listed on the NYSE and trades under the symbol "PMC".

The certifications of our Chief Executive Officer and Chief Financial Officer required under Section 302 of the Sarbanes-Oxley Act have been filed as Exhibits 31.1 and 31.2 to this Annual Report on Form 10-K.



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Item 1A. Risk Factors

You should consider carefully the risks described below, together with all of the other information, in evaluating our company and our common stock. If any of the risks described below actually occur, it could have a material adverse effect on our business, results of operations, financial condition and stock price.

Risk Factors Relating to Our Business

Financial soundness of our customers and suppliers may adversely affect our results of operations.

If our customers' operating and financial performance deteriorates, or if they are unable to make scheduled payments or obtain credit, our customers may not be able to pay, or may delay payment of accounts receivable owed to us. Any inability of customers to pay us for our products and services may adversely affect our earnings and cash flow. Additionally, both state and federal government sponsored payers, as a result of budget deficits or reductions, may seek to reduce their healthcare expenditures resulting in the long-term care customers renegotiating their contracts with us. Any reduction in payments by such government sponsored payers may adversely affect our earnings and cash flow. Also some of customers' real estate is owned by Real Estate Investment Trusts limiting their ability to renegotiate rental costs furthering their desire to reduce other controllable costs, such as pharmacy costs.

Intense competition may erode our profit margins.

The distribution of pharmaceuticals to healthcare facilities is highly competitive. In each geographic market, there are national, regional and local institutional pharmacies and numerous local retail pharmacies, which provide services comparable to those offered by our pharmacies and may be more established in the markets they serve than we are. We also compete against regional and local pharmacies that specialize in long-term care. Many of our competitors have equal or greater resources and access to capital than the Corporation. In addition, local pharmacies have strong personal relationships with their customers. Because relatively few barriers to entry exist in the local markets we serve, we may encounter substantial competition from local market entrants. In addition, owners of skilled nursing facilities, including prior and current customers, are also entering the institutional pharmacy market, particularly in areas of their geographic concentration. Consolidation within the institutional pharmacy industry may also lead to increased competition. Competitive pricing pressures may adversely affect our earnings and cash flow.

We compete based on innovation and service as well as price. To attract new clients and retain existing clients, we must continually meet service expectations of our clients and customers. We cannot be sure that we will continue to remain competitive with the service to our clients at our current levels of profitability.

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

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

- discounts for drugs we purchase to be dispensed from our institutional pharmacies;
- rebates based upon distributions of drugs from our institutional pharmacies; and
- administrative fees for managing rebate programs.

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

regulations relating to any of these programs may materially adversely affect our business.

CMS has questioned whether long-term care pharmacies should be permitted to receive discounts, rebates and other price concessions from pharmaceutical manufacturers with respect to prescriptions covered under the Medicare Part D benefit. Our business would be adversely affected if CMS should take any action that has the effect of eliminating or significantly reducing the rebates that we receive from pharmaceutical manufacturers.

Our operating revenue and profitability may suffer upon the occurrence of the loss of certain customers.

We have a number of customers that own or operate numerous facilities in our institutional pharmacy business. In addition, our hospital business revenues are primarily derived from one large multi-facility customer. If we are not able to continue these relationships or are only able to continue these relationships on less favorable terms than the ones currently in place, our operating revenues and results of operations would be materially impacted. There can be no assurance that these customers will not terminate all or a portion of their contracts with the Corporation.

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Home infusion joint ventures formed with hospitals could adversely affect our financial results.

The home infusion industry is currently seeing renewed activity in the formation of equity-based infusion joint ventures formed with hospitals. This activity stems, in part, from hospitals seeking to position themselves for new paradigms in the delivery of coordinated healthcare and new methods of payment, including an emerging interdisciplinary care model that is being labeled an “accountable care organization”. These organizations are encouraged by the 2010 Health Care Reform Legislation. These entities are being designed in order to save money and improve quality of care by better integrating care, with the healthcare provider possibly sharing in the financial benefits of the improved efficiency.

Participation in equity-based joint ventures offers hospitals and other providers an opportunity to more efficiently transfer patients to less expensive care settings, while keeping the patient within its network. Additionally, it provides many hospitals with a mechanism to invest accumulated profits in a growing sector with attractive margins.

If home infusion joint ventures continue to expand and we lose referrals as a result, our financial condition, results of operations and liquidity could be adversely affected.

Our operating revenue and profitability may suffer because of an increase in our generic dispensing rate.

A shift in prescriptions dispensed from brand-to-generic and a decline in generic reimbursement rates from the PDP/PBMs may affect our operating revenue. 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 revenues and improved our gross margin from sales of these classes of drugs during the initial time period a brand drug has a generic alternative. However, recent experience has indicated that the third-party payers may reduce their reimbursements to the Corporation faster than previously experienced. This acceleration in the reimbursement reduction and the number of generic manufacturers have resulted in margin compression as multi-source alternatives have become available much earlier than we have historically experienced. In addition, the number of generic manufacturers entering the market impacts the overall cost and reimbursement of generic drugs. 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 its results of operations.

If we fail to comply with complex and rapidly evolving laws and regulations, we could suffer penalties, be required to pay substantial damages or make significant changes to our operations.

We are subject to numerous federal and state regulations. If we fail to comply with existing or future applicable laws and regulations, we could suffer civil or criminal penalties, including the loss of our licenses to operate our institutional pharmacies and our ability to participate in federal and state healthcare programs. As a consequence of the severe penalties we could face, we must devote significant operational and managerial resources to complying with these laws and regulations. Although we believe that we are substantially compliant with all existing statutes and regulations applicable to our business, different interpretations and enforcement policies of these laws and regulations could subject our current practices to allegations of impropriety or illegality, or could require us to make significant changes to our operations. In addition, we cannot predict the impact of future legislation and regulatory changes on our business or assure that we will be able to obtain or maintain the regulatory approvals required to operate our business.

As a result of political, economic, and regulatory influences, the healthcare delivery industry in the United States is under intense scrutiny and subject to fundamental changes. We cannot predict which reform proposals will be adopted, when they may be adopted, or what impact they may have on us.

The costs associated with complying with federal and state regulations could be significant and the failure to comply with any such legal requirements could have a material adverse effect on our financial condition, results of operations, and liquidity.

Pharmaceutical products can develop unexpected safety or efficacy concerns.

Unexpected safety or efficacy concerns can arise with respect to marketed products, whether or not scientifically justified, leading to product recalls, withdrawals or declining sales. If we fail to or do not promptly withdraw pharmaceutical products upon a recall by a drug manufacturer, our business and results of operations could be negatively impacted.

Legal and regulatory changes reducing reimbursement rates for pharmaceuticals and/or medical treatments or services may reduce our profitability.

Both our own profit margins and the profit margins of our customers may be adversely affected by laws and regulations reducing reimbursement rates and charges. The sources and amounts of our revenues are determined by a number of factors, including licensed bed capacity and occupancy rates of our customers, the number of drugs administered to patients, the mix of pharmaceuticals

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dispensed, whether the drugs are brand or generic, and the rates of reimbursement among payers. Changes in the number of drugs administered to patients, as well as payer mix among private pay, Medicare and Medicaid, in our customers' facilities will significantly affect our earnings and cash flow.

Further modifications to the Medicare Part D program may reduce revenue and impose additional costs to the industry.

The Medicare Prescription Drug Improvement and Modernization Act of 2003 or MMA included a major expansion of the Medicare program with the addition of a prescription drug benefit under the new Medicare Part D program. The continued impact of these regulations depends upon a variety of factors, including our ongoing relationships with the Part D Plans and the patient mix of our customers. Future modifications to the Medicare Part D program may reduce revenue and impose additional costs to the industry. In addition, we cannot assure you that Medicare Part D and the regulations promulgated under Medicare Part D will not have a material adverse effect on our institutional pharmacy business.

Possible changes in, or our failure to satisfy our manufacturers' rebate programs could adversely affect our results of operations.

There can be no assurance that pharmaceutical manufacturers will continue to offer these rebates or that they will not change the terms upon which rebates are offered. A decrease in prescription volumes dispensed or a decrease in the number of brand or generic drugs which participate in rebate programs and are used by the geriatric population could affect our ability to satisfy our manufacturers' rebate programs. The termination of such programs or our failure to satisfy the criterion for earning rebates may have an adverse affect on our cost of goods sold, financial condition, results of operations and liquidity.

Changes in Medicaid reimbursement may reduce our revenue.

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

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

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

On February 2, 2012, CMS issued a proposed regulation further clarifying the AMP and FUL changes described above. CMS has indicated that the final rule will be issued in July 2014.

Until CMS provides final guidance and the industry adapts to this now public available pricing information, the Corporation is unable to fully evaluate the impact of the changes in FUL and AMP to its business.

Adverse results in material litigation matters or governmental inquiries could have a material adverse effect upon the Corporation's business.

The Corporation may from time to time become subject in the ordinary course of business to material legal action related to, among other things, intellectual property disputes, professional liability and employee-related matters, as well as inquiries from governmental agencies and Medicare or Medicaid carriers requesting comment and information on allegations of billing irregularities and other matters that are brought to their attention through billing audits, third parties or other sources. The healthcare industry is subject to substantial federal and state government regulation and audit. Legal actions could result in substantial monetary damages as well as damage to the Corporation's reputation with customers, which could have a material adverse effect upon our financial condition, results of operations, and liquidity.

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If we or our customers fail to comply with Medicare and Medicaid regulations, we may be subjected to penalties or loss of eligibility to participate in these programs.

The Medicare and Medicaid programs are highly regulated. These programs are also subject to frequent and substantial changes. If we or our customers' facilities fail to comply with applicable reimbursement laws and regulations, whether purposely or inadvertently, our reimbursement under these programs could be curtailed or reduced and our eligibility to continue to participate in these programs could be adversely affected. Federal or state governments may also impose other penalties on us for failure to comply with the applicable reimbursement regulations. Failure by our customers to comply with these or future laws and regulations could result in our inability to provide pharmacy services to these customers and their residents. We do not believe that we have taken any actions that could subject us to material penalties under these rules and regulations.

Among these laws is the federal anti-kickback statute. This statute prohibits anyone from knowingly and willfully soliciting, receiving, offering or paying any remuneration with the intent to refer, or to arrange for the referral or order of, services or items payable under a federal healthcare program. Courts have interpreted this statute broadly. Violations of the anti-kickback statute may be punished by a criminal fine of up to \$25,000 for each violation or imprisonment, civil money penalties of up to \$50,000 per violation and damages of up to three times the total amount of the remuneration and/or exclusion from participation in federal healthcare programs, including Medicare and Medicaid. This law impacts the relationships that we may have with potential referral sources. We have a variety of relationships with potential referral sources, including hospitals and skilled nursing facilities with which we have contracted to provide pharmacy services. The OIG, among other regulatory agencies, is responsible for identifying and eliminating fraud, abuse or waste. The OIG carries out this responsibility through a nationwide program of audits, investigations and inspections. The OIG has promulgated safe harbor regulations that outline practices that are deemed protected from prosecution under the anti-kickback statute. While we endeavor to comply with the applicable safe harbors, certain of our current arrangements may not qualify for safe harbor protection. Failure to meet a safe harbor does not mean that the arrangement necessarily violates the anti-kickback statute, but may subject the arrangement to greater scrutiny. It cannot be assured that practices outside of a safe harbor will not be found to violate the anti-kickback statute.

The anti-kickback statute and similar state laws and regulations are expansive. We do not always have the benefit of significant regulatory or judicial interpretation of these laws and regulations. In the future, different interpretations or enforcement of these laws and regulations could subject our current or past practices to allegations of impropriety or illegality, or could require us to make changes in our facilities, equipment, personnel, services, capital expenditure programs and operating expenses. A determination that we have violated these laws, or the public announcement that we are being investigated for possible violations of these laws, could have a material adverse effect on our business, financial condition, results of operations or prospects and our business reputation could suffer significantly. If we fail to comply with the anti-kickback statute or other applicable laws and regulations, we could be subjected to liabilities, including criminal penalties, civil penalties (including the loss of our licenses to operate one or more facilities), and exclusion of one or more facilities from participation in the Medicare, Medicaid and other federal and state healthcare programs. In addition, we are unable to predict whether other legislation or regulations at the federal or state level will be adopted, what form such legislation or regulations may take or their impact.

Continuing government and private efforts to contain healthcare costs may reduce our future revenue.

We could be adversely affected by the continuing efforts of government and private payers to contain healthcare costs. To reduce healthcare costs, payers seek to lower reimbursement rates, limit the scope of covered services and negotiate reduced or capped pricing arrangements. While many of the proposed policy changes would require congressional approval to implement, we cannot assure you that reimbursement payments under governmental and private third party payer programs will remain at levels comparable to present levels or will be sufficient to cover the costs allocable to patients eligible for reimbursement under these programs. Any changes that lower reimbursement

rates under Medicare, Medicaid or private pay programs could result in a substantial reduction in our net operating revenues. Our operating margins may continue to be under pressure because of deterioration in reimbursement, changes in payer mix and growth in operating expenses in excess of increases, if any, in payments by third party payers.

Healthcare reform could adversely affect the liquidity of our customers which would have an adverse effect on their ability to make timely payments to us for our products and services.

Healthcare reform and legislation may have an adverse effect on our business through decreasing funds available to our customers. Limitations or restrictions on Medicare and Medicaid payments to our customers could adversely impact the liquidity of our customers, resulting in their inability to pay us, or to timely pay us, for our products and services. This inability could have a material adverse effect on our financial condition, results of operations, and liquidity.

The changing U.S. healthcare industry and increasing enforcement environment may negatively impact our business.

Our products and services are part of the structure of the healthcare financing and reimbursement system currently existing in the United States. In recent years, the healthcare industry has undergone significant changes in an effort to reduce costs and

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government spending. These changes include an increased reliance on managed care, cuts in Medicare funding affecting our healthcare provider customer base and consolidation of competitors, suppliers and customers.

We expect the healthcare industry to continue to change significantly in the future. Some of these potential changes, such as a reduction in governmental support of healthcare services or adverse changes in legislation or regulations governing prescription drug pricing, healthcare services or mandated benefits, may cause healthcare providers to reduce the amount of our products and services they purchase or the price they are willing to pay for our products and services. If we are unable to adjust to changes in the healthcare environment, it could have a material adverse effect on our financial condition, results of operations and liquidity.

Further, both federal and state government agencies have increased their focus on and coordination of civil and criminal enforcement efforts in the healthcare area. The OIG and the U.S. Department of Justice have, from time to time, established national enforcement initiatives, targeting all providers of a particular type, that focus on specific billing practices or other suspected areas of abuse. In addition, under the federal False Claims Act, private parties have the right to bring “qui tam” whistleblower lawsuits against companies that submit false claims for payments to the government. A number of states have adopted similar state whistleblower and false claims provisions. We do not believe that we have taken any actions that could subject us to material penalties under these provisions.

Further consolidation of managed care organizations and other third-party payers may adversely affect our profits.

Managed care organizations and other third-party payers have continued to consolidate in order to enhance their ability to influence the delivery of healthcare services. Consequently, the healthcare needs of a large percentage of the U.S. population are increasingly served by a small number of managed care organizations. These organizations generally enter into service agreements with a limited number of providers for needed services. In addition, private payers, including managed care payers, increasingly are demanding discounted fee structures. To the extent that these organizations terminate us as a preferred provider, engage our competitors as a preferred or exclusive provider or demand discounted fee structures, our liquidity and results of operations could be materially and adversely affected.

If we or our customers fail to comply with licensure requirements, laws and regulations in respect of healthcare fraud or other applicable laws and regulations, we could suffer penalties or be required to make significant changes to our operations.

Our pharmacies must be licensed by the state board of pharmacy in the state in which they operate. Many states also regulate out-of-state pharmacies that are delivering prescription products to patients or residents in their states. The failure to obtain or renew any required regulatory approvals or licenses could adversely impact the operation of our business. In addition, the healthcare facilities we service are also subject to extensive federal, state and local regulations and are required to be licensed in the states in which they are located. The failure by these healthcare facilities to comply with these or future regulations or to obtain or renew any required licenses could result in our inability to provide pharmacy services to these facilities and their residents and could have a material adverse effect on our financial condition, results of operations and liquidity.

While we believe that we are in substantial compliance with all applicable laws, many of the regulations applicable to us, including those relating to marketing incentives offered by pharmaceutical suppliers, and rebates paid by pharmaceutical manufacturers are vague or indefinite and have not been interpreted by the courts. They may be interpreted or applied by a prosecutorial, regulatory or judicial authority in a manner that could require us to make changes in our operations. These changes may be material and may require the expenditure of material funds to implement. We believe that the regulatory environment surrounding most segments of the healthcare industry remains intense. Federal and state governments continue to impose intensive enforcement policies resulting in a significant number of inspections, citations of regulatory deficiencies and other regulatory sanctions including demands for refund of overpayments, terminations from the Medicare and Medicaid programs, bans on Medicare and Medicaid

payments and fines. If we or our customers fail to comply with the extensive applicable laws and regulations, we could become ineligible to receive government program reimbursement, suffer civil or criminal penalties or be required to make significant changes to our operations. In addition, we could be forced to expend considerable resources responding to an investigation or other enforcement action under these laws or regulations regardless of whether we have actually been involved in any violations or wrong-doing.

Federal and state medical privacy regulations may increase the costs of operations and expose us to civil and criminal sanctions.

We must comply with extensive federal and state requirements regarding the transmission and retention of health information. The Health Insurance Portability and Accountability Act of 1996 and its implementing regulations, referred to as HIPAA, was enacted to ensure that employees can retain and at times transfer their health insurance when they change jobs, to enhance the privacy and security of personal health information and to simplify healthcare administrative processes. HIPAA requires the adoption of standards for the exchange of electronic health information.

The Health Information Technology for Economic and Clinical Health Act (“HITECH”), part of the American Recovery and Reinvestment Act of 2009, changed several aspects of HIPAA including, without limitation, the following: (i) applies HIPAA security

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provisions and penalties directly to business associates of covered entities; (ii) requires certain notifications in the event of a security breach involving PHI; (iii) restricts certain unauthorized disclosures; (iv) changes the treatment of certain marketing activities; and (v) strengthens enforcement activities. In addition, the Secretary issued an interim final rule on August 24, 2009 that requires notifications for certain unpermitted disclosures of PHI. The final rule was issued on January 17, 2013.

Failure to comply with either HIPAA or HITECH could result in fines and penalties that could have a material adverse effect on our results of operations, financial condition, and liquidity.

Acquisitions, investments and strategic alliances that we have made or may make in the future may use significant resources, may be unsuccessful and could expose us to unforeseen liabilities.

We have made and anticipate that we may continue to make acquisitions of, investments in and strategic alliances with complementary businesses to enable us to capitalize on our position in the geographic markets in which we operate and to expand our businesses in new geographic markets. At any particular time, we may be in various stages of assessment, discussion and negotiation with regard to one or more potential acquisitions, investments or strategic alliances, not all of which, if any, will be consummated. Our acquisition program and strategy has and may lead us to contemplate acquisitions of companies in bankruptcy or financial distress, all of which entail additional risks and uncertainties. Such risks and uncertainties include, without limitation, that, before assets may be acquired, customers may leave in search of more stable providers and vendors may terminate key relationships. Also, assets are generally acquired on an “as is” basis, with no recourse to the seller if the assets are not as valuable as may be represented. Finally, while bankrupt companies may be acquired for comparatively little money, the cost of continuing the operations may significantly exceed expectations. Our growth plans rely, in part, on the successful completion of future acquisitions. If we are unsuccessful, our business would suffer.

We intend to make public disclosure of pending and completed acquisitions when appropriate or required by applicable securities laws and regulations. Acquisitions may involve significant cash expenditures, debt incurrence, additional operating losses, amortization of certain intangible assets of acquired companies, and expenses that could have a material adverse effect on our financial condition, results of operations and liquidity. Acquisitions involve numerous risks and uncertainties, including, without limitation:

- difficulties integrating acquired operations, personnel and information systems, or in realizing projected efficiencies and cost savings;
- diversion of management’s time from existing operations;
- potential loss of key employees or customers of acquired companies;
- inaccurate assessment of assets and liabilities and exposure to undisclosed or unforeseen liabilities of acquired companies, including liabilities for failure to comply with healthcare laws;
- increases in our indebtedness and a limitation on our ability to access additional capital when needed; and
- failure to operate acquired facilities profitably or to achieve improvements in their financial performance.

Risks generally associated with our sophisticated information systems may adversely affect our results of operations.

We rely on sophisticated information systems in our business to obtain, rapidly process, analyze, and manage data to facilitate the dispensing of prescription and non-prescription pharmaceuticals in accordance with physician orders and deliver those medications to patients and long-term care residents on a timely basis; to manage the accurate billing and collections for thousands of customers; and to process payments to suppliers. Our business and results of operations may be materially adversely affected if these systems are interrupted or damaged or if they fail for an extended period of time. Significant disruptions to our infrastructure or any of our facilities due to failure of technology or some other catastrophic event could adversely impact our business.

We purchase a significant portion of our pharmaceutical products from one supplier—AmerisourceBergen.

We are required to purchase a substantial amount of our pharmaceutical products from AmerisourceBergen, pursuant to the Amended Prime Vendor Agreement. If AmerisourceBergen fails to deliver products in accordance with the Amended Prime Vendor Agreement, there can be no assurance that our operations would not be disrupted or that we could obtain the products at similar cost or at all. In this event, failure to satisfy our customers' requirements would result in defaults under these customer contracts subjecting us to damages and the potential termination of those contracts. Such events could have a material adverse effect on our financial condition, results of operations and liquidity. In addition, under the terms of the Amended Prime Vendor Agreement by and between ABDC, a wholly owned subsidiary of AmerisourceBergen Corporation, the Corporation, Pharmacy Corporation of America and Chem Rx Pharmacy Services, LLC, entered into on January 4, 2011, (the "Amended Prime Vendor Agreement"), we are limited in our ability to negotiate potentially better pricing and other terms with other drug distributors, which could negatively impact our competitive position.

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Prescription volumes may decline, and our net revenues and profitability may be negatively impacted, if products are withdrawn from the market or if increased safety risk profiles of specific drugs result in utilization decreases.

We dispense significant volumes of drugs from our pharmacies. These volumes are the basis for our net revenues and profitability. When increased safety risk profiles of specific drugs or classes of drugs result in utilization decreases, physicians may cease writing or reduce the numbers of prescriptions written for these drugs. Additionally, negative press regarding drugs with higher safety risk profiles may result in reduced consumer demand for such drugs. On occasion, products are withdrawn by their manufacturers. In cases where there are no acceptable prescription drug equivalents or alternatives for these prescription drugs, our volumes, net revenues, profitability and cash flows may decline.

We could be required to record a material non-cash charge to income if our recorded goodwill or intangible assets are impaired, or if we shorten intangible asset useful lives.

We have \$282.6 million of goodwill and \$135.9 million of recorded intangible assets on our consolidated balance sheet as of December 31, 2013. Our intangible assets primarily represent the value of client relationships that were recorded from past acquisitions. Under current accounting rules, intangible assets are amortized over their useful lives. These assets may become impaired with the loss of significant clients. If the carrying amount of the assets exceeds the undiscounted pre-tax expected future cash flows from the lowest appropriate asset grouping, we would be required to record a non-cash impairment charge to our consolidated income statements in the amount the carrying value of these assets exceeds its fair value. In addition, while the intangible assets may not be impaired, the useful lives are subject to continual assessment, taking into account historical and expected losses of relationships that were in the base at time of acquisition. This assessment may result in a reduction of the remaining weighted average useful life of these assets, resulting in potentially significant increases to non-cash amortization expense that is charged to our consolidated income statements. A goodwill or intangible asset impairment charge, or a reduction of useful lives, could have a material effect on our results of operations.

We are highly dependent on our senior management team and our pharmacy professionals.

We are highly dependent upon the members of our senior management and our pharmacists and other pharmacy professionals. Our business is managed by a small number of senior management personnel. If we were unable to retain these persons, we might be materially adversely affected due to the limited pool of senior management personnel with significant experience in our industry. Accordingly, we believe we could experience significant difficulty in replacing key management personnel. We expect that any employment contracts we enter into with our key management personnel will be subject to termination without cause by either party. Moreover, although the majority of the members of our senior management team have significant experience in the industry, they will need time to fully assess and understand our business and operations. We can offer no assurance how long these members of senior management will choose to remain with us.

In addition, our continued success depends on our ability to attract and retain pharmacists and other pharmacy professionals. Competition for qualified pharmacists and other pharmacy professionals is intense. The loss of pharmacy personnel or the inability to attract or retain sufficient numbers of qualified pharmacy professionals could adversely affect our business. Although we generally have been able to meet our staffing requirements for pharmacists and other pharmacy professionals, our inability to do so in the future could have a material adverse effect on our financial condition, results of operations and liquidity.

Our revenues and volume trends may be adversely affected by certain factors relevant to the markets in which we have pharmacies, including weather conditions and other natural disasters.

Our revenues and volume trends will be predicated on many factors, including physicians' pharmaceutical decisions on patients, payer programs, seasonal and severe weather conditions including the effects of extreme low temperatures, hurricanes and tornadoes, earthquakes, current local economic and demographic changes. Any of these factors could have a material adverse effect on our revenues and volume trends, and many of these factors will not be within the control of our management. These factors may also have an effect on our customers and their ability to continue to operate. For further discussion, see Note 9.

There are inherent uncertainties involved in estimates, judgments, and assumptions used in the determination of our litigation-related accruals and the preparation of financial statements in accordance with generally accepted accounting principles in the United States (U.S. GAAP). Any changes in estimates, judgments, and assumptions could have a material adverse effect on the Company's financial position, results of operations, or cash flows.

Our financial statements filed with the SEC are prepared in accordance with U.S. GAAP, and the preparation of such financial statements includes making estimates, judgments, and assumptions that affect reported amounts of assets, liabilities, and related reserves, revenues, expenses, and income. We evaluate our exposure to legal proceedings and establish reserves for the estimated liabilities in accordance with GAAP. Assessing and predicting the outcome of these matters involves substantial uncertainties. Unexpected outcomes in these legal proceedings, or changes in management's evaluations or predictions and accompanying changes in established reserves, could have a material adverse impact on our financial results. Estimates are inherently subject to change in the

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future, and such changes could result in corresponding changes to the amounts of assets, liabilities, income, or expenses and likewise could have an adverse effect on our financial position, results of operations, or cash flows.

Risk Factors Relating to Ownership of Our Common Stock and Our Senior Secured Credit Facility

Certain provisions of our certificate of incorporation and bylaws and provisions of Delaware law could delay or prevent a change of control that stockholders favor.

Provisions of our certificate of incorporation and bylaws may discourage, delay or prevent a merger or other change of control that stockholders may consider favorable or may impede the ability of the holders of our common stock to change our management and Board of Directors. The provisions of our certificate of incorporation and bylaws, among other things:

- prohibit stockholder action except at an annual or special meeting. Specifically, this means our stockholders are unable to act by written consent;
- regulate how stockholders may present proposals or nominate directors for election at annual meetings of stockholders. Advance notice of such proposals or nominations is required;
- regulate how special meetings of stockholders may be called. Our stockholders do not have the right to call special meetings;
- authorize our board of directors to issue preferred stock in one or more series, without stockholder approval. Under this authority, our Board of Directors adopted the Rights Agreement which could ensure continuity of management by rendering it more difficult for a potential acquirer to obtain control of us; and
- require an affirmative vote of the holders of three-quarters or more of the combined voting power of our common stock entitled to vote in the election of our directors in order for the stockholders to amend our bylaws.

In addition, because we have not chosen to be exempt from Section 203 of the Delaware General Corporation Law (“DGCL”), this provision could also delay or prevent a change of control that some stockholders may view as favorable. Section 203 provides that unless board and/or stockholder approval is obtained pursuant to the requirements of the statute, persons that acquire, or are affiliated with a person that acquires, more than 15% of the outstanding voting stock of a Delaware corporation shall not engage in any business combination with that corporation, including by merger, consolidation or acquisitions of additional shares, for a three-year period following the date on which that person or its affiliate becomes the holder of more than 15% of the corporation’s outstanding voting stock.

The market price and trading volume of our common stock may be volatile.

The market price of our common stock could fluctuate significantly for many reasons, including, without limitation the following:

- as a result of the risk factors listed in this document;
- actual or anticipated fluctuations in our results of operations;
- for reasons unrelated to our specific performance, such as reports by industry analysts, investor perceptions, or negative announcements by our customers or competitors regarding their own performance;
- regulatory changes that could impact our business or that of our customers; and
- general economic and industry conditions.

In addition, when the market price of a company’s common stock drops significantly, stockholders often institute securities class action lawsuits against the company. A lawsuit against us could cause us to incur substantial costs and could divert the time and attention of our management and other resources.

Acquisitions, investments and strategic alliances we may make in the future may need to be financed by borrowings under the Credit Agreement for which funds may not be made available by certain participants.

We have made and anticipate that we may continue to make acquisitions of, investments in and strategic alliances with complementary businesses to enable us to capitalize on our position in the geographic markets in which we operate and to expand our business in new geographic markets. Our growth plans rely, in part, on the successful completion of future acquisitions. At any particular time, we may need to finance such acquisitions and strategic alliances with borrowings under the Credit Agreement. The financial markets are very volatile and certain participants in our Credit Agreement may not be able to participate in funding their commitments under the revolving line of credit. If we are unsuccessful in obtaining the financing, our business would be impacted.

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We are exposed to interest rate changes.

We are exposed to market risk related to changes in interest rates. As of December 31, 2013, we had outstanding debt of \$231.3 million, all of which was subject to variable rates of interest. See Item 7A, "Quantitative and Qualitative Disclosures about Market Risk."

We have indebtedness, which restricts our ability to pay cash dividends and has a negative impact on our financing options and liquidity.

We have \$231.3 million in indebtedness outstanding as of December 31, 2013 under our Credit Agreement and revolver.

On May 2, 2011, the Corporation entered into a long-term credit agreement (the "Credit Agreement") among the Corporation, the Lenders named therein, and Citibank N.A. ("Citibank"), as Administrative Agent. The Credit Agreement contains customary restrictions, requirements and other limitations on our ability to incur indebtedness. The Credit Agreement also contains financial covenants that require us to satisfy certain financial tests and maintain certain financial ratios, including a maximum of debt to EBITDA ratio. The Credit Agreement limits our ability to declare and pay dividends or other distributions on our shares of common stock. If our lenders permit us to declare dividends, the dividend amounts, if any, will be determined by our Board of Directors, which will consider a number of factors, including our financial condition, capital requirements, funds generated from operations, future business prospects, applicable contractual restrictions and any other factors our Board of Directors may deem relevant. The amount of this outstanding indebtedness could limit our ability to pay cash dividends and to obtain additional financing in the future for working capital, capital expenditure and acquisition purposes. A significant portion of our cash flows will be dedicated to debt service and will be unavailable for investment, capital expenditures or other operating expenses.

As a result of these and other factors, we cannot assure you that our business will generate sufficient cash flows from operations or that future borrowings will be available to us in amounts sufficient to enable us to pay our indebtedness or to fund our other liquidity needs. If we do not generate or are unable to borrow sufficient amounts of cash on satisfactory terms to meet these needs, we may need to seek to refinance all or a portion of our indebtedness on or before maturity, sell assets, curtail discretionary capital expenditures or seek additional capital. There can be no assurance that additional capital will be available to us on acceptable terms, or at all, which could adversely impact our business, results of operations, liquidity, capital resources, and financial condition.

We anticipate that future earnings will be used principally to support operations and finance the growth of our business. Thus, we do not intend to pay dividends or other cash distributions on our common stock in the foreseeable future. See Part II, Item 5 "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities."

See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources."

The ability to successfully renegotiate the Credit Agreement could adversely affect the Corporation's liquidity.

The scheduled payments under the Corporation's Credit Agreement are set to increase substantially at September 30, 2015. The Corporation intends to refinance its debt arrangements however, there is no assurance that it will be able to enter into a new agreement or that a new agreement will have terms similar to the existing agreement. If the Corporation is unable to refinance its debt obligations, it could adversely impact our business, results of operations, liquidity, capital resources, and financial condition.

Item 1B. Unresolved Staff Comments

None.

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## Item 2. Properties

We have facilities including offices and key operating facilities in various locations throughout the United States. The Corporation's corporate headquarters are located in Louisville, Kentucky. In addition to the pharmacies listed below, the Corporation also has multiple facilities throughout the nation with several overhead and administrative functions. As of December 31, 2013, all facilities were leased. We consider all of these facilities to be suitable, adequate, and are utilized at full capacity.

The following table presents certain information with respect to operating leases of our pharmacies identified by the Corporation as properties as of December 31, 2013:

State	# of Facilities	Square Footage	State	# of Facilities	Square Footage
Alabama	2	20,330	Mississippi	1	11,600
Arizona	2	21,436	Missouri	1	4,090
Arkansas	1	6,850	Montana	1	2,440
California	10	100,451	Nebraska	1	5,120
Colorado	4	28,971	Nevada	3	16,373
Connecticut	1	15,600	New Hampshire	1	7,500
Delaware	1	5,739	New Jersey	1	14,309
Florida	6	67,112	New Mexico	2	12,891
Georgia	2	33,202	New York	4	95,031
Hawaii	5	15,506	North Carolina	3	21,250
Idaho	1	4,031	Ohio	2	26,125
Illinois	1	15,495	Oklahoma	2	11,318
Indiana	1	20,386	Pennsylvania	7	50,634
Iowa	1	6,250	Rhode Island	1	9,415
Kansas	1	9,977	South Carolina	3	22,042
Kentucky	2	43,500	South Dakota	2	12,050
Louisiana	1	4,914	Tennessee	5	47,837
Maine	1	10,200	Texas	13	91,034
Maryland	1	10,744	Utah	3	18,002
Massachusetts	2	56,611	Virginia	2	15,807
Michigan	2	13,720	Washington	2	14,792
Minnesota	2	13,872	West Virginia	1	1,419
			Wisconsin	1	11,068

## Item 3. Legal Proceedings

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

On June 10, 2013, the United States District Court for the Eastern District of Wisconsin unsealed two consolidated qui tam complaints filed in 2009 and 2011 by relators who are former employees of the Corporation and a company acquired by the Corporation. The United States, acting through the U.S. Attorney's Office in Wisconsin, intervened in part and declined to intervene in part and filed its complaint in intervention on August 9, 2013, when the matter was formally brought to the Corporation's attention. The first complaint seeks statutory fines for the Corporation's alleged dispensing of Schedule II controlled substances without a valid prescription in violation of the Controlled Substances Act. It also seeks monetary damages and equitable relief alleging that this conduct caused false claims to be submitted in violation of the federal False Claims Act (the "FCA"). The Corporation has moved to dismiss the government's complaint for failure to state a claim upon which relief may be granted and is awaiting the Court's decision. The second complaint alleges that the Corporation submitted false claims to Medicare Part D and to Medicaid for drugs in connection with which the Corporation allegedly received kickbacks from the manufacturer in the form of market share rebates and other remuneration, all in violation of the Federal Antikickback statute (the "AKS/FCA" claims). The second complaint also includes a claim by the relator under the retaliatory termination provisions of the FCA. The government declined to intervene in the AKS/FCA claims and the relator thereafter moved, with the government's permission, to dismiss the AKS/FCA claims, which motion the Court has granted. The relator is independently pursuing the retaliatory termination claims. The Corporation has moved to dismiss the relator's complaint for failure to state a claim upon which relief may be granted and is awaiting the Court's decision. The Corporation intends to vigorously defend itself in both matters.

On November 20, 2013 the complaint filed by a relator, Robert Gadbois, on behalf of the U.S. Government and various state governments, was unsealed by the United States District for the District of Rhode Island against the Corporation alleging that the Corporation dispensed controlled and non-controlled substances in violation of the CSA and thus the dispenses were not eligible for

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payment and therefore 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 have declined to intervene in this case. The case therefore has been unsealed but relator has not yet served the Corporation. Gadbois has moved the court to file a Second Amended Complaint, which motion is still pending before the Court. Once relator serves the Complaint, the Corporation intends to defend the case vigorously.

On August 8, 2013, a complaint filed by the relator, Richard Templin, in the United States District Court for the Southern District of Texas was unsealed. The complaint sought monetary damages and alleged that the Corporation violated the federal False Claims Act and the Anti-Kickback Act by allegedly receiving rebates from pharmaceutical manufacturers, and by allegedly providing or receiving other remuneration from pharmaceutical manufacturers and its nursing facility customers in exchange for referrals. The relator then voluntarily dismissed all claims against the Corporation and the case is no longer pending.

On November 12, 2013, a relator, Fox Rx, Inc. ("Fox"), on behalf of the U.S. Government and various state governments and the District of Columbia, filed a complaint in the United States District Court for the Southern District of New York against the Corporation alleging that the Corporation violated the FCA by submitting false claims to Fox, other Medicare Part D sponsors and to Medicaid, by allegedly billing for expired drugs or for brand drugs when generic drugs should have been substituted. Following the U.S. Government's decision to decline to intervene in the case, the complaint was unsealed and served on the Corporation. The Corporation intends to vigorously defend itself against these allegations.

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 for the District of New Jersey against the Corporation alleging that the Corporation violated the False Claims Act and Anti-Kickback Statute through its agreements to provide prescription drugs to nursing homes under certain Medicare and Medicaid programs. On February 19, 2013, the U.S. Government declined to intervene in the case. The complaint has been amended several times, most recently on November 12, 2013 and thereafter served upon the Corporation. On December 6, 2013, the Corporation moved to dismiss the amended complaint for failure to state a claim upon which relief may be granted and is awaiting the Court's decision. The Corporation intends to vigorously defend itself against these allegations.

On January 31, 2014, a relator, Frank Kurnik, on behalf of the U.S. Government and various state governments served its complaint filed in the United States District for the District of South Carolina alleging that the Corporation solicited and received remuneration in violation of the federal Anti-kickback Statute from drug manufacturer Amgen in exchange for preferring and promoting Amgen's drug Aranesp over a competing drug called Procrit. The U.S. Government and the various states declined to intervene in the case. The Corporation intends to vigorously defend itself against these allegations.

The U.S. Department of Justice, through the U.S. Attorney's Office for the Western District of Virginia, is investigating whether the Corporation's activities in connection with agreements it had with the manufacturer of the pharmaceutical Depakote violated the False Claims Act or the Anti-Kickback Statute. The Corporation is cooperating with these investigations and believes it has complied with applicable laws and regulations with respect to these matters.

In addition, the Corporation is involved in certain legal actions and regulatory investigations arising in the ordinary course of business. At this time, the Corporation is unable to determine the impact of these investigations on its consolidated financial condition, results of operations, or liquidity. At December 31, 2013, the Corporation had accrued approximately \$20.0 million related to the legal actions and investigations.

In addition, the Corporation is involved in certain legal actions and regulatory investigations arising in the ordinary course of business. Also see Note 6 to the Corporation's Consolidated Financial Statements set forth in Part II, Item 8

of this report.

Item 4. Mine Safety Disclosures

Not applicable.

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## PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

## Market Information

Our only class of common equity is our \$0.01 par value common stock, which trades on the NYSE under the symbol "PMC."

The following table sets forth the high and low prices per share during the period and the closing price of our common stock as reported by the NYSE for the fiscal periods indicated.

	High	Low	Close
Fiscal 2012			
First Quarter	\$ 15.54	\$ 12.00	\$ 12.43
Second Quarter	\$ 12.90	\$ 9.03	\$ 10.92
Third Quarter	\$ 13.40	\$ 9.82	\$ 12.66
Fourth Quarter	\$ 14.85	\$ 11.75	\$ 14.24
Fiscal 2013			
First Quarter	\$ 15.42	\$ 13.39	\$ 14.00
Second Quarter	\$ 16.45	\$ 12.22	\$ 13.86
Third Quarter	\$ 15.80	\$ 11.84	\$ 13.27
Fourth Quarter	\$ 22.85	\$ 13.24	\$ 21.50

## Stockholders

As of January 31, 2014, we had approximately 2,749 stockholders of record of the Corporation's common stock. Because many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

## Cash Dividends

The Corporation has never paid a cash dividend on its common stock and does not expect to pay cash dividends on its common stock in the foreseeable future. Our Credit Agreement also limits our ability to declare and pay dividends or other distributions on our shares of common stock. Management believes the stockholders are better served if all of the Corporation's earnings are retained for expansion of the business.

## Securities authorized for issuance under equity compensation plans

The Corporation has adopted the Amended and Restated PharMerica Corporation 2007 Omnibus Incentive Plan (as amended and restated, "Omnibus Plan") under which the Corporation is authorized to grant equity-based and other awards to its employees, officers, directors and consultants. In connection with the Corporation's 2010 Annual Meeting of Stockholders, the stockholders of the Corporation approved and adopted the amended and restated Omnibus Plan to, among other things, implement a "fungible share pool" effective as of January 1, 2010, and preserve preferential tax treatment as "qualified performance-based compensation" under Section 162(m) of the Internal Revenue Code.

The Corporation has reserved 7,237,000 shares of its common stock for awards to be granted under the Omnibus Plan plus 534,642 shares reserved for substitute equity awards. Under the “fungible share pool,” one share of stock will be subtracted from the share limit for each share of stock covered by a stock option or stock appreciation right award and 1.65 shares of stock will be subtracted from the share limit for each share of stock covered by any full-value award, including restricted share awards, restricted stock units and performance share awards at target. The following shares are not available for re-grant under the Omnibus Plan: (i) shares tendered by a participant or withheld by the Corporation to pay the purchase price of a stock option award or to satisfy taxes owed with respect to an award, (ii) shares subject to a stock appreciation right that are not issued in connection with such award’s settlement upon the exercise thereof, and (iii) shares reacquired by the Corporation using cash proceeds received by the Corporation from the exercise of stock options. Effective January 1, 2010, shares subject to an award that is forfeited, expired or settled for cash, are available for re-grant under the Omnibus Plan as one share of stock for each share of stock covered by a stock option or appreciation right and 1.65 shares of stock for each share of stock covered by any other type of award.



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The following table sets forth equity compensation plan information as of December 31, 2013:

<u>Plan Category</u>	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by stockholders	2,386,247 (1)	\$ 14.63	(2) 3,170,983 (3)

(1) Includes the following:

- 1,289,573 shares of common stock to be issued upon exercise of outstanding stock options granted under the Omnibus Plan;
- 470,349 shares of common stock to be issued upon vesting of performance share units under the Omnibus Plan;
- 7,831 shares of common stock to be issued upon vesting of restricted stock awards under the Omnibus Plan; and
- 618,494 shares of common stock to be issued upon vesting of restricted stock units under the Omnibus Plan.

(2) The weighted average exercise price in column (b) does not take into account the 1,096,674 shares of common stock potentially to be issued under restricted stock awards, performance share units and restricted stock units.

(3) The 3,170,983 shares does not take into consideration the dilution of 1.65 shares of stock for any full-value award, including restricted stock awards, restricted stock units and performance share units at target. The number of shares remaining available for future issuance calculated under the fungible share pool would be 2,258,761.

See Note 10 to the Consolidated Financial Statements included in this Report for information regarding the material features of the Omnibus Plan.

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## Stock Performance Graph

The following graph compares the cumulative total return on a \$100 investment in each of the Common Stock of the Corporation, the Standard & Poor's 500 Stock Index and the Standard & Poor's Healthcare Index for the period from December 31, 2008 to December 31, 2013. This graph assumes an investment in the Corporation's common stock and the indices of \$100 on December 31, 2008 and that all dividends were reinvested:

	PharMerica Corporation	S&P 500	S&P Healthcare
December 31, 2008	\$ 100.00	\$100.00	\$ 100.00
March 31, 2009	106.19	146.44	116.60
June 30, 2009	144.16	141.71	114.58
September 30, 2009	143.52	129.13	114.58
December 31, 2009	101.34	123.45	117.07
March 31, 2010	106.19	88.33	91.48
June 30, 2010	93.55	101.78	99.04
September 30, 2010	60.82	117.03	107.87
December 31, 2010	73.07	123.45	117.07
March 31, 2011	116.27	129.47	120.45
June 30, 2011	81.43	114.11	105.64
September 30, 2011	91.07	126.34	114.33
December 31, 2011	96.87	139.23	117.89
March 31, 2012	79.32	155.93	140.83
June 30, 2012	69.69	150.81	142.45
September 30, 2012	80.79	159.50	150.38
December 31, 2012	90.87	157.89	149.62
March 31, 2013	89.34	173.73	172.40
June 30, 2013	88.45	177.83	178.14
September 30, 2013	84.68	186.17	189.40
December 31, 2013	137.20	204.63	207.59

## Recent Sales of Unregistered Securities

None.

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## Purchases of Equity Securities by the Issuer and Affiliated Purchasers

On August 24, 2010, the Corporation announced a stock repurchase program where the Corporation is authorized to repurchase up to \$25.0 million of the Corporation's common stock, of which \$10.5 million was used to purchase the Corporation's common stock. On July 2, 2012, the Board of Directors authorized an increase to the existing stock repurchase program that will allow the Corporation to again purchase back up to a maximum of \$25.0 million of the Corporation's common stock. The stock repurchase program does not have an expiration date and may be limited, terminated or extended at any time without prior notice. The Corporation did not repurchase shares under this program for the three months ended December 31, 2013.

Additionally, the Corporation may redeem shares from employees upon vesting of the Corporation's stock awards for minimum statutory tax withholding purposes and exercise cost of stock options. The Corporation redeemed 480,339 shares of certain vested awards and the exercise of certain stock options for an aggregate price of \$9.9 million during the three months ended December 31, 2013.

The following table summarizes our share repurchase activity by month for the three months ended December 31, 2013:

Period	Total Number of Shares Purchased	Weighted Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plans or Programs (2)	Approximate Dollar Value of Shares that may yet be Purchased under the Plans or Programs (in millions)
October 1, 2013 - October 31, 2013	327	(1) \$ 14.11	-	\$ 19.7
November 1, 2013 - November 30, 2013	479,735	(1) 20.79	-	19.7
December 1, 2013 - December 31, 2013	277	(1) 21.35	-	19.7

(1) The Corporation repurchased 480,339 shares of common stock in connection with the vesting of certain stock awards to cover minimum statutory withholding taxes and exercise cost of stock options.

(2) The Corporation did not repurchase shares under the stock repurchase program for the three months ended December 31, 2013.

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## Item 6. Selected Financial Data

The following table presents our selected historical consolidated financial and operating data. The selected historical financial and operating data should be read in conjunction with, and is qualified in its entirety by reference to, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and notes thereto included elsewhere in this Annual Report on Form 10-K (in millions, except where indicated):

	Years Ended December 31,				
	2009	2010	2011	2012	2013
Statement of operations data:					
Revenues	\$1,841.2	\$1,847.3	\$2,081.1	\$1,832.6	\$1,757.9
Cost of goods sold	1,563.3	1,604.8	1,786.2	1,532.4	1,430.7
Gross profit	277.9	242.5	294.9	300.2	327.2
Selling, general and administrative	193.2	182.8	216.5	214.7	225.3
Amortization expense	9.0	9.3	11.0	12.3	15.4
Impairment of intangible assets	-	-	5.1	-	-
Merger, acquisition, integration costs and other	5.2	14.6	16.8	17.8	8.1
Settlement, litigation and other related charges	-	-	(1.5 )	2.1	19.6
Restructuring and impairment charges	-	-	-	-	4.4
Hurricane Sandy disaster costs	-	-	-	4.5	(1.4 )
Operating income (1)	\$70.5	\$35.8	\$47.0	\$48.8	\$55.8
Net income	\$42.2	\$19.2	\$23.4	\$22.9	\$18.9
Earnings per common share: (2)					
Basic	\$1.39	\$0.64	\$0.80	\$0.78	\$0.64
Diluted	\$1.39	\$0.64	\$0.79	\$0.77	\$0.63
Adjusted earnings per diluted common share (3)	\$1.39	\$1.03	\$1.32	\$1.41	\$1.83
Shares used in computing earnings per common share:					
Basic	30.3	30.0	29.3	29.5	29.6
Diluted	30.4	30.1	29.5	29.9	30.1
Balance sheet data:					
Cash and cash equivalents	\$51.2	\$10.8	\$17.4	\$12.3	\$24.2
Working capital (4)	\$312.8	\$280.9	\$348.4	\$322.1	\$260.2
Goodwill (4)	\$140.1	\$179.4	\$214.9	\$269.4	\$282.6
Intangible assets, net	\$90.8	\$102.2	\$100.2	\$121.9	\$135.9
Total assets (4)	\$724.3	\$759.7	\$834.0	\$886.3	\$901.4
Long-term debt, including current portion	\$240.0	\$245.6	\$300.0	\$315.5	\$231.3
Total stockholder’s equity	\$370.9	\$384.4	\$413.8	\$442.6	\$462.5
Supplemental information:					
Adjusted EBITDA (3)	\$107.7	\$83.7	\$104.5	\$111.2	\$132.8
Adjusted EBITDA Margin (3)	5.8	% 4.5	% 5.0	% 6.1	% 7.5
Adjusted EBITDA per prescription dispensed (3)	\$2.76	\$2.21	\$2.51	\$2.84	\$3.52
Net cash provided by operating activities	\$84.8	\$98.2	\$26.8	\$85.7	\$155.7
Net cash used by investing activities	\$(76.1 )	\$(133.2 )	\$(64.0 )	\$(105.3 )	\$(53.7 )
Net cash (used in) provided by financing activities	\$1.2	\$(5.4 )	\$43.8	\$14.5	\$(90.1 )
Statistical information (in whole numbers except where indicated) Volume information:					
Prescriptions dispensed (in thousands)	39,037	37,826	41,677	39,212	37,731

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Revenue per prescription dispensed (6)	\$47.17	\$48.84	\$49.93	\$46.74	\$46.67
Gross profit per prescription dispensed (6)	\$7.12	\$6.41	\$7.08	\$7.66	\$8.75
Gross profit margin (6)	15.1	% 13.1	% 14.2	% 16.4	% 18.8
Generic drug dispensing rate (5)	74.6	% 76.5	% 79.6	% 83.3	% 83.4

- (1) Includes depreciation expense of \$18.0 million, \$18.8 million, \$20.1 million, \$18.6 million and \$19.3 million for the years ended December 31, 2009, 2010, 2011, 2012 and 2013, respectively.
- (2) The Corporation has never declared a cash dividend. Earnings per share in whole dollars and cents. See “Use of Non GAAP Measures for Measuring Annual Results” for a definition and Reconciliation of Adjusted Earnings per Diluted Common Share to Earnings Per Diluted Common Share and for Reconciliation of Net Income to Adjusted EBITDA and Adjusted EBITDA Margin.
- (3) As adjusted, see Note 2—Acquisitions in the Consolidated Financial Statements.
- (4) Single source generic drugs, previously classified as brand drugs, are now being classified as generics for purposes of the generic dispensing rate calculation in all periods.
- (5) Amounts in 2013 do not include the \$2.9 million California Medicaid estimated recoupment.

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Use of Non-GAAP Measures for Measuring Annual 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 an indicator of its ability to generate cash from reported operating results. The measurement is used in concert with net income 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 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 operating activities data as measured under U.S. generally accepted accounting principles ("GAAP"). The items excluded from Adjusted EBITDA but included in the calculation of the Corporation's reported net income and cash flows from operating activities are significant components of the accompanying consolidated income statements and 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 charges, Hurricane Sandy disaster costs, impairment of intangible assets, restructuring and impairment charges, California Medicaid estimated recoupment and impacts of discrete items on tax provision 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, which is exclusive of the impact of merger, acquisition, integration costs and other charges, settlement, litigation and other charges, Hurricane Sandy disaster costs, impairment of intangible assets, restructuring and impairment charges, California Medicaid estimated recoupment and impact of discrete items on tax provision 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 GAAP. The impact of merger, acquisition, integration costs and other charges, settlement, litigation and other charges, Hurricane Sandy disaster costs, impairment of intangible assets, restructuring and impairment charges, California Medicaid estimated recoupment and impact of discrete items on tax provision excluded from the diluted earnings per share are significant components of the accompanying 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 GAAP earnings per diluted common share for the periods presented.

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## Reconciliation of Net Income to Adjusted EBITDA

	Years Ended December 31,				
	2009	2010	2011	2012	2013
Net income	\$42.2	\$19.2	\$23.4	\$22.9	\$18.9
Add:					
Interest expense, net	9.4	3.6	8.8	10.0	10.6
Merger, acquisition, integration costs and other charges	5.2	14.6	16.8	17.8	8.1
Settlement, litigation and other related charges	-	-	(1.5 )	2.1	19.6
California Medicaid estimated recoupment	-	-	-	-	2.9
Restructuring and impairment charges	-	-	-	-	4.4
Hurricane Sandy disaster costs	-	-	-	4.5	(1.4 )
Stock-based compensation and deferred compensation	5.0	5.2	6.0	7.1	8.7
Provision for income taxes	18.9	13.0	14.8	15.9	26.3
Impairment of intangible assets	-	-	5.1	-	-
Depreciation and amortization expense	27.0	28.1	31.1	30.9	34.7
Adjusted EBITDA	\$107.7	\$83.7	\$104.5	\$111.2	\$132.8
Adjusted EBITDA Margin	5.8 %	4.5 %	5.0 %	6.1 %	7.5 %

## Reconciliation of Adjusted EBITDA to Net Operating Cash Flows

	Years Ended December 31,				
	2009	2010	2011	2012	2013
Adjusted EBITDA	\$107.7	\$83.7	\$104.5	\$111.2	\$132.8
Interest expense, net	(9.4 )	(3.6 )	(8.8 )	(10.0 )	(10.6 )
Merger, acquisition, integration costs and other charges	(4.8 )	(14.0)	(15.3 )	(16.5 )	(8.1 )
Provision for bad debt	16.6	18.5	24.8	25.2	22.5
Amortization of deferred financing fees	0.4	0.6	0.8	1.0	2.3
Loss on disposition of equipment	0.3	0.3	0.1	0.1	0.6
Gain on acquisition	-	-	-	-	(1.3 )
Provision for income taxes	(18.9 )	(13.0)	(14.8 )	(15.9 )	(26.3 )
Deferred income taxes	19.7	12.3	13.9	2.8	12.0
Changes in federal and state income tax payable	0.1	(0.1 )	0.2	1.1	-
Excess tax benefit from stock-based compensation	(0.2 )	-	-	-	(0.4 )
Changes in assets and liabilities	(26.4 )	13.5	(78.8 )	(13.5 )	32.2
Other	(0.3 )	-	0.2	0.2	-
Net Cash Flows from Operating Activities	\$84.8	\$98.2	\$26.8	\$85.7	\$155.7

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

	Years Ended December 31,				
	2009	2010	2011	2012	2013
Diluted earnings per share	\$1.39	\$0.64	\$0.79	\$0.77	\$0.63
Add:					
Diluted earnings per share impact of:					
Impairment of intangible assets	-	-	0.11	-	-
Merger, acquisition, integration costs and other charges	0.10	0.29	0.35	0.36	0.17
Settlement, litigation and other related charges	-	-	(0.03)	0.04	0.62
California Medicaid estimated recoupment	-	-	-	-	0.06
Restructuring and impairment charges	-	-	-	-	0.09

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Hurricane Sandy disaster costs	-	-	-	0.09	(0.03)
Stock-based compensation and deferred compensation	0.09	0.10	0.12	0.14	0.18
Impact of discrete items on tax provision	(0.19)	-	(0.02)	0.01	0.11
Adjusted diluted earnings per share	\$1.39	\$1.03	\$1.32	\$1.41	\$1.83

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K 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 revenue, costs of goods sold, and gross margin, business and growth strategies, financing plans, the Corporation's competitive position and the effects of competition, the projected growth of the industries in which we operate, and the Corporation's ability to consummate strategic acquisitions. Forward-looking statements include statements that are not historical facts and can be identified by forward-looking words such as "anticipate," "believe," "could," "estimate," "expect," "intend," "plan," "may," "should," "will," "project," and similar expressions. These forward-looking statements are based upon information currently available to the Corporation and are subject to a number of risks, uncertainties and other factors that could cause the Corporation's actual results, performance, prospects or opportunities to differ materially from those expressed in, or implied by, these forward-looking statements. Important factors that could cause the Corporation's actual results to differ materially from the results referred to in the forward-looking statements the Corporation makes in this report include:

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

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

the effects of the sequestration order issued by the Federal government in March 2013, mandating pending reductions impacting most federal programs, including Medicare;

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;

the Corporation's ability to successfully refinance its debt arrangements to decrease interest rates;

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;

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• 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;

• 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 this Report on Form 10-K for the year ended December 31, 2013.

YOU ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON ANY FORWARD-LOOKING STATEMENTS, ALL OF WHICH SPEAK ONLY AS OF THE DATE OF THIS ANNUAL 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 ANNUAL 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 THIS REPORT ON FORM 10-K AND IN OTHER REPORTS FILED WITH THE SEC BY THE CORPORATION.

### The Corporation's Business and Industry Trends

The Corporation is an institutional pharmacy services company that services healthcare facilities, provides pharmacy management services to hospitals, 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, 12 specialty infusion pharmacies and 5 specialty oncology pharmacies in 45 states. The Corporation's customers are typically institutional healthcare providers, such as skilled nursing facilities, nursing centers, assisted living facilities, hospitals, individuals receiving in-home care and other long-term alternative care providers. The Corporation is generally the primary source of supply of pharmaceuticals to its customers. The Corporation also provides pharmacy management services to 83 hospitals in the United States.

The institutional pharmacy services business is highly competitive. Competition is a significant factor that can impact the Corporation's overall financial results, pricing to customers, and bed retention. In each geographic market, there are national, regional and local institutional pharmacies that provide services comparable to those offered by the Corporation's pharmacies. These pharmacies may have greater financial and other resources than we do and may be

more established in the markets they serve than we are. The Corporation also competes against regional and local pharmacies that specialize in the highly-fragmented long-term care markets. In the future, some of the Corporation's customers may seek to in-source the provision of pharmaceuticals to patients in their facilities by establishing an internal pharmacy.

A variety of factors are affecting the institutional pharmacy industry. With an aging population and the extension of drug coverage to a greater number of individuals through Medicare Part D, the consumption of pharmaceuticals by residents of long-term care facilities is likely to increase in the future. In addition, individuals are expected to enter assisted living facilities, independent living facilities and continuing care retirement communities at increasing rates. Under Medicare Part D, eligible individuals may choose to enroll in various Medicare Part D Plans to receive prescription drug coverage. Each Medicare Part D Plan determines a distinct formulary for the long-term care residents enrolled in its plan. Accordingly, institutional pharmacies have incurred increased administrative costs to manage each Part D Plan's formulary, reimbursement and administrative processes for their long-term care enrollees. Institutional pharmacies may continue to experience increased administrative burdens and costs due to the greater complexity of the requirements for drug reimbursement. Medicare Part D also requires increased choices for patients with respect to complex drug categories and therapeutic interchange opportunities. Institutional pharmacies may realize increased revenue by

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providing long-term care residents with specialized services in these areas. Continued industry consolidation may also impact the dynamics of the institutional pharmacy market.

In addition, our continued success depends on our ability to attract and retain pharmacists and other pharmacy professionals. Competition for qualified pharmacists and other pharmacy professionals is strong. The loss of pharmacy personnel or the inability to attract, retain or motivate sufficient numbers of qualified pharmacy professionals could adversely affect our business. Although we generally have been able to meet our staffing requirements for pharmacists and other pharmacy professionals in the past, our inability to do so in the future could have a material adverse impact on us.

Acquisitions During the Periods Presented

For a discussion of acquisitions by the Corporation during the periods presented see Note 2 “Acquisitions” to our Consolidated Financial Statements included elsewhere in this Report.

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## Critical Accounting Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the U.S. 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 consolidated results of operations or financial condition.

The Corporation's management has discussed the development and selection of these critical accounting estimates with the audit committee of the Board of Directors and with the Corporation's independent registered public accounting firm, and they both have reviewed the disclosure presented below relating to critical accounting estimates.

The summary of critical accounting estimates is 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, as discussed in Note 1 of the consolidated financial statements included elsewhere 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 consolidated financial statements are appropriate. However, if actual experience differs from the assumptions and other considerations used in estimating amounts reflected in the consolidated financial statements, the resulting changes could have a material adverse effect on the consolidated results of operations and financial condition of the Corporation.

The following paragraphs present information about our critical accounting estimates, as well as the effects of hypothetical changes in the material assumptions used to develop each estimate. Our sensitivity analysis was performed assuming the assumptions listed, based upon the actual results of the Corporation for the year ended December 31, 2013, and the actual diluted shares.

## Allowance for doubtful accounts and provision for doubtful accounts

Accounts receivable primarily consist of amounts due from PDP's under Medicaid Part D, long-term care institutions, the 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 party is due a credit for such returns.

Our allowance for doubtful accounts, included in our balance sheets at December 31, 2012 and 2013, was \$56.4 million and \$56.7 million, respectively.

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

	2011		2012		2013			
	Amount	% of Revenues	Amount	% of Revenues	Amount	% of Revenues		
First Quarter	\$5.4	1.0	\$6.2	1.2	\$5.3*	1.2	%	
Second Quarter	5.8	1.1	6.2	1.4	5.2	1.2		
Third Quarter	6.4	1.2	7.3	1.7	5.2	1.2		
Fourth Quarter	7.2	1.5	5.5*	1.3	6.8	1.5		

\* Excludes a \$0.7 million and \$0.2 million expense related to Hurricane Sandy for the Fourth Quarter 2012 and the First Quarter 2013, respectively. See further discussion in Note 9.

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

	2011	2012	2013
First Quarter	39.0	42.8	41.6
Second Quarter	41.6	45.4	41.6
Third Quarter	42.5	44.1	39.8
Fourth Quarter	42.8	42.8	39.0

The following table shows our summarized aging categories by quarter:

	2011				2012				2013			
	First	Second	Third	Fourth	First	Second	Third	Fourth	First	Second	Third	Fourth
0 to 60 days	63.4%	63.9 %	63.1 %	61.2 %	61.5%	58.0 %	58.6%	58.8 %	58.0%	58.0 %	56.5 %	55.5 %
61 to 120 days	19.3	18.0	18.9	19.5	17.3	17.7	15.7	17.1	15.8	18.2	18.0	18.8
Over 120 Days	17.3	18.1	18.0	19.3	21.2	24.3	25.7	24.1	26.2	23.8	25.5	25.7

The following table shows our allowance for doubtful accounts as a percent of gross accounts receivable:

	2011			2012			2013		
	Allowance	Gross Accounts Receivable	% of Gross Accounts Receivable	Allowance	Gross Accounts Receivable	% of Gross Accounts Receivable	Allowance	Gross Accounts Receivable	% of Gross Accounts Receivable
First Quarter	\$38.1	\$ 273.9	13.9 %	\$52.1	\$ 296.4	17.6 %	\$55.8	\$ 262.1	21.3 %
Second Quarter	39.6	282.4	14.0	52.8	272.1	19.4	54.8	249.5	22.0
Third Quarter	42.9	282.8	15.2	56.1	266.0	21.1	54.6	243.1	22.5
Fourth Quarter	48.6	280.8	17.3	56.4	261.6	21.6	56.7	256.5	22.1

If our provision as a percent of revenue increases 0.10%, our after tax income would decrease by approximately \$1.1 million or \$0.04 per diluted share.

This is only one example of reasonably possible sensitivity scenarios. The process of determining the allowance requires us to estimate uncollectible accounts that are highly uncertain and requires a high degree of judgment. Our estimates may be impacted by economic conditions, success in collections, payer mix and trends in federal and state regulations.



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## Revenue recognition/Allowance for contractual discounts

We recognize revenues at the time services are provided or products are delivered.

Our sources of revenues for the quarters ended March 31, June 30, September 30, and December 31, 2011, 2012, and 2013 are as follows:

	Three Months Ended			Three Months Ended		
	March, 31			June, 30		
	2011	2012	2013	2011	2012	2013
Medicare Part D	47.7 %	48.2 %	44.1 %	47.5 %	48.1 %	47.0 %
Institutional healthcare providers	30.7	30.0	31.2	29.8	30.2	29.9
Medicaid	10.4	9.6	9.5	10.7	9.2	8.8
Private and other	4.0	4.7	4.8	4.6	4.7	3.9
Insured	4.1	4.1	5.9	4.2	4.1	5.8
Medicare	0.2	0.2	0.8	0.2	0.2	0.9
Hospital management fees	2.9	3.2	3.7	3.0	3.5	3.7
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

  

	Three Months Ended			Three Months Ended		
	September, 30			December, 31		
	2011	2012	2013	2011	2012	2013
Medicare Part D	48.3 %	47.4 %	47.5 %	48.3 %	46.8 %	46.6 %
Institutional healthcare providers	29.7	31.3	29.3	28.5	31.1	27.8
Medicaid	10.4	8.7	8.0	10.2	8.7	9.4
Private and other	4.6	4.4	4.6	4.6	4.6	4.3
Insured	3.8	4.4	6.2	5.1	4.9	7.7
Medicare	0.2	0.2	0.8	0.2	0.3	1.0
Hospital management fees	3.0	3.6	3.6	3.1	3.6	3.2
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

If our reimbursement declined or was negatively impacted 0.25% of revenues, the negative impact on net income would be \$2.7 million or \$0.09 per diluted common share.

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## Inventory and cost of drugs dispensed

We have inventory located at each of our institutional pharmacy and specialty infusion locations. Our inventory is valued at the lower of first-in, first-out cost or market. The inventory consists of prescription drugs, over the counter products and intravenous solutions. Our inventory relating to controlled substances is maintained on a manually prepared perpetual system to the extent required by the Drug Enforcement Agency and state board of pharmacies. All other inventory is maintained on a periodic system, through the performance of, at a minimum, 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.

At December 31, 2012 and 2013, our inventories on our consolidated balance sheets were \$135.7 million and \$110.3 million, respectively.

Our inventory days on hand were as follows:

	2011	2012	2013
First Quarter	19.8	22.2	25.4
Second Quarter	25.9	25.9	29.6
Third Quarter	26.9	24.6	18.1
Fourth Quarter	28.6	34.9	26.2

Please refer to Note 1 to our consolidated financial statements included elsewhere in this report for a detailed discussion of our inventory.

Actual inventory counts may include estimates based on amounts that may be dispensed from an open container. In addition, items are reviewed for potential obsolescence.

A 1.0% error rate in the count of prescription drugs in inventory would impact net income \$0.7 million, or \$0.02 per diluted common share.

## Goodwill, other intangible assets and accounting for business combinations

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 included in our accompanying consolidated balance sheet as of December 31, 2012 (as adjusted) and 2013 was \$269.4 million and \$282.6 million, respectively.

Goodwill represents the excess purchase price of an acquired entity over the net amounts assigned to assets acquired and liabilities assumed. The Corporation's policy is to perform a qualitative assessment on goodwill impairment 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 as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The Corporation performed a qualitative assessment as of December 31, 2012 and did not find it necessary to perform the first step of the two-step impairment test based on that analysis. As a result of the Corporation being notified during June 2013 that it will be losing its largest customer effective December 31, 2013, the Corporation performed the first step of the two step analysis for the pharmacy segment during the quarter ended December 31, 2013 and determined that an impairment of goodwill did not occur as a result of this triggering event. The Corporation's fair value as calculated for the step one analysis was approximately 65% greater than current book value.

Please refer to Note 4 to our consolidated financial statements included elsewhere in this report for a detailed roll forward of our goodwill and intangible assets.

We performed our annual testing for goodwill impairment as of 2012 and 2013 and determined that no goodwill impairment existed, as described above. If actual future results are not consistent with our assumptions and estimates, we may be required to record goodwill impairment charges in the future. Our estimate of fair value of acquired assets and assumed liabilities are based upon assumptions believed to be reasonable based upon current facts and circumstances.

#### Accounting for income taxes

The provision for income taxes is based upon the Corporation's annual income or loss for each respective accounting period. 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 consolidated financial statements. Deferred tax assets generally represent items that will result in a tax deduction in future years for which we have already recorded the tax benefit in the accompanying consolidated

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income statements. The Corporation also recognizes as deferred tax assets the future tax benefits from net operating and capital loss carryforwards.

We assess the likelihood that deferred tax assets will be realized from future taxable income. A valuation allowance is provided for deferred tax assets if it is more-likely-than-not that some portion or all of the net deferred tax assets will not be realized. Our deferred tax asset balances in our consolidated balance sheets as of December 31, 2012 and 2013 were as \$26.1 million and \$18.2 million, respectively. Our valuation allowances for state deferred tax assets in our consolidated balance sheets as of the year ended December 31, 2012 and 2013 was \$1.0 million and \$4.1 million, respectively.

Please refer to Note 11 to our consolidated financial statements included elsewhere in this report for a detailed discussion of our accounting for income taxes.

Tax benefits from uncertain tax positions are recognized in the Corporation's consolidated financial statements if it is more-likely-than-not that the position is sustainable based on the technical merits of the position. In evaluating whether the position has met this recognition threshold, the Corporation assumes that the appropriate taxing authority has full knowledge of all relevant information. The amount of benefit recognized in the Corporation's consolidated financial statements for a tax position meeting the recognition threshold is determined by a measurement of the largest amount of benefit that is more than 50 percent likely to be realized upon ultimate settlement. Subsequent recognition, derecognition and measurement of uncertain tax positions are based on management's best judgment given the facts, circumstances, and information available at the reporting date.

The first step in determining the deferred tax asset valuation allowance is identifying reporting jurisdictions where we have a history of tax and operating losses or are projected to have losses in future periods as a result of changes in operational performance. We then determine if a valuation allowance should be established against the deferred tax assets for that reporting jurisdiction. The second step is to determine the amount of valuation allowance. We will generally establish a valuation allowance equal to the net deferred tax asset (deferred tax assets less deferred tax liabilities) related to the jurisdiction identified in step one of the analysis. In certain cases, we may not reduce the valuation allowance by the amount of the deferred tax liabilities depending on the nature and timing of future taxable income attributable to deferred tax liabilities.

With respect to net deferred tax assets, the Corporation considers all available positive and negative evidence to determine whether a valuation allowance is needed. This includes an analysis of net operating loss carryforwards available under law, anticipated future income or loss, as well as tax planning strategies. If the cumulative weight of evidence suggests that it is more-likely-than-not that all or some portion of the net deferred tax assets will not be realized, a full or partial valuation allowance will be recognized based upon the qualitative and quantitative evidence examined.

Our deferred tax assets exceeded our deferred tax liabilities by \$18.2 million as of December 31, 2013 including the impact of valuation allowances. Historically, we have produced taxable income and we expect to generate taxable income in future years. Therefore, we believe that the likelihood of our not realizing the tax benefit of our net deferred tax assets is remote.

While we have generated taxable income in recent years and expect to continue to do so in the future, we have deferred tax assets in select states for tax loss carryforwards that we expect to expire before we are able to fully use them to offset taxable income. We have recorded a valuation allowance against these deferred tax assets. If our conclusion about our ability to realize these deferred tax assets is incorrect, then our deferred tax assets would be understated or overstated at December 31, 2013.

The IRS may propose adjustments for items we have failed to identify as tax contingencies. If the IRS were to propose and sustain assessments we would incur additional tax payments for 2012 and 2013 plus the applicable penalties and interest.

The federal statute of limitations remains open for tax years 2010 through 2012. The Corporation's consolidated U.S. income tax returns for 2010 and 2011 are currently under examination by the IRS.

#### 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.

Revenues per prescription dispensed: Represents the revenues divided by the total prescriptions dispensed.

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## Results of Operations

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

	Years Ended December 31,		Increase		Increase		2013			
	2011	% of	(Decrease)	2012	(Decrease)	2013	% of	Amount	% of	Revenues
	Amount	Revenues		Amount		Amount	Revenues		Amount	Revenues
Revenues	\$2,081.1	100.0%	\$(248.5)	(11.9)%	\$1,832.6	100.0%	\$(74.7 )	(4.1 )%	\$1,757.9	100.0%
Cost of goods sold	1,786.2	85.8	(253.8)	(14.2)	1,532.4	83.6	(101.7)	(6.6 )	1,430.7	81.4
Gross profit	294.9	14.2	\$5.3	1.8 %	300.2	16.4	\$27.0	9.0 %	327.2	18.6
California Medicaid estimated recoupment	-	-			-	-			2.9	0.2
Adjusted gross profit	\$294.9	14.2 %			\$300.2	16.4 %			\$330.1	18.8 %

Statistical information (in whole numbers except where indicated)

## Volume data

## Prescriptions dispensed

(in thousands)	41,677	(2,465)	(5.9 )%	39,212	(1,481)	(3.8 )%	37,731
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## Revenue per prescription dispensed

(1)	\$49.93	\$(3.19 )	(6.4 )%	\$46.74	\$(0.07 )	- %	\$46.67
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## Gross profit per prescription dispensed

(1)	\$7.08	\$0.58	8.2 %	\$7.66	\$1.09	14.2%	\$8.75
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## Gross profit margin (1)

	14.2 %	2.2 %	15.6 %	16.4 %	2.4 %	14.6%	18.8 %
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## Generic dispensing rate

	79.6 %	3.7 %	4.6 %	83.3 %	0.1 %	0.1 %	83.4 %
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(1) Amounts in 2013 do not include the \$2.9 million California Medicaid estimated recoupment.

## Revenues

Revenues decreased \$74.7 million for the year ended December 31, 2013 compared to the year ended December 31, 2012 due to the decrease in prescriptions dispensed, resulting from the decrease in the number of customer licensed beds serviced. The decline was partially offset by the acquisition of Amerita Inc. ("Amerita") in the fourth quarter of 2012. Excluding the \$2.9 million California Medicaid estimated recoupment recorded in the third quarter of 2013, the

remaining decrease of \$71.8 million is comprised of an unfavorable volume variance of approximately \$69.2 million or 1,481,000 less prescriptions dispensed, along with an unfavorable rate variance of approximately \$2.6 million or a \$0.07 decrease per prescription dispensed.

Revenues decreased \$248.5 million for the year ended December 31, 2012 compared to the year ended December 31, 2011 due to the net decline in customer licensed beds under contract as well as other factors including the continued wave of drugs converting from brand to generic which results in lower revenues. The decrease of \$248.5 million is comprised of an unfavorable volume variance of approximately \$123.1 million or 2,465,000 less prescriptions dispensed and an unfavorable rate variance of approximately \$125.4 million or \$3.19 decrease per prescription dispensed.

#### Gross Profit and Operating Expenses

Gross profit for the year ended December 31, 2013, excluding the \$2.9 million California Medicaid estimated recoupment, was \$330.1 million or \$8.75 per prescription dispensed compared to \$300.2 million or \$7.66 per prescription dispensed for the year ended December 31, 2012. Gross profit margin for the year ended December 31, 2013 was 18.8% compared to 16.4% for the year ended December 31, 2012. Gross profit margin was positively impacted by the effects of the Corporation's purchasing strategies.

Gross profit for the year ended December 31, 2012 was \$300.2 million or \$7.66 per prescription dispensed compared to \$294.9 million or \$7.08 per prescription dispensed for the year ended December 31, 2011. Gross profit margin for the year ended December 31, 2012 was 16.4% compared to 14.2% for the year ended December 31, 2011. Gross profit margin was positively impacted by higher margins on certain brand-name drugs that recently went generic and decreases in overall drug costs.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$225.3 million for the year ended December 31, 2013 compared to \$214.7 million for the year ended December 31, 2012. The increase of \$10.6 million is due primarily to an increase of \$15.8 million in labor

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costs, of which \$12.5 million is related to the Amerita acquisition, along with a \$2.3 million increase in professional fees. These increases are partially offset by a \$7.1 million decrease in contracted services and \$2.7 million decrease in bad debt expense. All other costs included in selling, general and administrative expenses increased approximately \$2.3 million.

Selling, general and administrative expenses were \$214.7 million for the year ended December 31, 2012, compared to \$216.5 million the year ended December 31, 2011. The decrease of \$1.8 million is due primarily to decreases of \$2.3 million in professional fees and \$1.3 million in labor costs as a result of a realignment of certain overhead functions, partially offset by an increase of \$0.8 million in both contracted services and stock-based compensation. All other costs included in selling, general and administrative expenses increased approximately \$0.2 million.

### Depreciation and Amortization

Depreciation expense was \$19.3 million for the year ended December 31, 2013 compared to \$18.6 million for the year ended December 31, 2012. The increase of \$0.7 million is due primarily to depreciation expense recognized on assets acquired with Amerita and computer hardware additions purchased in the fourth quarter 2012 related to the transition of IT services from one vendor to another ("IT Transition").

Amortization expense was \$15.4 million for the year ended December 31, 2013 compared to \$12.3 million for the year ended December 31, 2012. The increase of \$3.1 million is due primarily to the amortization expense recognized on intangibles acquired through the Amerita acquisition on December 13, 2012.

Depreciation expense was \$18.6 million for the year ended December 31, 2012 compared to \$20.1 million for the year ended December 31, 2011. The decrease of \$1.5 million was a result of certain equipment and leasehold improvements becoming fully depreciated in 2011 and having no expense in 2012. Additionally, there was a decrease in depreciation on leased equipment of \$0.5 million as a result of the capital lease expiration in the first half of 2012.

Amortization expense was \$12.3 million for the year ended December 31, 2012 compared to \$11.0 million for the year ended December 31, 2011. The increase of \$1.3 million was a result of amortization expense recognized primarily on customer relationships acquired through the 2011 acquisitions. Additionally, more expense was recognized in 2012 compared to 2011 related to short-term non-compete agreements.

### Impairment of intangible assets

During the third quarter of 2011, the Corporation recorded a pre-tax impairment charge of \$5.1 million related to finite-lived customer relationships. The impairment incurred was the result of non-renewal of certain customer contracts. The impairment was related to intangible assets acquired in an acquisition during the year ended December 31, 2005. These asset groups were assessed for recoverability and management determined the finite-lived customer relationship assets to be impaired. No other assets within the asset groups were deemed impaired. Using a discounted cash flow analysis, the Corporation determined that the pre-tax impairment charge of \$5.1 million was required to write the carrying value down to fair value, resulting in a loss per diluted share impact of \$0.11. The Corporation recognized the impairment as a permanent write-down of the cost basis and accumulated amortization of the affected assets.

### Settlements, Litigation and Other Related Charges

Settlements, litigation and other related charges were \$19.6 million for the year ended December 31, 2013 compared to \$2.1 million and \$(1.5) million for the years ended December 31, 2012 and 2011, respectively. These costs in 2011 and 2012 were previously classified under merger, acquisition costs and other charges in the Corporation's consolidated income statements. These costs relate to the Corporation being the subject of certain investigations and defenses in a



number of cases for which the outcome of the litigation is uncertain. Management accrued, based on information currently known, \$17.0 million in the third quarter of 2013 as an estimated liability for these litigations, plus additional costs associated with legal costs, which is described more fully in Note 6.

#### Restructuring and Impairment Charges

Restructuring and impairment charges were \$4.4 million for the year ended December 31, 2013. There were no similar expenses in the comparable periods of the prior years. These costs are a part of the Corporation's initiative to realign the organization which was the result of the loss of two significant customers, Kindred Healthcare and Golden Living. The Corporation expects to continue to incur costs related to restructuring efforts through 2014, which is more fully described in Note 8.

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### Merger, Acquisition, Integration Costs and Other Charges

Merger, acquisition, integration costs and other charges were \$16.8 million, \$17.8 million and \$8.1 million for the years ended December 31, 2011, 2012 and 2013, respectively.

Merger, integration costs and other charges for the years ended December 31, 2011, 2012, and 2013 were \$3.9 million, \$7.1 million, and \$3.7 million, respectively. Acquisition related costs for the years ended December 31, 2011, 2012, and 2013 were \$12.9 million, \$10.7 million, and \$4.4 million, respectively.

The negative impact on diluted earnings per share was \$(0.35), \$(0.36) and \$(0.17) for the years ended December 2011, 2012 and 2013, respectively.

### Hurricane Sandy disaster costs

In October 2012, Hurricane Sandy caused significant damage on Long Island, New York and surrounding areas. The financial impacts of the storm to the Corporation's Long Beach facility as well as damage and disruption at our customers facilities included lower revenue estimated at \$8.6 million due to the inability to operate at full capacity during the recovery period.

The Corporation expects a portion of the cost associated with Hurricane Sandy to be covered by insurance. While the exact amount has not been determined, the Corporation's current estimate of covered losses, net of its deductible, is approximately \$5.4 million. After consideration of a \$5.3 million advance by the insurance carrier the Corporation has recorded a receivable for \$0.1 million which is included in prepaids and other assets in the consolidated balance sheet. The actual recovery will vary depending on the outcome of the insurance loss adjustment process. Accordingly, no offsetting benefit for insurance recoveries above the amount of the cumulative loss has been recorded. Additionally, the Corporation allocated \$1.4 million of certain operating costs and \$1.0 million in bad debt expense and contractual revenue adjustments in 2012, associated with lost business and customers to Hurricane Sandy disaster costs in the consolidated income statements.

### Interest Expense

Interest expense was \$10.6 million for the year ended December 31, 2013 compared to \$10.0 million for the year ended December 31, 2012. The increase was primarily due to a higher amortization of deferred financing costs, partially offset by lower interest rates on long-term debt and lower debt levels. Long-term debt, including the current portion, was \$231.3 million and \$315.5 million as of December 31, 2013 and December 31, 2012, respectively.

Interest expense was \$10.0 million for the year ended December 31, 2012 compared to \$8.8 million for the year ended December 31, 2011. The increase of \$1.2 million was due to higher interest rates, partially offset by lower interest on the revolving credit facility due to the lower average outstanding balance. The Corporation's interest rate on its borrowings increased from London Interbank Offered Rate ("LIBO Rate" or "LIBOR") plus 1.0% to LIBOR plus 2.75% on May 2, 2011 due to the Corporation's refinancing activities in the second quarter 2011, which paid off the 2007 credit agreement and replaced it with the Credit Agreement dated May 2, 2011. Long-term debt, including the current portion, was \$300.0 million and \$315.5 million as of December 31, 2011 and December 31, 2012, respectively.

### Tax Provision

The effective tax rate for the year ended December 31, 2013 was 58.2%, which was comprised of the 35.0% federal rate, 4.3% for the state rate, and 18.9% for permanent differences and other discrete items. The rate for the year ended December 31, 2013 was unfavorably impacted by the Corporation's accrued legal liability for the Department of Justice settlement discussed in Note 6. For purposes of the tax provision for the year ended December 31, 2013, the

Corporation has made an assumption in the absence of more definitive information that this liability is non-deductible and has accounted for the absence of a tax benefit as a discrete item. Ultimate amounts may differ from the estimate. Accordingly, this resulted in an increase in the twelve month tax provision of approximately \$6.6 million, or approximately 14.8% of pre-tax income. The rate for the year ended December 31, 2013 was also unfavorably impacted by an expense of \$3.2 million associated with an increase in the valuation allowances primarily related to the deferred tax asset for state net operating losses. The increase in the valuation allowances was necessitated by a restructuring that the Corporation implemented at the end of 2013. The increases in the tax provision for these items were partially offset by net deductible permanent differences. Excluding the impact of the discrete tax items, the provision for income taxes as a percentage of pre-tax income would have been 37.0%, comprised of 35.0% federal rate, 4.3% for the state rate and (2.3%) for the permanent differences and other discrete items. The decrease in the effective tax rate, excluding the impact of the discrete items, from 40.2% at December 31, 2012 to 37.0% at December 31, 2013 was the result of an increase in net deductible permanent differences in 2013, including the Domestic Production Activities Deduction and the bargain purchase gain (as discussed in Note 2), which is not subject to tax.

The effective tax rate for the year ended December 31, 2012 was 40.9%, which was comprised of the 35.0% federal rate, 4.2% for the state rate, and 1.7% for permanent differences and other discrete items. The rate for the year ended December 31, 2012 was unfavorably impacted by the impact of Hurricane Sandy and non-deductible transaction costs related to the Amerita acquisition. Exclusive of these adjustments, the effective rate for the period ended December 31, 2012 would have been 40.2%, comprised of 35.0% federal rate, 4.2% for the state rate and 1.0% for the permanent differences and other discrete items.

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## Liquidity and Capital Resources

The primary sources of liquidity for the Corporation are cash flows from operations and the availability under the Credit Agreement. Historically, the Corporation has used substantially all of its' available cash to make acquisitions. In addition, due to the availability of net operating loss carryforwards, the Corporation has historically not been a tax paying entity. However, during the year ended December 31, 2012 the federal net operating loss carryforwards were fully utilized and therefore the Corporation's cash flows were impacted. Based upon our existing cash levels, expected operating cash flows, capital spending, potential future acquisitions, and the availability of funds under our revolving credit facility, we believe that we have the necessary financial resources to satisfy our expected short-term and long-term liquidity needs.

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

	Years Ended December		
	31,	2012	2013
	2011	2012	2013
Net cash provided by operating activities	\$26.8	\$85.7	\$155.7
Net cash used in investing activities	(64.0)	(105.3)	(53.7)
Net cash provided by (used in) financing activities	43.8	14.5	(90.1)
Net increase (decrease) in cash and cash equivalents	6.6	(5.1)	11.9
Cash and cash equivalents at beginning of year	10.8	17.4	12.3
Cash and cash equivalents at end of year	\$17.4	\$12.3	\$24.2

Operating Activities – Cash provided by operating activities aggregated \$155.7 million for the year ended December 31, 2013 compared to \$85.7 million for the year ended December 31, 2012. The increase in cash provided by operating activities is due to an overall improvement in working capital, primarily enhanced inventory management.

Cash provided by operating activities aggregated \$85.7 million for the year ended December 31, 2012 compared to \$26.8 million for the year ended December 31, 2011. The increase in cash provided by operating activities compared to the prior period is a result of an increase in accounts receivable collections and a decrease in cash used for inventory and accounts payable primarily resulting from a decrease in revenue. These increases are partially offset by cash used for taxes of \$12.6 million and \$10.8 million of cash used for items related to Hurricane Sandy, which includes an estimated \$7.8 million of decreased cash collections. Also, for the year ended December 31, 2011 compared to the 2012 period there were additional payments of \$42.3 million to AmerisourceBergen as a result of 2011 containing an additional Friday and an adjustment of Chem Rx's payment terms, relating to the Amended Prime Vendor Agreement, thus lowering the 2011 cash from operations.

Investing Activities – Cash used in investing activities aggregated \$53.7 million for the year ended December 31, 2013 compared to \$105.3 million for the year ended December 31, 2012. The decrease in cash used in investing activities is due to the decrease used in cash for acquisitions partially offset by an increase in capital expenditures.

Cash used in investing activities aggregated \$105.3 million for the year ended December 31, 2012 as compared to \$64.0 million for the year ended December 31, 2011. The increase in investing activities compared to the prior period is due primarily to the \$84.0 million acquisition of Amerita on December 13, 2012. In addition, capital expenditures increased over prior period due to the purchase of computer hardware and software necessary for the IT Transition.

Financing Activities – Cash used in financing activities aggregated \$90.1 million for the year ended December 31, 2013 compared to cash provided by financing activities of \$14.5 million for the year ended December 31, 2012. The increase in cash used in financing activities is due to the increase in term loan debt and revolving credit facility

repayments during 2013 along with an increase in treasury stock repurchases. The Corporation had no amounts outstanding on its revolving credit facility at December 31, 2013.

Cash provided by financing activities aggregated \$14.5 million for the year ended December 31, 2012 as compared to \$43.8 million for the year ended December 31, 2011. The Corporation paid \$6.3 million on the term loan during 2012 as compared to the prior year when the Corporation borrowed a net \$10.0 million on the term loan in conjunction with the refinancing. The Corporation had net borrowings of \$21.7 million on its revolver, including \$58.5 million during 2012 for the acquisition of Amerita. In 2011, the Corporation had net borrowings on the revolver of \$44.4 million. Additionally, in 2011 the Corporation paid \$9.8 million in debt issuance costs related to the Credit Agreement.

#### Credit Agreement

On May 2, 2011, the Corporation entered into a long-term credit agreement (the "Credit Agreement") among the Corporation, the Lenders named therein, and Citibank, N.A. ("Citibank"), as Administrative Agent. The Credit Agreement consists of a \$250.0 million term loan facility and a \$200.0 million revolving credit facility. The terms and conditions of the Credit Agreement are

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customary to facilities of this nature. Indebtedness under the Credit Agreement matures on June 30, 2016, at which time the commitments of the Lenders to make revolving loans also expire.

The Credit Agreement requires term loan principal payments by the Corporation in an amount of \$3.1 million on the last business day of each quarter beginning September 2012 through June 2015 and \$53.1 million on the last business day of each quarter beginning September 2015 through June 2016. The final principal repayment installment of term loans shall be repaid on the term maturity date, June 30, 2016. In addition, the term loan is subject to certain prepayment obligations relating to certain asset sales, certain casualty losses and the incurrence by the Corporation of certain indebtedness.

The Corporation had a total of \$231.3 million outstanding of term debt under the Credit Agreement and no outstanding balance under the revolving portion of the Credit Agreement as of December 31, 2013. 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 December 31, 2013 was \$2.3 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 \$197.7 million as of December 31, 2013. The revolving credit facility contains a \$100.0 million accordion feature, which permits the Corporation to increase the total debt capacity, up to an aggregate of \$531.3 million, subject to securing additional commitments from existing or new lenders.

The Corporation was compliant with all debt covenant requirements at December 31, 2013.

### Prime Vendor Agreement

On January 4, 2011, the Corporation entered into an Amended and Restated Prime Vendor Agreement for Long-Term Care Pharmacies (the "Amended Prime Vendor Agreement") by and between ABDC, a wholly owned subsidiary of AmerisourceBergen Corporation, the Corporation, Pharmacy Corporation of America and Chem Rx Pharmacy Services, LLC. On January 25, 2013 the Corporation renegotiated its Amended Prime Vendor Agreement with AmerisourceBergen effective January 1, 2013. The First Amendment to the Amended Prime Vendor Agreement (the "First Amendment") modifies the previous agreement, which was set to expire September 30, 2013 and extends its term until September 30, 2016.

The First Amendment requires the Corporation to purchase certain levels of brand and non-injectable generic drugs from ABDC. The First Amendment does provide the flexibility for the Corporation to contract with other suppliers. If the Corporation fails to adhere to the contractual purchase provisions ABDC has the ability to increase the Corporation's drug pricing under the terms of the First Amendment.

We also obtain pharmaceutical and other products from contracts negotiated directly with pharmaceutical manufacturers for discounted prices. While the loss of a supplier could adversely affect our business if alternate sources of supply are unavailable, numerous sources of supply are generally available to us and we have not experienced any difficulty in obtaining pharmaceuticals or other products and supplies to conduct our business.

We seek to maintain an on-site inventory of pharmaceuticals and supplies to ensure prompt delivery to our customers. ABDC maintains local distribution facilities in most major 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 December 31, 2013. 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 were funded from available cash. 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 stock 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.

The Corporation purchased 349,091 shares under the program during the year ended December 31, 2013 for an aggregate purchase price, including commissions, of \$4.3 million at an average purchase price of \$12.33 per share. 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 611,587 shares of certain vested awards and the exercise of certain stock options for an aggregate price of approximately \$11.9 million during the year ended December 31, 2013. These shares have also been designated by the Corporation as treasury stock.

As of December 31, 2013, the Corporation had a total of 2,416,971 shares held as treasury stock.

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## Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, other than purchase commitments and lease obligations. See “Contractual Obligations” below.

## Contractual Obligations

The Corporation is obligated to make future payments under various contracts such as long-term purchase obligations, debt agreements, and lease agreements, and has certain commitments. The Corporation has grouped these contractual obligations and off-balance sheet arrangements into operating activities, financing activities, and investing activities in the same manner as they are classified in the Consolidated Statements of Cash Flows in order to provide a better understanding of the nature of the obligations and arrangements and to provide a basis for comparison to historical information.

The table below provides a summary of contractual obligations and off-balance sheet arrangements as of December 31, 2013 (dollars in millions):

	2014	2015	2016	2017	2018	Thereafter
Operating activities:						
Amended Prime Vendor Agreement (1)	\$-	\$-	\$-	\$-	\$-	\$ -
Non-cancelable operating leases	15.0	12.2	9.2	6.3	6.2	5.3
Financing activities:						
Total debt and estimated interest (2) (3)	12.5	112.5	106.3	-	-	-
Totals	\$27.5	\$124.7	\$115.5	\$6.3	\$6.2	\$ 5.3

(1) Under the First Amendment to the Amended Prime Vendor Agreement the Corporation is required to purchase a certain percentage of its drug purchases through AmerisourceBergen through September 30, 2016.

(2) At December 31, 2013, the Corporation had no outstanding obligation on the revolving credit facility.

(3) Estimated interest amounts do not include interest on the revolving credit facility, as the interest rate is variable and the timing and amounts are uncertain.



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## Supplemental Quarterly Information

The following tables represent the results of the Corporation's quarterly operations for the years ended December 31, 2012 and 2013 (in millions, except where indicated):

	2012 Quarters				2013 Quarters			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Revenues	\$498.9	\$458.5	\$442.0	\$433.2	\$439.8	\$430.8	\$436.8	\$450.5
Cost of goods sold	426.3	382.6	365.9	357.6	355.5	348.2	357.6	369.4
Gross profit	72.6	75.9	76.1	75.6	84.3	82.6	79.2	81.1
Selling, general and administrative	52.4	54.9	54.5	52.9	56.7	55.5	55.5	57.6
Amortization expense	2.8	3.0	3.2	3.3	4.1	3.9	3.7	3.7
Merger, acquisition, integration costs, and other charges	4.8	1.8	5.8	5.4	2.8	2.7	1.1	1.5
Settlement, litigation and other related charges	0.6	1.0	0.3	0.2	0.1	0.1	17.2	2.2
Restructuring and impairment charges	-	-	-	-	-	-	1.0	3.4
Hurricane Sandy disaster costs	-	-	-	4.5	0.6	(0.9 )	0.1	(1.2 )
Operating income	12.0	15.2	12.3	9.3	20.0	21.3	0.6	13.9
Interest expense, net	2.7	2.5	2.4	2.4	2.6	2.9	2.6	2.5
Income (loss) before income taxes	9.3	12.7	9.9	6.9	17.4	18.4	(2.0 )	11.4
Provision for income taxes	3.7	5.1	3.9	3.2	6.9	8.2	4.2	7.0
Net income (loss)	\$5.6	\$7.6	\$6.0	\$3.7	\$10.5	\$10.2	\$(6.2 )	\$4.4
Earnings (loss) per share (1):								
Basic	\$0.19	\$0.26	\$0.20	\$0.13	\$0.36	\$0.34	\$(0.21 )	\$0.15
Diluted	\$0.19	\$0.26	\$0.20	\$0.12	\$0.35	\$0.34	\$(0.21 )	\$0.15
Adjusted diluted earnings per diluted share (1)(2):	\$0.33	\$0.35	\$0.38	\$0.36	\$0.46	\$0.44	\$0.49	\$0.44
Shares used in computing earnings (loss) per share:								
Basic	29.4	29.5	29.5	29.5	29.6	29.7	29.7	29.5
Diluted	29.7	29.7	29.8	30.0	30.1	30.1	29.7	30.2
Balance sheet data:								
Cash and cash equivalents	\$6.7	\$12.0	\$49.5	\$12.3	\$7.8	\$12.3	\$52.4	\$24.2
Working capital (3)	\$330.0	\$316.6	\$323.2	\$322.1	\$291.9	\$291.8	\$281.8	\$260.2
Goodwill (3)	\$214.9	\$214.9	\$214.9	\$269.4	\$269.4	\$269.4	\$269.4	\$282.6
Intangible assets, net	\$97.8	\$95.7	\$94.0	\$121.9	\$120.1	\$116.3	\$114.4	\$135.9
Total assets (3)	\$800.7	\$782.3	\$798.2	\$886.3	\$840.9	\$850.3	\$845.1	\$901.4
Long-term debt	\$272.1	\$250.0	\$243.8	\$315.5	\$271.7	\$257.1	\$234.4	\$231.3
Total stockholders' equity	\$420.8	\$429.7	\$437.3	\$442.6	\$453.6	\$465.4	\$456.7	\$462.5

Supplemental information:

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Adjusted EBITDA(2)	\$26.8	\$26.7	\$28.8	\$28.9	\$34.6	\$33.7	\$33.9	\$30.6
Adjusted EBITDA Margin (2)	5.4 %	5.8 %	6.5 %	6.7 %	7.9 %	7.8 %	7.7 %	6.8 %
Adjusted EBITDA per prescription dispensed (2)	\$2.66	\$2.70	\$2.97	\$3.03	\$3.56	\$3.58	\$3.64	\$3.30
Net cash provided by (used in) operating activities	\$19.9	\$31.9	\$51.4	\$(17.5)	\$47.5	\$26.4	\$78.1	\$3.7
Net cash used in investing activities	\$(2.4)	\$(4.6)	\$(7.0)	\$(91.3)	\$(7.2)	\$(7.2)	\$(11.0)	\$(28.3)
Net cash (used in) provided by financing activities	\$(28.2)	\$(22.0)	\$(6.9)	\$71.6	\$(44.8)	\$(14.7)	\$(27.0)	\$(3.6)

Statistical information (in whole numbers except where indicated)

Volume information

Prescriptions dispensed (in thousands)	10,085	9,879	9,711	9,546	9,711	9,420	9,320	9,280
Revenue per prescription dispensed (5)	\$49.47	\$46.41	\$45.52	\$45.38	\$45.29	\$45.73	\$47.18	\$48.87
Gross profit per prescription dispensed (5)	\$7.20	\$7.68	\$7.84	\$7.92	\$8.68	\$8.77	\$8.81	\$9.06
Gross profit margin (5)	14.6 %	16.6 %	17.2 %	17.5 %	19.2 %	19.2 %	18.7 %	18.5 %
Generic drug dispensing rate (4)	80.9 %	83.2 %	84.4 %	84.8 %	83.3 %	83.3 %	83.3 %	83.7 %
Inventory days on hand	22.2	25.9	24.6	34.9	25.4	29.6	18.1	26.2
Revenue days outstanding	42.8	45.4	44.1	42.8	41.6	41.6	39.8	39.0

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- (1) The Corporation has never declared a cash dividend. Earnings per common share in actual cents.
- (2) See “Use of Non-GAAP Measures For Measuring Quarterly Results” for a definition and Reconciliation of Adjusted Earnings Per Diluted Common Share to Earnings Per Diluted Common Share, and for Reconciliation of Net Income to Adjusted EBITDA and Adjusted EBITDA Margin.
- (3) As adjusted, see Note 2—Acquisitions in the Consolidated Financial Statements.
- (4) Single source generic drugs, previously classified as brand drugs, are now being classified as generics for purposes of the generic dispensing calculation for all prior periods.
- (5) The third quarter 2013 amounts do not include the \$2.9 million California Medicaid estimated recoupment and the fourth quarter 2013 amounts do not include the \$3.0 million in settlements.

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 adjusted for the contractual amount associated with the California Medicaid estimated recoupment. The Corporation calculates and uses Adjusted EBITDA as an indicator of its ability to generate cash from reported operating results. The measurement is used in concert with net income 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 operating activities data as measured under U.S. generally accepted accounting principles (“GAAP”). The items excluded from Adjusted EBITDA but included in the calculation of the Corporation’s reported net income and cash flows from operating activities are significant components of the accompanying consolidated income statements and 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 costs and other charges, Hurricane Sandy disaster costs, impairment of intangible assets, restructuring and impairment charges, California Medicaid estimated recoupment, and impact of discrete items on tax provision 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, which is exclusive of the impact of merger, acquisition, integration costs and other charges, settlement, litigation costs and other charges, Hurricane Sandy disaster costs, impairment of intangible assets, restructuring and impairment charges, California Medicaid estimated recoupment, and impact of discrete items on tax provision 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 GAAP. The impact of merger, acquisition, integration costs and other charges, settlement, litigation costs and other charges, Hurricane Sandy disaster costs, impairment of intangible assets, restructuring and impairment charges, California Medicaid estimated recoupment, and impact of discrete items on tax provision excluded from the diluted earnings per share are significant components of the accompanying 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 GAAP earnings per diluted common share for the periods presented.

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## Unaudited Reconciliation of Net Income to Adjusted EBITDA

	2012 Quarters				2013 Quarters			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Net income	\$5.6	\$ 7.6	\$6.0	\$3.7	\$10.5	\$ 10.2	\$(6.2 )	\$4.4
Add:								
Interest expense, net	2.7	2.5	2.4	2.4	2.6	2.9	2.6	2.5
Merger, acquisition, integration cost and other charges	4.8	1.8	5.8	5.4	2.8	2.7	1.1	1.5
Settlement, litigation and other charges	0.6	1.0	0.3	0.2	0.1	0.1	17.2	2.2
California Medicaid estimated recoupment	-	-	-	-	-	-	2.9	-
Restructuring and impairment charges	-	-	-	-	-	-	1.0	3.4
Hurricane Sandy disaster costs	-	-	-	4.5	0.6	(0.9 )	0.1	(1.2 )
Stock-based compensation and deferred compensation	1.8	1.2	2.6	1.5	2.2	1.8	2.4	2.3
Provision for income taxes	3.7	5.1	3.9	3.2	6.9	8.2	4.2	7.0
Depreciation and amortization expense	7.6	7.5	7.8	8.0	8.9	8.7	8.6	8.5
Adjusted EBITDA	\$26.8	\$ 26.7	\$28.8	\$28.9	\$34.6	\$ 33.7	\$33.9	\$ 30.6
Adjusted EBITDA Margin	5.4 %	5.8 %	6.5 %	6.7 %	7.9 %	7.8 %	7.7 %	6.8 %

## Unaudited Reconciliation of Adjusted EBITDA to Net Operating Cash Flows

	2012 Quarters				2013 Quarters			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Adjusted EBITDA	\$26.8	\$ 26.7	\$28.8	\$28.9	\$34.6	\$ 33.7	\$33.9	\$30.6
Interest expense, net	(2.7 )	(2.5 )	(2.4 )	(2.4 )	(2.6 )	(2.9 )	(2.6 )	(2.5 )
Merger, acquisition, integration costs and other charges	(3.8 )	(2.5 )	(5.8 )	(6.5 )	(2.9 )	(2.8 )	(1.3 )	(1.5 )
Provision for bad debt	6.2	6.2	7.3	5.5	5.3	5.2	5.2	6.8
Amortization of deferred financing fees	0.2	0.2	0.3	0.3	0.3	0.7	0.6	0.7
Loss (gain) on disposition of equipment	(0.1 )	-	-	0.2	-	(0.1 )	0.4	0.3
Gain on acquisition	-	-	-	-	-	-	-	(1.3 )
Provision for income taxes	(3.7 )	(5.1 )	(3.9 )	(3.2 )	(6.9 )	(8.2 )	(4.2 )	(7.0 )
Deferred income taxes	2.6	3.4	(2.1 )	(1.1 )	3.6	(0.7 )	3.5	5.6
Changes in federal and state income tax payable	(0.2 )	1.0	4.4	(4.1 )	2.9	3.2	(4.8 )	(1.3 )
Excess tax benefit from stock-based compensation	-	-	-	-	(0.2 )	(0.2 )	-	-
Changes in assets and liabilities	(5.2 )	4.3	24.7	(35.2)	13.3	(1.7 )	47.6	(26.5)
Other	(0.2 )	0.2	0.1	0.1	0.1	0.2	(0.2 )	(0.2 )
Net Cash Flows from Operating Activities	\$19.9	\$ 31.9	\$51.4	\$(17.5)	\$47.5	\$ 26.4	\$78.1	\$3.7

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

	2012 Quarters				2013 Quarters			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Diluted earnings per share	\$0.19	\$ 0.26	\$0.20	\$0.12	\$0.35	\$0.34	\$(0.21)	\$0.15
Add:								
Diluted earnings per share impact of:								
	0.10	0.04	0.12	0.08	0.06	0.06	0.03	0.03

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Merger, acquisition, integration cost and other charges

Settlement, litigation and other related charges	0.01	0.02	0.01	0.03	-	-	0.56	0.05
California Medicaid estimated recoupment	-	-	-	-	-	-	0.07	-
Restructuring and impairment charges	-	-	-	-	-	-	0.03	0.08
Hurricane Sandy disaster costs	-	-	-	0.09	0.01	(0.02)	-	(0.03)
Stock-based compensation and deferred compensation	0.03	0.03	0.05	0.03	0.04	0.03	0.06	0.05
Impact of discrete items of tax provision	-	-	-	0.01	-	0.03	(0.05)	0.11
Adjusted diluted earnings per share	\$0.33	\$0.35	\$0.38	\$0.36	\$0.46	\$0.44	\$0.49	\$0.44

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Following Represent the Fourth Quarter 2013 Results compared to the Fourth Quarter 2012

## Results of Operations

The following table presents selected consolidated comparative results of operations and statistical information for the periods presented (dollars in millions):

	Quarter Ended			Increase			December 31, 2013		
	December 31, 2012		(Decrease)	December 31, 2013					
	Amount	% of Total Revenues		Amount	% of Total Revenues				
Revenues	\$433.2	100.0 %	\$17.3	4.0 %	\$450.5	100.0 %			
Cost of goods sold	357.6	82.5	11.8	3.3	369.4	82.0			
Gross profit	75.6	17.5	\$5.5	7.3 %	81.1	18.0			
Customer and third party settlements	-	-			3.0	0.5			
Adjusted gross profit	\$75.6	17.5 %			\$84.1	18.5 %			

Statistical Information (in whole numbers except where indicated)

## Volume data

Prescriptions dispensed (in thousands)	9,546	(266)	(2.8)%	9,280
Revenue per prescription dispensed (1)	\$45.38	\$3.49	7.7 %	\$48.87
Gross profit per prescription dispensed (1)	\$7.92	\$1.14	14.4 %	\$9.06
Gross profit margin (1)	17.5 %	1.0	5.7 %	18.5 %
Generic dispensing rate	84.8 %	(1.1)	(1.3)%	83.7 %

(1) Amounts do not include the \$3.0 million related to customer and third party settlements for the three months ended December 31, 2013.

## Revenues

During the fourth quarter of 2013, charges of approximately \$3.0 million were recorded for customers and third party settlements. Excluding the impact of these settlements, revenues increased \$20.3 million for the three months ended December 31, 2013 compared to the three months ended December 31, 2012 due to the 2013 acquisitions, including the acquisition of an interest in OncoMed Specialty, LLC ("the Onco Acquisition"). The increase of \$20.3 million is comprised of an unfavorable volume variance of approximately \$12.1 million or 266,000 less prescriptions dispensed and a favorable rate variance of approximately \$32.4 million or \$3.49 increase per prescription dispensed.

## Gross Profit

Gross profit for the three months ended December 31, 2013, excluding the \$3.0 million of settlements, was \$84.1 million or \$9.06 per prescription dispensed compared to \$75.6 million or \$7.92 per prescription dispensed for the three months ended December 31, 2012. Gross profit margin for the three months ended December 31, 2013 was 18.5% compared to 17.5% for the three months ended December 31, 2012. Gross profit margin was positively impacted by the effects of the Corporation's purchasing strategies.

## Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$57.6 million for the three months ended December 31, 2013 compared to \$52.9 million for the three months ended December 31, 2012. The increase of \$4.7 million is due to an increase of \$4.5 million in labor costs, which is primarily related to the Amerita acquisition and \$1.5 million increase in professional fees. These increases were partially offset by a decrease of \$2.1 million in contracted services and \$1.5 million decrease in other operating expense. All other costs included in selling, general and administrative expenses increased approximately \$2.3 million.

#### Depreciation and Amortization

Depreciation expense was \$4.8 million for the three months ended December 31, 2013 compared to \$4.7 million for the three months ended December 31, 2012. The increase of \$0.1 million is due primarily to depreciation expense recognized on assets acquired through the Amerita acquisition and computer hardware additions purchased in the fourth quarter of 2012 related to the IT Transition, partially offset by non-competes fully amortized in first quarter of 2013.

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Amortization expense was \$3.7 million for the three months ended December 31, 2013 compared to \$3.3 million for the three months ended December 31, 2012. The increase of \$0.4 million is due primarily to the amortization expense recognized on intangibles acquired through the Amerita acquisition on December 13, 2012.

### Settlements, Litigation and Other Related Charges

Settlements, litigation and other related charges were \$2.2 million for the three months ended December 31, 2013 compared to \$0.2 million for the three months ended December 31, 2012. These costs were previously classified under merger, acquisition costs and other charges in the Corporation's consolidated income statement. These costs relate to the Corporation being the subject of certain investigations and defenses in a number of cases for which the outcome of the litigation is uncertain.

### Restructuring and Impairment Charges

Restructuring and impairment charges were \$3.4 million for the three months ended December 31, 2013. There were no similar expenses in the comparable periods of the prior years. These costs are a part of the Corporation's initiative to realign the organization which was the result of the loss of two significant customers, Kindred Healthcare and Golden Living. The Corporation expects to continue to incur costs related to restructuring efforts through 2014.

### Merger, Acquisition, Integration Costs and Other Charges

Merger, acquisition, integration costs and other charges were \$1.5 million and \$5.4 million for the three months ended December 31, 2013 and 2012, respectively.

Integration costs and other charges were \$0.1 million and \$3.3 million for the three months ended December 31, 2013 and 2012, respectively. The decrease is primarily attributable to a decrease related to the transition of information technology services from one vendor to another ("the IT Transition") costs and professional fees. Acquisition costs were \$1.4 million for the three months ended December 31, 2013 compared to \$2.1 million for the three months ended December 31, 2012. Acquisition costs relate primarily due to professional fees incurred in both periods, related to the Amerita acquisition in 2012 and certain 2013 acquisitions.

### Interest Expense

Interest expense was \$2.5 million for the three months ended December 31, 2013 compared to \$2.4 million for the three months ended December 31, 2012. The increase was primarily due to a higher amortization of deferred financing costs, partially offset by lower interest rates on long-term debt and lower debt levels.

### Tax Provision

The effective tax rate for the three months ended December 31, 2013 was 61.1%, comprised of the 35.0% federal rate, 4.2% for the state rate, and 21.9% for permanent differences and other discrete items. The effective rate excluding the impact of the state valuation allowances, and other discrete items was 31.7% for the three months ended December 31, 2013. The effective tax rate for the three months ended December 31, 2012 was 45.6%, comprised of the 35.0% federal rate, 4.2% for the state rate, and 6.4% for permanent differences and other discrete items. The decrease in the effective tax rate excluding the impact of the discrete items between the two periods was the result of an increase in net deductible permanent differences during the three months ending December 31, 2013, including the Domestic Activities Deduction and the bargain purchase gain (as described in Note 2), which is not subject to tax.

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## Liquidity and Capital Resources

The following compares the Corporation's Statement of Cash Flows for the quarters ended December 31, 2012 and 2013 (dollars in millions):

	Quarter Ended December	
	31, 2012	December 31, 2013
Cash flows provided by (used in) operating activities:		
Net income	\$3.7	\$ 4.4
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	4.7	4.8
Amortization	3.3	3.7
Impairment charge	-	0.1
Merger, acquisition, integration costs and other charges	(0.9 )	-
Hurricane Sandy disaster costs	1.5	-
Stock-based compensation and deferred compensation	1.5	2.3
Amortization of deferred financing fees	0.3	0.7
Deferred income taxes	(1.1 )	5.6
Loss on disposition of equipment	0.2	0.3
Gain on acquisition	-	(1.3 )
Other	0.1	(0.2 )
Change in operating assets and liabilities:		
Accounts receivable, net	13.5	1.7
Inventory	(37.4)	(32.7 )
Prepays and other assets	(1.4 )	(1.1 )
Accounts payable	1.5	13.3
Salaries, wages and other compensation	0.4	3.0
Income taxes payable	(4.1 )	(1.3 )
Other accrued liabilities	(3.3 )	0.4
Net cash (used in) provided by operating activities	(17.5)	3.7
Cash flows provided by (used in) investing activities:	(7.3 )	(6.4 )
Purchase of equipment and leasehold improvements	(84.0)	(21.9 )
Acquisitions, net of cash acquired	-	-
Net cash used in investing activities	(91.3)	(28.3 )
Cash flows provided by (used in) financing activities:		
Repayment of long-term debt	-	(3.1 )
Net activity of long-term revolving credit facility	71.7	-
Issuance of common stock	(0.1 )	9.5
Treasury stock at cost	(0.1 )	(9.9 )
Excess tax benefit from stock-based compensation	0.1	(0.1 )
Net cash provided by (used in) financing activities	71.6	(3.6 )
Change in cash and cash equivalents	(37.2)	(28.2 )
Cash and cash equivalents at beginning of period	49.5	52.4
Cash and cash equivalents at end of period	\$12.3	\$ 24.2

Supplemental information:

Cash paid for interest	\$2.1	\$ 1.8
Cash paid for taxes	\$8.6	\$ 6.2

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Following Represents the Fourth Quarter 2013 Results compared to the Third Quarter 2013

## Results of Operations

The following table presents selected consolidated comparative results of operations and statistical information for the periods presented (dollars in millions, except where indicated):

	Quarter Ended		Increase		December 31,	
	September 30, 2013	% of Revenue	(Decrease)		2013	% of Revenue
Revenues	\$436.8	100.0 %	\$13.7	3.1 %	\$450.5	100.0 %
Cost of goods sold	357.6	81.9	11.8	3.3	369.4	82.0
Gross profit	79.2	18.1	1.9	2.4 %	81.1	18.0
Adjustments (1)	2.9	0.6			3.0	0.5
Adjusted gross profit	\$82.1	18.7 %			\$84.1	18.5 %

Statistical information (in whole numbers except where indicated)

## Volume information

Prescriptions dispensed (in thousands)	9,320	(40 )	(0.4)%	9,280
Revenue per prescription dispensed (2)	\$47.18	\$1.69	3.6 %	\$48.87
Gross profit per prescription dispensed (2)	\$8.81	\$0.25	2.8 %	\$9.06
Gross profit margin (2)	18.7 %	(0.2 )	(1.1)%	18.5 %
Generic dispensing rate	83.3 %	0.4	0.5 %	83.7 %

Adjustments for the three months ended December 31, 2013 represent \$3.0 million related to customer and third (1) party settlements and for the three months ended September 30, 2013 represent the \$2.9 million California Medicaid estimated recoupment.

(2) Amounts do not include the adjustments for either period.

## Revenues

Revenues increased \$13.8 million, after consideration of the adjustments in both periods, for the three months ended December 31, 2013 compared to the three months ended September 30, 2013 due to the 2013 acquisitions, including the Onco Acquisition. The increase of \$13.8 million is comprised of an unfavorable volume variance of approximately \$1.9 million or 40,000 less prescriptions dispensed and a favorable rate variance of approximately \$15.7 million or \$1.69 increase per prescription dispensed.

## Gross Profit

Gross profit for the three months ended December 31, 2013 was \$84.1 million or \$9.06 per prescription dispensed compared to \$82.1 million or \$8.81 per prescription dispensed, for the three months ended September 30, 2013, excluding the adjustments in both periods. Gross profit margin for the three months ended December 31, 2013 was 18.5% compared to 18.7% for the three months ended September 30, 2013, excluding the adjustments in both periods.

## Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$57.6 million for the three months ended December 31, 2013 compared to \$55.5 million for the three months ended September 30, 2013. The increase of \$2.1 million is due to an increase of \$1.5 million increase in bad debt expense and \$0.8 million increase in supplies. These increases were partially offset by a decrease of \$0.9 million in professional fees. All other costs included in selling, general and administrative expenses increased approximately \$0.7 million.

#### Depreciation and Amortization

Depreciation expense was \$4.8 million for the three months ended December 31, 2013 compared to \$4.9 million for the three months ended September 30, 2013.

Amortization expense was consistent at \$3.7 million for both the three months ended December 31, 2013 and September 30, 2013.

#### Settlements, Litigation and Other Related Charges

Settlements, litigation and other related charges were \$2.2 million for the three months ended December 31, 2013 compared to \$17.2 million for the three months ended September 30, 2013. These costs relate to the Corporation being the subject of certain

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investigations and defenses in a number of cases for which the outcome of the litigation is uncertain. Management accrued, based on information currently known, \$17.0 million in the third quarter 2013 as an estimated liability for these litigations, along with additional legal costs of \$0.2 million and \$2.2 million in the third and fourth quarter of 2013, respectively, which is described more fully in Note 6.

### Restructuring and Impairment Charges

Restructuring and impairment charges were \$3.4 million for the three months ended December 31, 2013 compared to \$1.0 million for the three months ended September 30, 2013. These costs are a part of the Corporation's initiative to realign the organization as a result of the loss of two significant customers, Kindred and Golden Living. The Corporation expects to continue to incur costs related to restructuring efforts through 2014.

### Merger, Acquisition, Integration Costs and Other Charges

Merger, acquisition, integration costs and other charges were \$1.5 million and \$1.1 million for the three months ended December 31, 2013 and September 30, 2013, respectively.

Integration costs and other charges were \$0.1 million for both the three months ended December 31, 2013 and September 30, 2013. Acquisition costs were \$1.4 million for the three months ended December 31, 2013 compared to \$1.0 million for the three months ended September 30, 2013. Acquisition costs relate primarily to professional fees incurred in both periods related to the 2013 acquisitions, along with additional costs related to the acquisitions such as employee related expenses.

### Interest Expense

Interest expense was \$2.5 million for the three months ended December 31, 2013 compared to \$2.6 million for the three months ended September 30, 2013. The decrease was due to lower interest rates on long-term debt.

### Tax Provision

The effective tax rate for the three months ended December 31, 2013 was 61.1%, comprised of the 35.0% federal rate, 4.2% for the state rate, and 21.9% for permanent differences and other discrete items. The effective rate excluding the legal liability, the state valuation allowance, and other discrete items was 31.7% for the three months ended December 31, 2013. The effective tax rate for the three months ended September 30, 2013 was (202.3%), comprised of the 35.0% federal rate, 4.2% for the state rate, and (242.4%) for permanent differences and other discrete items. Excluding the impact of discrete items, the provision for income taxes as a percentage of pre-tax income would have been for 38.1% for the three months ended September 30, 2013. The decrease in the effective rate excluding the impact of the discrete tax items between the two periods was the result of an increase in net deductible permanent differences during the three months ending December 31, 2013, including the increase in its estimate of the full year domestic Production Activities Deduction during the three months ended December 31, 2013 and the bargain purchase gain (as described in Note 2), which is not subject to tax.

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## Liquidity and Capital Resources

The following compares the Corporation's Statement of Cash Flows for the three months ended September 30, 2013 and December 31, 2013 (dollars in millions):

	Quarter Ended	
	September	December
	30, 2013	31, 2013
Cash flows provided by (used in) operating activities:		
Net (loss) income	\$(6.2 )	\$ 4.4
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation	4.9	4.8
Amortization	3.7	3.7
Impairment charge	-	0.1
Hurricane Sandy disaster costs	1.8	-
Stock-based compensation and deferred compensation	2.4	2.3
Amortization of deferred financing fees	0.6	0.7
Deferred income taxes	3.5	5.6
Loss on disposition of equipment	0.4	0.3
Gain on acquisition		(1.3 )
Other	(0.2 )	(0.2 )
Change in operating assets and liabilities:		
Accounts receivable, net	4.5	1.7
Inventory	42.9	(32.7 )
Prepays and other assets	(1.3 )	(1.1 )
Accounts payable	11.7	13.3
Salaries, wages and other compensation	(4.5 )	3.0
Income taxes payable	(4.8 )	(1.3 )
Other accrued liabilities	18.7	0.4
Net cash provided by operating activities	78.1	3.7
Cash flows provided by (used in) investing activities:		
Purchase of equipment and leasehold improvements	(6.9 )	(6.4 )
Acquisitions, net of cash acquired	(4.1 )	(21.9 )
Net cash used in investing activities	(11.0)	(28.3 )
Cash flows provided by (used in) financing activities:		
Repayments of long-term debt	(3.1 )	(3.1 )
Net activity of long-term revolving credit facility	(19.6)	-
Issuance of common stock	-	9.5
Treasury stock at cost	(4.4 )	(9.9 )
Other	0.1	(0.1 )
Net cash (used in) provided by financing activities	(27.0)	(3.6 )
Change in cash and cash equivalents	40.1	(28.2 )
Cash and cash equivalents at beginning of period	12.3	52.4
Cash and cash equivalents at end of period	\$52.4	\$ 24.2
Supplemental information:		

Cash paid for interest	\$2.0	\$ 1.8
Cash paid for taxes	\$5.5	\$ 6.2

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Item 7A. Quantitative and Qualitative Disclosures about Market Risk

On May 2, 2011, the Corporation entered into the Credit Agreement. The Credit Agreement consists of a \$250.0 million term loan facility and a \$200.0 million revolving credit facility. Borrowings under the Credit Agreement bear interest at a floating rate equal to, at the Corporation's option, a base rate plus a margin between 1.25% and 2.00% per annum, or an adjusted LIBO Rate plus a margin between 2.25% and 3.00% per annum, in each case depending on the leverage ratio of the Corporation as defined by the Credit Agreement. The base rate is the greater of the prime lending rate in effect on such day, the federal funds effective rate published by the Federal Reserve Bank of New York on such day plus 0.5%, and the adjusted LIBO Rate for deposits for a period equal to one month plus 1.0%. As of December 31, 2013, borrowings under the term loan bore interest at a rate of 2.67% per annum based upon the one month adjusted LIBO rate plus margin and the revolving credit facility bore interest at a rate of 4.75% per annum based upon the prime rate plus margin.

Based upon the amount of variable rate debt outstanding as of December 31, 2013, a 100 basis point change in interest rates would affect the Corporation's future pre-tax earnings by approximately \$2.3 million on an annual basis. The estimated change to the Corporation's interest expense is determined by considering the impact of hypothetical interest rates on the Corporation's borrowing cost and debt balances. These analyses do not consider the effects, if any, of the potential changes in the Corporation's credit ratings or leverage and the overall level of economic activity of the Corporation. Further, in the event of a change of significant magnitude, the Corporation's management would expect to take actions intended to further mitigate its exposure to such change.

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Item 8. Financial Statements and Supplementary Data

Index to Consolidated Financial Statements

<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Income Statements for the years ended December 31, 2011, 2012 and 2013</u>	F-3
<u>Consolidated Balance Sheets as of December 31, 2012 and 2013</u>	F-4
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2012 and 2013</u>	F-5
<u>Consolidated Statements of Stockholders' Equity for the years ended December 31, 2011, 2012 and 2013</u>	F-6
<u>Notes to Consolidated Financial Statements for the years ended December 31, 2011, 2012 and 2013</u>	F-7

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

PharMerica Corporation:

We have audited the accompanying consolidated balance sheets of PharMerica Corporation and subsidiaries (the Corporation) as of December 31, 2012 and 2013, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2013. We also have audited the Corporation's internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Corporation's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Corporation's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PharMerica Corporation and subsidiaries as of December 31, 2012 and 2013, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles. Also in our opinion, PharMerica Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework (1992) issued by the Committee of Sponsoring

Organizations of the Treadway Commission.

As described in Management's Annual Report on Internal Control over Financial Reporting under Item 9A, management has excluded the 2013 acquisitions from its assessment of internal control over financial reporting as of December 31, 2013 because they were acquired by the Corporation in the 2013. We have also excluded the 2013 acquisitions from our audit of internal control over financial reporting. The total assets and total revenues of the 2013 acquisitions represent 6.0% and 0.7%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2013.

/s/ KPMG LLP  
Louisville, Kentucky  
February 28, 2014  
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## PHARMERICA CORPORATION

## CONSOLIDATED INCOME STATEMENTS

For the Years Ended December 31, 2011, 2012 and 2013

(In millions, except share and per share amounts)

	2011	2012	2013
Revenues	\$2,081.1	\$1,832.6	\$1,757.9
Cost of goods sold	1,786.2	1,532.4	1,430.7
Gross profit	294.9	300.2	327.2
Selling, general and administrative expenses	216.5	214.7	225.3
Amortization expense	11.0	12.3	15.4
Impairment of intangible assets	5.1	-	-
Merger, acquisition, integration costs and other charges	16.8	17.8	8.1
Settlement, litigation and other related charges	(1.5	) 2.1	19.6
Restructuring and impairment charges	-	-	4.4
Hurricane Sandy disaster costs	-	4.5	(1.4
Operating income	47.0	48.8	55.8
Interest expense, net	8.8	10.0	10.6
Income before income taxes	38.2	38.8	45.2
Provision for income taxes	14.8	15.9	26.3
Net income	\$23.4	\$22.9	\$18.9
Earnings per common share:			
Basic	\$0.80	\$0.78	\$0.64
Diluted	\$0.79	\$0.77	\$0.63
Shares used in computing earnings per common share:			
Basic	29,343,221	29,471,734	29,601,199
Diluted	29,468,452	29,901,896	30,075,699

See accompanying Notes to Consolidated Financial Statements

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## PHARMERICA CORPORATION

## CONSOLIDATED BALANCE SHEETS

As of December 31, 2012 and 2013

(In millions, except share and per share amounts)

	(As Adjusted)	December 31, 2012	December 31, 2013
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 12.3	\$ 24.2	
Accounts receivable, net	205.2	199.8	
Inventory	135.7	110.3	
Deferred tax assets, net	37.2	36.9	
Income taxes receivable	-	1.9	
Prepays and other assets	38.8	38.6	
	429.2	411.7	
Equipment and leasehold improvements	158.8	179.5	
Accumulated depreciation	(105.7 )	(117.6 )	
	53.1	61.9	
Goodwill	269.4	282.6	
Intangible assets, net	121.9	135.9	
Other	12.7	9.3	
	\$ 886.3	\$ 901.4	
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Current liabilities:			
Accounts payable	\$ 49.7	\$ 83.8	
Salaries, wages and other compensation	35.8	34.5	
Current portion of long-term debt	12.5	12.5	
Income taxes payable	1.5	-	
Other accrued liabilities	7.6	20.7	
	107.1	151.5	
Long-term debt	303.0	218.8	
Other long-term liabilities	22.5	49.9	
Deferred tax liabilities	11.1	18.7	
Commitments and contingencies (See Note 6)			
Stockholders' equity:			
Preferred stock, \$0.01 par value per share; 1,000,000 shares authorized and no shares issued, December 31, 2012 and 2013	-	-	
Common stock, \$0.01 par value per share; 175,000,000 shares authorized; 30,943,748 and 31,954,264 shares issued as of December 31, 2012 and 2013, respectively	0.3	0.3	
Capital in excess of par value	363.0	380.2	
Retained earnings	91.3	110.2	
Treasury stock at cost, 1,456,293 and 2,416,971 shares at December 31, 2012 and 2013, respectively	(12.0 )	(28.2 )	

442.6	462.5
\$ 886.3	\$ 901.4

See accompanying Notes to Consolidated Financial Statements

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## PHARMERICA CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2011, 2012 and 2013

(In millions)

	2011	2012	2013
Cash flows provided by (used in) operating activities:			
Net income	\$23.4	\$22.9	\$18.9
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation	20.1	18.6	19.3
Amortization	11.0	12.3	15.4
Impairment charge	5.1	-	0.1
Merger, acquisition, integration costs and other charges	1.5	1.3	-
Hurricane Sandy disaster costs	-	1.5	0.2
Stock-based compensation and deferred compensation	6.0	7.1	8.7
Amortization of deferred financing fees	0.8	1.0	2.3
Deferred income taxes	13.9	2.8	12.0
Loss on disposition of equipment	0.1	0.1	0.6
Gain on acquisition	-	-	(1.3 )
Other	0.2	0.2	(0.1 )
Change in operating assets and liabilities:			
Accounts receivable, net	9.1	35.8	16.5
Inventory	(38.3 )	(4.7 )	32.7
Prepays and other assets	(9.7 )	(1.3 )	(1.4 )
Accounts payable	(25.0 )	(9.3 )	17.1
Salaries, wages and other compensation	11.1	(3.4 )	(4.2 )
Income taxes payable	0.2	1.1	-
Excess tax benefit from stock-based compensation	-	-	(0.4 )
Other accrued liabilities	(2.7 )	(0.3 )	19.3
Net cash provided by operating activities	26.8	85.7	155.7
Cash flows provided by (used in) investing activities:			
Purchase of equipment and leasehold improvements	(13.2 )	(20.8 )	(27.3 )
Acquisitions, net of cash acquired	(51.0 )	(84.8 )	(26.5 )
Cash proceeds from the sale of assets	0.2	0.3	0.1
Net cash used in investing activities	(64.0 )	(105.3)	(53.7 )
Cash flows provided by (used in) financing activities:			
Repayments of long-term debt	(240.0)	(6.3 )	(12.5 )
Proceeds from long-term debt	250.0	-	-
Net activity of long-term revolving credit facility	44.4	21.7	(71.7 )
Payment of debt issuance costs	(9.8 )	-	-
Repayments of capital lease obligations	(0.8 )	(0.1 )	-
Issuance of common stock	0.2	0.4	9.9
Treasury stock at cost	(0.2 )	(1.2 )	(16.2 )
Excess tax benefit from stock-based compensation	-	-	0.4
Net cash provided by (used in) financing activities	43.8	14.5	(90.1 )
Change in cash and cash equivalents	6.6	(5.1 )	11.9
Cash and cash equivalents at beginning of year	10.8	17.4	12.3
Cash and cash equivalents at end of year	\$17.4	\$12.3	\$24.2



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Supplemental information:

Cash paid for interest	\$7.6	\$9.3	\$8.4
Cash paid for taxes	\$0.5	\$12.6	\$18.1

See accompanying Notes to Consolidated Financial Statements

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## PHARMERICA CORPORATION

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the Years Ended December 31, 2011, 2012 and 2013

(In millions, except share amounts)

	Common Stock		Capital in Excess of Par Value	Retained Earnings	Treasury Stock	Total
	Shares	Amount				
Balance at December 31, 2010	29,359,444	\$ 0.3	\$349.7	\$ 45.0	\$ (10.6 )	\$384.4
Net income				23.4		23.4
Exercise of stock options and tax components of stock-based awards, net	18,713	-	0.3	-	-	0.3
Vested restricted stock units	79,026		-	-	-	
Treasury stock at cost	(13,311 )	-	-	-	(0.2 )	(0.2 )
Stock-based compensation—non-vested restricted stock	-	-	3.5	-	-	3.5
Stock-based compensation—stock options	-	-	2.4	-	-	2.4
Balance at December 31, 2011	29,443,872	\$ 0.3	\$355.9	\$ 68.4	\$ (10.8 )	\$413.8
Net income				22.9		22.9
Exercise of stock options and tax components of stock-based awards, net	40,468	-	0.4	-	-	0.4
Vested restricted stock units	109,280		-	-	-	
Treasury stock at cost	(106,165 )	-	-	-	(1.2 )	(1.2 )
Stock-based compensation—non-vested restricted stock	-	-	5.1	-	-	5.1
Stock-based compensation—stock options	-	-	1.6	-	-	1.6
Balance at December 31, 2012	29,487,455	\$ 0.3	\$363.0	\$ 91.3	\$ (12.0 )	\$442.6
Net income				18.9		18.9
Exercise of stock options and tax components of stock-based awards, net	622,712	-	10.0	-	-	10.0
Vested restricted stock units	325,257		-	-	-	
Vested performance share units	62,547		-	-	-	
Treasury stock at cost	(960,678 )	-	-	-	(16.2 )	(16.2 )
Stock-based compensation—non-vested restricted stock	-	-	6.2	-	-	6.2
Stock-based compensation—stock options	-	-	1.0	-	-	1.0
Balance at December 31, 2013	29,537,293	\$ 0.3	\$380.2	\$ 110.2	\$ (28.2 )	\$462.5

See accompanying Notes to Consolidated Financial Statements

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PHARMERICA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

PharMerica Corporation (together with its subsidiaries, the “Corporation”) is an institutional pharmacy services company that services healthcare facilities, provides pharmacy management services to hospitals, 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, 12 specialty infusion centers, and 5 specialty oncology pharmacies in 45 states. The Corporation’s customers are typically institutional healthcare providers, such as skilled nursing facilities, nursing centers, assisted living facilities, hospitals, individuals receiving in-home care and other long-term alternative care providers. The Corporation is generally the primary source of supply of pharmaceuticals to its customers. The Corporation also provides pharmacy management services to 83 hospitals in the United States.

Operating Segments

The Corporation consists of three operating segments: pharmacy, specialty infusion services, and speciality oncology pharmacy. For financial reporting purposes, management considers these three operating segments to be similar and, therefore, has aggregated them into a single reportable segment.

Principles of Consolidation

All intercompany transactions have been eliminated.

Use of Estimates

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates are involved in collectability of accounts receivable, revenue recognition, inventory valuation, supplier rebates, the valuation of long-lived assets and goodwill and accounting for income taxes. Actual amounts may differ from these estimates.

Potential risks and uncertainties, many of which are beyond the control of the Corporation, include, but are not necessarily limited to, such factors as overall economic, financial and business conditions; the overall condition of the Corporation’s customers and suppliers; the intense competition in the Corporation’s industry; the loss of one or more key pharmaceutical manufacturers; changes in manufacturers’ rebate programs; the risk of loss of revenues due to the loss of certain customers or 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 home infusion joint ventures formed with hospitals could adversely affect the Corporation’s financial results; the decline in operating revenues and profitability with an increase in the Corporation’s generic dispensing rate; the loss of prescription volumes and revenue from pharmaceutical products that develop unexpected safety or efficacy concerns; reduction in reimbursement rates for the Corporation’s products and/or medical treatments or services may reduce profitability; modifications to the Medicare Part D program which may reduce

revenue or impose additional costs; changes in Medicaid reimbursement which may reduce revenue; the payments of significant penalties and damages for failure to comply with complex and rapidly evolving laws and regulations, as well as licensure requirements; the adverse results from material litigation or governmental inquiries including the possible insufficiency of any accruals established by the Corporation could have a material impact on the Corporation's business; failure to comply with Medicare and Medicaid regulations could result in loss of eligibility to participate in these programs; efforts by payers to control costs; healthcare reform adversely impacting the liquidity of the Corporation's customers thus affecting their ability to make timely payments to the Corporation; the effects of the sequestration order issued by the Federal government mandating pending reductions impacting most Federal programs including Medicare; increasing enforcement in the U.S. healthcare industry negatively impacting the Corporation's business; further consolidation of managed care organizations and other third-party payers adversely affecting the Corporation's profits; Federal and state medical privacy regulations increasing costs of operations and expose the Corporation's to civil and criminal sanctions; interruption or damage to the Corporation's sophisticated information systems; purchasing a significant portion of the Corporation's pharmaceutical products from one supplier; attracting and retaining key executives, pharmacists, and other healthcare personnel; revenues and volumes adversely affected by certain factors in markets in which the Corporation operates, including weather; the provisions in the Corporation's

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PHARMERICA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

certification of incorporation and bylaws could delay or prevent a change of control that stockholders favor; changes in volatility of the Corporation's stock price; successfully pursuing development and acquisition activities; indebtedness that restricts the Corporation's ability to pay cash dividends and has a negative impact on the Corporation's financing options; exposure to changes in interest rates; the Corporation's ability to successfully refinance its debt arrangements to decrease interest rates; changes to critical accounting estimates and changes in and interpretations of accounting rules and standards.

Unsolicited Tender Offer by Omnicare

On August 23, 2011, Omnicare, Inc. ("Omnicare") made public an unsolicited proposal to acquire all of the outstanding shares of the Corporation's common stock for \$15.00 per share in cash. On January 27, 2012, the Federal Trade Commission ("FTC") issued an administrative complaint to block Omnicare's proposed acquisition of the Corporation. The complaint alleged that the proposed acquisition would be illegal and in violation of Section 15 of the FTC Act and Section 7 of the Clayton Act because it would harm competition and enable Omnicare to raise the price of drugs for Medicare Part D consumers and others. On February 21, 2012 the unsolicited tender offer expired, and Omnicare did not extend the offer.

In connection with these matters, for the years ended December 31, 2011 and 2012, the Corporation expensed \$2.8 million and \$1.9 million, respectively, of legal, investment banking, and other fees, which are included in merger, acquisition, integration costs and other charges in the consolidated income statements. No such expenses were incurred for the year ended December 31, 2013.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand and cash equivalents with original maturities of three months or less. The Corporation places its cash in financial institutions that are federally insured. As of December 31, 2012 and 2013, the Corporation did not hold a material amount of funds in cash equivalent money market accounts. Management believes it effectively safeguards cash assets.

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 in which there is little or no market data, which require the Corporation to develop its own assumptions.

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

- A. Market approach: Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
- B. Cost approach: Amount that would be required to replace the service capacity of an asset (replacement cost).
- C. Income approach: Techniques to convert future amounts to a single present amount based upon market expectations (including present value techniques, option-pricing and excess earnings models).

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## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

Financial liabilities and non-financial assets recorded at fair value at December 31, 2012 and 2013, are set forth in the tables below (dollars in millions):

As of December 31, 2012	Asset/(Liability)	Level 1	Level 2	Level 3	Valuation Technique
Financial Liability					
Deferred Compensation Plan	\$ (4.8 )	\$ -	\$ (4.8)	\$ -	A

  

As of December 31, 2013	Asset/(Liability)	Level 1	Level 2	Level 3	Valuation Technique
Financial Liability					
Deferred Compensation Plan	\$ (6.9 )	\$ -	\$ (6.9)	\$ -	A
Contingent Consideration	\$ (0.7 )	\$ -	\$ -	\$ (0.7)	C
Mandatorily Redeemable Interest	\$ (8.2 )	\$ -	\$ -	\$ (8.2)	C

The deferred compensation plan liability represents an unfunded obligation associated with the deferred compensation plan offered to eligible employees and members of the Board of Directors of the Corporation. The fair value of the liability associated with the deferred compensation plan is derived using pricing and other relevant information for similar assets or liabilities generated by market transactions.

The contingent consideration represents a future earn-out associated with the Corporation's acquisition of an institutional pharmacy business purchased in 2013. The fair value of the liability associated with the contingent consideration was derived using an option pricing model 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 the fair value of the liability as of December 31, 2013.

The mandatorily redeemable interest represents a future obligation associated with the Corporation's acquisition of a specialty pharmacy business ("Onco360") purchased on December 6, 2013. The mandatorily redeemable interest is classified as a long-term liability and measured at fair value. The fair value was derived using the income approach with unobservable inputs, which included a future gross profit forecast and present value assumptions, and there was little or no market data.

There were no transfers between the three-tier fair value hierarchy levels during the period.

The carrying amounts reported in the accompanying 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).

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

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## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

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

	December 31,	
	2012	2013
Institutional healthcare providers	\$ 158.1	\$ 160.9
Medicare Part D	41.6	31.1
Private payer and other	28.1	30.1
Insured	16.1	20.0
Medicaid	15.8	11.9
Medicare	1.9	2.5
Allowance for doubtful accounts	(56.4 )	(56.7 )
	\$205.2	\$199.8
0 to 60 days	58.8 %	55.5 %
61 to 120 days	17.1 %	18.8 %
Over 120 days	24.1 %	25.7 %
	100.0%	100.0%

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

	Beginning Balance	Charges to Costs and Expenses	Write-offs	Ending Balance
Allowance for doubtful accounts:				
Year Ended December 31, 2011	\$ 36.8	\$ 24.8	\$ (13.0 )	\$ 48.6
Year Ended December 31, 2012	\$ 48.6	\$ 25.9	\$ (18.1 )	\$ 56.4
Year Ended December 31, 2013	\$ 56.4	\$ 22.7	\$ (22.4 )	\$ 56.7

**Concentration of Credit Risk**

For the years ended December 31, 2011, 2012 and 2013, the Corporation derived approximately 13.2%, 14.3% and 12.5% of its revenues from a single customer, respectively, including all payer sources associated with the residents of its long-term care facilities.

**Deferred Financing Fees**

The Corporation capitalizes financing fees related to acquiring or issuing new debt instruments. These expenditures include bank fees and premiums, legal costs, and filing fees. The Corporation amortizes these deferred financing fees using the effective interest method.

**Inventory**

Inventory is primarily located at the Corporation's pharmacy locations. Inventory consists solely of finished products (primarily prescription drugs) and is valued at the lower of first-in, first-out cost ("FIFO") or market. Physical inventories are performed at a minimum on a quarterly basis at the end of the quarter at all pharmacy sites. Cost of goods sold is adjusted based upon the actual results of the physical inventory counts.

#### Equipment and Leasehold Improvements

Equipment and leasehold improvements are recorded at cost on the acquisition date and are depreciated using the straight-line method over their estimated useful lives or lease term, if shorter, as follows (in years):

	Estimated Useful Lives
Leasehold improvements	1-7
Equipment and software	3-10

Expenditures for maintenance, repairs and renewals of minor items are expensed as incurred. Major rebuilds and improvements are capitalized. For the years ended December 31, 2011, 2012 and 2013, maintenance and repairs were \$7.5 million, \$8.1 million and \$10.0 million, respectively.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability of long-lived assets is assessed by a comparison of the carrying amount of the asset or asset group to the estimated future undiscounted net cash flows expected to be generated by the asset or group of assets. If estimated future undiscounted net cash flows are less than the carrying amount of the asset or group of assets, the asset is considered impaired and an expense is recorded in an amount required to reduce the carrying amount of the asset or asset group to its then fair value. The Corporation did not record impairment charges on equipment and leasehold improvements for the years ended December 31, 2011 or December 31, 2012. The Corporation incurred fixed asset impairment charges of \$0.1 million for the year ended December 31, 2013 associated with the Corporation's restructuring plan. The Corporation recorded \$1.6 million in charges related to Hurricane Sandy for fixed assets which were destroyed in the year ended December 31, 2012. See Note 9.

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PHARMERICA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

The Corporation's equipment and leasehold improvements are further described in Note 3.

Capitalization of Internal Software Costs

The Corporation capitalizes the costs incurred during the application development stage, which includes costs to design the software configuration and interfaces, coding, installation, and testing. Costs incurred during the preliminary project stage along with post-implementation stages of internal use computer software are expensed as incurred. Capitalized development costs are amortized generally over three years and are subject to impairment evaluations. Costs incurred to maintain existing software development are expensed as incurred. The capitalization and ongoing assessment of recoverability of development costs requires judgment by management with respect to certain external factors, including, but not limited to, technological and economic feasibility and estimated economic life. For the years ended December 31, 2012 and 2013, the Corporation capitalized internally developed software costs of \$6.7 million and \$13.3 million, respectively. As of December 31, 2012 and 2013, net capitalized software costs, including acquired assets and amounts for projects which have not been completed, totaled \$16.6 million and \$23.1 million, respectively.

Goodwill and Other Intangibles

Goodwill represents the excess purchase price of an acquired entity over the net amounts assigned to assets acquired and liabilities assumed. The Corporation's policy is to perform a qualitative assessment on goodwill impairment 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 as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The Corporation performed a qualitative assessment as of December 31, 2012 and did not find it necessary to perform the first step of the two-step impairment test based on that analysis. As a result of the Corporation being notified during June 2013 that it will be losing its largest customer effective December 31, 2013, the Corporation performed the first step of the two step analysis for the pharmacy segment during the quarter ended December 31, 2013 and determined that an impairment of goodwill did not occur as a result of this triggering event. The Corporation's fair value as calculated for the step one analysis was approximately 65% greater than current book value.

The Corporation's finite-lived intangible assets are comprised primarily of trade names, customer relationship assets, limited distributor relationships, doctor and insurer relationships and non-compete agreements. Finite-lived intangible assets are amortized on a straight-line basis over the course of their lives ranging from 5 to 20 years. For impairment reviews, intangible assets are reviewed on a specific pharmacy basis or as a group of pharmacies depending on the intangible assets under review. The Corporation's goodwill and intangible assets are further described in Note 4.

Self-Insured Employee Health Benefits

The Corporation is self-insured for the majority of its employee health benefits. The Corporation's self-insurance for employee health benefits includes a stop-loss policy to limit the maximum potential liability of the Corporation for both individual and aggregate claims per year. The Corporation records a monthly expense for self-insurance based on historical claims data and inputs from third-party administrators. For years ended December 31, 2011, 2012 and 2013, the expense for employee health benefits was \$20.3 million, \$23.6 million and \$22.3 million, respectively, the majority of which was related to its self-insured plans. As of December 31, 2012 and 2013, the Corporation had \$3.3

million and \$3.2 million, respectively, recorded as a liability for self-insured employee health benefits.

#### Supplier Rebates

The Corporation receives rebates on purchases from its vendors and suppliers for achieving market share or purchase volumes. 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 primarily based on achieving purchasing volume requirements. The Corporation generally accounts for these rebates and other incentives received from its vendors and suppliers, relating to the purchase or distribution of inventory, on an accrual basis as an estimated reduction of cost of goods sold and inventory. The estimated accrual is adjusted, if necessary, after the third party validates the appropriate data and notifies the Corporation of its agreement under the terms of the contract. The Corporation considers these rebates to represent product discounts, and as a result, the rebates are allocated as a reduction of product cost and relieved through cost of goods sold upon the sale of the related inventory or as a reduction of inventory for drugs which have not yet been sold.

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PHARMERICA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

Delivery Expenses

The Corporation incurred delivery expenses of \$67.4 million, \$63.2 million and \$62.0 million for the years ended December 31, 2011, 2012, and 2013, respectively, to deliver products sold to its customers. Delivery expenses are reported as a component of cost of goods sold in the accompanying consolidated income statements.

Stock Option Accounting

The Corporation recognizes stock-based compensation expense in its consolidated financial statements using the Black-Scholes-Merton option valuation model (see Note 10).

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Corporation accrues for tax obligations, as appropriate, based on facts and circumstances in the various regulatory environments. Deferred tax assets and liabilities are more fully described in Note 11.

Mandatorily Redeemable Interest

The Corporation acquired 37.5% of the membership interests of OncoMed Specialty, LLC ("the Onco Acquisition") while also obtaining control of the business. As further discussed in Note 2, the subsidiary is fully consolidated in the Corporation's consolidated financial statements and the mandatorily redeemable interest is classified as debt within other long-term liabilities in the consolidated balance sheets.

Measurement Period Adjustments

For the year ended December 31, 2013, the Corporation has adjusted certain amounts on the consolidated balance sheet as of December 31, 2012 as a result of measurement period adjustments related to the acquisitions occurring in 2012 (See Note 2).

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PHARMERICA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 2—ACQUISITIONS

2013 Acquisitions

During the year ended December 31, 2013, the Corporation completed five acquisitions of long-term care businesses (the “2013 Acquisitions”), none of which were, individually or in the aggregate, significant to the Corporation. Acquisitions of businesses required cash payments of approximately \$25.5 million. The resulting amount of goodwill related to these transactions in the aggregate was \$7.5 million and identifiable intangibles of \$10.3 million. The net assets and operating results of acquisitions have been included in the Company’s consolidated financial statements from their respective dates of acquisition.

The Corporation also recognized a bargain purchase gain related to one of the 2013 Acquisitions in the amount of \$1.3 million as a result of certain deferred tax assets acquired through the business combination. This gain is recorded in selling, general and administrative expenses in the accompanying consolidated income statements.

Amounts contingently payable related to the 2013 Acquisitions, representing payments originating from earnout provisions of acquisitions, were \$0.7 million as of December 31, 2013.

On December 6, 2013 the Corporation through one of its wholly owned subsidiaries, acquired 37.5% of the issued share capital of OncoMed Specialty, LLC (“Onco”) for \$10.8 million, net of cash acquired. The Corporation’s primary purpose in acquiring Onco was to continue to expand pharmacy services through the addition of specialty pharmacy services. The total purchase price of Onco was allocated to the net tangible and identifiable intangible assets based upon their fair values on December 6, 2013. The excess of the purchase price over the fair values of the net tangible and identifiable intangible assets of \$16.9 million was recorded as goodwill of \$5.7 million. The Corporation believes the resulting amount of goodwill reflects its expectation of the synergistic benefits of the acquisition. Provisions in the acquisition agreement include a mandatorily redeemable interest whereby the Corporation is required to purchase the remaining capital of Onco on the fifth anniversary of the agreement, if not purchased earlier under the provisions of the acquisition agreement. The Corporation is accounting for the mandatorily redeemable interest of \$8.2 million as a debt obligation and subsequently measuring that obligation at fair value. Changes in the fair value of the related debt will be recorded as interest expense in our consolidated income statements for the respective periods. The operating results of Onco subsequent to the acquisition are fully consolidated in the Corporation’s consolidated financial statements.

Pro forma financial statements are not presented on the 2013 acquisitions as the results are not material to the Corporations's consolidated financial statements.

2012 Acquisitions

Amerita Acquisition

On December 13, 2012 the Corporation, through a wholly-owned subsidiary, acquired all of the outstanding stock of Amerita, Inc., a Delaware corporation (“Amerita”), for \$84.5 million in cash, less cash acquired of \$1.0 million, including the final working capital adjustment of \$0.5 million in the first quarter of 2013. The Corporation’s primary purpose in acquiring Amerita was to complement existing pharmacy services through the provision of additional infusion services. The total purchase price of Amerita was allocated to the net tangible and identifiable intangible assets based upon their fair values on December 13, 2012. The excess of the purchase price over the fair values of the

net tangible and identifiable intangible assets was recorded as goodwill. The Corporation believes the resulting amount of goodwill reflects its expectation of the synergistic benefits of the acquisition. For tax purposes, the transaction was considered a stock acquisition. Approximately \$14.5 million of goodwill related to previous acquisitions made by Amerita remains tax deductible by the Corporation.

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## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 2—ACQUISITIONS (**Continued**)

The purchase price allocation was as follows (dollars in millions):

	Amounts Previously Recognized as of Acquisition Date (1)	Measurement Period Adjustments	Amounts Recognized as of Acquisition Date (As Adjusted)
Accounts receivable	\$ 11.1	\$ (1.3 )	\$ 9.8
Inventory	1.6	-	1.6
Other current assets	0.6	0.2	0.8
Equipment and leasehold improvements	0.8	-	0.8
Other long-term assets	0.2	-	0.2
Deferred tax assets	1.2	0.5	1.7
Identifiable intangibles	30.8	-	30.8
Goodwill	53.3	1.2	54.5
Total Assets	99.6	0.6	100.2
Current liabilities	(5.6 )	(0.1 )	(5.7 )
Deferred tax liabilities - long-term	(9.9 )	-	(9.9 )
Other long-term liabilities	(0.1 )	-	(0.1 )
Total Liabilities	(15.6 )	(0.1 )	(15.7 )
Total purchase price, less cash acquired	\$ 84.0	\$ 0.5	\$ 84.5

(1) As previously reported in the Corporation's 2012 Annual Report on Form 10-K.

The following is the fair value of the equipment and leasehold improvements of the Amerita acquisition at the date of acquisition (dollars in millions):

<u>Equipment and leasehold improvements</u>	Fair-Value	Weighted Average Useful Life (Yr)
Leasehold improvements	\$ 0.1	1.8
Equipment and software	0.7	4.9
	\$ 0.8	

The following are the fair values of the identifiable intangible assets of the Amerita acquisition at the date of acquisition (dollars in millions):

<u>Identifiable intangibles</u>	Fair-Value	Weighted Average
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		Useful Life (Yr)
Trade name	\$ 27.0	13.0
Customer (payer) relationships	2.4	10.0
Non-compete agreements	1.4	5.0
	\$ 30.8	

Other

For the years ended December 31, 2011, 2012 and 2013, the Corporation incurred \$12.9 million, \$10.7 million, and \$4.4 million, respectively, of acquisition related costs, which have been classified as a component of merger, acquisition, integration costs and other charges.

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## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 3—EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Equipment and leasehold improvements consist of the following (dollars in millions):

	December 31,	
	2012	2013
Leasehold improvements	\$ 14.7	\$ 17.8
Equipment and software	139.0	154.2
Construction in progress	5.1	7.5
	158.8	179.5
Accumulated depreciation	(105.7)	(117.6)
Total equipment and leasehold improvements	\$ 53.1	\$ 61.9

Depreciation expense totaled \$20.1 million, \$18.6 million, and \$19.3 million for the years ended December 31, 2011, 2012, and 2013, respectively.

## NOTE 4—GOODWILL AND INTANGIBLES

The following table presents the changes in the carrying amount of goodwill for the years ended December 31, 2012 and 2013 (dollars in millions):

Balance at December 31, 2011, as adjusted	\$ 214.9
Goodwill acquired from 2012 acquisitions, as adjusted	54.5
Balance at December 31, 2012, as adjusted	269.4
Goodwill acquired from 2013 acquisitions	13.2
Balance at December 31, 2013	\$ 282.6

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

	Balance at December		Balance at December		Balance at December
<u>Finite Lived Intangible Assets</u>	31, 2011	Additions	31, 2012	Additions	31, 2013
Customer relationships	\$ 96.0	\$ 2.8	\$ 98.8	\$ 22.4	\$ 121.2
Trade name	30.0	27.0	57.0	2.8	59.8
Non-compete agreements	8.4	4.2	12.6	4.2	16.8
Sub Total	134.4	34.0	168.4	29.4	197.8
Accumulated amortization	(34.2 )	(12.3 )	(46.5 )	(15.4 )	(61.9 )
Net intangible assets	\$ 100.2	\$ 21.7	\$ 121.9	\$ 14.0	\$ 135.9

Amortization expense relating to finite-lived intangible assets was \$11.0 million, \$12.3 million, and \$15.4 million for the years ended December 31, 2011, 2012 and 2013, respectively.

During the third quarter of 2011, the Corporation recorded a pre-tax impairment charge of \$5.1 million related to finite-lived customer relationships. The impairment was incurred as the result of non-renewal of certain customer contracts. The impairment was related to intangible assets acquired in an acquisition during the year ended December

31, 2005. These asset groups were assessed for recoverability and management determined the finite-lived customer relationship assets to be impaired. No other assets within the asset groups were deemed impaired. Using a discounted cash flow analysis, the Corporation determined that the pre-tax impairment charge of \$5.1 million was required to write the carrying value down to fair value, resulting in a loss per diluted share impact of \$0.11. The Corporation recognized the impairment as a permanent write-down of the cost basis and accumulated amortization of the affected assets.

Total estimated amortization expense for the Corporation's finite-lived intangible assets for the next five years and thereafter are as follows (dollars in millions):

<u>Year Ending December 31.</u>	
2014	\$ 17.3
2015	17.1
2016	16.2
2017	15.0
2018	14.3
Thereafter	56.0
	\$ 135.9

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## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 5—CREDIT AGREEMENT

On May 2, 2011, the Corporation entered into a long-term credit agreement (the “Credit Agreement”) among the Corporation, the Lenders named therein, and Citibank, N.A. (“Citibank”), as Administrative Agent. The Credit Agreement consists of a \$250.0 million term loan facility and a \$200.0 million revolving credit facility. The terms and conditions of the Credit Agreement are customary to facilities of this nature.

Borrowings under the Credit Agreement bear interest at a floating rate equal to, at the Corporation’s option, a base rate plus a margin between 1.25% and 2.00% per annum, or an adjusted LIBO Rate plus a margin between 2.25% and 3.00% per annum, in each case depending on the leverage ratio of the Corporation as defined by the Credit Agreement. The base rate is the greater of the prime lending rate in effect on such day, the federal funds effective rate published by the Federal Reserve Bank of New York on such day plus 0.5%, and the adjusted LIBO Rate for deposits for a period equal to one month plus 1.0%. As of December 31, 2013, borrowings under the term loan bore interest at a rate of 2.67% per annum based upon the one month adjusted LIBO rate and the revolving credit facility bore interest at a rate of 4.75% per annum based upon the prime rate.

As of December 31, 2013, \$231.3 million was outstanding under the term loan facility and there was no amount outstanding under the revolving credit facility. Indebtedness under the Credit Agreement matures on June 30, 2016, at which time the commitments of the Lenders to make revolving loans also expire.

The table below summarizes the term debt and revolving credit facility of the Corporation (dollars in millions):

	December 31, 2012	2013
Credit Agreement:		
Term Debt—payable to lenders at LIBOR plus applicable margin (2.67% as of December 31, 2013), matures June 30, 2016	\$243.8	\$231.3
Revolving Credit Facility payable to lenders, interest base rate plus applicable margin (4.75% as of December 31, 2013), matures June 30, 2016	71.7	-
Total debt	315.5	231.3
Less: Current portion of long-term debt	12.5	12.5
Total long-term debt	\$303.0	\$218.8

The Corporation’s indebtedness had the following maturities for the remaining life of the Credit Agreement (dollars in millions):

<u>Year Ending December 31,</u>	Term Debt	Revolving Credit Facility	Total Maturities
2014	\$12.5	\$ -	\$ 12.5
2015	112.5	-	112.5
2016	106.3	-	106.3
	\$231.3	\$ -	\$ 231.3

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 December 31, 2013 was \$2.3

million. After giving effect to the letters of credit, total availability under the revolving credit facility was \$197.7 million as of December 31, 2013. The revolving credit facility contains a \$100.0 million accordion feature, which permits the Corporation to increase the total debt capacity, up to an aggregate of \$531.3 million, subject to securing additional commitments from existing or new lenders.

The Corporation was compliant with all debt covenant requirements at December 31, 2013.

#### Deferred Financing Fees

The Corporation capitalized a total of \$9.8 million in deferred financing fees associated with the Credit Agreement and recorded them as other assets in the accompanying consolidated balance sheets. As of December 31, 2013, the Corporation had \$6.0 million of unamortized deferred financing fees.

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PHARMERICA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 6—COMMITMENTS AND CONTINGENCIES

Legal Action and Regulatory

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

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

On June 10, 2013, the United States District Court for the Eastern District of Wisconsin unsealed two consolidated qui tam complaints filed in 2009 and 2011 by relators who are former employees of the Corporation and a company acquired by the Corporation. The United States, acting through the U.S. Attorney's Office in Wisconsin, intervened in part and declined to intervene in part and filed its complaint in intervention on August 9, 2013, when the matter was formally brought to the Corporation's attention. The first complaint seeks statutory fines for the Corporation's alleged dispensing of Schedule II controlled substances without a valid prescription in violation of the Controlled Substances Act. It also seeks monetary damages and equitable relief alleging that this conduct caused false claims to be submitted in violation of the federal False Claims Act (the "FCA"). The Corporation has moved to dismiss the government's complaint for failure to state a claim upon which relief may be granted and is awaiting the Court's decision. The second complaint alleges that the Corporation submitted false claims to Medicare Part D and to Medicaid for drugs in connection with which the Corporation allegedly received kickbacks from the manufacturer in the form of market share rebates and other remuneration, all in violation of the Federal Antikickback statute (the "AKS/FCA" claims). The second complaint also includes a claim by the relator under the retaliatory termination provisions of the FCA. The government declined to intervene in the AKS/FCA claims and the relator thereafter moved, with the government's permission, to dismiss the AKS/FCA claims, which motion the Court has granted. The relator is independently pursuing the retaliatory termination claims. The Corporation has moved to dismiss the relator's complaint for failure to state a claim upon which relief may be granted and is awaiting the Court's decision. The Corporation intends to vigorously defend itself in both matters.

On November 20, 2013 the complaint filed by a relator, Robert Gadbois, on behalf of the U.S. Government and various state governments, was unsealed by the United States District for the District of Rhode Island against the Corporation alleging that the Corporation dispensed controlled and non-controlled substances in violation of the CSA and thus the dispenses were not eligible for payment and therefore 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 have declined to intervene in this case. The case therefore has been unsealed but relator has not yet served the Corporation. Gadbois has moved the court to file a Second Amended Complaint, which motion is still pending before the Court. Once relator serves the Complaint, the Corporation intends to defend the case vigorously.

On August 8, 2013, a complaint filed by the relator, Richard Templin, in the United States District Court for the Southern District of Texas was unsealed. The complaint sought monetary damages and alleged that the Corporation violated the federal False Claims Act and the Anti-Kickback Act by allegedly receiving rebates from pharmaceutical manufacturers, and by allegedly providing or receiving other remuneration from pharmaceutical manufacturers and its nursing facility customers in exchange for referrals. The relator then voluntarily dismissed all claims against the Corporation and the case is no longer pending.

On November 12, 2013, a relator, Fox Rx, Inc. ("Fox"), on behalf of the U.S. Government and various state governments and the District of Columbia, filed a complaint in the United States District Court for the Southern District of New York against the Corporation alleging that the Corporation violated the FCA by submitting false claims to Fox, other Medicare Part D sponsors and to Medicaid, by allegedly billing for expired drugs or for brand drugs when generic drugs should have been substituted. Following the U.S. Government's decision to decline to intervene in the case, the complaint was unsealed and served on the Corporation. The Corporation intends to vigorously defend itself against these allegations.

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 for the District of New Jersey against the Corporation alleging that the Corporation violated the False Claims Act and Anti-Kickback Statute through its agreements to provide prescription drugs to nursing homes under certain Medicare and Medicaid programs. On February 19, 2013, the U.S. Government declined to intervene in the case. The complaint has been amended several times, most recently on November 12, 2013 and thereafter served upon the Corporation. On December 6, 2013, the Corporation moved to dismiss the amended complaint for failure to state a claim upon which relief may be granted and is awaiting the Court's decision. The Corporation intends to vigorously defend itself against these allegations.

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PHARMERICA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 6—COMMITMENTS AND CONTINGENCIES (Continued)

On January 31, 2014, a relator, Frank Kurnik, on behalf of the U.S. Government and various state governments served its complaint filed in the United States District for the District of South Carolina alleging that the Corporation solicited and received remuneration in violation of the federal Anti-kickback Statute from drug manufacturer Amgen in exchange for preferring and promoting Amgen's drug Aranesp over a competing drug called Procrit. The U.S. Government and the various states declined to intervene in the case. The Corporation intends to vigorously defend itself against these allegations.

The U.S. Department of Justice, through the U.S. Attorney's Office for the Western District of Virginia, is investigating whether the Corporation's activities in connection with agreements it had with the manufacturer of the pharmaceutical Depakote violated the False Claims Act or the Anti-Kickback Statute. The Corporation is cooperating with these investigations and believes it has complied with applicable laws and regulations with respect to these matters.

In addition, the Corporation is involved in certain legal actions and regulatory investigations arising in the ordinary course of business. At this time, the Corporation is unable to determine the impact of these investigations on its consolidated financial condition, results of operations, or liquidity. At December 31, 2013, the Corporation had accrued approximately \$20.0 million related to the legal actions and investigations.

California Medicaid

On August 14, 2013 the California Department of Health Care Service (“DHCS”) announced its intent to implement a ten (10) percent reimbursement reduction for numerous healthcare providers, including long term care pharmacies. Originally, the DHCS received federal approval for the reduction effective June 1, 2011, but the DHCS has been prevented from implementing the reductions due to a court injunction. The United States Court of Appeals for the Ninth Circuit denied the plaintiffs’ motion for a stay of mandate, allowing for the implementation of the reimbursement reduction.

The DHCS intends to implement the reduction prospectively beginning January 9, 2014. In addition, the DHCS will begin recouping a percentage of provider payments representing a ten (10) percent reduction on certain drug reimbursements retroactive to June 1, 2011. These retroactive recoveries will not occur until after the prospective payment reductions are implemented. The Corporation has recorded a \$3.3 million liability and reduction of revenue which represents its best estimate of the expected amount of recoveries from June 1, 2011 through December 31, 2013.

FUL and AMP Changes

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

The 2010 Health Care Reform Legislation amended the Deficit Reduction Act of 2005 (“DRA”) to change the definition of the FUL by requiring the calculation of the FUL as no less than 175% of the weighted average, based on



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

In the Proposed Rule, CMS also proposes to require physicians and eligible professionals to enroll in the Medicare program in order to prescribe covered Part D drugs. CMS proposes that a prescriber or eligible professional of Part D drugs must have either an approved enrollment record in the Medicare fee-for-service program or a valid opt-out affidavit on file with a Part A or Part B Medicare Administrative Contractor for a prescription written by a prescriber to be eligible for coverage under the Part D program. Until CMS issues final guidance, the Corporation is unable to evaluate the full impact of these proposed changes to drug categories and classes and prescriber enrollment requirements on its business.

#### Acquisitions

The Corporation has historically acquired the stock or assets of businesses with prior operating histories. Acquired companies may have unknown or contingent liabilities, including liabilities for failure to comply with healthcare laws and regulations, medical and general professional liabilities, workers' compensation liabilities, previous tax liabilities, and unacceptable business practices. Although the Corporation institutes policies designed to conform practices to its standards following completion of acquisitions, there

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PHARMERICA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 6—COMMITMENTS AND CONTINGENCIES (Continued)

can be no assurance the Corporation will not become liable for past activities that may later be asserted to be improper by private plaintiffs or government agencies. While the Corporation generally seeks to obtain indemnification from prospective sellers covering such matters, there can be no assurance that any such matter will be covered by indemnification, or if covered, that such indemnification will be adequate to cover potential losses and fines. In the ordinary course of business, the Corporation enters into contracts containing standard indemnification provisions and indemnifications specific to a transaction such as business acquisitions and disposals of an operating facility. These indemnifications may cover claims against employment-related matters, governmental regulations, environmental issues, tax matters, as well as customer, third party payer, supplier, and contractual relationships. Obligations under these indemnities generally would be initiated by a breach of the terms of the contract or by a third party claim or event.

Prime Vendor Agreement

On January 25, 2013 the Corporation renegotiated its Amended Prime Vendor Agreement with AmerisourceBergen Drug Corporation (“ABDC”) effective January 1, 2013. The First Amendment to the Amended Prime Vendor Agreement (the “First Amendment”) modified the previous agreement, which was set to expire September 30, 2013 and extended its term until September 30, 2016.

The First Amendment requires the Corporation to purchase certain levels of brand and non-injectable generic drugs from ABDC. The First Amendment does provide the flexibility for the Corporation to contract with other suppliers. If the Corporation fails to adhere to the contractual purchase provisions, ABDC has the ability to increase the Corporation’s drug pricing under the terms of the First Amendment.

Employment Agreements

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

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

Leases

The Corporation leases real estate properties, buildings, vehicles, and equipment under cancelable and non-cancelable leases. The leases expire at various times and have various renewal options. Certain leases that meet the lease capitalization criteria have been recorded as an asset and liability at the net present value of the minimum lease payments at the inception of the lease. Interest rates used in computing the net present value of the lease payments are

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based on the Corporation's incremental borrowing rate at the inception of the lease. The Corporation recorded the following lease expense for the periods presented (dollars in millions):

	2011	2012	2013
Pharmacy locations and administrative offices lease expense	\$14.4	\$14.4	\$15.2
Office equipment lease expense	2.5	2.4	2.1
Total lease expense	\$16.9	\$16.8	\$17.3

Future minimum lease payments for those leases having an initial or remaining non-cancelable lease term in excess of one year are as follows for the years indicated (dollars in millions):

Year Ending December 31,	Operating Leases
2014	\$ 15.0
2015	12.2
2016	9.2
2017	6.3
2018	6.2
Thereafter	5.3
Total	\$ 54.2

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## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 7—MERGER, ACQUISITION, INTEGRATION COSTS AND OTHER CHARGES

Merger, acquisition, integration costs and other charges were \$16.8 million, \$17.8 million and \$8.1 million for the years ended December 31, 2011, 2012 and 2013, respectively.

Merger, integration costs and other charges for the years ended December 31, 2011, 2012, and 2013 were \$3.9 million, \$7.1 million, and \$3.7 million, respectively. Acquisition related costs for the years ended December 31, 2011, 2012, and 2013 were \$12.9 million, \$10.7 million, and \$4.4 million, respectively.

The negative impact on diluted earnings per share was \$(0.35), \$(0.36) and \$(0.17) for the years ended December 2011, 2012 and 2013, respectively.

## NOTE 8-RESTRUCTURING COSTS AND OTHER CHARGES

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

The Corporation recorded restructuring costs and other related charges of approximately \$4.4 million during the year ended December 31, 2013. 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):

	Balances at December 31, 2013
Employee severance and related costs	\$ 1.8
Facility lease costs	0.8
Total	\$ 2.6

The liability at December 31, 2013 represent amounts not yet paid relating to actions taken in connection with the program (primarily lease payments and severance costs). The Corporation expects to have the restructuring program fully implemented in the first half of 2014.

## NOTE 9—HURRICANE SANDY DISASTER COSTS

In October 2012, Hurricane Sandy caused significant damage on Long Island, New York and surrounding areas. The financial impacts of the storm to the Corporation's Long Beach facility as well as damage and disruption at the Corporation's customers' facilities have been recorded as a separate component in the consolidated income statements.

The Corporation expects a portion of the cost associated with Hurricane Sandy to be covered by insurance. While the exact amount has not been determined, the Corporation's current estimate of covered losses, net of its deductible, is

approximately \$5.4 million. After consideration of a \$5.3 million advance by the insurance carrier the Corporation has recorded a receivable for \$0.1 million which is included in prepaids and other assets in the consolidated balance sheets. The actual recovery will vary depending on the outcome of the insurance loss adjustment process. Accordingly, no offsetting benefit for insurance recoveries above the amount of the cumulative loss has been recorded. For the years ended December 31, 2012 and 2013, Hurricane Sandy disaster costs were \$4.5 million and \$(1.4) million, respectively.

**NOTE 10—COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS**

**Common Stock**

Holders of the Corporation's common stock are entitled to one vote for each share held of record on all matters on which stockholders may vote. There are no preemptive, conversion, redemption or sinking fund provisions applicable to the Corporation's common stock. In the event of liquidation, dissolution or winding up, holders of common stock are entitled to share ratably in the assets available for distribution, subject to any prior rights of any holders of preferred stock then outstanding. In addition, the Corporation's Credit Agreement imposes restrictions on its ability to pay cash dividends.

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PHARMERICA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 10—COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS (Continued)

Preferred Stock

The certificate of incorporation authorizes the issuance of an aggregate of 1.0 million shares of preferred stock. On August 25, 2011, the Board of Directors designated 175,000 shares of preferred stock as Series A Junior Participating Preferred Stock (“Series A Junior Preferred Stock”). As of December 31, 2013, there were no shares of preferred stock outstanding.

The Series A Junior Preferred Stock is entitled to receive quarterly cumulative dividends in an amount per whole share equal to the greater of \$10.00 or 1,000 times the dividends declared on the Common Stock since the preceding quarterly dividend payment date, or with respect to the first quarterly dividend payment date, since the date of issuance, and a liquidation preference of a minimum of \$10.00 per whole share, plus an amount equal to any accrued dividends and distributions thereon, whether or not declared, to the date of payment, and will be entitled to an aggregate payment per whole share equal to 1,000 times the amount per share distributed to the holders of Common Stock. Holders of Series A Junior Preferred Stock are entitled to vote on each matter on which holders of Common Stock are entitled to vote, and have 1,000 votes per whole share. The preferred stockholders also are entitled to certain corporate governance and special voting rights, as defined in the certificate of designation.

The Corporation’s Board of Directors may, from time to time, direct the issuance of shares of preferred stock in series and may, at the time of issuance, determine the designation, powers, rights, preferences and limitations of each series. Satisfaction of any dividend preferences of outstanding preferred stock would reduce the amount of funds available for the payment of dividends on the Corporation’s shares of common stock. Holders of preferred stock may be entitled to receive a preference payment in the event of any liquidation, dissolution or winding-up of the Corporation before any payment is made to the holders of the Corporation’s common stock. Under certain circumstances, the issuance of preferred stock may render more difficult or tend to discourage a merger, tender offer or proxy contest, the assumption of control by a holder of a large block of the Corporation’s securities or the removal of incumbent management. The Board of Directors may issue shares of preferred stock with voting and conversion rights that could adversely affect the holders of common stock. Specifically, the Corporation’s certificate of incorporation authorizes the Corporation’s Board of Directors to adopt a rights plan without stockholder approval. This could delay or prevent a change in control of the Corporation or the removal of existing management.

Treasury Stock Purchases

In August 2010, the Board of Directors authorized a share repurchase of up to \$25.0 million of the Corporation’s common stock, of which \$10.5 million was used. On July 2, 2012 the Board of Directors authorized an increase to the remaining portion of the existing stock repurchase program that allows the Corporation to 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 December 31, 2013. 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 were funded from available cash. 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 stock repurchase program does not

have an expiration date and may be limited, terminated or extended at any time without prior notice. During the year ended December 31, 2013, the Corporation repurchased 349,091 shares of common stock for an aggregate purchase price, including commissions, of \$4.3 million at an average purchase price of \$12.33 per share.

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 611,587 shares of certain vested awards and exercise of certain stock options for an aggregate price of approximately \$11.9 million during year ended December 31, 2013. These shares have also been designated by the Corporation as treasury stock.

As of December 31, 2013, the Corporation had a total of 2,416,971 shares held as treasury stock.

#### Amended and Restated 2007 Omnibus Incentive Plan

The Corporation has adopted the Amended and Restated PharMerica Corporation 2007 Omnibus Incentive Plan (as amended and restated, the "Omnibus Plan") under which the Corporation is authorized to grant equity-based and other awards to its employees, officers, directors, and consultants.

The Corporation has reserved 7,237,000 shares of its common stock for awards to be granted under the Omnibus Plan plus 534,642 shares reserved for substitute equity awards. Under the "fungible share pool," one share of stock will be subtracted from the share limit for each share of stock covered by a stock option or stock appreciation right award and 1.65 shares of stock will be subtracted from the share limit for each share of stock covered by any full-value award, including restricted share awards, restricted stock units and performance share awards at target. The following shares are not available for re-grant under the Omnibus Plan: (i) shares tendered by a participant or withheld by the Corporation to pay the purchase price of a stock option award or to satisfy taxes

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## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 10—COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS (Continued)

owed with respect to an award, (ii) shares subject to a stock appreciation right that are not issued in connection with such award's settlement upon the exercise thereof, and (iii) shares reacquired by the Corporation using cash proceeds received by the Corporation from the exercise of stock options. Effective January 1, 2010, shares subject to an award that is forfeited, expired or settled for cash, are available for re-grant under the Omnibus Plan as one share of stock for each share of stock covered by a stock option or appreciation right and 1.65 shares of stock for each share of stock covered by any other type of award.

The Corporation's Compensation Committee administers the Omnibus Plan and has the authority to determine the recipient of the awards, the types of awards, the number of shares covered, and the terms and conditions of the awards. The Omnibus Plan allows for grants of incentive stock options, non-qualified stock options, stock appreciation rights, restricted share and restricted stock units, deferred shares, performance awards, including cash bonus awards, and other stock-based awards.

Stock options granted to officers and employees under the Omnibus Plan generally vest in four equal annual installments and have a term of seven years. The restricted stock units granted to officers generally vest in two or three equal annual installments. The restricted stock units granted to members of the Board of Directors vest in one annual installment. The performance share units granted under the Omnibus Plan vest based upon the achievement of a target amount of the Corporation's earnings before interest, income taxes, depreciation and amortization, merger, acquisition, integration costs and other charges, Hurricane Sandy disaster costs, restructuring charges, settlements, litigation and other charges, California medicaid recoupment, and any changes in accounting principles, which reinforces the importance of achieving the Corporation's profitability objectives. The performance is generally measured over a three-year period.

As of December 31, 2013, total shares available for grants of stock-based awards pursuant to the Omnibus Plan were 3,170,983 shares. The 3,170,983 shares do not take into consideration the dilution of 1.65 shares of stock for any full-value award, including restricted stock awards, restricted stock units and performance share awards at target. The number of shares remaining available for future issuance calculated under the fungible share pool would be 2,258,761.

## Stock-Based Compensation Expense

The following is a summary of stock-based compensation incurred by the Corporation (dollars in millions, except per share amounts):

	2011	2012	2013
Stock option compensation expense	\$2.4	\$1.6	\$1.0
Nonvested stock compensation expense	3.5	5.1	6.2
Total Stock Compensation Expense	\$5.9	\$6.7	\$7.2
Negative effect on diluted earnings per share	\$(0.12)	\$(0.13)	\$(0.15)

As of December 31, 2013, there was \$8.1 million of total unrecognized compensation cost related to the Corporation's stock compensation arrangements. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.



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The following weighted average assumptions were used to estimate the fair value of options granted during the periods presented, using the Black-Scholes-Merton option valuation model:

	2011
Expected volatility (range)	42.23 - 46.34 %
Risk free interest rate (range)	0.19 - 2.20 %
Expected dividends	-
Average expected term (years)	2.0 - 5.0
Average fair value per share of stock options granted based on the Black-Scholes-Merton model (dollars)	\$ 3.61
Weighted average fair value of options granted (in millions)	\$ 2.4

The Corporation did not issue stock options during the years ended December 31, 2012 or December 31, 2013.  
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## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 10—COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS (Continued)

## Expected Volatility

Volatility is a measure of the tendency of investment returns to vary around a long-term average rate. Historical volatility is an appropriate starting point for setting this assumption. The Corporation also considers how future experience may differ from the past. This may require using other factors to adjust historical volatility, such as implied volatility, peer-group volatility and the range and mean-reversion of volatility estimates over various historical periods. The peer-group utilized consisted of twelve companies in 2011, in the same or similar industries as the Corporation. The Corporation estimates the volatility of its common stock in conjunction with the Corporation's annual grant and volatility is calculated utilizing the historical volatility of the Corporation and its peer-group. To the extent material grants are made subsequent to the Corporation's annual grant, the volatility calculation is updated through the most recent grant date of the awards.

## Risk-Free Interest Rate

The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for the expected term of the option.

## Expected Dividends

The Corporation has never paid any cash dividends on its common stock and does not anticipate paying any cash dividends in the foreseeable future. Consequently, it uses an expected dividend yield of zero.

## Expected Term

The Corporation calculated an expected term using management's estimate and expectation of option exercises. The majority of the Corporation's stock options are on a graded-vesting schedule. The Corporation estimates the value of awards with graded vesting by treating each vesting tranche as a separate award. Management has determined to value each tranche of the awards separately utilizing a "multiple fair value" method.

## Stock Option Activity

The following table summarizes option activity for the periods presented:

	Number of Options	Weighted- Average Exercise Price Per Share	Weighted- Average Remaining Term	Aggregate Intrinsic Value (in millions)
Outstanding options at December 31, 2012	2,424,285	\$ 15.14	3.2 years	\$ 1.8
Exercised	(622,712 )	16.00		
Canceled	(68,375 )	13.09		
Expired	(443,625 )	15.70		
Outstanding options at December 31, 2013	1,289,573	\$ 14.63	2.9 years	\$ 8.9

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Exercisable options at December 31, 2013    993,701    \$ 15.12    2.6 years    \$ 6.4

The total intrinsic value of stock options exercised for the years ended December 31, 2011, 2012, and 2013 was \$0.1 million, \$0.2 million and \$3.5 million, respectively. Cash received from stock option exercises during the year ended December 31, 2013 was \$1.0 million. The total fair value of options vested for the years ended December 31, 2011, 2012, and 2013 was \$2.3 million, \$2.1 million, and \$1.6 million, respectively. The Corporation expects to recognize stock based compensation expense for stock options over a remaining weighted average period of less than one year.

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## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 10—COMMON STOCK, PREFERRED STOCK, TREASURY STOCK, STOCK-BASED COMPENSATION AND OTHER BENEFITS (Continued)

## Nonvested Shares

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

	Number of Shares	Weighted- Average Grant Date Fair Value
Outstanding nonvested shares at December 31, 2012	1,133,335	\$ 13.00
Granted—Restricted Stock Units	348,742	14.75
Granted—Performance Share Units	237,294	14.46
Forfeited	(234,893 )	14.84
Vested	(387,804 )	13.03
Outstanding nonvested shares at December 31, 2013	1,096,674	\$ 13.47

The total fair value of shares vested for the years ended December 31, 2011, 2012, and 2013 was \$2.5 million, \$1.4 million, and \$5.1 million, respectively. The weighted average remaining term and intrinsic value of nonvested shares at December 31, 2013 was 4.4 years and \$23.6 million, respectively. The Corporation expects to recognize stock based compensation expense of \$7.4 million for nonvested shares over a weighted average period of more than 1.7 years.

Based upon the achievement of the performance criteria at the end of the performance cycle for the performance share units issued to date, the Corporation may issue no shares or a maximum of 773,322 shares.

## 401(k) Plan

The Corporation sponsors a salary reduction plan qualified under Section 401(k) of the Internal Revenue Code with a safe harbor matching contribution which is also a defined contribution retirement plan under Section 401(a) for all eligible employees, as defined in the plan document. Contributions to the plan are based upon employee contributions and the Corporation's matching contributions. For the years ended December 31, 2011, 2012, and 2013, the Corporation's matching contributions to the plan were \$5.9 million, \$6.0 million, and \$5.9 million, respectively.

## Deferred Compensation Plans

The Corporation maintains an unfunded deferred compensation plan for certain management and highly compensated employees. Under the plan, a participant may elect to defer up to 50 % of such participant's annual base salary and up to 100 % of such participant's annual short-term incentive program cash bonus into the plan during each plan year. In addition, the Corporation may, in its sole discretion, make discretionary contributions to a participant's account.

The Corporation also maintains a deferred compensation plan for the directors of the Corporation. The directors of the Corporation may elect to defer up to 100 % of their cash fees and their stock fees in any one year. If a director elects to defer his/her restricted share grant, the shares will be deferred as they vest until the participant elects for the

deferred compensation to be a taxable event.

As of December 31, 2012 and 2013, the Corporation had \$4.8 million and \$6.9 million, respectively, recognized as a long-term liability related to the deferred compensation plans in the accompanying consolidated balance sheets. Deferred compensation expense was \$0.1 million, \$0.4 million and \$1.5 million for the years ended December 31, 2011, 2012, and 2013, respectively.

#### NOTE 11—INCOME TAXES

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

	2011	2012	2013
Current provision:			
Federal	\$0.1	\$11.6	\$13.0
State	0.8	1.5	1.3
Total	0.9	13.1	14.3
Deferred provision:			
Federal	12.4	1.4	4.8
State	1.5	1.4	7.2
Total	13.9	2.8	12.0
Total provision for income taxes	\$14.8	\$15.9	\$26.3

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## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 11—INCOME TAXES (Continued)

A reconciliation of the U.S. statutory rate to the Corporation's effective tax rate and the is as follows for the years ended December 31:

	2011	2012	2013
U.S. statutory rate applied to pretax income	35.0%	35.0%	35.0%
Differential arising from:			
State taxes	4.5	4.2	4.3
Non-deductible legal expenses	-	-	14.8
Domestic Production Activities Deduction	-	-	(4.7)
Stock compensation	-	-	2.6
Valuation Allowance	(0.1)	-	7.1
Other	(0.7)	1.7	(0.9)
Effective tax rate	38.7%	40.9%	58.2%

The provision for income taxes as a percentage of taxable income for the year ended December 31, 2011 included a discrete tax benefit related to the release of reserves for unrecognized tax benefits. Excluding the one-time benefit associated with the Corporation's release of the reserve, the provision for income taxes for the year ended December 31, 2011 would have been \$15.9 million (41.9% of income). Apart from the discrete tax benefit recorded as a result of the release of reserve in 2011, the effective tax rates in 2011 and 2012 are higher than the federal statutory rate largely as a result of the combined impact of state and local taxes and various non-deductible expenses.

The increase in the provision for income taxes as a percentage of pre-tax income for the year ended December 31, 2013 as compared to the prior years was primarily due to the Corporation's accrued legal expenses for the Department of Justice settlement discussed in Note 6. The Corporation has made an assumption in the absence of more definitive information that this liability is non-deductible and has accounted for the absence of a tax benefit as a discrete item. Accordingly, this resulted in an increase in the twelve month tax provision of approximately \$6.6 million, or approximately 14.8% of pre-tax income. In addition, the Corporation recorded an increase in the state valuation allowance of approximately \$3.2 million, or approximately 7.1% of pre-tax book income. The increase in the tax provision attributable to these two items was partially offset by net deductible permanent differences. Excluding the impact of the legal expenses, the state valuation allowance, and other discrete items, the provision for income taxes as a percentage of pre-tax income would have been 37.0%.

The Corporation derives a current federal and state income tax benefit from the impact of deductions associated with the amortization of tax deductible goodwill acquired through business combinations. The tax basis of the Corporation's tax deductible goodwill was approximately \$123.3 million (as adjusted) and \$125.5 million at December 31, 2012 and 2013, respectively.

The Corporation recognizes an asset or liability for the deferred tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets are recovered or liabilities are settled. The Corporation also recognizes as deferred tax assets, the future tax benefits from net operating and capital loss carryforwards. As of December 31, 2013, the Corporation has utilized all tax benefits from federal net operating loss carryforwards, and the future tax benefits from state net operating loss carryforwards are \$3.1 million, net of federal impact and valuation allowances. The state net operating losses have carryforward

periods ranging from 1 to 18 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 \$26.1 million and \$18.2 million at December 31, 2012 and 2013, net of valuation allowances of \$1.0 million and \$4.1 million, respectively.

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## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 11—INCOME TAXES (Continued)

Current deferred income taxes consisted of (dollars in millions):

	December 31, 2012		December 31, 2013	
	Assets	Liabilities	Assets	Liabilities
Accrued expenses	\$8.4	\$ -	\$9.6	\$ -
Allowance for doubtful accounts	20.8	-	20.8	-
Net operating losses	1.2	-	1.0	-
Other	7.2	-	7.2	-
Valuation allowance	(0.4 )	-	(1.7 )	-
Total current deferred taxes	\$37.2	\$ -	\$36.9	\$ -

Noncurrent deferred income taxes consisted of (dollars in millions):

	December 31, 2012		December 31, 2013	
	Assets	Liabilities	Assets	Liabilities
Accelerated depreciation	\$-	\$ 9.2	\$-	\$ 11.2
Stock-based compensation	6.4	-	4.8	-
Goodwill and intangibles	-	22.8	-	25.4
Net operating losses	6.7	-	8.0	-
Other	8.5	0.1	7.5	-
Valuation allowances	(0.6 )	-	(2.4 )	-
Total noncurrent deferred taxes	\$21.0	32.1	\$17.9	36.6
Noncurrent deferred taxes, net		\$ 11.1		\$ 18.7

As of December 31, 2012 and December 31, 2013, the Corporation had no reserves recorded as a liability for unrecognized tax benefits for U.S. federal and state tax jurisdictions. There were no unrecognized tax benefits at December 31, 2013 that, if recognized, would affect the tax rate.

It is the Corporation's policy to accrue interest and penalties related to liabilities for income tax contingencies in the provision for income taxes. As of December 31, 2013, the Corporation had no accrued interest or penalties related to uncertain tax positions.

The federal statute of limitations remains open for tax years 2010 through 2012. The Corporation's consolidated U.S. income tax returns for 2010 and 2011 are currently under examination by the IRS.

State tax jurisdictions generally have statutes of limitation ranging from three to five years. The Corporation is no longer subject to state and local income tax examinations by tax authorities for years before 2007. 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. Kindred Healthcare, Inc. ("Kindred") and AmerisourceBergen are responsible for any taxes that relate to periods before July 31, 2007.



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## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 12—EARNINGS PER SHARE

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

	2011	2012	2013
Numerator:			
Numerator for basic and earnings per diluted share—net income	\$23.4	\$22.9	\$18.9
Denominator:			
Denominator for basic earnings per share—weighted average shares	29,343,221	29,471,734	29,601,199
Effective of dilutive securities (stock options, restricted units and performance share units)	125,231	430,162	474,500
Denominator for earnings per diluted share - adjusted weighted average shares	29,468,452	29,901,896	30,075,699
Basic earnings per share	\$0.80	\$0.78	\$0.64
Earnings per diluted share	\$0.79	\$0.77	\$0.63
Unexercised employee stock options and unvested restricted shares excluded from the effect of dilutive securities above (a)	2,594,643	2,574,284	1,417,272

(a) These unexercised employee stock options and nonvested restricted shares were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the periods presented.

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

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

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## PHARMERICA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 13—UNAUDITED QUARTERLY FINANCIAL INFORMATION

The quarterly interim information shown below has been prepared by the Corporation's management and is unaudited. It should be read in conjunction with the audited consolidated financial statements appearing herein (dollars in millions, except per share amounts).

	2012 Quarters				2013 Quarters			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Revenue	\$498.9	\$458.5	\$442.0	\$433.2	\$439.8	\$430.8	\$436.8	\$450.5
Cost of goods sold	426.3	382.6	365.9	357.6	355.5	348.2	357.6	369.4
Gross profit	\$72.6	\$75.9	\$76.1	\$75.6	\$84.3	\$82.6	\$79.2	\$81.1
Operating income	\$12.0	\$15.2	\$12.3	\$9.3	\$20.0	\$21.3	\$0.6	\$13.9
Net income (loss)	\$5.6	\$7.6	\$6.0	\$3.7	\$10.5	\$10.2	\$(6.2)	\$(1) \$4.4
Earnings (loss) per common share:								
Basic	\$0.19	\$0.26	\$0.20	\$0.13	\$0.36	\$0.34	\$(0.21)	\$0.15
Diluted	\$0.19	\$0.26	\$0.20	\$0.12	\$0.35	\$0.34	\$(0.21)	\$0.15
Shares used in computing earnings (loss) per common share:								
Basic	29.4	29.5	29.5	29.5	29.6	29.7	29.7	29.5
Diluted	29.7	29.7	29.8	30.0	30.1	30.1	29.7	30.2

(1) During the third quarter 2013, the Corporation recognized losses related to settlement, litigation and other charges. See Note 6.

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. 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) 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 Annual Report on Form 10-K, 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 December 31, 2013, the Corporation's disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in the reports that the Corporation files and submits under the Exchange Act is recorded, processed, summarized and reported as and when required and such information is accumulated and communicated as appropriate to allow timely decisions regarding required disclosures.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Corporation's internal control over financial reporting during the quarter ended December 31, 2013, that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

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Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

- (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Corporation;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Corporation are being made only in accordance with authorizations of management and directors of the Corporation; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Corporation's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2013. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework (1992).

Based upon our assessment and those criteria, management has concluded that the Corporation maintained effective internal control over financial reporting as of December 31, 2013.

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The Corporation has excluded the 2013 acquisitions from its assessment of internal control over financial reporting as of December 31, 2013 because they were acquired by the Corporation in 2013. The total assets and total revenues of the 2013 acquisitions represent 6.0% and 0.7%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2013. The Corporation continues to integrate new acquisitions into corporate processes. No potential internal control changes due to new acquisitions would be considered material to, or are reasonably likely to materially affect, our internal control over financial reporting.

The effectiveness of the Corporation's internal control over financial reporting as of December 31, 2013 has been audited by KPMG LLP, our independent registered public accounting firm, who also audited our consolidated financial statements as of December 31, 2012 and 2013 and for each of the years in the three year period ended December 31, 2013 included in this Annual Report on Form 10-K, as stated in their report which appears with our accompanying consolidated financial statements.

Item 9B. Other Information

None.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this Item is incorporated herein by reference from the Corporation's definitive proxy statement to be filed no later than 120 days after December 31, 2013. We refer to this proxy statement as the 2014 Proxy Statement.

Item 11. Executive Compensation

Incorporated herein by reference from the Corporation's 2014 Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Incorporated herein by reference from the Corporation's 2014 Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Incorporated herein by reference from the Corporation's 2014 Proxy Statement.

Item 14. Principal Accounting Fees and Services.

Incorporated herein by reference from the Corporation's 2014 Proxy Statement.

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PART IV

Item 15. Exhibits

(a)

(1) All Financial Statements

Consolidated financial statements filed as part of this report are listed under Part II, Item 8 of this Form 10-K.

(2) Financial Statement Schedules

No schedules are required because either the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the accompanying consolidated financial statements or the notes thereto.

(3) Exhibits

<u>Exhibit</u> <u>No.</u>	<u>Description</u>
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2.1	Asset Purchase Agreement, dated as of September 26, 2010, by and between Chem Rx Corporation, and certain of its subsidiaries, as Seller, Chem Rx Acquisition Sub, LLC, as Buyer, and PharMerica Corporation, as Buyer's Guarantor (8)
3.1	Certificate of Incorporation of the Registrant, as amended (1)
3.2	Amended and Restated By-Laws of the Registrant (1)
3.3	Series A Junior Participating Preferred Stock Certificate of Designation (16)
3.4	Certificate of Elimination for PharMerica Corporation Series A Junior Participant Preferred Stock (13)
4.1	Specimen Common Stock Certificate of the Registrant (17)
10.1	Form CEO Stock Option Award Agreement (3) †
10.2	Form Non-Qualified Stock Option Award Agreement (3) †
10.3	Employment Agreement dated July 31, 2007 between Robert McKay and PharMerica Corporation (1) †
10.4	Employment Agreement dated August 7, 2007 between Thomas Caneris and PharMerica Corporation (1) †
10.5	Form Director Non-Qualified Stock Option Award Agreement (5) †
10.6	Form of Substitution NQSO Agreement for AmerisourceBergen 2001 Grants (1) †
10.7	Form of Substitution NQSO Agreement for AmerisourceBergen 2002 Grants (1) †
10.8	Form of Substitution NQSO Agreement for Kindred Grants (1) †

10.9 Form of Substitution ISO Agreement for Kindred Grants (1) †

10.10 Trademark License Agreement (2)

10.11 Summary of Director Compensation Program (2) †

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Exhibit No. Description

10.12	Form of Non-Qualified Stock Option Award Agreement (4) †
10.13	Form of Performance Share Award Agreement (adjusted EBITDA and adjusted ROIC) (6) †
10.14	Form of Restricted Stock Unit Award Agreement (6) †
10.15	Amended and Restated PharMerica Corporation 2007 Omnibus Incentive Plan Adopted May 26, 2010 (7) †
10.16	Form of Director Restricted Stock Unit Award Agreement (7) †
10.17	Employment Agreement dated September 30, 2010 between Gregory S. Weishar and PharMerica Corporation (8) †
10.18	Amended and Restated Prime Vendor Agreement for Long-Term Care Pharmacies dated January 4, 2011 by and between AmerisourceBergen Drug Corporation, PharMerica Corporation, Pharmacy Corporation of America and Chem Rx Pharmacy Services, LLC (10)
10.19	Amendment No. 1 to Amended and Restated Prime Vendor Agreement for Long-term Care Pharmacies, dated as of January 25, 2013, by and between AmerisourceBergen Drug Corporation, PharMerica Corporation, Pharmacy Corporation of America and Chem Rx Pharmacy Services, LLC (10)
10.20	Credit Agreement dated May 2, 2011 between PharMerica Corporation, the Lenders named therein, and Citibank, N.A., as Administrative Agent (11)
10.21	Guarantee and Collateral Agreement dated as of May 2, 2011 between PharMerica Corporation, Its subsidiaries Party thereto, and Citibank, N.A. as Collateral Agent (11)
10.22	Summary of 2011 Long-Term Incentive Program (11) †
10.23	Form of Indemnification Agreement (12)
10.24	Employment Agreement dated March 22, 2011 between Suresh Vishnubhatla and PharMerica Corporation (12) †
10.25	Summary of 2012 Long-Term Incentive Program (11) †
10.26	Employment Agreement, dated September 27, 2012, between PharMerica Corporation and Mark Lindemoen (14)
10.27	Summary of 2013 CEO Short-term Incentive Program and 2013 Short-term Incentive Program (10) †
10.28	Summary of 2013 Long-term Incentive Program (10) †
10.29	Employment Agreement, dated August 1, 2013, between PharMerica Corporation and David W. Frosel Jr. (15)
21.1	Subsidiaries of the Registrant

- 23.1 Consent of KPMG LLP
- 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.SCHXBRL Taxonomy Extension Schema Document

101.CALXBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LABXBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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- (1) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 31, 2007, and incorporated herein by reference.
  - (2) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 9, 2007, and incorporated herein by reference.
  - (3) Filed with the Corporation's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 13, 2007, and incorporated herein by reference.
  - (4) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 8, 2008, and incorporated herein by reference.
  - (5) Filed with the Corporation's Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 5, 2009, and incorporated herein by reference.
  - (6) Filed with the Corporation's Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 4, 2010, and incorporated herein by reference.
  - (7) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 5, 2010, and incorporated herein by reference.
  - (8) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 4, 2010, and incorporated herein by reference.
  - (9) Filed with the Corporation's Annual Report on Form 10-K/A filed with the Securities and Exchange Commission on May 25, 2011, and incorporated herein by reference.
  - (10) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 1, 2013, and incorporated herein by reference.
  - (11) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 4, 2011, and incorporated herein by reference.
  - (12) Filed with the Corporation's Schedule 14D-9 filed with the Securities and Exchange Commission on September 20, 2011, and incorporated herein by reference.
  - (13) Filed with the Corporation's Current Report on Form 8-K file with the Securities and Exchange Commission on April 2, 2012, and incorporated herein by reference.
  - (14) Filed with the Corporation's Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 7, 2013, and incorporated herein by reference.
  - (15) Filed with the Corporation's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 5, 2013, and incorporated herein by reference.
  - (16) Filed with the Corporation's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 25, 2011, and incorporated herein by reference.
  - (17) Filed with Amendment No. 2 to the Corporation's Registration Statement on Form S-4/S-1 (Reg. No 333-142940) filed with the Securities and Exchange Commission on June 27, 2007, and incorporated herein by reference.
- Management contract or compensatory plan or arrangement.

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## SIGNATURES

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

## PHARMERICA CORPORATION

Date: February 28, 2014 By: /S/ GREGORY S. WEISHAR  
 Gregory S. Weishar  
 Chief Executive Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
/S/ GREGORY S. WEISHAR (Gregory S. Weishar)	Chief Executive Officer and Director	February 28, 2014
/S/ DAVID W. FROESEL, JR. (David W. Froesel, Jr.)	Executive Vice President, Chief Financial Officer and Treasurer	February 28, 2014
/S/ BERARD E. TOMASSETTI (Berard E. Tomassetti)	Senior Vice President and Chief Accounting Officer	February 28, 2014
/S/ FRANK E. COLLINS (Frank E. Collins)	Director	February 28, 2014
/S/ W. ROBERT DAHL JR. (W. Robert Dahl Jr.)	Director	February 28, 2014
/S/ MARJORIE W. DORR (Marjorie W. Dorr)	Director	February 28, 2014
/S/ DR. THOMAS P. GERRITY (Dr. Thomas P. Gerrity)	Director	February 28, 2014
/S/ THOMAS P. MAC MAHON (Thomas P. Mac Mahon)	Director	February 28, 2014
/S/ GEOFFREY G. MEYERS (Geoffrey G. Meyers)	Director	February 28, 2014
/S/ DR. ROBERT A. OAKLEY (Dr. Robert A. Oakley)	Director	February 28, 2014
/S/ PATRICK G. LEPORE (Patrick G. LePore)	Director	February 28, 2014

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EXHIBIT INDEX

Exhibit No.	Description
<u>21.1</u>	Subsidiaries of the Registrant
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101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.