

PharMerica CORP
Form 10-Q
August 05, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2010

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____.

Commission File Number: 001-33380

PHARMERICA CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of

Incorporation or Organization)

1901 Campus Place

Louisville, KY

87-0792558
(I.R.S. Employer

Identification No.)

40299

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(Address of Principal Executive Offices)

(Zip Code)

(502) 627-7000

(Registrant's Telephone Number, Including Area Code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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

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

Class of Common Stock	Outstanding at July 30, 2010
Common stock, \$0.01 par value	30,646,597 shares

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PHARMERICA CORPORATION

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2010	2009	2010
Revenues	\$ 460.6	\$ 450.5	\$ 928.8	\$ 912.7
Cost of goods sold	391.0	392.9	787.0	791.8
Gross profit	69.6	57.6	141.8	120.9
Selling, general and administrative expenses	48.0	43.0	99.7	87.8
Amortization expense	1.9	2.4	3.7	4.7
Integration, merger and acquisition related costs and other charges	0.6	9.2	2.6	10.4
Operating income	19.1	3.0	35.8	18.0
Interest expense, net	3.3	0.8	6.5	1.7
Income before income taxes	15.8	2.2	29.3	16.3
Provision for income taxes	6.6	0.9	11.9	6.6
Net income	\$ 9.2	\$ 1.3	\$ 17.4	\$ 9.7
Earnings per common share:				
Basic	\$ 0.30	\$ 0.04	\$ 0.58	\$ 0.32
Diluted	\$ 0.30	\$ 0.04	\$ 0.57	\$ 0.32
Shares used in computing earnings per common share:				
Basic	30,231,797	30,421,549	30,221,804	30,409,104
Diluted	30,366,640	30,605,727	30,330,992	30,576,479

See accompanying Notes to Condensed Consolidated Financial Statements

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PHARMERICA CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

As of December 31, 2009 and June 30, 2010

(Unaudited)

(In millions, except share and per share amounts)

	December 31, 2009	June 30, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 51.2	\$ 91.2
Accounts receivable, net	215.3	200.5
Inventory	79.8	78.3
Deferred tax assets	39.8	40.9
Prepays and other assets	23.6	21.3
	409.7	432.2
Equipment and leasehold improvements	119.6	124.3
Accumulated depreciation	(59.0)	(68.0)
	60.6	56.3
Deferred tax assets, net	21.0	14.3
Goodwill	140.1	140.4
Intangible assets, net	90.8	86.6
Other	2.1	1.4
	\$ 724.3	\$ 731.2
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 59.6	\$ 54.9
Salaries, wages and other compensation	30.9	26.6
Other accrued liabilities	6.4	6.1
	96.9	87.6
Long-term debt	240.0	240.0
Other long-term liabilities	16.5	20.2
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, 2009 and June 30, 2010	-	-
Common stock, \$0.01 par value per share; 175,000,000 shares authorized; 30,619,830 shares and 30,646,597 shares issued and outstanding as of December 31, 2009 and June 30, 2010, respectively	0.3	0.3
Capital in excess of par value	344.8	347.6
Retained earnings	25.8	35.5
	370.9	383.4
	\$ 724.3	\$ 731.2

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See accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents**PHARMERICA CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****For the Three Months and Six Months Ended June 30, 2009 and 2010****(Unaudited)****(In millions)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2010	2009	2010
Cash flows provided by operating activities:				
Net income	\$ 9.2	\$ 1.3	\$ 17.4	\$ 9.7
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation	4.2	4.7	8.9	9.3
Amortization	1.9	2.4	3.7	4.7
Integration, merger and acquisition related costs and other charges	-	0.4	0.2	0.5
Stock-based compensation	1.3	1.7	1.9	2.5
Amortization of deferred financing fees	0.1	0.1	0.2	0.3
Deferred income taxes	6.8	0.9	11.6	5.7
Loss on disposition of equipment	-	0.1	0.1	0.1
Other	-	(0.1)	(0.1)	-
Change in operating assets and liabilities:				
Accounts receivable, net	8.1	3.5	8.7	14.6
Inventory and other assets	1.1	(1.2)	2.5	1.4
Prepays and other assets	0.2	(1.2)	3.3	2.6
Accounts payable	0.2	6.8	(7.8)	(4.7)
Salaries, wages and other compensation	(1.0)	(1.9)	(6.0)	(4.7)
Other accrued and long-term liabilities	(3.3)	3.1	(1.9)	3.3
Net cash provided by operating activities	28.8	20.6	42.7	45.3
Cash flows used in investing activities:				
Purchases of equipment and leasehold improvements	(3.3)	(2.9)	(6.5)	(5.1)
Other	0.1	-	0.1	(0.1)
Net cash used in investing activities	(3.2)	(2.9)	(6.4)	(5.2)
Cash flows provided by (used in) financing activities:				
Repayments of capital lease obligations	(0.2)	(0.2)	(0.3)	(0.4)
Issuance of common stock	0.2	0.2	0.3	0.3
Tax benefit from stock-based compensation	-	-	0.1	-
Net cash provided by (used in) financing activities	-	-	0.1	(0.1)
Change in cash and cash equivalents	25.6	17.7	36.4	40.0
Cash and cash equivalents at beginning of period	52.1	73.5	41.3	51.2
Cash and cash equivalents at end of period	\$ 77.7	\$ 91.2	\$ 77.7	\$ 91.2
Supplemental information:				
Cash paid for interest	\$ 3.2	\$ 0.7	\$ 6.5	\$ 1.5
Cash paid for taxes	\$ 1.1	\$ 0.5	\$ 1.4	\$ 0.3

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Supplemental schedule of non-cash activities:

Capital lease obligations	\$	-	\$	-	\$	1.8	\$	0.4
Integrity purchase accounting adjustments (Note 2)	\$	-	\$	(0.3)	\$	-	\$	0.2

See accompanying Notes to Condensed Consolidated Financial Statements

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PHARMERICA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the Six Months Ended June 30, 2010

(Unaudited)

(In millions, except share amounts)

	Common Stock		Capital in Excess of Par Value	Retained Earnings	Total
	Shares	Amount			
Balance at December 31, 2009	30,619,830	\$ 0.3	\$ 344.8	\$ 25.8	\$ 370.9
Comprehensive income:					
Net income				9.7	9.7
Total comprehensive income				9.7	9.7
Vested performance share units	4,695	-	-	-	-
Exercise of stock options	22,072	-	0.3	-	0.3
Stock-based compensation - restricted stock	-	-	1.3	-	1.3
Stock-based compensation - stock options	-	-	1.2	-	1.2
Balance at June 30, 2010	30,646,597	\$ 0.3	\$ 347.6	\$ 35.5	\$ 383.4

See accompanying Notes to Condensed Consolidated Financial Statements

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

PharMerica Corporation (the Corporation) is an institutional pharmacy services company that services healthcare facilities and provides pharmacy management services to hospitals. The Corporation is the second largest institutional pharmacy services company in the United States, operating 90 institutional pharmacies in 41 states. The Corporation's customers are typically institutional healthcare providers, such as nursing centers, assisted living facilities, hospitals and other long-term alternative care settings and generally the primary source of supply of pharmaceuticals to its customers. The Corporation also provides pharmacy management services to 89 hospitals in the United States.

Principles of Consolidation

All intercompany transactions have been eliminated.

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information and disclosures required by generally accepted accounting principles in the United States (U.S. GAAP) for complete financial statements. Accordingly, the accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements of the Corporation and related footnotes for the year ended December 31, 2009, included in the Corporation's Annual Report on Form 10-K. The balance sheet as of December 31, 2009 has been derived from the audited consolidated financial statements as of that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

The results of operations for the interim periods are not necessarily indicative of results of operations for a full year. It is the opinion of management that all necessary adjustments for a fair presentation of the condensed consolidated income statements, balance sheets, cash flows, and stockholders' equity for the interim periods have been made and are of a normal recurring nature.

Use of Estimates

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. GAAP which require 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates are involved in collectibility of accounts receivable, revenue recognition, inventory valuation, supplier rebates, the valuation of long-lived assets and goodwill, accounting for income taxes and stock-based compensation. 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; delays and reductions in reimbursement by the government and other payers to the Corporation and/or its customers; the overall financial condition of the Corporation's customers; the effect of new government regulations, executive orders and/or legislative initiatives, including those relating to reimbursement and drug pricing policies and changes in the interpretation and application of such policies; efforts by payers to control costs; the outcome of litigation; the outcome of audit, compliance, administrative or investigatory reviews, including governmental/ regulatory inquiries; delays or difficulties in integrating acquired businesses; other contingent liabilities; changes in international economic and political conditions; changes in interest rates; changes in the valuation of the Corporation's financial instruments; changes in tax laws and regulations; access to capital and financing; the demand for the Corporation's products and services; pricing and other competitive factors in the industry; changes in manufacturers' rebate programs; shifts in demand for generic drug equivalents; changes in insurance claims experience and related assumptions; variations in costs or expenses; and changes in accounting rules and standards.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

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, 2009 and June 30, 2010, the Corporation did not hold a material amount of funds in cash equivalent money market accounts. Management believes it effectively safeguards cash assets given current economic conditions.

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 reporting entity 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).

Financial liabilities disclosed at fair value at December 31, 2009 and June 30, 2010, are set forth in the tables below (dollars in millions):

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As of June 30, 2010	Liabilities	Level 1	Level 2	Level 3	Valuation Technique
Deferred Compensation Plan	\$ 3.2	\$ -	\$ 3.2	\$ -	A
Contingent Consideration	\$ 1.7	\$ -	\$ -	\$ 1.7	C

As of December 31, 2009	Liabilities	Level 1	Level 2	Level 3	Valuation Technique
Deferred Compensation Plan	\$ 2.9	\$ -	\$ 2.9	\$ -	A
Contingent Consideration	\$ 1.7	\$ -	\$ -	\$ 1.7	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 our acquisition of an institutional pharmacy business based in West Virginia (West Virginia Acquisition). The fair value of the liability associated with the contingent consideration is derived using the income approach with unobservable inputs, which include future gross profit forecast and present value assumptions, and there is 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 condensed consolidated balance sheets for cash and cash equivalents, accounts receivable, inventory and accounts payable approximate fair value because of the short-term maturity of these instruments. The Corporation's debt approximates fair value due to the terms of the interest being set at variable market interest rates.

Table of Contents**PHARMERICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)***Accounts Receivable and Allowance for Doubtful Accounts*

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

The Corporation has an established process to determine the adequacy of the allowance for doubtful accounts, which relies on analytical tools, specific identification, and benchmarks to arrive at a reasonable allowance. No single statistic or measurement determines the adequacy of the allowance for doubtful accounts. In evaluating the collectibility of accounts receivable, the Corporation considers a number of factors, which include, but are not limited to, the impact of changes in the regulatory and payer environment, historical trends, the financial viability of the payer, contractual reimbursement terms and other factors that may impact ultimate reimbursement. Accounts receivable are written off after collection efforts have been completed in accordance with the Corporation's policies.

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

	December 31, 2009	June 30, 2010
Institutional healthcare providers	\$ 138.7	\$ 137.9
Medicare Part D	60.2	41.5
Private payor and other	34.5	35.6
Insured	9.7	8.6
Medicaid	10.9	12.3
Medicare	1.5	1.7
Allowance for doubtful accounts	(40.2)	(37.1)
	\$ 215.3	\$ 200.5
0 to 60 days	64.9 %	65.7 %
61 to 120 days	17.1 %	18.0 %
Over 120 days	18.0 %	16.3 %
	100.0 %	100.0 %

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

Beginning Balance	Acquisitions/ Transfers	Charges to Costs and	Write-offs	Ending Balance
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Expenses

Allowance for doubtful accounts:						
Year Ended December 31, 2009	\$ 46.5	\$ 3.5	\$ 16.6	\$ (26.4)	\$ 40.2	
Six Months Ended June 30, 2010	\$ 40.2	\$ -	\$ 8.5	\$ (11.6)	\$ 37.1	

The allowance for doubtful accounts for 2009 included a transfer of reserves on contractual adjustments into the allowance for doubtful accounts during the period. The reclassification did not impact the provision for bad debt.

Concentration of Credit Risk

For the three months and six months ended June 30, 2009 and 2010, the Corporation derived approximately 15.0% of its revenues from a single customer, 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.

Table of Contents**PHARMERICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)***Inventory*

Inventory is primarily located at the Corporation's institutional 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 on a quarterly basis at the end of the quarter at all pharmacy sites. Cost of goods sold is recorded based upon the actual results of the physical inventory counts.

Equipment and Leasehold Improvements

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

	Estimated Useful Lives
Leasehold improvements	1-7
Equipment and software	3-10
Leased equipment	1-5

Expenditures for maintenance, repairs and renewals of minor items are expensed as incurred. Major rebuilds and improvements are capitalized. For the three months ended June 30, 2009 and 2010, maintenance and repairs were \$1.7 million and \$1.5 million, respectively. For the six months ended June 30, 2009 and 2010, maintenance and repairs were \$3.3 million and \$2.9 million, respectively.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets is assessed by a comparison of the carrying amount of the asset to the estimated future undiscounted net cash flows expected to be generated by the asset. 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 to its then fair value. The Corporation did not record impairment charges on equipment and leasehold improvements for the six months ended June 30, 2009 and 2010.

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 include costs to design the software configuration and interfaces, coding, installation, and testing. Costs incurred during the preliminary project along with post-implementation stages of internal use computer software are expensed as incurred. Capitalized development costs are amortized over various periods up to 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 three months ended June 30, 2009 and 2010, the Corporation capitalized software development costs of \$0.7 million and \$0.6 million, respectively. For the six months ended June 30, 2009 and 2010, the Corporation capitalized software development costs of \$1.2 million. As of December 31, 2009 and June 30, 2010, net capitalized software costs, including amounts for projects which have not been completed, totaled \$9.5 million and \$9.1 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. Goodwill and intangible assets with indefinite lives are reviewed by the Corporation at least annually for impairment, each of which are reviewed separately for impairment. The Corporation's business is comprised of two reporting units, institutional pharmacy and hospital management, each of which are reviewed separately for impairment. The Corporation performed its annual impairment tests for goodwill recorded as of December 31, 2009, and did not incur an impairment charge.

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PHARMERICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

The Corporation's finite-lived intangible assets are comprised primarily of trade names, customer relationship assets and non-compete agreements primarily originating from business acquisitions. Finite-lived intangible assets are amortized on a straight-line basis over the terms of the agreements 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 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 the three months ended June 30, 2009 and 2010, the expense for employee health benefits were \$4.4 million and \$4.6 million, respectively, and for the six months ended June 30, 2009 and 2010, the expense for employee health benefits were \$8.6 million and \$9.4 million, respectively. As of December 31, 2009 and June 30, 2010, the Corporation had \$2.5 million and \$2.6 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. The Corporation generally accounts for these rebates and other incentives received from its vendors and suppliers, relating to the purchase or distribution of inventory, as a reduction of cost of goods sold and inventory. The Corporation considers these rebates to represent product discounts, and as a result, the rebates are capitalized as a reduction of product cost and relieved through cost of goods sold upon the sale of the related inventory. For the three months ended June 30, 2009 and 2010, rebates were \$11.6 million and \$13.0 million, respectively, and for the six months ended June 30, 2009 and 2010, rebates were \$22.1 million and \$26.4 million, respectively. The Corporation had \$3.0 million and \$3.4 million of rebates capitalized in inventory as of December 31, 2009 and June 30, 2010, respectively.

Delivery Expenses

The Corporation incurred delivery expenses of \$13.7 million and \$14.7 million for the three months ended June 30, 2009 and 2010, respectively, and \$27.3 million and \$29.3 million for the six months ended June 30, 2009 and 2010, respectively, to deliver products sold to its customers. Delivery expenses are reported as a component of cost of goods sold in the accompanying condensed consolidated income statements.

Stock Option Accounting

The Corporation recognizes stock-based compensation expense in its condensed consolidated financial statements using a Black-Scholes-Merton model for non-vested stock options. See Note 9.

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 10.

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Pharmacy Transaction

The Corporation, formerly known as Safari Holding Corporation, was formed on October 23, 2006, by Kindred Healthcare, Inc. (Kindred or Former Parent) and AmerisourceBergen Corporation (AmerisourceBergen) for the purpose of consummating the transactions contemplated by the Master Transaction Agreement dated October 25, 2006, as amended (the Master Agreement). Pursuant to the Master Agreement, Kindred and AmerisourceBergen, through a series of transactions (collectively, the Pharmacy Transaction), spun-off and combined their respective institutional pharmacy businesses, Kindred Pharmacy Services (KPS) and PharMerica Long-Term Care (PharMerica LTC), into a new, stand-alone, publicly traded company. The Pharmacy Transaction was consummated on July 31, 2007 (the Closing Date).

Table of Contents**PHARMERICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 2 ACQUISITIONS***2009 Acquisitions**Integrity Pharmacy Services Acquisition*

On December 31, 2009, the Corporation through a wholly-owned subsidiary, acquired all of the membership interests in Integrity Pharmacy Services, LLC (IPS), and Integrity Medical Supplies, LLC (IMS together with IPS, Integrity), for \$38.0 million in cash plus \$3.3 million to retire outstanding promissory notes in favor of the sellers. The Corporation's primary purpose in acquiring Integrity was to increase the Corporation's market share in certain regions.

The acquisition of Integrity has been accounted for as a business combination using the acquisition method of accounting. The total purchase price of Integrity was allocated to the net tangible and identifiable intangible assets based upon their fair values on December 31, 2009. The excess of the purchase price over the fair values of the net tangible and identifiable intangible assets was recorded as goodwill. For tax purposes, the transaction was considered an asset acquisition, therefore, the amount of goodwill recorded in the transaction of \$12.0 million will be tax deductible to the Corporation. The Corporation believes the resulting amount of goodwill reflects its expectations of the synergistic benefits of being able to fully integrate the Integrity business into its existing institutional pharmacy locations.

Except for identifiable intangible assets, and equipment and leasehold improvements, the assets acquired and liabilities assumed were valued at their respective carrying amounts recorded by Integrity as the Corporation believes that their carrying value amounts approximate their fair value at the acquisition date.

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

Current assets, net of cash acquired	\$	9.8
Equipment and leasehold improvements		1.2
Identifiable intangible assets		20.6
Goodwill		12.0
Total assets		43.6
Current liabilities		(4.4)
Purchase price, net of cash acquired	\$	39.2

The following are the fair values of the equipment and leasehold improvements of Integrity acquired at the date of acquisition (dollars in millions):

	Fair Value	Weighted Average Useful Lives
Leasehold improvements	\$ 0.3	7.0
Equipment and software	0.9	4.0
Total equipment and leasehold improvements acquired	\$ 1.2	5.1

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

	Fair Value	Weighted Average Useful Lives
Non-competition agreement	\$ 0.2	5.0
Customer relationships	20.4	15.0
Total identifiable intangible assets acquired	\$ 20.6	14.9

Table of Contents**PHARMERICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 2 ACQUISITIONS (Continued)***West Virginia Acquisition*

On August 10, 2009, the Corporation acquired certain assets and assumed certain liabilities of an institutional pharmacy business providing medications, pharmacy and medical supplies and services to residents of long-term care facilities located mostly in West Virginia. The Corporation paid \$15.9 million in cash for the business, with an additional amount not to exceed \$10.0 million in the form of contingent consideration to be paid at the end of a three year period based upon the cumulative achievement of certain financial performance measures. The transaction was accounted for under the acquisition method of accounting, in which the preliminary purchase price was allocated based upon the fair value of the assets acquired and liabilities assumed with the difference recorded as goodwill. As a result of the acquisition the Corporation recorded \$4.4 million as finite-lived intangible assets and \$12.6 million of goodwill. The contingent consideration was recorded at fair value at the acquisition date in the amount of \$1.7 million. The contingent consideration will be adjusted to fair value through earnings until the final amount is determined.

Other

For the three months and six months ended June 30, 2010, the Corporation incurred \$2.3 million and \$2.9 million, respectively, of acquisition related costs, which have been classified as a component of integration, merger, acquisition related costs and other charges. For the three months and six months ended June 30, 2009, \$0.1 million was incurred for acquisition related costs.

The total amount of goodwill expected to be deductible for tax purposes from past acquisitions of the Corporation was \$92.4 million as of June 30, 2010. Deferred tax assets and liabilities are further described in Note 10.

Pro forma

The following unaudited pro forma consolidated financial information is not intended to represent or be indicative of the consolidated results of operations or financial condition of the Corporation that would have been reported had the acquisitions been completed as of the date or for the periods presented, and should not be taken as representative of the future consolidated results of operations or financial condition of the Corporation.

The unaudited pro forma effect of the Integrity Pharmacy Services and West Virginia acquisitions assuming the acquisitions occurred on January 1, 2009, excluding the integration, merger and acquisition related costs and other charges for the three months and six months ended June 30, 2009, would be as follows (dollars in millions, except per share amounts):

	Three Months Ended June 30, 2009	Six Months Ended June 30, 2009
Revenues	\$ 483.3	\$ 973.3
Net income	\$ 10.1	\$ 20.0
Earnings per common share:		
Basic	\$ 0.33	\$ 0.66
Diluted	\$ 0.33	\$ 0.66

Table of Contents**PHARMERICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 3 EQUIPMENT AND LEASEHOLD IMPROVEMENTS**

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

	December 31, 2009	June 30, 2010
Leasehold improvements	\$ 11.6	\$ 12.1
Equipment and software	95.3	99.8
Leased equipment	2.6	3.0
Construction in progress	10.1	9.4
	119.6	124.3
Accumulated depreciation	(59.0)	(68.0)
Total Equipment and leasehold improvements	\$ 60.6	\$ 56.3

The following is a progression of equipment and leasehold improvements for the period presented (dollars in millions):

	Balance at December 31, 2009	Additions	Disposals	Transfers	Balance at June 30, 2010
Equipment and leasehold improvements:					
Leasehold improvements	\$ 11.6	\$ 0.3	\$ -	\$ 0.2	\$ 12.1
Equipment and software	95.3	3.5	(0.8)	1.8	99.8
Leased equipment	2.6	0.4	-	-	3.0
Construction in progress	10.1	1.3	-	(2.0)	9.4
Sub-Total	119.6	5.5	(0.8)	-	124.3
Accumulated depreciation	(59.0)	(9.3)	0.3	-	(68.0)
Total	\$ 60.6	\$ (3.8)	\$ (0.5)	\$ -	\$ 56.3

Depreciation expense totaled \$4.2 million and \$4.7 million for the three months ended June 30, 2009 and 2010, respectively. Depreciation expense totaled \$8.9 million and \$9.3 million for the six months ended June 30, 2009 and 2010, respectively.

Total estimated depreciation expense for the Corporation's equipment and leasehold improvements for the current year and next four years and thereafter are as follows (dollars in millions):