

MCKESSON CORP
Form 10-Q
January 26, 2010

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 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 December 31, 2009

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

For the transition period from _____ to _____

Commission File Number: 1-13252

McKESSON CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware

**(State or other jurisdiction of incorporation or
organization)**

94-3207296

(IRS Employer Identification No.)

One Post Street, San Francisco, California

(Address of principal executive offices)

94104

(Zip Code)

(415) 983-8300

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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. (Check one):

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
Common stock, \$0.01 par value

Outstanding as of December 31, 2009
269,392,477 shares

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McKESSON CORPORATION
PART I. FINANCIAL INFORMATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except per share amounts)
(Unaudited)

| | Quarter Ended | | Nine Months Ended | |
|-------------------------------------|----------------------|-------------|--------------------------|-------------|
| | December 31, | | December 31, | |
| | 2009 | 2008 | 2009 | 2008 |
| Revenues | \$ 28,272 | \$ 27,130 | \$ 82,059 | \$ 80,408 |
| Cost of Sales | 26,817 | 25,787 | 77,966 | 76,495 |
| Gross Profit | 1,455 | 1,343 | 4,093 | 3,913 |
| Operating Expenses | 946 | 904 | 2,678 | 2,722 |
| Litigation Charge (Credit) | | 493 | (20) | 493 |
| Total Operating Expenses | 946 | 1,397 | 2,658 | 3,215 |
| Operating Income (Loss) | 509 | (54) | 1,435 | 698 |
| Other Income, Net | 25 | 17 | 39 | 71 |
| Interest Expense | (47) | (33) | (142) | (102) |
| Income (Loss) Before Income Taxes | 487 | (70) | 1,332 | 667 |
| Income Tax (Expense) Benefit | (161) | 50 | (417) | (125) |
| Net Income (Loss) | \$ 326 | \$ (20) | \$ 915 | \$ 542 |
| Earnings (Loss) Per Common Share | | | | |
| Diluted | \$ 1.19 | \$ (0.07) | \$ 3.36 | \$ 1.94 |
| Basic | \$ 1.21 | \$ (0.07) | \$ 3.41 | \$ 1.97 |
| Dividends Declared Per Common Share | \$ 0.12 | \$ 0.12 | \$ 0.36 | \$ 0.36 |
| Weighted Average Shares | | | | |
| Diluted | 274 | 274 | 272 | 279 |
| Basic | 269 | 274 | 269 | 275 |

See Financial Notes

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McKESSON CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions, except per share amounts)
(Unaudited)

| | December 31, 2009 | March 31, 2009 |
|---|------------------------------|---------------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 3,428 | \$ 2,109 |
| Receivables, net | 8,319 | 7,774 |
| Inventories, net | 8,842 | 8,527 |
| Prepaid expenses and other | 265 | 261 |
| Total | 20,854 | 18,671 |
| Property, Plant and Equipment, Net | 835 | 796 |
| Capitalized Software Held for Sale, Net | 236 | 221 |
| Goodwill | 3,559 | 3,528 |
| Intangible Assets, Net | 580 | 661 |
| Other Assets | 1,475 | 1,390 |
| Total Assets | \$ 27,539 | \$ 25,267 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current Liabilities | | |
| Drafts and accounts payable | \$ 13,021 | \$ 11,739 |
| Deferred revenue | 1,250 | 1,145 |
| Current portion of long-term debt | 217 | 219 |
| Other accrued liabilities | 2,430 | 2,503 |
| Total | 16,918 | 15,606 |
| Long-Term Debt | 2,294 | 2,290 |
| Other Noncurrent Liabilities | 1,204 | 1,178 |
| Other Commitments and Contingent Liabilities (Note 12) | | |
| Stockholders Equity | | |
| Preferred stock, \$0.01 par value, 100 shares authorized, no shares issued or outstanding | | |
| Common stock, \$0.01 par value | | |
| Shares authorized: December 31, 2009 and March 31, 2009 800 | | |
| Shares issued: December 31, 2009 357 and March 31, 2009 351 | 4 | 4 |
| Additional Paid-in Capital | 4,644 | 4,417 |
| Retained Earnings | 6,921 | 6,103 |
| Accumulated Other Comprehensive Income (Loss) | 23 | (179) |
| Other | (12) | (8) |

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| | | | | |
|---|----|--------------------|-----------|-----------|
| Treasury Shares, at Cost, December 31, 2009 | 88 | and March 31, 2009 | | |
| 80 | | | (4,457) | (4,144) |
| Total Stockholders' Equity | | | 7,123 | 6,193 |
| Total Liabilities and Stockholders' Equity | | | \$ 27,539 | \$ 25,267 |

See Financial Notes

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

| | Nine Months Ended December | |
|--|-----------------------------------|-------------|
| | 31, | |
| | 2009 | 2008 |
| Operating Activities | | |
| Net income | \$ 915 | \$ 542 |
| Adjustments to reconcile to net cash provided by operating activities: | | |
| Depreciation and amortization | 350 | 330 |
| Other deferred taxes | 73 | 76 |
| Income tax reserve reversals | | (65) |
| Share-based compensation expense | 83 | 72 |
| Other non-cash items | (7) | (7) |
| Changes in operating assets and liabilities, net of business acquisitions: | | |
| Receivables | (415) | (881) |
| Impact of accounts receivable sales facility | | 350 |
| Inventories | (205) | (490) |
| Drafts and accounts payable | 1,131 | 384 |
| Deferred revenue | 57 | 88 |
| Taxes | 95 | 107 |
| Litigation charge (credit) | (20) | 493 |
| Deferred tax (benefit) expense on litigation charge (credit) | 116 | (182) |
| Litigation settlement payments | (350) | |
| Other | (98) | (83) |
| Net cash provided by operating activities | 1,725 | 734 |
| Investing Activities | | |
| Property acquisitions | (137) | (151) |
| Capitalized software expenditures | (134) | (137) |
| Acquisitions of businesses, less cash and cash equivalents acquired | (18) | (320) |
| Restricted cash for litigation charge | 55 | |
| Other | 31 | 76 |
| Net cash used in investing activities | (203) | (532) |
| Financing Activities | | |
| Proceeds from short-term borrowings | 5 | 3,602 |
| Repayments of short-term borrowings | (6) | (3,602) |
| Common stock transactions - issuances | 159 | 77 |
| Common stock share repurchases, including shares surrendered for tax withholding | (322) | (147) |
| Common stock share repurchases, retirements | | (204) |
| Common stock transactions - other | 26 | 10 |
| Dividends paid | (98) | (83) |
| Other | (1) | (2) |

| | | |
|--|----------|----------|
| Net cash used in financing activities | (237) | (349) |
| Effect of exchange rate changes on cash and cash equivalents | 34 | (40) |
| Net increase (decrease) in cash and cash equivalents | 1,319 | (187) |
| Cash and cash equivalents at beginning of period | 2,109 | 1,362 |
| Cash and cash equivalents at end of period | \$ 3,428 | \$ 1,175 |

See Financial Notes

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**McKESSON CORPORATION
FINANCIAL NOTES
(UNAUDITED)**

1. Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements of McKesson Corporation (McKesson, the Company, or we and other similar pronouns) include the financial statements of all wholly-owned subsidiaries, majority-owned or controlled companies and certain immaterial variable interest entities (VIEs) of which the Company is the primary beneficiary. Intercompany transactions and balances have been eliminated. The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial reporting and the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Accordingly, certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with GAAP have been condensed.

In accordance with the applicable sections of Accounting Standards Codification (ASC or Codification) 810, Consolidation, the Company evaluates its ownership, contractual and other interests in entities to determine if they are VIEs, if it has a variable interest in those entities and the nature and extent of those interests. These evaluations are highly complex and involve judgment and the use of estimates and assumptions based on available historical information and management s estimates, among other factors.

To prepare the financial statements in conformity with GAAP, management must make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of these financial statements and income and expenses during the reporting period. Actual amounts may differ from these estimated amounts. In our opinion, these unaudited condensed consolidated financial statements include all adjustments necessary for a fair presentation of the Company s financial position as of December 31, 2009, the results of operations for the quarters and nine months ended December 31, 2009 and 2008 and cash flows for the nine months ended December 31, 2009 and 2008.

The results of operations for the quarter and nine months ended December 31, 2009 are not necessarily indicative of the results that may be expected for the entire year. These interim financial statements should be read in conjunction with the annual audited financial statements, accounting policies and financial notes included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009 (2009 Annual Report) previously filed with the SEC on May 5, 2009. Certain prior period amounts have been reclassified to conform to the current period presentation.

The Company s fiscal year begins on April 1 and ends on March 31. Unless otherwise noted, all references to a particular year shall mean the Company s fiscal year.

The Company evaluated all subsequent events that occurred after the balance sheet date through the date and time our financial statements were issued on January 26, 2010.

Significant Accounting Policies Update

The Company has disclosed its significant accounting policies in Financial Note 1, Significant Accounting Policies, included in the 2009 Annual Report. The following significant accounting policy provides an update to the policy included under the same caption in the Company s Annual Report on Form 10-K.

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McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

Revenue Recognition: The Company's Distribution Solutions segment engages in multiple-element arrangements which may contain a combination of various products and services. Revenue from a multiple element arrangement is allocated to the separate elements based on estimates of fair value and recognized in accordance with the revenue recognition criteria applicable to each element. If fair value cannot be established for any undelivered element, all of the arrangement's revenue is deferred until delivery of the last element has occurred and services have been performed or until fair value can objectively be determined for any remaining undelivered elements.

Recently Adopted Accounting Pronouncements

On July 1, 2009, we adopted Accounting Standards Update (ASU) No. 2009-1, Topic 105 Generally Accepted Accounting Principles, which amended ASC 105, Generally Accepted Accounting Principles, to establish the Codification as the source of authoritative GAAP recognized by the Financial Accounting Standards Board (FASB) to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date, the Codification superseded all then-existing non-SEC accounting and reporting standards. All previous references to the superseded standards in our consolidated financial statements have been replaced by references to the applicable sections of the Codification. The adoption of these sections did not have a material impact on our consolidated financial statements.

ASC 820, Fair Value Measurements and Disclosures, provides a consistent definition of fair value that focuses on exit price, prioritizes the use of market-based inputs over entity-specific inputs for measuring fair value and establishes a three-level hierarchy for fair value measurements. On April 1, 2008, we adopted the applicable sections of ASC 820 for financial assets and financial liabilities and for nonfinancial assets and nonfinancial liabilities that are remeasured at least annually. At that time, we elected to defer adoption of ASC 820 for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. On April 1, 2009, we adopted the sections of ASC 820 regarding nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The applicable sections of ASC 820 were applied prospectively. The adoption of the various sections of ASC 820 on April 1, 2008 and 2009 did not have a material impact on our consolidated financial statements.

On April 1, 2009, we adopted the applicable sections of ASC 805, Business Combinations. ASC 805 provides revised guidance for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed and any noncontrolling interest in the acquiree in a business combination. Additionally, this ASC provides disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of the business combination. ASC 805 amends the applicable sections of ASC 740, Income Taxes, such that adjustments made to valuation allowances on deferred taxes and acquired tax contingencies related to acquisitions made prior to April 1, 2009 also fall within the scope of these sections. The adoption of the applicable sections of this ASC did not have a material impact on our consolidated financial statements; however, the ASC may have an impact on the accounting for any future acquisitions or divestitures.

On April 1, 2009, we adopted the applicable sections of ASC 805, Business Combinations, that address accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies. These applicable sections address application issues raised on the initial recognition and measurement, subsequent measurement and accounting and disclosure of assets and liabilities arising from contingencies in a business combination. These sections generally apply to assets acquired and liabilities assumed in a business combination that arise from contingencies that would be within the scope of ASC 450, Contingencies, if not acquired or assumed in a business combination. The adoption of these applicable sections did not have a material impact on our consolidated financial statements; however, these sections may have an impact on the accounting for any future acquisitions or divestitures.

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**McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)**

On April 1, 2009, we adopted ASC 810-10-65-1, Consolidation. This section requires reporting entities to present noncontrolling interests in any of its consolidated entities as equity (as opposed to a liability or mezzanine equity) and provides guidance on the accounting for transactions between an entity and noncontrolling interests. The adoption of this section did not have a material impact on our consolidated financial statements; however, this section may have an impact on any future investments or divestitures of our investments.

On April 1, 2009, we adopted the applicable sections of ASC 275, Risks and Uncertainties, and ASC 350, Intangibles Goodwill and Other, that address the determination of the useful life of intangible assets. These sections address the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The adoption of these applicable sections did not have a material impact on our consolidated financial statements.

On April 1, 2009, we adopted the applicable sections of ASC 260-10, Earnings Per Share, that address whether instruments granted in share-based payment transactions are participating securities. These sections conclude that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of basic earnings per share pursuant to the two-class method. The adoption of these applicable sections did not have a material impact on our consolidated financial statements.

On April 1, 2009, we adopted the applicable sections of ASC 323-10, Investments Equity Method and Joint Ventures, that provide guidance on how an investor should initially measure an equity method investment, test the investment for other-than-temporary impairment and account for any subsequent equity activities by the investee. Upon adoption, these applicable sections did not have a material impact on our consolidated financial statements.

On April 1, 2009, we adopted the applicable sections of ASC 350-30, Intangibles Goodwill and Other: General Intangibles Other than Goodwill, that address accounting for defensive intangible assets. These applicable sections provide guidance to situations in which an entity does not intend to actively use an acquired intangible asset but will hold (lock up) the asset to prevent others from obtaining access to the asset (a defensive intangible asset), excluding intangible assets that are used in research and development activities. Upon adoption, these applicable sections did not have a material impact on our consolidated financial statements.

On April 1, 2009, we adopted ASC 320-10-65-1, Investments Debt and Equity Securities. This section of the Codification revises guidance for determining how and when to recognize other-than-temporary impairments of debt securities for which changes in fair value are not regularly recognized in earnings and the financial statement presentation of such impairments. This section also expands and increases the frequency of disclosures related to other-than-temporary impairments of both debt and equity securities. Upon adoption, this section did not have a material impact on our consolidated financial statements.

On April 1, 2009, we adopted ASC 820-10-65-4, Fair Value Measurements and Disclosures. This section provides additional guidance for estimating fair value when an asset or liability experiences a significant decrease in volume and activity in relation to their normal market activity. Additionally, this section provides guidance on identifying circumstances that may indicate if a transaction is not orderly. Retrospective application of this section to a prior interim or annual reporting period was not permitted. The adoption of this section did not have a material impact on our consolidated financial statements.

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McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

On June 30, 2009, we adopted ASC 825-10-65-1, Financial Instruments. This section requires disclosures about the fair value of financial instruments for interim reporting periods and annual financial statements. This section does not require disclosures for earlier periods presented for comparative purposes at initial adoption. The adoption of this section did not have a material impact on our consolidated financial statements. Refer to Financial Note 11, Financial Instruments, for further discussion.

On June 30, 2009, we adopted ASC 855-10, Subsequent Events. This ASC establishes general standards of accounting and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The adoption of this ASC requires us to evaluate all subsequent events that occur after the balance sheet date through the date and time our financial statements are issued.

On October 1, 2009, we adopted ASU No. 2009-05, Measuring Liabilities at Fair Value, as codified in ASC 820, Fair Value Measurements, which provides additional guidance on determining the fair value of liabilities when a quoted price in an active market for an identical liability is not available. The adoption of this ASU did not have a material impact on our consolidated financial statements; however, the ASU may affect future fair value measurements.

On October 1, 2009, we adopted ASU No. 2009-12, Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent), as codified in ASC 820-10, Fair Value Measurements and Disclosures Overall. ASU No. 2009-12 permits a reporting entity to measure the fair value of certain alternative investments that do not have a readily determinable fair value on the basis of the investments' net asset value per share or its equivalent. This ASU also requires expanded disclosures. The adoption of this ASU did not have a material impact on our consolidated financial statements; however, it may impact the valuation of our future investments.

On October 1, 2009, we adopted ASU No. 2010-01, Equity (Topic 505): Accounting for Distributions to Shareholders with Components of Stock and Cash a consensus of the FASB Emerging Issues Task Force, as codified in ASC 505, Equity. ASU No. 2010-01 clarifies the treatment of certain distributions to shareholders that have both stock and cash components. The stock portion of such distributions is considered a share issuance that is reflected in earnings per share prospectively and is not a stock dividend. The adoption of this ASU did not have a material impact on our consolidated financial statements; however, it may affect any future stock distributions.

On October 1, 2009, we adopted ASU No. 2010-02, Consolidation (Topic 810) Accounting and Reporting for Decreases in Ownership of a Subsidiary a Scope Clarification, as codified in ASC 810, Consolidation. ASU No. 2010-02 applies retrospectively to April 1, 2009, our adoption date for ASC 810-10-65-1 as previously discussed in this financial note. This ASU clarifies the applicable scope of ASC 810 for a decrease in ownership in a subsidiary or an exchange of a group of assets that is a business or nonprofit activity. The ASU also requires expanded disclosures. The adoption of this ASU did not have a material impact on our consolidated financial statements; however, it may affect future divestitures of subsidiaries or groups of assets within its scope.

Newly Issued Accounting Pronouncements

In December 2008, the FASB issued ASC 715-20-65-2, Compensation Retirement Benefits: Defined Benefit Plans. This section provides guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. This section will become effective for us on March 31, 2010. We do not currently anticipate that this section will have a material impact on our consolidated financial statements upon adoption.

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McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

In October 2009, the FASB issued ASU No. 2009-13, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements (a consensus of the FASB Emerging Issues Task Force), which amends ASC 605-25, Revenue Recognition: Multiple-Element Arrangements. ASU No. 2009-13 addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how to allocate consideration to each unit of accounting in the arrangement. This ASU replaces all references to fair value as the measurement criteria with the term selling price and establishes a hierarchy for determining the selling price of a deliverable. ASU No. 2009-13 also eliminates the use of the residual value method for determining the allocation of arrangement consideration. Additionally, ASU No. 2009-13 requires expanded disclosures. This ASU will become effective for us for revenue arrangements entered into or materially modified on or after April 1, 2011. Earlier application is permitted with required transition disclosures based on the period of adoption. We are currently evaluating the application date and the impact of this ASU on our consolidated financial statements.

In October 2009, the FASB issued ASU No. 2009-14, Software (Topic 985): Certain Revenue Arrangements That Include Software Elements (a consensus of the FASB Emerging Issues Task Force). ASU No. 2009-14 amends ASC 985-605, Software: Revenue Recognition, such that tangible products, containing both software and non-software components that function together to deliver the tangible product's essential functionality, are no longer within the scope of ASC 985-605. It also amends the determination of how arrangement consideration should be allocated to deliverables in a multiple-deliverable revenue arrangement. This ASU will become effective for us for revenue arrangements entered into or materially modified on or after April 1, 2011. Earlier application is permitted with required transition disclosures based on the period of adoption. We are currently evaluating the application date and the impact of this ASU on our consolidated financial statements. Both ASU No. 2009-13 and ASU No. 2009-14 must be adopted in the same period and must use the same transition disclosures.

In December 2009, the FASB issued ASU No. 2009-16, Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets. ASU No. 2009-16 is a revision to ASC 860, Transfers and Servicing, and amends the guidance on accounting for transfers of financial assets, including securitization transactions, where entities have continued exposure to risks related to transferred financial assets. ASU No. 2009-16 also expands the disclosure requirements for such transactions. This ASU will become effective for us on April 1, 2010. We are currently evaluating the impact of this ASU on the treatment of our accounts receivable sales facility and consolidated financial statements.

In December 2009, the FASB issued ASU No. 2009-17, Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities. ASU No. 2009-17 amends the guidance for consolidation of VIEs primarily related to the determination of the primary beneficiary of the VIE. This ASU will become effective for us on April 1, 2010. We are currently evaluating the impact of this ASU on our consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. ASU No. 2010-06 amends ASC 820 and clarifies and provides additional disclosure requirements related to recurring and non-recurring fair value measurements and employers' disclosures about postretirement benefit plan assets. This ASU became effective for us on January 1, 2010. We do not currently anticipate that this ASU will have a material impact on our consolidated financial statements upon adoption.

2. Business Acquisitions

During the first quarter of 2009, we acquired McQueary Brothers Drug Company (McQueary Brothers) of Springfield, Missouri for approximately \$190 million. McQueary Brothers is a regional distributor of pharmaceutical, health and beauty products to independent and regional chain pharmacies in the Midwestern U.S. This acquisition expanded our existing U.S. pharmaceutical distribution business. The acquisition was funded with cash on hand. Approximately \$126 million of the purchase price allocation was assigned to goodwill, which primarily reflects the expected future benefits from synergies to be realized upon integrating the business. During the first quarter of 2010,

the acquisition accounting was completed. Financial results for McQueary Brothers have been included within our Distribution Solutions segment since the date of acquisition.

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McKESSON CORPORATION
FINANCIAL NOTES (CONTINUED)
(UNAUDITED)

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

3. Gain on Sale of Equity Investments

In October 2009, our Distribution Solutions segment sold its 50% equity interest in McKesson Logistics Solutions L.L.C. (*MLS*), a Canadian logistics company, for a pre-tax gain of approximately \$17 million or \$14 million after income taxes. The pre-tax gain is included in other income, net on our condensed consolidated statements of operations.

In July 2008, our Distribution Solutions segment sold its 42% equity interest in Verispan, L.L.C. (*Verispan*), a data analytics company, for a pre-tax gain of approximately \$24 million or \$14 million after income taxes. The pre-tax gain is included in other income, net on our condensed consolidated statements of operations.

4. Share-Based Payments

We provide share-based compensation for our employees, officers and non-employee directors, including stock options, an employee stock purchase plan, restricted stock units (*RSUs*) and performance-based restricted stock units (*PeRSUs*) (collectively, *share-based awards*). Most of the Company's share-based awards are granted in the first quarter of each fiscal year.

Compensation expense for employee stock options is recognized on a straight-line basis over the requisite service period and is based on the grant-date fair value for the portion of the awards that is ultimately expected to vest. We have elected to expense the fair value of RSUs with only graded vesting and service conditions on a straight-line basis over the requisite service period.

PeRSUs are RSUs for which the number of RSUs awarded may be conditional upon the attainment of one or more performance objectives over a specified period. PeRSUs are accounted for as variable awards until the performance goals are reached and the grant date is established. The fair value of PeRSUs is determined by the product of the number of shares eligible to be awarded and the market price of the Company's common stock, commencing at the inception of the requisite service period. During the performance period, the PeRSUs are re-valued using the market price and the performance modifier at the end of a reporting period. At the end of the performance period, if the goals are attained, the awards are granted and classified as RSUs and accounted for on that basis. For PeRSUs granted prior to 2009 with multiple vest dates, we recognize the fair value of these awards on a graded vesting basis over the requisite service period of two to four years. PeRSUs granted during or after 2009 and the related RSUs (granted during or after 2010) have a single vest date and accordingly, we recognize expense on a straight-line basis over the requisite service period of four years.

Compensation expense is recognized for the portion of the awards that is ultimately expected to vest. We develop an estimate of the number of share-based awards that will ultimately vest primarily based on historical experience. The estimated forfeiture rate established upon grant is re-assessed throughout the requisite service period. As required, the forfeiture estimates will be adjusted to reflect actual forfeitures when an award vests. The actual forfeitures in future reporting periods could be higher or lower than our current estimates.

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The compensation expense recognized has been classified in the condensed consolidated statements of operations or capitalized on the condensed consolidated balance sheets in the same manner as cash compensation paid to our employees. There was no material share-based compensation expense capitalized as part of the cost of an asset for the quarters and nine months ended December 31, 2009 and 2008.

The components of share-based compensation expense and the related tax benefit for the quarters and nine months ended December 31, 2009 and 2008 are shown in the following table:

| <i>(In millions, except per share amounts)</i> | Quarter Ended December 31, | | Nine Months Ended December 31, | |
|---|---------------------------------------|-------------|---|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| RSUs ⁽¹⁾ | \$ 11 | \$ 12 | \$ 37 | \$ 46 |
| PeRSUs ⁽²⁾ | 12 | 1 | 25 | 8 |
| Stock options | 5 | 4 | 14 | 12 |
| Employee stock purchase plan | 2 | 2 | 7 | 6 |
| Share-based compensation expense | 30 | 19 | 83 | 72 |
| Tax benefit for share-based compensation expense ⁽³⁾ | (11) | (7) | (30) | (25) |
| Share-based compensation expense, net of tax | \$ 19 | \$ 12 | \$ 53 | \$ 47 |
| Impact of share-based compensation | | | | |
| Earnings per common share: ⁽⁴⁾ | | | | |
| Diluted | \$ 0.07 | \$ 0.04 | \$ 0.19 | \$ 0.17 |
| Basic | \$ 0.07 | \$ 0.04 | \$ 0.20 | \$ 0.17 |

(1) This expense was primarily the result of P e R S U s awarded in prior years, which converted to RSUs due to the attainment of goals during the applicable years performance period.

(2) Represents estimated compensation expense for PeRSUs that are

conditional upon
a t t a i n i n g
p e r f o r m a n c e
o b j e c t i v e s d u r i n g
t h e c u r r e n t y e a r ' s
p e r f o r m a n c e
p e r i o d .

(3) I n c o m e t a x
e x p e n s e i s
c o m p u t e d b a s e d
o n a p p l i c a b l e t a x
j u r i s d i c t i o n s .
A d d i t i o n a l l y , a
p o r t i o n o f
p r e - t a x
c o m p e n s a t i o n
e x p e n s e i s n o t
t a x - d e d u c t i b l e .

(4) C e r t a i n
c o m p u t a t i o n s
m a y r e f l e c t
r o u n d i n g
a d j u s t m e n t s .

Share-based compensation expense is affected by our stock price, the number and type of annual share-based awards as well as assumptions regarding a number of complex and subjective variables and the related tax impact. These variables include, but are not limited to, the volatility of our stock price, employee stock option exercise behavior and the attainment of performance goals. As a result, the actual future share-based compensation expense may differ from historical amounts.

5. Income Taxes

The Company's reported income tax rates for the third quarters of 2010 and 2009 were 33.1% and 71.4% and 31.3% and 18.7% for the first nine months of 2010 and 2009. Fluctuations in our reported income tax rates are primarily due to discrete items as discussed below.

During the third quarter and first nine months of 2010, income tax expense included net discrete items of an expense of \$11 million and a benefit of \$4 million. The expense in the third quarter of 2010 primarily consists of income taxes on the disposition of MLS and adjustments in connection with tax return filings.

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McKESSON CORPORATION
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During the third quarter of 2009, we recorded a total income tax benefit of \$50 million, which included an income tax benefit of \$182 million related to the Average Wholesale Price (AWP) litigation charge described in more detail in Financial Note 12, Other Commitments and Contingent Liabilities. The tax benefit could change in the future depending on the resolution of the expected future claims. In addition, during the first nine months of 2009, income tax expense included \$80 million of net income tax benefits for discrete items primarily relating to previously unrecognized tax benefits and related accrued interest. The recognition of these discrete items was primarily due to the lapsing of the statutes of limitations. Of the \$80 million of net tax benefits, \$65 million represented a non-cash benefit to McKesson. In accordance with ASC 740, Income Taxes, the net tax benefit was included in our income tax expense from continuing operations.

As of December 31, 2009, we had \$609 million of unrecognized tax benefits, of which \$368 million would reduce income tax expense and the effective tax rate if recognized. During the next twelve months, it is reasonably possible that audit resolutions and the expiration of statutes of limitations could potentially reduce our unrecognized tax benefits by up to \$11 million. However, this amount may change because we continue to have ongoing negotiations with various taxing authorities throughout the year. In Canada, we have received assessments from the Canada Revenue Agency (CRA) and some provinces for a total of \$61 million related to transfer pricing for 2003, 2004 and 2005. We paid the total assessments of \$61 million to the CRA to stop interest and penalty liabilities. We have appealed the assessment for 2003 and have filed a notice of objection for 2004 and 2005.

We report interest and penalties on tax deficiencies as income tax expense. At December 31, 2009, before any tax benefits, our accrued interest on unrecognized tax benefits amounted to \$113 million. We recognized \$4 million and \$13 million of interest expense before any tax benefits in our condensed consolidated statements of operations during the quarter and nine months ended December 31, 2009. We have no material amounts accrued for penalties.

6. Earnings (Loss) Per Share

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

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

| <i>(In millions, except per share data)</i> | Quarter Ended | | Nine Months Ended | |
|--|----------------------|-------------|--------------------------|-------------|
| | December 31, | | December 31, | |
| | 2009 | 2008 | 2009 | 2008 |
| Net income (loss) | \$ 326 | \$ (20) | \$ 915 | \$ 542 |
| Weighted average common shares outstanding: | | | | |
| Basic | 269 | 274 | 269 | 275 |
| Effect of dilutive securities: | | | | |
| Options to purchase common stock | 3 | | 3 | 3 |
| Restricted stock units | 2 | | 1 | 1 |
| Diluted | 274 | 274 | 272 | 279 |
| Earnings (Loss) Per Common Share: ⁽¹⁾ | | | | |
| Diluted | \$ 1.19 | \$ (0.07) | \$ 3.36 | \$ 1.94 |
| Basic | \$ 1.21 | \$ (0.07) | \$ 3.41 | \$ 1.97 |

(1) Certain
computations
may reflect
rounding
adjustments.

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Approximately 2 million stock options were excluded from the computations of diluted net earnings per share for the quarter ended December 31, 2009 as their exercise price was higher than the Company's average stock price for the quarter. For the third quarter of 2009, potentially dilutive securities were excluded from the per share computations due to their antidilutive effect. For the nine months ended December 31, 2009 and 2008, the number of stock options excluded was approximately 8 million and 10 million.

7. Goodwill and Intangible Assets, Net

Changes in the carrying amount of goodwill for the nine months ended December 31, 2009 are as follows:

| <i>(In millions)</i> | Distribution Solutions | Technology Solutions | Total |
|--|-----------------------------------|---------------------------------|-----------------|
| Balance, March 31, 2009 | \$ 1,869 | \$ 1,659 | \$ 3,528 |
| Goodwill acquired | 7 | 4 | 11 |
| Acquisition accounting and other adjustments | (29) | | (29) |
| Foreign currency translation adjustments | 19 | 30 | 49 |
| Balance, December 31, 2009 | \$ 1,866 | \$ 1,693 | \$ 3,559 |

Information regarding intangible assets is as follows:

| <i>(In millions)</i> | December 31, 2009 | March 31, 2009 |
|--------------------------|----------------------------------|---------------------------|
| Customer lists | \$ 831 | \$ 824 |
| Technology | 190 | 187 |
| Trademarks and other | 73 | 70 |
| Gross intangibles | 1,094 | 1,081 |
| Accumulated amortization | (514) | (420) |
| Intangible assets, net | \$ 580 | \$ 661 |

Amortization expense of intangible assets was \$31 million and \$90 million for the quarter and nine months ended December 31, 2009 and \$32 million and \$96 million for the quarter and nine months ended December 31, 2008. The weighted average remaining amortization periods for customer lists, technology and trademarks and other intangible assets at December 31, 2009 were 7 years, 2 years and 6 years. Estimated annual amortization expense of these assets is as follows: \$119 million, \$114 million, \$107 million, \$88 million and \$76 million for 2010 through 2014, and \$166 million thereafter. All intangible assets were subject to amortization as of December 31, 2009 and March 31, 2009.

8. Financing Activities*Accounts Receivable Sales Facility*

In May 2009, we renewed our accounts receivable sales facility for an additional one year period under terms similar to those previously in place. The renewed facility will expire in May 2010. The May 2009 renewal increased the committed balance from \$1.0 billion to \$1.1 billion, although from time-to-time the available amount may be less than \$1.1 billion based on concentration limits and receivable eligibility requirements.

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McKESSON CORPORATION
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Through this facility, McKesson Corporation, the parent company, sells certain U.S. pharmaceutical trade accounts receivable on a non-recourse basis to a wholly-owned and consolidated subsidiary which then sells these receivables to a special purpose entity (SPE), which is a wholly-owned, bankruptcy-remote subsidiary of McKesson Corporation that is consolidated in our financial statements. This SPE then sells undivided interests in the receivables to third-party purchaser groups, each of which includes commercial paper conduits (Conduits), which are special purpose legal entities administered by financial institutions. Sales of undivided interests in the receivables by the SPE to the Conduits are accounted for as a sale because we have relinquished control of the receivables. Accordingly, accounts receivable sold under these transactions are excluded from receivables, net in the accompanying condensed consolidated balance sheets. Receivables sold and receivables retained by the Company are carried at face value, which due to the short-term nature of our accounts receivable and terms of the facility, approximates fair value. McKesson receives cash in the amount of the face value for the undivided interests in the receivables sold. No gain or loss is recorded upon sale as fee charges from the Conduits are based upon a floating yield rate and the period the undivided interests remain outstanding. Fee charges from the Conduits are accrued at the end of each month and are recorded within administrative expenses in the condensed consolidated statements of operations. Should we default under the accounts receivable sales facility, the Conduits are entitled to receive only collections on receivables owned by the SPE.

We continue servicing the receivables sold. No servicing asset is recorded at the time of sale because we do not receive any servicing fees from third parties or other income related to servicing the receivables. We do not record any servicing liability at the time of sale as the receivables collection period is relatively short and the costs of servicing the receivables sold over the servicing period are insignificant. Servicing costs are recognized as incurred over the servicing period.

Information regarding our outstanding balances related to our interests in accounts receivable sold or qualifying receivables retained is as follows:

| <i>(In millions)</i> | December 31, 2009 | March 31, 2009 |
|--|----------------------------------|---------------------------|
| Receivables sold outstanding ⁽¹⁾ | \$ | \$ |
| Receivables retained, net of allowance for doubtful accounts | \$ 4,859 | \$ 4,814 |

(1) Deducted from receivables, net in the condensed consolidated balance sheets.

The following table summarizes the activity related to our interests in accounts receivable sold:

| <i>(In millions)</i> | Quarter Ended December 31, | | Nine Months Ended December 31, | |
|---|---------------------------------------|-------------|---|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| Proceeds from accounts receivable sales | \$ | \$ 633 | \$ | \$ 5,070 |
| Fees and charges ⁽¹⁾ | \$ 3 | \$ 5 | \$ 8 | \$ 9 |

- (1) Recorded in operating expenses in the condensed consolidated statements of operations.

The delinquency ratio for the qualifying receivables represented less than 1% of the total qualifying receivables as of December 31, 2009 and March 31, 2009.

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**McKESSON CORPORATION
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Revolving Credit Facility

We have a syndicated \$1.3 billion five-year, senior unsecured revolving credit facility which expires in June 2012. Borrowings under this credit facility bear interest based upon either a Prime rate or the London Interbank Offering Rate. Total borrowings under this facility were nil and \$259 million for the first nine months of 2010 and 2009. As of December 31, 2009 and March 31, 2009, there were no amounts outstanding under this facility.

Commercial Paper

We issued and repaid commercial paper of nil and approximately \$3.3 billion for the first nine months of 2010 and 2009. There were no commercial paper issuances outstanding at December 31, 2009 and March 31, 2009.

Long-Term Debt

On February 12, 2009, we issued 6.50% notes due February 15, 2014 (the 2014 Notes) in an aggregate principal amount of \$350 million and 7.50% notes due February 15, 2019 (the 2019 Notes) in an aggregate principal amount of \$350 million. Interest is payable on February 15 and August 15 of each year beginning on August 15, 2009. The 2014 Notes will mature on February 15, 2014 and the 2019 Notes will mature on February 15, 2019. We utilized net proceeds, after offering expenses, of \$693 million from the issuance of the 2014 Notes and 2019 Notes for general corporate purposes.

9. Pension and Other Postretirement Benefit Plans

Net periodic expense for the Company's defined pension and other postretirement benefit plans was \$7 million and \$19 million for the third quarter and first nine months of 2010 compared to \$2 million and \$7 million for the comparable prior year periods. Cash contributions to these plans for the first nine months of 2010 were \$24 million.

As previously reported in our 2009 Annual Report and our Quarterly Reports on Form 10-Q for the quarterly periods ended June 30, 2009 (First Quarter 2010 Form 10-Q) and September 30, 2009 (Second Quarter 2010 Form 10-Q), the McKesson Corporation Profit Sharing Investment Plan (PSIP) is a member of the settlement class in the Consolidated Securities Litigation Action. On April 27, 2009, the court issued an order approving the distribution of the settlement funds. On October 9, 2009, the PSIP received approximately \$119 million of the Consolidated Securities Litigation Action proceeds. Approximately \$42 million of the proceeds are attributable to the allocated shares of McKesson common stock owned by the PSIP participants during the Consolidated Securities Litigation Action class holding period and were allocated to the respective participants on that basis in the third quarter of 2010. Approximately \$77 million of the proceeds are attributable to the unallocated shares (the Unallocated Proceeds) of McKesson common stock owned by the PSIP in an employee stock ownership plan (ESOP) suspense account. In accordance with the plan terms, the PSIP will distribute all of the Unallocated Proceeds to current PSIP participants as soon as administratively feasible after the close of the plan year. The receipt of the Unallocated Proceeds by the PSIP is reimbursement for the loss in value of the Company's common stock held by the PSIP in its ESOP suspense account during the Consolidated Securities Litigation Action class holding period and is not a contribution made by the Company to the PSIP or ESOP. Accordingly, there are no accounting consequences to the Company's financial statements relating to the receipt of the Unallocated Proceeds by the PSIP.

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The Company accounts for shares of its common stock contributed to the ESOP prior to 1993 in accordance with the American Institute of Certified Public Accountants Statement of Position (SOP) 76-3, Accounting Practices for Certain Employee Stock Ownership Plans. SOP 76-3 requires that compensation expense be recognized only to the extent that the Company contributes or commits to contribute to the ESOP. The Company accounts for all contributions of shares of its common stock made to the ESOP after 1993 under ASC 718-40, Compensation Stock Compensation: Employee Stock Ownership Plans. During the first quarter of 2010, the Company contributed \$1 million to the ESOP in order to extinguish the remaining ESOP loan and made no commitments to otherwise contribute to the PSIP or ESOP. Upon repayment, our ESOP became a non-leveraged ESOP. At December 31, 2009, of the 24 million shares of the Company s common stock purchased by the ESOP since its inception, all but 66,444 shares have been allocated to PSIP participants. As a result of the payment in the first quarter of 2010, pre-tax PSIP expense for the first nine months of 2010 was \$1 million. The Company anticipates that its PSIP expense for the full year will remain at \$1 million, as it currently does not anticipate making or committing to make additional contributions to the PSIP or ESOP. As a result, our compensation expense in 2010 will be lower than 2009. During the first nine months of and full year 2009, PSIP expense was \$39 million and \$53 million.

PSIP expense by segment for the quarters and nine months ended December 31, 2009 and 2008 was as follows:

| <i>(In millions)</i> | Quarter Ended | | Nine months Ended | |
|------------------------|----------------------|-------------|--------------------------|-------------|
| | December 31, | | December 31, | |
| | 2009 | 2008 | 2009 | 2008 |
| Distribution Solutions | \$ | \$ 5 | \$ | \$ 17 |
| Technology Solutions | | 6 | 1 | 21 |
| Corporate | | | | 1 |
| PSIP expense | \$ | \$ 11 | \$ 1 | \$ 39 |

10. Financial Guarantees and Warranties*Financial Guarantees*

We have agreements with certain of our customers financial institutions under which we have guaranteed the repurchase of inventory (primarily for our Canadian business) at a discount in the event these customers are unable to meet certain obligations to those financial institutions. Among other requirements, these inventories must be in resalable condition. The inventory repurchase agreements mostly range from one to two years. Customer guarantees range from one to five years and were primarily provided to facilitate financing for certain customers. The majority of our other customer guarantees are secured by certain assets of the customer. We also have an agreement with one software customer that, under limited circumstances, may require us to secure standby financing. Because the amount of the standby financing is not explicitly stated, the overall amount of these guarantees cannot reasonably be estimated. At December 31, 2009, the maximum amounts of inventory repurchase guarantees and other customer guarantees were \$117 million and \$14 million none of which has been accrued.

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

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(UNAUDITED)

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

Warranties

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

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

11. Financial Instruments

At December 31, 2009 and March 31, 2009, the carrying amounts of cash and cash equivalents, restricted cash, marketable securities, receivables, drafts and accounts payable and other current liabilities approximated their estimated fair values because of the short maturity of these financial instruments. All highly liquid debt instruments purchased with a maturity of three months or less at the date of acquisition are included in cash and cash equivalents. Included in cash and cash equivalents at December 31, 2009 and March 31, 2009 are money market fund investments of \$2.1 billion and \$1.7 billion which are reported at fair value. The fair value of these investments was determined by using quoted prices for identical investments in active markets which are considered to be Level 1 inputs under ASC 820, Fair Value Measurements and Disclosures.

The carrying amounts and estimated fair values of our long-term debt and other financing were \$2,511 million and \$2,731 million at December 31, 2009 and \$2,509 million and \$2,545 million at March 31, 2009. The estimated fair value of our long-term debt and other financing was determined using quoted market prices and other inputs that were derived from available market information and may not be representative of actual values that could have been or will be realized in the future.

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12. Other Commitments and Contingent Liabilities

In addition to commitments and obligations in the ordinary course of business, we are subject to various claims, other pending and potential legal actions for damages, investigations relating to governmental laws and regulations and other matters arising out of the normal conduct of our business. In accordance with ASC 450, Contingencies, we record a provision for a liability when management believes that it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We believe we have adequate provisions for any such matters. Management reviews these provisions at least quarterly and adjusts these provisions to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Because litigation outcomes are inherently unpredictable, these decisions often involve a series of complex assessments by management about future events that can rely heavily on estimates and assumptions and it is possible that the ultimate cost of these matters could impact our earnings, either negatively or positively, in the quarter of their resolution.

Based on our experience, we believe that any damage amounts claimed in the specific matters referenced in our 2009 Annual Report, First and Second Quarter 2010 Form 10-Q filings and those matters discussed below are not meaningful indicators of our potential liability. We believe that we have valid defenses to these legal proceedings and are defending the matters vigorously. Nevertheless, the outcome of any litigation is inherently uncertain. We are currently unable to estimate the remaining possible losses in these unresolved legal proceedings. Should any one or a combination of more than one of these proceedings against us be successful, or should we determine to settle any or a combination of these matters on unfavorable terms, we may be required to pay substantial sums, become subject to the entry of an injunction, or be forced to change the manner in which we operate our business, which could have a material adverse impact on our financial position or results of operations.

As more fully described in our previous public reports filed with the SEC, we are involved in numerous legal proceedings. For a discussion of these proceedings, please refer to the Financial Notes entitled Other Commitments and Contingent Liabilities included in our 2009 Annual Report and in our First and Second Quarter 2010 Form 10-Q filings. Significant developments in previously reported proceedings and in other litigation and claims since the referenced filings are set out below.

As previously reported, on July 14, 2009, the Georgia Court of Appeals issued its opinion on our appeals in the last two remaining lawsuits filed against the Company arising out of our January 12, 1999 acquisition of HBO & Company, *Holcombe T. Green and HTG Corp. v. McKesson Corporation, et al.* (Georgia State Court, Fulton County, Case No. 06-VS-096767-D) and *Hall Family Investments, L.P. v. McKesson Corporation, et al.* (Georgia State Court, Fulton County, Case No. 06-VS-096763-F), ruling that the trial court committed error in denying our motions for summary judgment in those two matters. On July 23, 2009, plaintiffs petitioned the Georgia Supreme Court to take their appeal from the Georgia Court of Appeals decision. On October 19, 2009, the Georgia Supreme Court issued orders rejecting plaintiffs petitions. Plaintiffs petitions for reconsideration of the Georgia Supreme Court's October 19, 2009 orders were all denied on December 15, 2009. These cases were remanded to the Court of Appeals, which in turn has remanded them to the trial court to enter judgment in favor of defendants as provided in the Georgia Court of Appeals decisions dated July 14, 2009. On January 4, 2010, we filed our motion for entry of judgment in favor of the Company as to all causes of action.

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We have previously reported on certain private party class action litigation filed against the Company in the United States District Court for Massachusetts relating to alleged misstatements and manipulations of the benchmark for drug reimbursement known as AWP and relating to a proposed settlement of that litigation, *New England Carpenters Health Benefits Fund, et al. v. First DataBank, Inc. and McKesson Corporation, et al.* (Civil Action No. 1:05-CV-11148-PBS) (the *Private Payor RICO Action*) and *New England Carpenters Health Benefits Fund, et al. v. McKesson Corporation, et al.* (Civil Action No. 1:07-CV-12277-PBS) (the *Antitrust Action*). As previously disclosed, in the fourth quarter of 2009, \$55 million was paid by the Company into the settlement escrow account established by plaintiffs' counsel in accordance with the terms of the settlement. On July 24, 2009, the trial court issued an order approving the settlement of these matters. On August 21, 2009, a settlement class member filed a motion challenging the order of approval and also a motion seeking leave to intervene in the case and on November 5, 2009, the trial court denied both of those motions. On August 31, 2009, the trial court entered judgment on the settlement and dismissed all private party claims against the Company. On September 29 and 30, 2009, four appeals to the First Circuit Court of Appeals were filed by settlement class members challenging the final judgment. On October 9, 2009, the Company paid \$295 million into the settlement escrow account as the final installment on the \$350 million total settlement. Between November 30 and December 22, 2009, all four appeals were voluntarily dismissed. These private party actions have been concluded, the releases have become final and binding on the classes and the settlement consideration has been paid and is no longer subject to return to the Company. Accordingly, in the third quarter of 2010, the Company removed its AWP litigation liability of \$350 million and corresponding restricted cash balance as all criteria for the extinguishment of this liability were met.

Regarding the consolidated public payor actions, collectively known as *In re McKesson Governmental Entities Average Wholesale Price Litigation*, pending in United States District Court for the District of Massachusetts, which actions are based on allegations nearly identical to those made in the *Private Payor RICO Action* referenced above (*Board of County Commissioners of Douglas County, Kansas v. McKesson Corporation, et al.*, (Civil Action No. 1:08-CV-11349-PBS) (*Douglas County, Kansas Action*), *San Francisco Health Plan, et al. v. McKesson Corporation, et al.* (Civil Action No. 1:08-CV-10843-PBS) (*San Francisco Action*), *State of Connecticut v. McKesson Corporation, et al.* (Civil Action No. 1:08-CV-10900-PBS) (*Connecticut Action*)), the trial court extended the discovery cut-off to February 19, 2010, reset the class certification hearing in the *Douglas County, Kansas* and *San Francisco Actions* for June 9, 2010 and left unchanged the trial in the *Connecticut Action*, previously set for July 19, 2010. No trial date has yet been proposed or set in the *San Francisco* and *Douglas County, Kansas Actions*.

On November 30, 2009, the California Supreme Court issued its decision in the previously disclosed matter, *Roby v. McKesson HBOC, et al.* (Superior Court for Yolo County, California, Case No. CV01-573), reducing the ratio of punitive damages to compensatory damages from that ordered by the California Court of Appeals and reinstating the harassment claim previously stricken by the Court of Appeals with a revised award of \$4 million, before interest. Both parties have filed petitions for rehearing before the California Supreme Court and are awaiting a ruling. The Company has paid the uncontested portion of the revised award.

As has been previously reported, in late 2001, Angeles Chemical Company (*Angeles*) filed an action against the Company in the United States District Court for the Central District of California, *Angeles Chemical Company v. McKesson Corporation, et al.*, (No. 01-10532 TJH), claiming that the Company's chemical repackaging facility in Santa Fe Springs, California contaminated an adjacent property where Angeles conducted similar repackaging operations. The Company, Angeles and other relevant parties, have agreed to terms of a settlement, subject only to obtaining (1) certain remaining signatures to the written settlement document and (2) a good faith settlement order in a related environmental action pending in the same court. The settlement, which the Company believes will be concluded in the fourth quarter of 2010, will resolve all disputes between the relevant parties.

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FINANCIAL NOTES (CONTINUED)
(UNAUDITED)**13. Stockholders Equity**

Comprehensive income (loss) is as follows:

| <i>(In millions)</i> | Quarter Ended December 31, | | Nine Months Ended December 31, | |
|--|-------------------------------|----------|-----------------------------------|--------|
| | 2009 | 2008 | 2009 | 2008 |
| Net income (loss) | \$ 326 | \$ (20) | \$ 915 | \$ 542 |
| Foreign currency translation adjustments and other | 20 | (166) | 202 | (215) |
| Comprehensive income (loss) | \$ 346 | \$ (186) | \$ 1,117 | \$ 327 |

Foreign currency translation adjustments and other are primarily the result of the impact of favorable and unfavorable foreign currency exchange rates on foreign subsidiaries.

Stock Repurchase Activities

In April 2008, the Company's Board of Directors (the Board) approved a plan to repurchase \$1.0 billion of the Company's common stock, of which \$830 million remained available at March 31, 2009. During the third quarter of 2010, we did not repurchase shares. During the first nine months of 2010, we repurchased 8 million shares for \$299 million, leaving \$531 million available for future repurchases as of December 31, 2009. Stock repurchases may be made from time-to-time in open market or private transactions.

In July 2008, the Board authorized the retirement of shares of the Company's common stock that may be repurchased from time-to-time pursuant to its stock repurchase program. During the second quarter of 2009, all of the 4 million repurchased shares, which we purchased for \$204 million, were formally retired by the Company. The retired shares constitute authorized but unissued shares. We elected to allocate any excess of share repurchase price over par value between additional paid-in capital and retained earnings. As such, \$165 million was recorded as a decrease to retained earnings.

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McKESSON CORPORATION
FINANCIAL NOTES (CONCLUDED)
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14. Segment Information

We report our operations in two operating segments: McKesson Distribution Solutions and McKesson Technology Solutions. The factors for determining the reportable segments included the manner in which management evaluates the performance of the Company combined with the nature of the individual business activities. We evaluate the performance of our operating segments based on operating profit (loss) before interest expense, income taxes and results from discontinued operations. Financial information relating to our reportable operating segments and reconciliations to the condensed consolidated totals is as follows:

| <i>(In millions)</i> | Quarter Ended December 31, | | Nine Months Ended December 31, | |
|---|---------------------------------------|-------------|---|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| Revenues | | | | |
| Distribution Solutions ⁽¹⁾ | | | | |
| Direct distribution & services | \$ 18,992 | \$ 17,037 | \$ 53,880 | \$ 50,076 |
| Sales to customers warehouses | 5,330 | 6,695 | 16,882 | 19,678 |
| Total U.S. pharmaceutical distribution & services | 24,322 | 23,732 | 70,762 | 69,754 |
| Canada pharmaceutical distribution & services | 2,421 | 1,967 | 6,816 | 6,390 |
| Medical-Surgical distribution & services | 758 | 680 | 2,177 | 2,007 |
| Total Distribution Solutions | 27,501 | 26,379 | 79,755 | 78,151 |
| Technology Solutions | | | | |
| Services | 610 | 576 | 1,812 | 1,722 |
| Software & software systems | 138 | 141 | 410 | 419 |
| Hardware | 23 | 34 | 82 | 116 |
| Total Technology Solutions | 771 | 751 | 2,304 | 2,257 |
| Total | \$ 28,272 | \$ 27,130 | \$ 82,059 | \$ 80,408 |
| Operating Profit (Loss) ⁽²⁾ | | | | |
| Distribution Solutions ^{(3) (4)} | \$ 558 | \$ (54) | \$ 1,403 | \$ 736 |
| Technology Solutions | 81 | 91 | 300 | 228 |
| Total | 639 | 37 | 1,703 | 964 |
| Corporate | (105) | (74) | (249) | (195) |
| Litigation Credit | | | 20 | |
| Interest Expense | (47) | (33) | (142) | (102) |
| Income (Loss) Before Income Taxes | \$ 487 | \$ (70) | \$ 1,332 | \$ 667 |

(1)

Revenues derived from services represent less than 1% of this segment's total revenues for the quarters and nine months ended December 31, 2009 and 2008.

- (2) Operating profit (loss) includes net earnings of \$ 3 a n d \$8 million from e q u i t y investments for the third quarter and first nine months of 2010 and net earnings of \$5 million and \$10 million for the comparable p r i o r y e a r periods which were primarily recorded within our Distribution S o l u t i o n s segment.
- (3) Operating profit for the third quarter and first nine months of 2010 includes a \$17 million pre-tax gain on the sale of our 50 % e q u i t y interest in MLS and for the first nine months of 2009 includes a \$24 million pre-tax gain on the sale of our 42 % e q u i t y

i n t e r e s t i n
Verispan.

- (4) Operating profit (loss) for the third quarter and first nine months of 2009 for our Distribution Solutions segment includes the AWP litigation pre-tax charge of \$493 million.

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FINANCIAL REVIEW
(UNAUDITED)

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

| <i>(In millions, except per share data)</i> | Quarter Ended December 31, | | | Nine Months Ended December 31, | | |
|---|---------------------------------------|-------------|---------------|---|-------------|---------------|
| | 2009 | 2008 | Change | 2009 | 2008 | Change |
| Revenues | \$ 28,272 | \$ 27,130 | 4% | \$ 82,059 | \$ 80,408 | 2% |
| Litigation Charge (Credit) | \$ | \$ 493 | (100) | \$ (20) | \$ 493 | NM |
| Income (Loss) Before Income Taxes | \$ 487 | \$ (70) | NM | \$ 1,332 | \$ 667 | 100 |
| Income Tax (Expense) Benefit | \$ (161) | \$ 50 | NM | \$ (417) | \$ (125) | 234 |
| Net Income (Loss) | \$ 326 | \$ (20) | NM | \$ 915 | \$ 542 | 69 |
| Diluted Earnings (Loss) Per Common Share ⁽¹⁾ | \$ 1.19 | \$ (0.07) | NM | \$ 3.36 | \$ 1.94 | 73 |
| Weighted Average Diluted Shares | 274 | 274 | | 272 | 279 | (3) |

NM not meaningful

(1) For the quarter ended December 31, 2008, potentially dilutive securities have been excluded from the per share computations due to their antidilutive effect.

Revenues for the third quarter of 2010 increased 4% to \$28.3 billion and for the first nine months of 2010 revenues increased 2% to \$82.1 billion compared to the same periods a year ago primarily due to increases associated with market growth and, to a lesser extent, an increase in demand related to the flu season, partially offset by lost business in late 2009.

Income before income taxes for the third quarter of 2010 increased to \$487 million and for the first nine months increased 100% to \$1,332 million. Results for the third quarter of 2010 were positively affected by an increase in our Distribution Solutions segment's operating profit, which includes a \$17 million pre-tax gain on the sale of our 50% equity interest in McKesson Logistics Solutions L.L.C. (MLS), partially offset by a slight decrease in our Technology Solutions segment's operating profit. For the first nine months of 2010, results were positively affected by increases in our Distribution Solutions and Technology Solutions segments' operating profit, partially offset by a \$24 million pre-tax gain on the sale of our 42% equity interest in Verispan, L.L.C. (Verispan) in 2009. Results for 2009 were affected by the pre-tax charge of \$493 million (\$311 million after-tax) for the Average Wholesale Price (AWP)

litigation as discussed in further detail under the caption Operating Expenses and Other Income, Net in this financial review.

Net income for the third quarter of 2010 increased to \$326 million and for the first nine months increased 69% to \$915 million. For those same periods, diluted earnings per share increased to \$1.19 and increased 73% to \$3.36 compared to the prior year. In addition to the pre-tax items discussed above, net income for the first nine months of 2009 was favorably affected by \$76 million of previously unrecognized tax benefits and related interest as a result of the effective settlement of uncertain tax positions. Diluted earnings per share in 2010 were favorably affected by a decrease in our weighted average shares outstanding due to the cumulative effect of share repurchases.

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McKESSON CORPORATION
FINANCIAL REVIEW (CONTINUED)
(UNAUDITED)

Results of Operations**Revenues:**

| <i>(In millions)</i> | Quarter Ended December 31, | | | Nine Months Ended December 31, | | |
|---|---------------------------------------|-------------|---------------|---|-------------|---------------|
| | 2009 | 2008 | Change | 2009 | 2008 | Change |
| Distribution Solutions | | | | | | |
| Direct distribution & services | \$ 18,992 | \$ 17,037 | 11% | \$ 53,880 | \$ 50,076 | 8% |
| Sales to customers warehouses | 5,330 | 6,695 | (20) | 16,882 | 19,678 | (14) |
| Total U.S. pharmaceutical distribution & services | 24,322 | 23,732 | 2 | 70,762 | 69,754 | 1 |
| Canada pharmaceutical distribution & services | 2,421 | 1,967 | 23 | 6,816 | 6,390 | 7 |
| Medical-Surgical distribution & services | 758 | 680 | 11 | 2,177 | 2,007 | 8 |
| Total Distribution Solutions | 27,501 | 26,379 | 4 | 79,755 | 78,151 | 2 |
| Technology Solutions | | | | | | |
| Services | 610 | 576 | 6 | 1,812 | 1,722 | 5 |
| Software & software systems | 138 | 141 | (2) | 410 | 419 | (2) |
| Hardware | 23 | 34 | (32) | 82 | 116 | (29) |
| Total Technology Solutions | 771 | 751 | 3 | 2,304 | 2,257 | 2 |
| Total Revenues | \$ 28,272 | \$ 27,130 | 4 | \$ 82,059 | \$ 80,408 | 2 |

Total revenues increased 4% and 2% for the third quarter and first nine months of 2010 compared to the same periods a year ago primarily due to continued growth in our Distribution Solutions segment, which accounted for approximately 97% of our consolidated revenues.

Direct distribution and services revenues increased primarily due to a shift of revenues from sales to customers warehouses to direct store delivery and market growth, which includes price increases and increased volume from new and existing customers. This increase was partially offset by the loss of several customers in late 2009. Sales to customers warehouses decreased primarily due to a shift of revenues to direct store delivery partially offset by expanded business with existing customers. For the first nine months of 2010, sales to customers warehouses were also affected by the loss of a large customer.

Canadian pharmaceutical distribution and services revenues increased on a constant currency basis by 8% and 9% in the third quarter and first nine months of 2010 primarily due to market growth. Our growth for the third quarter was affected by a favorable foreign exchange rate of 15% and was partially offset by an unfavorable foreign exchange rate

of 2% for the first nine months of 2010.

Medical-Surgical distribution and services revenues increased reflecting an increase in demand related to the flu season and aided by acquisitions made in late 2009.

Technology Solutions revenues increased in the third quarter and first nine months of 2010 compared to the same periods a year ago due to higher services revenues primarily reflecting increases in software maintenance and claims processing. These increases were partially offset by lower hardware installations. For the first nine months of 2010, revenues were partially offset by unfavorable foreign exchange rates. The first nine months of 2010 were also positively affected by McKesson's Horizon Enterprise Revenue Management™ solution which became generally available in the second quarter of 2010 and as a result we recognized previously deferred revenue.

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McKESSON CORPORATION
FINANCIAL REVIEW (CONTINUED)
(UNAUDITED)

Gross Profit:

| <i>(Dollars in millions)</i> | Quarter Ended December 31, | | | Nine Months Ended December 31, | | |
|------------------------------|---------------------------------------|-------------|---------------|---|-------------|---------------|
| | 2009 | 2008 | Change | 2009 | 2008 | Change |
| Gross Profit | | | | | | |
| Distribution Solutions | \$ 1,104 | \$ 988 | 12% | \$ 3,018 | \$ 2,873 | 5% |
| Technology Solutions | 351 | 355 | (1) | 1,075 | 1,040 | 3 |
| Total | \$ 1,455 | \$ 1,343 | 8 | \$ 4,093 | \$ 3,913 | 5 |
| Gross Profit Margin | | | | | | |
| Distribution Solutions | 4.01% | 3.75% | 26 bp | 3.78% | 3.68% | 10 bp |
| Technology Solutions | 45.53% | 47.27% | (174) | 46.66% | 46.08% | 58 |
| Total | 5.15% | 4.95% | 20 | 4.99% | 4.87% | 12 |

bp basis points

Distribution Solutions segment's gross profit margin for the third quarter and first nine months of 2010 increased primarily due to the impact of the H1N1 flu virus, which helped drive an improved mix of higher margin revenues stemming from increased flu-related demand across our distribution businesses. Gross profit margin was also favorably affected by increased margins from sales of generic drugs. These benefits were partially offset by a decline in sell margin. For the third quarter of 2010, the increase in gross profit margin was partially offset by lower buy side margin due to the timing of price increases. For the first nine months of 2010, gross profit margin was favorably affected by a higher buy side margin. The buy side increase primarily reflects compensation from branded pharmaceutical manufacturers.

Technology Solutions segment's gross profit margin for the third quarter and first nine months of 2010 was negatively affected by a higher software deferral rate and by additional amortization and costs related to McKesson's Horizon Enterprise Revenue Management™ solution, which became generally available in the second quarter of 2010. For the third quarter and first nine months of 2010, the segment's gross profit margin was favorably affected by a change in revenue mix. The first nine months of 2010 were also favorably affected by the recognition of previously deferred revenue, which was recognized as a result of McKesson's Horizon Enterprise Revenue Management™ solution becoming generally available.

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McKESSON CORPORATION
FINANCIAL REVIEW (CONTINUED)
(UNAUDITED)

Operating Expenses and Other Income, Net:

| <i>(Dollars in millions)</i> | Quarter Ended December 31, | | | Nine Months Ended December 31, | | |
|---|---------------------------------------|-----------------|---------------|---|-----------------|---------------|
| | 2009 | 2008 | Change | 2009 | 2008 | Change |
| Operating Expenses | | | | | | |
| Distribution Solutions ⁽¹⁾ | \$ 568 | \$ 1,048 | (46)% | \$ 1,645 | \$ 2,180 | (25)% |
| Technology Solutions | 271 | 265 | 2 | 778 | 817 | (5) |
| Corporate | 107 | 84 | 27 | 255 | 218 | 17 |
| Litigation credit | | | | (20) | | NM |
| Total | \$ 946 | \$ 1,397 | (32) | \$ 2,658 | \$ 3,215 | (17) |
| Operating Expenses as a Percentage of Revenues | | | | | | |
| Distribution Solutions | 2.07% | 3.97% | (190) bp | 2.06% | 2.79% | (73) bp |
| Technology Solutions | 35.15% | 35.29% | (14) | 33.77% | 36.20% | (243) |
| Total | 3.35% | 5.15% | (180) | 3.24% | 4.00% | (76) |
| Other Income, Net | | | | | | |
| Distribution Solutions ⁽²⁾ | \$ 22 | \$ 6 | 267% | \$ 30 | \$ 43 | (30)% |
| Technology Solutions | 1 | 1 | | 3 | 5 | (40) |
| Corporate | 2 | 10 | (80) | 6 | 23 | (74) |
| Total | \$ 25 | \$ 17 | 47 | \$ 39 | \$ 71 | (45) |

(1) Operating expenses for the third quarter and first nine months of 2009 include the AWP litigation charge of \$493 million in our Distribution Solutions segment.

(2) Includes Distribution Solutions segment's sale of its 50% equity

interest in MLS
in the third
quarter of 2010
and 42% equity
interest in
Verispan during
the first nine
months of 2009.

Operating expenses decreased 32% and 17% for the third quarter and the first nine months of 2010 compared to the same periods a year ago. As a percentage of revenues, operating expenses decreased 180 basis points (bp) and 76 bp for these same periods. Operating expenses decreased primarily due to the AWP litigation charge in the third quarter of 2009 as more fully described below. For the third quarter of 2010, operating expenses increased due to employee compensation costs, unfavorable foreign exchange rates and higher legal expenses and legal settlement charges, partially offset by our continued cost containment efforts and lower Profit Sharing Investment Plan (PSIP) expense as more fully described below. For the first nine months of 2010, operating expenses were favorably affected by lower PSIP expense, cost containment efforts, the sales of two businesses during the first and third quarters in 2009 and the reversal of a previously established litigation accrual. These benefits were partially offset by an increase in compensation costs and expenses associated with our 2009 business acquisitions.

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As previously reported in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009 (2009 Annual Report) and Quarterly Reports on Form 10-Q for the quarterly periods ended June 30, 2009 and September 30, 2009, the McKesson Corporation PSIP is a member of the settlement class in the Consolidated Securities Litigation Action. On April 27, 2009, the court issued an order approving the distribution of the settlement funds. On October 9, 2009, the PSIP received approximately \$119 million of the Consolidated Securities Litigation Action proceeds. Approximately \$42 million of the proceeds are attributable to the allocated shares of McKesson common stock owned by the PSIP participants during the Consolidated Securities Litigation Action class holding period and were allocated to the respective participants on that basis in the third quarter of 2010. Approximately \$77 million of the proceeds are attributable to the unallocated shares (the Unallocated Proceeds) of McKesson common stock owned by the PSIP in an employee stock ownership plan (ESOP) suspense account. In accordance with the plan terms, the PSIP will distribute all of the Unallocated Proceeds to current PSIP participants as soon as administratively feasible after the close of the plan year. The receipt of the Unallocated Proceeds by the PSIP is reimbursement for the loss in value of the Company s common stock held by the PSIP in its ESOP suspense account during the Consolidated Securities Litigation Action class holding period and is not a contribution made by the Company to the PSIP or ESOP. Accordingly, there are no accounting consequences to the Company s financial statements relating to the receipt of the Unallocated Proceeds by the PSIP.

The Company anticipates that its PSIP expense for the full year will be negligible, as it currently does not anticipate making or committing to make additional contributions to the PSIP or ESOP. As a result, our compensation expense in 2010 will be lower than 2009. During the first nine months of and full year 2009, PSIP expense was \$39 million and \$53 million.

PSIP expense by segment for the quarters and nine months ended December 31, 2009 and 2008 was as follows:

| <i>(In millions)</i> | Quarter Ended | | Nine Months Ended | |
|------------------------|----------------------|-------------|--------------------------|-------------|
| | December 31, | | December 31, | |
| | 2009 | 2008 | 2009 | 2008 |
| Distribution Solutions | \$ | \$ 5 | \$ | \$ 17 |
| Technology Solutions | | 6 | 1 | 21 |
| Corporate | | | | 1 |
| PSIP expense | \$ | \$ 11 | \$ 1 | \$ 39 |

Distribution Solutions segment s operating expenses for the third quarter and first nine months of 2010 decreased compared to the same periods a year ago primarily reflecting the 2009 AWP litigation charge, the sale of two businesses during the first and third quarters of 2009, our continued focus on cost containment and lower PSIP expense in 2010. For the third quarter of 2010, these decreases were partially offset by an unfavorable foreign exchange rate and higher employee compensation costs. For the first nine months of 2010, these decreases were partially offset by an increase in expenses associated with our 2009 business acquisitions. Operating expenses as a percentage of revenues decreased compared with the same periods a year ago primarily due to the AWP litigation charge, the sale of two businesses during the first and third quarters of 2009, our continued focus on cost containment and lower PSIP expense in 2010.

As discussed in Financial Note 18, Other Commitments and Contingent Liabilities, to the 2009 Annual Report, we reached an agreement to settle all private party claims relating to First DataBank, Inc. s published drug reimbursement benchmarks for \$350 million. We also recorded an accrual for pending and expected AWP-related claims by public payors, which is currently estimated to be \$143 million. The combination of the AWP settlement for all private party claims and the decision by us to establish an estimated accrual for the pending and expected AWP-related claims by

public payors resulted in a pre-tax, non-cash charge of \$493 million in the third quarter of 2009.

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McKESSON CORPORATION
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Technology Solutions segment's operating expenses increased for the third quarter of 2010 compared to the same period a year ago primarily due to our continued investment in research and development activities and an unfavorable foreign exchange rate, partially offset by lower PSIP expense. Operating expenses decreased for the first nine months of 2010 compared to the same period a year ago due to cost containment efforts and lower PSIP expense. During the third and fourth quarters of 2009, the segment implemented reduction in workforce plans which positively affected the first nine months of 2010.

Corporate expenses in the third quarter and first nine months of 2010 increased compared to the same periods a year ago mostly due to higher compensation costs and higher legal expenses and legal settlement charges. In the first nine months of 2010, corporate expenses were also partially offset by the reversal of a previously established litigation accrual.

Other income, net for the third quarter and first nine months of 2010 included a \$17 million pre-tax gain from the sale of our 50% equity interest in MLS, which was partially offset by a decrease in interest income and lower earnings from equity investments. During the first nine months of 2010, other income, net was lower than 2009, which included a \$24 million pre-tax gain from the sale of our 42% equity interest in Verispan. Interest income is primarily recorded within our Corporate segment and financial results for Verispan and MLS were recorded within our Distribution Solutions segment.

Segment Operating Profit (Loss) and Corporate Expenses, Net:

| <i>(Dollars in millions)</i> | Quarter Ended December 31, | | | Nine Months Ended December 31, | | |
|--|---------------------------------------|-------------|---------------|---|-------------|---------------|
| | 2009 | 2008 | Change | 2009 | 2008 | Change |
| Segment Operating Profit (Loss) ⁽¹⁾ | | | | | | |
| Distribution Solutions ^{(2) (3)} | \$ 558 | \$ (54) | NM | \$ 1,403 | \$ 736 | 91% |
| Technology Solutions | 81 | 91 | (11)% | 300 | 228 | 32 |
| Subtotal | 639 | 37 | 1,627 | 1,703 | 964 | 77 |
| Corporate Expenses, Net | (105) | (74) | 42 | (249) | (195) | 28 |
| Litigation Credit | | | | 20 | | NM |
| Interest Expense | (47) | (33) | 42 | (142) | (102) | 39 |
| Income (Loss) Before Income Taxes | \$ 487 | \$ (70) | NM | \$ 1,332 | \$ 667 | 100 |
| Segment Operating Profit (Loss) Margin | | | | | | |
| Distribution Solutions | 2.03% | (0.20)% | 223 bp | 1.76% | 0.94% | 82 bp |
| Technology Solutions | 10.51% | 12.12% | (161) | 13.02% | 10.10% | 292 |

(1) Segment operating profit (loss) includes gross profit, net of operating

expenses, plus other income for our two operating segments.

(2) Operating expenses for the third quarter and first nine months of 2009 include the AWP litigation charge of \$493 million in our Distribution Solutions segment.

(3) Other income, net for the third quarter of 2010 includes the MLS sale of \$17 million and for the first nine months of 2009 includes the Verispan sale of \$24 million in our Distribution Solutions segment.

Operating profit as a percentage of revenues in our Distribution Solutions segment increased for the third quarter and the first nine months of 2010 compared to the same periods a year ago primarily due to the AWP litigation charge in the third quarter of 2009, a higher gross profit margin and the gain on the sale of our equity interest in MLS. For the first nine months of 2010, the increase in operating profit as a percentage of revenues was partially offset by the 2009 gain on the sale of our equity interest in Verispan.

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Operating profit as a percentage of revenues in our Technology Solutions segment decreased for the third quarter of 2010 compared to the same period a year ago primarily reflecting a decrease in gross profit margin. Operating profit as a percentage of revenues increased for the first nine months of 2010 compared to the same period a year ago primarily reflecting decreases in operating expenses as a percentage of revenues and an increase in gross profit margin.

Corporate expenses, net increased primarily due to additional operating expenses as previously discussed and a decrease in interest income.

Interest Expense: Interest expense increased compared to the same periods a year ago primarily due to our issuance of \$700 million of long-term notes in February 2009.

Income Taxes: The Company's reported income tax rates for the third quarters of 2010 and 2009 were 33.1% and 71.4% and 31.3% and 18.7% for the first nine months of 2010 and 2009. Fluctuations in our reported income tax rates are primarily due to discrete items as discussed below.

During the third quarter and first nine months of 2010, income tax expense included net discrete items of an expense of \$11 million and a benefit of \$4 million. The expense in the third quarter of 2010 primarily consists of income taxes on the disposition of MLS and adjustments in connection with tax return filings.

During the third quarter of 2009, we recorded a total income tax benefit of \$50 million, which included an income tax benefit of \$182 million for the AWP litigation charge described in more detail in Financial Note 12 Other Commitments and Contingent Liabilities, in the Financial Notes in Item 1 of Part I of this Quarterly Report on Form 10-Q. The tax benefit could change in the future depending on the resolution of the expected future claims. In addition, during the first nine months of 2009, income tax expense included \$80 million of net income tax benefits for discrete items primarily relating to previously unrecognized tax benefits and related accrued interest. The recognition of these discrete items was primarily due to the lapsing of the statutes of limitations. Of the \$80 million of net tax benefits, \$65 million represented a non-cash benefit to McKesson.

Net Income (Loss): Net income was \$326 million compared to a net (loss) of (\$20) million for the third quarters of 2010 and 2009, or \$1.19 and (\$0.07) per diluted share. Net income was \$915 million and \$542 million for the first nine months of 2010 and 2009, or \$3.36 and \$1.94 per diluted share. The net loss and diluted loss per basic share for the quarter ended December 31, 2008 included a pre-tax charge of \$493 million (\$311 million after-tax) for the AWP litigation as discussed in further detail under the caption Operating Expenses and Other Income, Net in this financial review. For the third quarter of 2009, potentially dilutive securities were excluded from the per share computations due to their antidilutive effect.

Weighted Average Diluted Shares Outstanding: Diluted earnings (loss) per share was calculated based on a weighted average number of diluted shares outstanding of 274 million for the third quarters of 2010 and 2009 and 272 million and 279 million for the nine months ended December 31, 2009 and 2008. The decrease in the number of weighted average diluted shares outstanding for the nine months ended December 31, 2009 primarily reflects a decrease in the number of common shares outstanding as a result of stock repurchases, partially offset by the exercise of share-based awards. For the third quarter of 2009, potentially dilutive securities were excluded from the per share computations due to their antidilutive effect.

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**McKESSON CORPORATION
FINANCIAL REVIEW (CONTINUED)
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Business Acquisitions

During the first quarter of 2009, we acquired McQueary Brothers Drug Company (McQueary Brothers) of Springfield, Missouri for approximately \$190 million. McQueary Brothers is a regional distributor of pharmaceutical, health and beauty products to independent and regional chain pharmacies in the Midwestern U.S. This acquisition expanded our existing U.S. pharmaceutical distribution business. The acquisition was funded with cash on hand. Approximately \$126 million of the purchase price allocation was assigned to goodwill, which primarily reflects the expected future benefits from synergies to be realized upon integrating the business. During the first quarter of 2010, the acquisition accounting was completed. Financial results for McQueary Brothers have been included within our Distribution Solutions segment since the date of acquisition.

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

New Accounting Developments

New accounting pronouncements that we have recently adopted as well as those that have been recently issued but not yet adopted by us are included in Financial Note 1, Significant Accounting Policies, in the Financial Notes in Item 1 of Part I of this Quarterly Report on Form 10-Q.

Financial Condition, Liquidity and Capital Resources

We expect our available cash generated from operations, together with our existing sources of liquidity from our accounts receivable sales facility and short-term borrowings under the revolving credit facility and commercial paper, will be sufficient to fund our long-term and short-term capital expenditures, working capital and other cash requirements. In addition, from time-to-time, we may access the long-term debt capital markets to discharge our other liabilities.

Operating activities provided cash of \$1,725 million and \$734 million during the first nine months of 2010 and 2009. Operating activities for 2010 were primarily affected by improved management of drafts and accounts payable as well as inventory, an increase in receivables primarily associated with our revenue growth, partially offset by the AWP litigation settlement payments. See Financial Note 12, Other Commitments and Contingent Liabilities, in the Financial Notes in Item 1 of Part I of this Quarterly Report on Form 10-Q for further information related to the AWP litigation. Operating activities for 2009 include a non-cash charge of \$493 million for the AWP litigation. Operating activities for 2009 were affected by the accelerated receipt of \$350 million of our accounts receivable through our accounts receivable sales facility. Operating activities for 2009 also reflected an increase in receivables primarily associated with our revenue growth as well as an increase in our net financial inventory (inventory, net of accounts payable) primarily associated with the timing of inventory purchases to support our revenue growth. Cash flows from operations can be significantly affected by factors such as the timing of receipts from customers and payments to vendors.

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Investing activities utilized cash of \$203 million and \$532 million during the first nine months of 2010 and 2009. Investing activities for 2010 include the release of restricted cash from escrow related to the AWP litigation settlement payments. Investing activities include \$271 million and \$288 million in capital expenditures for property acquisitions and capitalized software in 2010 and 2009 as well as \$18 million and \$320 million in 2010 and 2009 of payments for business acquisitions. Activity for 2009 includes the McQueary Brothers acquisition for approximately \$190 million.

Financing activities utilized cash of \$237 million and \$349 million in the first nine months of 2010 and 2009. Financing activities for 2010 and 2009 include \$322 million and \$351 million in cash paid for stock repurchases, partially offset by cash generated from stock issuances of \$159 million and \$77 million for 2010 and 2009.

In April 2008, the Company's Board of Directors (the Board) approved a plan to repurchase \$1.0 billion of the Company's common stock, of which \$830 million remained available at March 31, 2009. During the third quarter of 2010, we did not repurchase shares. During the first nine months of 2010, we repurchased 8 million shares for \$299 million, leaving \$531 million available for future repurchases as of December 31, 2009. Stock repurchases may be made from time-to-time in open market or private transactions.

In July 2008, the Board authorized the retirement of shares of the Company's common stock that may be repurchased from time-to-time pursuant to its stock repurchase program. During the second quarter of 2009, all of the 4 million repurchased shares, which we purchased for \$204 million, were formally retired by the Company. The retired shares constitute authorized but unissued shares. We elected to allocate any excess of share repurchase price over par value between additional paid-in capital and retained earnings. As such, \$165 million was recorded as a decrease to retained earnings.

We believe that our operating cash flow, financial assets and current access to capital and credit markets, as evidenced by our debt issuance in February 2009, including our existing credit and sales facilities, will give us the ability to meet our financing needs for the foreseeable future. However, there can be no assurance that continued or increased volatility and disruption in the global capital and credit markets will not impair our liquidity or impact our costs of borrowing.

Selected Measures of Liquidity and Capital Resources

| <i>(Dollars in millions)</i> | December 31, 2009 | March 31, 2009 |
|---|----------------------------------|---------------------------|
| Cash and cash equivalents | \$ 3,428 | \$ 2,109 |
| Working capital | 3,936 | 3,065 |
| Debt, net of cash and cash equivalents | (916) | 403 |
| Debt to capital ratio ⁽¹⁾ | 26.1% | 28.9% |
| Net debt to net capital employed ⁽²⁾ | (14.8) | 6.1 |
| Return on stockholders' equity ⁽³⁾ | 18.4 | 13.2 |

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

(2) Ratio is computed as total debt, net of cash and cash equivalents (net debt), divided by net debt and stockholders' equity (net capital employed).

(3) Ratio is computed as net income for the last four quarters, divided by a five-quarter average of stockholders' equity.

Working capital primarily includes cash and cash equivalents, receivables and inventories, net of drafts and accounts payable, deferred revenue and other current liabilities. Our Distribution Solutions segment requires a substantial investment in working capital that is susceptible to large variations during the year as a result of inventory purchase patterns and seasonal demands. Inventory purchase activity is a function of sales activity and customer requirements. Consolidated working capital increased as a result of a favorable increase in cash and cash equivalents, higher receivables balance and inventories, net of an increase in drafts and accounts payable.

Our ratio of net debt to net capital employed decreased in 2010 primarily due to a higher cash and cash equivalents balance.

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**McKESSON CORPORATION
FINANCIAL REVIEW (CONTINUED)
(UNAUDITED)**

Credit Resources

We fund our working capital requirements primarily with cash and cash equivalents, our accounts receivable sales facility, short-term borrowings under the revolving credit facility and commercial paper.

Accounts Receivable Sales Facility

In May 2009, we renewed our accounts receivable sales facility for an additional one year period under terms similar to those previously in place. The renewed facility will expire in May 2010. The May 2009 renewal increased the committed balance from \$1.0 billion to \$1.1 billion, although from time-to-time the available amount may be less than \$1.1 billion based on concentration limits and receivable eligibility requirements.

Through this facility, McKesson Corporation, the parent company, sells certain U.S. pharmaceutical trade accounts receivable on a non-recourse basis to a wholly-owned and consolidated subsidiary which then sells these receivables to a special purpose entity (SPE), which is a wholly-owned, bankruptcy-remote subsidiary of McKesson Corporation that is consolidated in our financial statements. This SPE then sells undivided interests in the receivables to third-party purchaser groups, each of which includes commercial paper conduits, which are special purpose legal entities administered by financial institutions.

Additional information regarding our accounts receivable sales facility is included in Financial Note 8, Financing Activities, in the Financial Notes in Item 1 of Part I of this Quarterly Report on Form 10-Q.

Revolving Credit Facility

We have a syndicated \$1.3 billion five-year, senior unsecured revolving credit facility which expires in June 2012. Borrowings under this credit facility bear interest based upon either a Prime rate or the London Interbank Offering Rate. Total borrowings under this facility were nil and \$259 million for the first nine months of 2010 and 2009. As of December 31, 2009 and March 31, 2009, there were no amounts outstanding under this facility.

Commercial Paper

We issued and repaid commercial paper of nil and approximately \$3.3 billion for the first nine months of 2010 and 2009. There were no commercial paper issuances outstanding at December 31, 2009 and March 31, 2009.

Long-Term Debt

On February 12, 2009, we issued 6.50% notes due February 15, 2014 (the 2014 Notes) in an aggregate principal amount of \$350 million and 7.50% notes due February 15, 2019 (the 2019 Notes) in an aggregate principal amount of \$350 million. Interest is payable on February 15 and August 15 of each year beginning on August 15, 2009. The 2014 Notes will mature on February 15, 2014 and the 2019 Notes will mature on February 15, 2019. We utilized net proceeds, after offering expenses, of \$693 million from the issuance of the 2014 Notes and 2019 Notes for general corporate purposes.

Debt Covenants

Our various borrowing facilities and long-term debt are subject to certain covenants. Our principal debt covenant is our debt to capital ratio, which cannot exceed 56.5%. If we exceed this ratio, repayment of debt outstanding under the revolving credit facility and \$215 million of term debt could be accelerated. As of December 31, 2009, this ratio was 26.1% and we were in compliance with our other financial covenants. A reduction in our credit ratings or the lack of compliance with our covenants could negatively impact our ability to finance operations through our credit facilities or issue additional debt at the interest rates then currently available.

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

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**McKESSON CORPORATION
FINANCIAL REVIEW (CONCLUDED)
(UNAUDITED)**

FACTORS AFFECTING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2 of Part I of this report, 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. Some of these statements can be identified by use of forward-looking words such as believes, expects, anticipates, may, will, should, seeks, approximates, intends, plans, or estimates, or the negative or other comparable terminology. The discussion of financial trends, strategy, plans or intentions may also include forward-looking statements. Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected, anticipated or implied. Although it is not possible to predict or identify all such risks and uncertainties, they may include, but are not limited to, the following factors. The reader should not consider this list to be a complete statement of all potential risks and uncertainties:

material adverse resolution of pending legal proceedings;

changes in the U.S. healthcare industry and regulatory environment;

competition;

the frequency or rate of branded drug price inflation and generic drug price deflation;

substantial defaults in payments or a material reduction in purchases by, or loss of, a large customer;

implementation delay, malfunction or failure of internal information systems;

the adequacy of insurance to cover property loss or liability claims;

the Company's failure to attract and retain customers for its software products and solutions due to integration and implementation challenges, or due to an inability to keep pace with technological advances;

loss of third party licenses for technology incorporated into the Company's products and solutions;

the Company's proprietary products and services may not be adequately protected and its products and solutions may infringe on the rights of others;

failure of our technology products and solutions to conform to specifications;

disaster or other event causing interruption of customer access to the data residing in our service centers;

increased costs or product delays required to comply with existing and changing regulations applicable to our businesses and products;

changes in government regulations relating to sensitive personal information and to format and data content standards;

the delay or extension of our sales or implementation cycles for external software products;

changes in circumstances that could impair our goodwill or intangible assets;

foreign currency fluctuations or disruptions to our foreign operations;

new or revised tax legislation or challenges to our tax positions;

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

continued volatility and disruption to the global capital and credit markets;

failure to adequately prepare for and accurately assess the scope, duration or financial impact of public health issues on our operations, particularly the Company's current H1N1 flu vaccine distribution effort with the Centers for Disease Control and Prevention, whether occurring in the United States or abroad; and

changes in accounting standards issued by the Financial Accounting Standards Board or other standard setting bodies.

These and other risks and uncertainties are described herein and in other information contained in our publicly available Securities and Exchange Commission filings and press releases. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date such statements were first made. Except to the extent required by federal securities laws, we undertake no obligation to publicly release the result of any revisions to these forward-looking statements to reflect events or circumstances after the date hereof, or to reflect the occurrence of unanticipated events.

Table of Contents**McKESSON CORPORATION****Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We believe there has been no material change in our exposure to risks associated with fluctuations in interest and foreign currency exchange rates as disclosed in our 2009 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Our Chief Executive Officer and our Chief Financial Officer, with the participation of other members of the Company's management, have evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act)) as of the end of the period covered by this quarterly report, and our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective based on their evaluation of these controls and procedures as required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15.

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

PART II. OTHER INFORMATION**Item 1. Legal Proceedings**

The information set forth in Financial Note 12, Other Commitments and Contingent Liabilities, in the Financial Notes in Item 1 of Part I of this Quarterly Report on Form 10-Q is incorporated herein by reference.

Item 1A. Risk Factors

There have been no material changes during the period covered by this Quarterly Report on Form 10-Q to the risk factors disclosed in Part 1, Item 1A, of our 2009 Annual Report on Form 10-K.

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

The following table provides information on the Company's share repurchases during the third quarter of 2010.

| | | Share Repurchases | | Approximate |
|--|-------------------|-------------------|------------|-------------------------|
| | | Total | Total | Dollar Value |
| | | Number of | Number of | of |
| | | Shares | Shares | Shares that |
| | | Purchased | Purchased | May |
| | | of | As Part of | Yet Be |
| | | Total | Publicly | Purchased |
| | | Number | Announced | Under the |
| | | of | Program | Programs ⁽¹⁾ |
| | | Shares | Average | |
| | | Purchased | Price Paid | |
| | | | Per Share | |
| <i>(In millions, except price per share)</i> | | | | |
| October 1, 2009 | October 31, 2009 | | \$ | \$ 531 |
| November 1, 2009 | November 30, 2009 | | | 531 |
| December 1, 2009 | December 31, 2009 | | | 531 |
| Total | | | | 531 |

(1) This table does not include shares tendered to satisfy the

exercise price in connection with cashless exercises of employee stock options or shares tendered to satisfy tax withholding obligations in connection with employee equity awards.

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McKESSON CORPORATION

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits

| Exhibit Number | Description |
|-----------------------|--|
| 31.1 | Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101* | The following materials from the McKesson Corporation Quarterly Report on Form 10-Q for the quarter ended December 31, 2009, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Operations, (ii) Condensed Consolidated Balance Sheets, (iii) Condensed Consolidated Statements of Cash Flows, and (iv) related notes, tagged as blocks of text. |

* Furnished
herewith.

SIGNATURES

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

McKesson Corporation

Dated: January 26, 2010

/s/ Jeffrey C. Campbell

Jeffrey C. Campbell

Executive Vice President and Chief Financial
Officer

/s/ Nigel A. Rees

Nigel A. Rees

Vice President and Controller