MCKESSON CORP
Form 10-Q
November 01, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For quarter ended September 30, 2006

o **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	**94-3207296**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**
One Post Street, San Francisco, California	**94104**
(Address of principal executive offices)	**(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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

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

Class	**Outstanding at September 30, 2006**
Common stock, $0.01 par value	**295,968,992 shares**

TABLE OF CONTENTS

Item	Page
PART I FINANCIAL INFORMATION	
1. Condensed Consolidated Financial Statements	
Condensed Consolidated Balance Sheets September 30, 2006 and March 31, 2006	3
Condensed Consolidated Statements of Operations Quarters and Six Months ended September 30, 2006 and 2005	4
Condensed Consolidated Statements of Cash Flows Six Months ended September 30, 2006 and 2005	5
Financial Notes	6
2. Management s Discussion and Analysis of Results of Operations and Financial Condition	22-35
3. Quantitative and Qualitative Disclosures about Market Risk	35
4. Controls and Procedures	35
PART II. OTHER INFORMATION	
1. Legal Proceedings	35
1A. Risk Factors	35
2. Unregistered Sales of Equity Securities and Use of Proceeds	36
3. Defaults Upon Senior Securities	36
4. Submission of Matters to a Vote of Security Holders	36
5. Other Information	37
6. Exhibits	38
Signatures	39

EXHIBIT 10.10
EXHIBIT 10.13
EXHIBIT 10.14
EXHIBIT 10.15
EXHIBIT 10.21
EXHIBIT 10.30
EXHIBIT 10.31
EXHIBIT 10.32
EXHIBIT 10.33
EXHIBIT 10.34

EXHIBIT 10.35
EXHIBIT 31.1
EXHIBIT 31.2
EXHIBIT 32

Table of Contents

McKESSON CORPORATION
PART I. FINANCIAL INFORMATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions, except per share amounts)
(Unaudited)

	September 30, 2006	March 31, 2006
ASSETS		
Current Assets		
Cash and cash equivalents	$ 2,254	$ 2,139
Restricted cash	981	962
Receivables, net	5,983	6,247
Inventories	7,791	7,127
Prepaid expenses and other	293	522
Total	17,302	16,997
Property, Plant and Equipment, Net	634	663
Capitalized Software Held for Sale, Net	150	139
Goodwill	1,696	1,637
Intangible Assets, Net	132	116
Other Assets	1,565	1,409
Total Assets	$ 21,479	$ 20,961
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Drafts and accounts payable	$ 10,426	$ 9,944
Deferred revenue	813	827
Current portion of long-term debt	25	26
Securities Litigation	1,002	1,014
Other	1,664	1,679
Total	13,930	13,490
Postretirement Obligations and Other Noncurrent Liabilities	669	599
Long-Term Debt	959	965
Other Commitments and Contingent Liabilities (Note 14)		
Stockholders Equity		
Preferred stock, $0.01 par value, 100 shares authorized, no shares issued or outstanding		
Common stock, $0.01 par value Shares authorized: September 30, 2006 and March 31, 2006 800 Shares issued: September 30, 2006 335 and March 31, 2006 330	3	3

Additional paid-in capital		3,444		3,238
Other capital		(33)		(75)
Retained earnings		4,248		3,871
Accumulated other comprehensive income		94		55
ESOP notes and guarantees		(17)		(25)
Treasury shares, at cost, September 30, 2006 39 and March 31, 2006 26		(1,818)		(1,160)
Total Stockholders Equity		5,921		5,907
Total Liabilities and Stockholders Equity	$	21,479	$	20,961

See Financial Notes

Table of Contents

McKESSON CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except per share amounts)
(Unaudited)

	Quarter Ended September 30,		Six Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Revenues	$ 22,386	$ 21,253	$ 45,701	$ 41,953
Cost of Sales	21,362	20,385	43,681	40,189
Gross Profit	1,024	868	2,020	1,764
Operating Expenses	724	642	1,448	1,232
Securities Litigation Charge (Credit), Net	(6)		(6)	52
Total Operating Expenses	718	642	1,442	1,284
Operating Income	306	226	578	480
Other Income, Net	32	35	67	62
Interest Expense	(22)	(22)	(45)	(47)
Income from Continuing Operations Before Income Taxes	316	239	600	495
Income Tax Provision	(29)	(87)	(129)	(177)
Income from Continuing Operations	287	152	471	318
Discontinued Operations, net	(6)	2	(6)	7
Discontinued Operations gain (loss) on sale, net	(52)	13	(52)	13
Total Discontinued Operations	(58)	15	(58)	20
Net Income	$ 229	$ 167	$ 413	$ 338
Earnings Per Common Share				
Diluted				
Continuing operations	$ 0.94	$ 0.48	$ 1.54	$ 1.02
Discontinued operations	(0.02)	0.01	(0.02)	0.02
Discontinued operations gain (loss) on sale, net	(0.17)	0.04	(0.17)	0.04
Total	$ 0.75	$ 0.53	$ 1.35	$ 1.08
Basic				
Continuing operations	$ 0.96	$ 0.49	$ 1.57	$ 1.04
Discontinued operations	(0.02)	0.01	(0.02)	0.03
Discontinued operations gain (loss) on sale, net	(0.17)	0.04	(0.17)	0.04
Total	$ 0.77	$ 0.54	$ 1.38	$ 1.11

Dividends Declared Per Common Share	$ 0.06	$ 0.06	$ 0.12	$ 0.12
Weighted Average Shares				
Diluted	305	316	307	315
Basic	298	308	300	305

See Financial Notes

4

Table of Contents

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

	Six Months Ended September 30,	
	2006	**2005**
Operating Activities		
Net income	$ 413	$ 338
Discontinued operations, net of income taxes	58	(20)
Adjustments to reconcile to net cash provided by (used in) operating activities:		
Depreciation and amortization	139	125
Securities Litigation charge (credit), net	(6)	52
Deferred taxes	70	111
Other non-cash items	(15)	(9)
Total	659	597
Effects of changes in:		
Receivables	256	58
Inventories	(635)	262
Drafts and accounts payable	454	1,090
Deferred revenue	12	101
Taxes	33	12
Securities Litigation settlement payments	(6)	(69)
Proceeds from sale of notes receivable		28
Other	(88)	(77)
Total	26	1,405
Net cash provided by operating activities	685	2,002
Investing Activities		
Property acquisitions	(51)	(82)
Capitalized software expenditures	(86)	(65)
Acquisitions of businesses, less cash and cash equivalents acquired	(95)	(573)
Proceeds from sale of businesses	175	63
Other	(38)	5
Net cash used in investing activities	(95)	(652)
Financing Activities		
Repayment of debt	(8)	(20)
Capital stock transactions:		
Issuances	191	282
Share repurchases	(658)	(289)

ESOP notes and guarantees	7	9
Dividends paid	(36)	(36)
Other	29	(101)
Net cash used in financing activities	(475)	(155)
Net increase in cash and cash equivalents	115	1,195
Cash and cash equivalents at beginning of period	2,139	1,800
Cash and cash equivalents at end of period	$ 2,254	$ 2,995

See Financial Notes

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 majority-owned or controlled companies. Significant intercompany transactions and balances have been eliminated. 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 September 30, 2006, and the results of operations for the quarters and six months ended September 30, 2006 and 2005 and cash flows for the six months ended September 30, 2006 and 2005.

The results of operations for the quarters and six months ended September 30, 2006 and 2005 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 2006 consolidated financial statements previously filed with the Securities and Exchange Commission (SEC).

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. Certain prior year amounts have been reclassified to conform to the current year presentation.

New Accounting Pronouncements. On April 1, 2006, we adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment, which requires the recognition of expense resulting from transactions in which we acquire goods and services by issuing our shares, share options, or other equity instruments. This standard requires a fair-value based measurement method in accounting for share-based payment transactions. The share-based compensation expense is recognized for the portion of the awards that is ultimately expected to vest. This standard replaced SFAS No. 123, Accounting for Stock-Based Compensation, and superseded Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. Accordingly, the use of the intrinsic value method as provided under APB Opinion No. 25, which was utilized by the Company, was eliminated. We adopted SFAS No. 123(R) using the modified prospective method of transition. See Financial Note 4, Share-Based Payment, for further details.

As a result of the provisions of SFAS No. 123(R), in 2007, we now expect share-based compensation charges to approximate $0.10 to $0.12 per diluted share, or an increase of $0.02 per diluted share from our previous expectations. These charges are now expected to be approximately $0.07 to $0.09 per diluted share more than the share-based compensation expense recognized in our net income in 2006. Our assessments of estimated compensation charges are affected by our stock price 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 behaviors, timing, level and types of our grants of annual share-based awards and the attainment of performance goals. As a result, the actual share-based compensation expense in 2007 may differ from the Company s current estimate.

In July 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN No. 48 provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. This interpretation also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 will become effective for us in 2008. We are currently assessing the impact of FIN No. 48 on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This standard applies under other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements. SFAS No. 157 will become effective for us in 2009. We are currently assessing the impact of SFAS No. 157; however, we do not believe the adoption of this standard will have a material

effect on our consolidated financial statements.

Table of Contents

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, which requires us to recognize the funded status of our defined benefit plans in the consolidated balance sheets and changes in the funded status in comprehensive income. This standard also requires us to recognize the gains/losses, prior year service costs and transition assets/obligations as a component of other comprehensive income upon adoption, and provide additional annual disclosure. SFAS No.158 does not affect the computation of benefit expense recognized in our consolidated statements of operations. The recognition and disclosure provisions are effective in 2007. In addition, SFAS No. 158 requires us to measure plan assets and benefit obligations as of the year-end balance sheet date effective in 2009. We are required to apply the provisions of this standard prospectively. We are currently assessing the impact of SFAS No. 158 on our consolidated financial statements.

In September 2006, the SEC staff issued Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. This guidance indicates that the materiality of a misstatement must be evaluated using both the rollover and iron curtain approaches. The iron curtain approach quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, while the rollover approach quantifies a misstatement based on the amount of the error originating in the current year income statement. SAB No. 108 is effective for our 2007 annual consolidated financial statements. We are currently assessing the impact of SAB No. 108; however, we do not believe the adoption of this standard will have a material effect on our consolidated financial statements.

2. Acquisitions and Investments

In the first half of 2007, we acquired the following three entities for a total cost of $91 million, which was paid in cash:

Sterling Medical Services LLC (Sterling), based in Moorestown, New Jersey, a national provider and distributor of medical disposable supplies, health management services and quality management programs to the home care market. Financial results for Sterling are included in our Medical-Surgical Solutions segment;

HealthCom Partners LLC (HealthCom), based in Mt. Prospect, Illinois, a leading provider of patient billing solutions designed to simplify and enhance healthcare providers financial interactions with their patients; and

RelayHealth Corporation (RelayHealth), based in Emeryville, California, a provider of secure online healthcare communication services linking patients, healthcare professionals, payors and pharmacies. Financial results for HealthCom and RelayHealth are included in our Provider Technologies segment.

Goodwill recognized in these transactions amounted to $60 million.

In addition, in the first quarter of 2007, we contributed $36 million in cash and $45 million in net assets primarily from our Automated Prescription Systems business to Parata Systems, LLC (Parata), in exchange for a significant minority interest in Parata. In connection with the investment, we abandoned certain assets which resulted in a $15 million charge to cost of sales and we incurred $6 million of other expenses related to the transaction which were recorded within operating expenses. We did not recognize any additional gains or losses as a result of this transaction as we believe the fair value of our investment in Parata, as determined by a third-party valuation, approximates the carrying value of consideration contributed to Parata. Our investment in Parata is accounted for under the equity method of accounting within our Pharmaceutical Solutions segment.

In 2006, we made the following acquisitions:

In the second quarter of 2006, we acquired all of the issued and outstanding stock of D&K Healthcare Resources, Inc. (D&K) of St. Louis, Missouri, for an aggregate cash purchase price of $479 million, including the assumption of D&K s debt. D&K is primarily a wholesale distributor of branded and generic pharmaceuticals and over-the-counter health and beauty products to independent and regional pharmacies, primarily in the Midwest. Approximately $158 million of the purchase price has been assigned to goodwill. Included in the purchase price

were acquired identifiable intangibles of $43 million primarily representing

Table of Contents

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

customer lists and not-to-compete covenants which have an estimated weighted-average useful life of nine years. Financial results for D&K are included in our Pharmaceutical Solutions segment.

Also in the second quarter of 2006, we acquired all of the issued and outstanding shares of Medcon, Ltd. (Medcon), an Israeli company, for an aggregate purchase price of $82 million. Medcon provides web-based cardiac image and information management services to healthcare providers. Approximately $60 million of the purchase price was assigned to goodwill and $20 million was assigned to intangibles which represent technology assets and customer lists which have an estimated weighted-average useful life of four years. Financial results for Medcon are included in our Provider Technologies segment.

During the last two years, we also completed a number of other acquisitions and investments within all three 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 and, for certain recent acquisitions, may be subject to change. Goodwill recognized for our business acquisitions is 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. Discontinued Operations

Results from discontinued operations were as follows:

	Quarter Ended September 30,		Six Months Ended September 30,	
(In millions)	**2006**	**2005**	**2006**	**2005**
Income (loss) from discontinued operations				
Acute Care	$(10)	$ 3	$(10)	$10
BioServices				2
Income taxes	4	(1)	4	(5)
Total	$ (6)	$ 2	$ (6)	$ 7
Gain (loss) on sale of discontinued operations				
Acute Care	$(49)	$	$(49)	$
BioServices		22		22
Other	6		6	
Income taxes	(9)	(9)	(9)	(9)
Total	$(52)	$13	$(52)	$13
Discontinued operations, net of taxes				
Acute Care	$(67)	$ 2	$(67)	$ 6
PBI	5		5	
BioServices		13		14
Other	4		4	
Total	$(58)	$15	$(58)	$20

In July 2006, we signed an agreement to sell our Medical-Surgical Solutions segment s Acute Care supply business to Owens & Minor, Inc. (OMI) for net cash proceeds of approximately $160 million, subject to certain adjustments. This transaction closed on September 30, 2006. In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the financial results of this business are classified as a discontinued operation for all periods presented in the accompanying condensed consolidated financial statements. Such presentation includes the classification of all applicable assets of the disposed business under the caption Prepaid expenses and other and all applicable liabilities under the caption Other under Current Liabilities

8

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

within our condensed consolidated balance sheets for all periods presented. Revenues associated with the Acute Care business were $274 million and $260 million for the second quarters of 2007 and 2006, and $573 million and $528 million for the first halves of 2007 and 2006.

Financial results for this discontinued operation include an after-tax loss of $67 million, which primarily consists of an after-tax loss of $61 million for the business disposition and $6 million of after-tax losses associated with operations, other asset impairment charges and employee severance costs. The after-tax loss of $61 million for the business disposition includes a $79 million non-tax deductible write-off of goodwill, as further described below.

In connection with this divestiture, we allocated a portion of our Medical-Surgical Solutions segment s goodwill to the Acute Care business as required by SFAS No. 142, Goodwill and Other Intangible Assets. The allocation was based on the relative fair values of the Acute Care business and the continuing businesses that are being retained by the Company. The fair value of the Acute Care business was determined based on the net cash proceeds resulting from the divestiture and the fair value of the continuing businesses was determined by a third-party valuation. As a result, we allocated $79 million of the segment s goodwill to the Acute Care business.

Additionally, as part of the divestiture, we entered into a transition services agreement (TSA) with OMI under which we will continue to provide certain services to the Acute Care business during a transition period of approximately nine months. We also anticipate incurring approximately $6 million of pre-tax employee severance charges over the transition period. These charges, as well as the financial results from the TSA, will be recorded as part of discontinued operations. The continuing cash flows generated from the TSA are not anticipated to be material to our condensed consolidated financial statements.

In the second quarter of 2007, we also sold a wholly-owned subsidiary, Pharmaceutical Buyers Inc. (PBI), for net cash proceeds of $10 million. The divestiture resulted in an after-tax gain of $5 million resulting from the tax basis of the subsidiary exceeding its carrying value. Financial results of this business, which were previously included in our Pharmaceutical Solutions segment, have been presented as a discontinued operation for all periods presented in the accompanying condensed consolidated financial statements. These results were not material to our condensed consolidated financial statements.

Results for discontinued operations for 2007 also include an after-tax gain of $4 million associated with the collection of a note receivable from a business sold in 2003.

In the second quarter of 2006, we sold our wholly-owned subsidiary, McKesson BioServices Corporation (BioServices), for net cash proceeds of $63 million. The divestiture resulted in an after-tax gain of $13 million. Financial results for this business, which were previously included in our Pharmaceutical Solutions segment, have been presented as a discontinued operation for all periods presented in the accompanying condensed consolidated financial statements. These results were not material to our condensed consolidated financial statements.

4. Share-Based Payment

We provide various share-based compensation for our employees, officers and non-employee directors, including stock options, an employee stock purchase plan, restricted stock (RS), restricted stock units (RSUs) and performance-based restricted stock units (PeRSUs) (collectively, share-based.) On April 1, 2006, we adopted SFAS No. 123(R), as discussed in Financial Note 1, Significant Accounting Policies. Accordingly, we began to recognize compensation expense for the fair value of share-based awards granted, modified, repurchased or cancelled from April 1, 2006 forward. For the unvested portion of awards issued prior to and outstanding as of April 1, 2006, the expense is recognized at the grant-date fair value as the remaining requisite service is rendered. We recognize compensation expense on a straight-line basis over the requisite service period for those awards with graded vesting and service conditions. For the awards with performance conditions, we recognize the expense on a straight-line basis, treating each vesting tranche as a separate award. In 2006, 2005 and 2004, we reduced the vesting period of substantially all of the then outstanding stock options for employee retention purposes and in anticipation of the requirements of SFAS No. 123(R), either through acceleration or shortened vesting schedules at grant. We adopted SFAS No. 123(R) using the modified prospective method and therefore have not restated prior period financial

statements. Prior to adopting SFAS No. 123(R), we accounted for our employee share-based

Table of Contents

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

compensation plans using the intrinsic value method under APB Opinion No. 25. This standard generally did not require recognition of compensation expense for the majority of our share-based awards except for RS and RSUs. In addition, as required under APB Opinion No. 25, we previously recognized forfeitures as they occurred.

The compensation expense recognized under SFAS No. 123(R) has been classified in the income statement or capitalized on the balance sheet in the same manner as cash compensation paid to our employees. There was no material share-based compensation expense capitalized as part of the balance sheet at September 30, 2006. In addition, SFAS No. 123(R) requires that the benefits of realized tax deductions in excess of previously recognized tax benefits on compensation expense be reported as a financing cash flow rather than an operating cash flow, as was done under APB Opinion No. 25. For the quarter and six months ended September 30, 2006, $27 million and $36 million of excess tax benefits were recognized.

In conjunction with the adoption of SFAS No. 123(R), we elected the short-cut method for calculating the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of share-based compensation. Under this method, a simplified calculation is applied in establishing the beginning APIC pool balance as well as determining the future impact on the APIC pool and our consolidated statements of cash flows relating to the tax effects of share-based compensation. The election of this accounting policy did not have a material impact on our consolidated financial statements.

I. Impact on Net Income

During the second quarter and first half of 2007, we recorded $16 million and $24 million of pre-tax share-based compensation expense, compared to $25 million and $32 million pre-tax pro forma expense for the comparable prior year periods. The share-based compensation expense for the second quarter and first half of 2007 was comprised of RS, RSUs and PeRSUs expense of $12 million and $20 million, stock option expense of $2 million and $3 million, and employee stock purchase plan expense of $2 million and $4 million. The amount for the first half of 2007 also included a credit of $3 million for a cumulative effect adjustment to reflect estimated forfeitures relating to unvested RS and RSUs outstanding upon the adoption of SFAS No. 123(R). We recognized tax benefits related to the share-based compensation of $6 million and $8 million in the second quarter and first half of 2007.

The following table illustrates the impact of share-based compensation on reported amounts:

	Quarter Ended September 30, 2006		Six Months Ended September 30, 2006	
(In millions, except per share data)	As Reported	Impact of Share-Based Compensation	As Reported	Impact of Share-Based Compensation
Income from continuing operations before income taxes	$ 316	$ 16	$ 600	$ 24
Net income	229	10	413	16
Earnings per share:				
Diluted	$0.75	$ 0.03	$1.35	$ 0.05
Basic	0.77	0.03	1.38	0.05

Table of Contents

McKESSON CORPORATION
FINANCIAL NOTES (Continued)
(Unaudited)

II. SFAS No. 123 Pro Forma Information for 2006

As noted above, prior to April 1, 2006 we accounted for our employee share-based compensation plans using the intrinsic value method under APB Opinion No. 25. Had compensation expense for our employee share-based compensation been recognized based on the fair value method, consistent with the provisions of SFAS No. 123, net income and earnings per share would have been as follows:

(In millions, except per share data)	**Quarter Ended September 30, 2005**	**Six Months Ended September 30, 2005**