On the Corner.

On the Phone.

On the Web.™

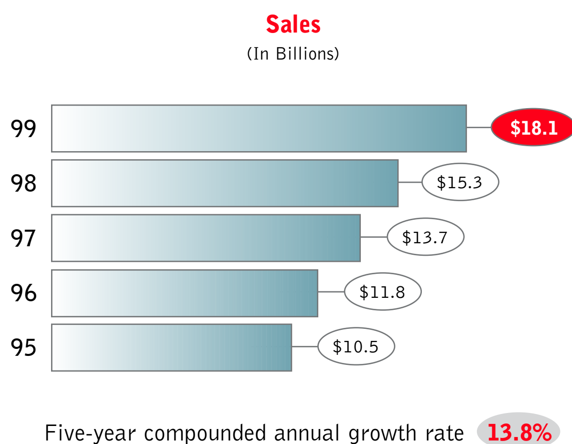
Total healthcare solutions for the way we live.

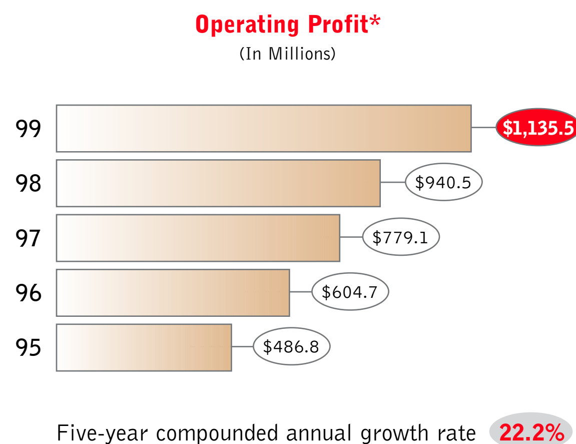
1999 – Another Outstanding Year

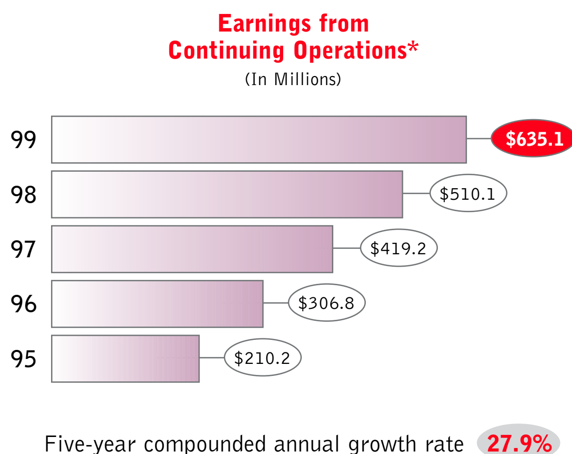
- Our total sales climbed 18.5 percent to $18.1 billion. Same-store sales increased 12.5 percent, while pharmacy same-store sales rose 19.4 percent.
- CVS once again filled more prescriptions than any other retailer in America, dispensing a record 281 million prescriptions.
- We opened a record 433 new and relocated CVS/pharmacy stores, and 12 CVS ProCare stores.
- We aggressively launched our specialty pharmacy business, CVS ProCare, in this $14 billion fast-growing segment of the pharmacy market.
- The first major "clicks and mortar" pharmacy in America was created when we purchased Soma.com and rebranded it CVS.com.
- We continued to improve our return on invested capital with inventory turns increasing to 4.0x per year.
- CVS has the #1 market share in 30 of the top 100 U.S. drugstore markets – more than any other drugstore chain.
- CVS cared for 2.5 million customers per day in 1999.

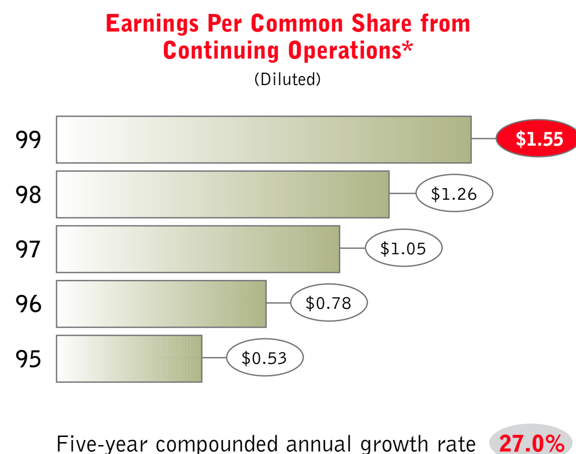
Financial Highlights

In millions, except per share	**1999**	1998	% Change
Sales	$18,098.3	$15,273.6	18.5
Operating profit*	1,135.5	940.5	20.7
Net earnings*	635.1	510.1	24.5
Diluted earnings per common share*	1.55	1.26	23.0









** Excludes the effect of the merger, restructuring and other nonrecurring charges that were recorded in 1998, 1997, 1996 and 1995. See page 41 for further information.*

TO OUR SHAREHOLDERS

CVS Corporation made great strides in 1999 in reaching out to customers everywhere they want to shop—*On the Corner, On the Phone and On the Web*™. Our tireless commitment to service, convenience and innovation has enabled us to become a leader in providing *total healthcare solutions* to our customers.

On the Corner, we opened and relocated a record number of stores to make the shopping experience pleasant and productive for time-starved consumers, increasing our number of 24-hour stores and drive-thru pharmacies. With 4,100 stores, we have more retail locations than any other drugstore chain in the United States. *On the Phone,* our Rapid Refill service makes it easy for customers to refill their prescriptions quickly and conveniently. *On the Web,* CVS.com provides prescription filling options, comprehensive healthcare information and a wide range of front store merchandise with the added convenience of mail delivery or in-store pharmacy pickup.

At the heart of our long-term growth strategy is cutting-edge technology, which we use aggressively to achieve breakthroughs in service. We are exploring new and innovative ways to provide more personalized service and product offerings that build customer loyalty.

Our CareCheck Plus[SM] program, for example, combines health advice, prescription education and direct marketing capabilities to target consumers with appropriate health information and over-the-counter product offers related to their prescription purchases.

The establishment of CVS as the first major "clicks and mortar" pharmacy in the nation provides us with a significant competitive advantage in the growing field of e-pharmacy.

In January 2000, we became the first and only drugstore chain in America to use technology to protect patients from dangerous drug interactions between prescription medications, over-the-counter remedies, vitamins and herbal products. We extend this critical service to all CVS customers, wherever they like to shop.

And we are leveraging our industry leadership position by forming technology-based alliances with other healthcare leaders that enable us to provide more complete and meaningful solutions for our customers. In January 2000, we entered an alliance with Healtheon/WebMD, the leader in physician connectivity and the leading provider of healthcare information on the Internet, to become the exclusive e-pharmacy for several major Internet portals, including WebMD, Excite, Lycos, and the Microsoft Network. WebMD will become the exclusive health content provider for all CVS businesses. This will dramatically increase our exposure on the Internet, drive new traffic to CVS.com and bring new customers into the CVS/pharmacy family.

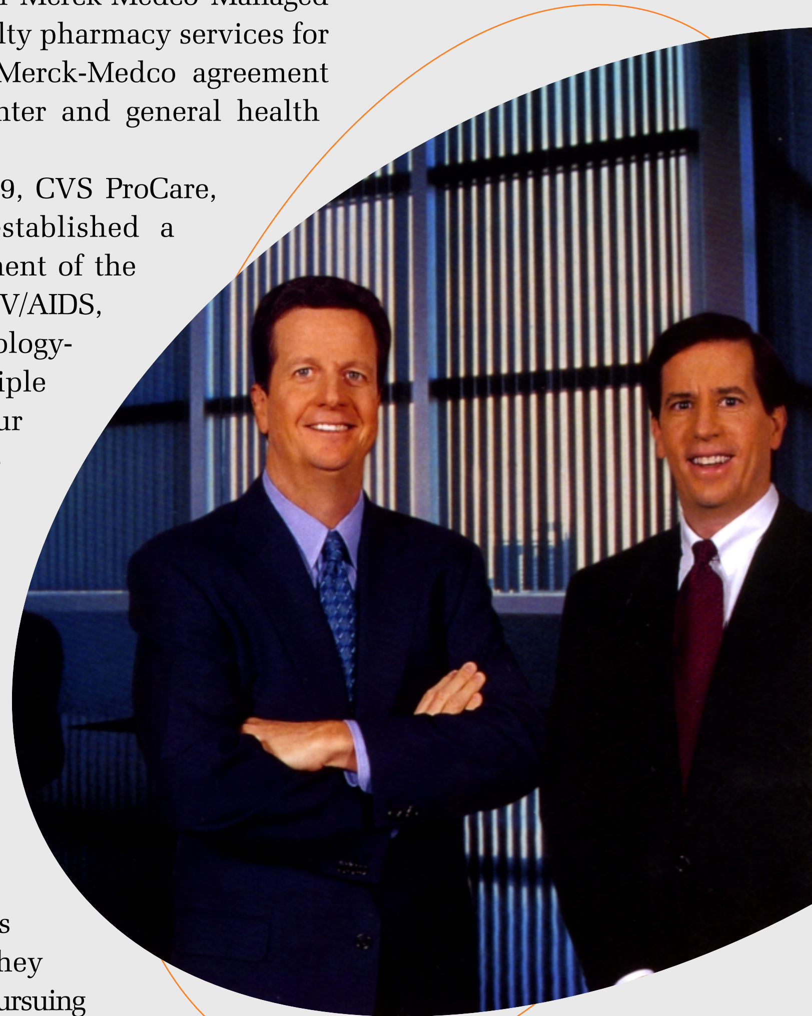
CVS holds the **#1 share** of the U.S. prescription market. We achieved a five-year compounded

We plan to jointly create an integrated, full-service Internet healthcare offering and make CVS.com the most comprehensive, online destination for healthcare information and pharmacy needs. We will partner to develop new healthcare services and programs to benefit consumers, such as a method for electronically generating, transmitting and billing prescriptions.

CVS also entered a broad-based strategic alliance with Merck-Medco Managed Care to collaborate on enhanced Internet, retail and specialty pharmacy services for Merck-Medco's 51 million health plan members. The Merck-Medco agreement makes CVS.com the exclusive provider of over-the-counter and general health products to Merck-Medco's Internet customers.

We announced another exciting new business in 1999, CVS ProCare, our specialty pharmacy business that has already established a significant position in this $14 billion, fast-growing segment of the pharmacy market. CVS ProCare services individuals with HIV/AIDS, organ transplants, infertility and those requiring biotechnology-based injectable products for conditions such as multiple sclerosis or growth hormone deficiency. By leveraging our core capabilities and experience with managed care, CVS ProCare is uniquely positioned to support our managed care clients in effectively servicing this customer segment.

We have truly created a new business model in specialty pharmacy with CVS ProCare. Services are provided through a dedicated specialty pharmacy mail order facility located in Ohio and through retail apothecary stores to be located across the nation that are distinct from our core CVS stores. We expect CVS ProCare to be a $1 billion business in the next three to four years.



Thomas M. Ryan
Chairman of the Board and
Chief Executive Officer (left)

Charles C. Conaway
President and
Chief Operating Officer (right)

The key to maximizing the potential of all of our offerings is to weave them seamlessly together so customers can make purchases any time, anywhere and any way they find most convenient. We also will remain committed to pursuing alliances with leaders in healthcare that leverage the CVS brand and our significant market leadership position so we can provide end-to-end solutions as the delivery of healthcare services evolves. We already are experiencing new growth and market penetration with this strategy, and we have continued to deliver strong financial performance, including another year of record sales and earnings.

Sales for the 53-week period ended January 1, 2000, increased 18.5 percent to $18.1 billion compared with the 52-week period ended December 26, 1998, fueled by a 12.5 percent increase in same-store sales over the prior year. Pharmacy same-store sales grew a robust 19.4 percent in 1999, driven by the vibrant dynamics of our industry as well as our success in operating in a managed care environment, our outstanding customer service and the trust customers have in our pharmacists. To give perspective to our outstanding growth record, consider

On the Corner

annual earnings growth rate from continuing operations of nearly **28%.** At year-end, we operated

that our one-year sales gain of $3 billion in 1999 is greater than our entire sales level for 1990.

Our front store business delivered a 3.6 percent increase in same-store sales. We experienced substantial growth in key front store destination categories across the chain, including photo, beauty and seasonal merchandise, that enabled us to continue to gain market share. Most significantly, our photo business experienced rapid growth as we more than doubled the number of one-hour labs in our stores and dramatically increased market share. We expect that growth to continue with the strategic alliance we formed with Kodak to provide innovative new services and position CVS as one of the largest and fastest-growing photo retailers in the United States.

CVS offers complete photo-finishing services, including one-hour photo, digital and online capabilities, and a variety of film and camera products.

We also remain one of the largest and fastest-growing beauty retailers in the nation, achieving significant market share gains in key beauty categories, including hair care, skin care and hair color. We continue to leverage our dominant health franchise to gain market share in pharmacy as well as substantial gains in categories such as vitamins, stomach remedies and baby care products. Our success is evidenced by our strong organic comparable store sales gains, which continue to lead the industry.

Careful management of our front store mix has helped us achieve improved front store gross margins while we continue to invest in reducing everyday prices in high traffic key categories, such as baby care. We expect our focus on branding, innovation, convenience and execution to drive new growth in our front store business. We have grown our market share position in 1999 and expect continued gains in 2000.

We also are very pleased with how the integration of the former Revco stores into our business has bolstered our front store position. We continue to see steady gains in front store sales in the former Revco markets, which are experiencing the most rapid same-store sales growth of any geographic area of our chain.

We demonstrated substantial improvement in inventory productivity, which ended 1999 at 4.0x. We expect continued improvement in our inventory turns, with a goal of 5.0x in the next few years, and continued increases in free cash flow. We generated $165 million in free cash flow in 1999, exceeding our goal.

During all of this exciting business development activity, we remained focused on our core business and delivered quality earnings throughout 1999, with comparable earnings per share rising 23 percent to $1.55. Our outlook for 2000 remains quite positive, even as we continue investing in new long-term growth opportunities.

If there can be any disappointment for 1999, it was in our stock price, which fell from a record high in February 1999. However, we were not alone in experiencing fluctuations caused more by market activity than our own performance. We are confident that our continued positive results and our commitment to growing our business for the long term will be recognized for the value they provide to our customers and our shareholders.

4,100 stores in 26 states & D.C., maintaining our position as the **largest drugstore chain in America.**

We have good reason to be optimistic. CVS remains a powerful leader in a vibrant industry. The pharmaceutical market is projected to grow by approximately 13 percent per year for the next several years. We hold the No. 1 share of this growing market, and we are well-positioned to continue to capture more than our fair share of that growth. We are the No. 1 provider in 30 of the nation's top 100 drugstore markets, more than any other drugstore chain. Yet there are still 48 of those top 100 markets where CVS currently has no retail stores, presenting significant growth potential. We opened a record 433 new or relocated CVS stores and 12 ProCare apothecaries in 1999, and we expect to open 400 to 450 new or relocated stores each year for the foreseeable future.

CVS has created a new business model in the fast-growing specialty pharmacy field. CVS ProCare provides specialty pharmacy mail services and plans to have more than 100 retail ProCare apothecaries, which serve patients requiring complex and expensive drug therapies, in cities across the nation.

We expect continued strong growth in our pharmacy business, and healthy increases in our front store business as we emphasize convenience and service. New stores and relocations, as well as the rapid development of our new strategic business units, will further accelerate our long-term growth rate. All of these initiatives will help us achieve our long-term goal of our return on invested capital to equal two times our weighted average cost of capital.

Of course, it is the wise counsel of our distinguished board of directors and the fervent commitment of our employees that enable us to capitalize on these opportunities. We are fortunate to benefit from the wealth of leadership experience in social service that Marian L. Heard brought to the CVS board of directors when she joined in 1999. We want to express our sincere gratitude to our 100,000 employees for their dedication and commitment to our customers.

CVS enters the new millennium ideally positioned to build on its success. It is with good reason that a special year-end issue of *Fortune* magazine selected CVS as one of "10 Stocks for the Millennium," noting our ability to combine the best of the virtual and real worlds into our "clicks and mortar" retail format. We invite you to visit us—*On the Corner, On the Phone and On the Web*—to see for yourself how we continually enhance the delivery of *total healthcare solutions* for the way we live.

On the Web

Sincerely,

Thomas M. Ryan
Chairman of the Board and Chief Executive Officer

Charles C. Conaway
President and Chief Operating Officer

We have already attained a leading position in the specialty pharmacy business with CVS ProCare.

Total healthcare solutions for the way we live.

Solutions

Pharmacy Solutions

CVS is leading the way in providing new pharmacy solutions for its customers. As a result, we have seen significant growth in the pharmacy business; a 24.4 percent increase in 1999 retail pharmacy sales to $10.6 billion, now representing 59 percent of our total revenues; and a similarly positive outlook for the future.

The demand for prescription drugs is rising for a variety of reasons. Managed care organizations are relying increasingly on pharmaceuticals as the first line of defense in managing illness and injury. New drugs are entering the market at a breathtaking pace. Pharmaceutical makers also are marketing those drugs more directly and aggressively to consumers than ever before.

CVS pharmacies provide a total healthcare solution for patients and dispense more prescriptions than any other pharmacy in America.

Each day, more than 12,000 CVS pharmacists help us fulfill our mission to help people live longer, healthier, happier lives by providing professional expertise and personal care.

Generic drugs, which generate higher gross profit for CVS than branded drugs, will increase dramatically in the coming years as well. The Food and Drug Administration estimates that some $6.2 billion worth of drugs sold under brand names will be coming off patent in the year 2000 alone, more than four times the 1999 level. Those patent expirations pave the way for considerable generic drug introductions, which lower costs for our customers.

The aging population in the United States also translates into an increased demand for pharmaceuticals. Research shows that an average 60-year-old takes 16 prescriptions per year compared with six taken by an average 30-year-old.

Increased demand for pharmaceuticals represents only half of the growth story. CVS has leveraged innovative ideas and cutting-edge technology to capitalize on those growth opportunities, resulting in an industry-leading drugstore chain that captures new business by serving customers the way they want to be served.

CVS is **leading the way** in providing pharmacy solutions. We have leveraged innovative ideas

CVS has made a long-term commitment to Excellence in Pharmacy Innovation and Care (EPIC), a comprehensive, multiyear project to develop breakthrough capabilities across the many complex dimensions of pharmacy operations and delivery of healthcare services. The objective is to enhance pharmacy productivity, lower costs and improve service by enabling our pharmacists to spend more time with customers.

We are creating a paperless environment by reinventing pharmacy work flow and increasing the sophistication of our clinical tools. We also are using the latest in pill-counting automation, which has had a significant impact on higher-volume pharmacies. Labor is reduced, capacity is increased, customer wait times are cut in half, and customer satisfaction ratings improve, all of which contribute to improved performance.

Rapid Refill remains an important part of the pharmacy business, accounting for more than half of all prescription refills in 1999. Patients enjoy the speed and convenience of renewing prescriptions using a touch-tone telephone system, because it eliminates their wait time and makes their lives easier. An increasing number of drive-thru windows, now totaling more than 1,000, make the prescription pickup process even faster and more convenient.

PharmaCare, our pharmacy benefit management (PBM) subsidiary, is a shining example of how CVS has developed cost-saving solutions for the managed care community. PharmaCare appeals to managed care companies by providing a proprietary formulary management tool and risk-sharing arrangements to help them deliver the best healthcare in the most cost-effective manner. CIMS, PharmaCare's unique communication system that helps direct utilization to the most appropriate and cost-effective medications, has won the favor of more than 50,000 physicians. Since its start in 1995, PharmaCare has demonstrated rapid sales and earnings growth, making it one of the top 10 PBMs in the nation.

Drive-thru pharmacy windows at more than 1,000 CVS stores combine convenience and service for our customers.

and cutting-edge technology to provide service **On the Corner, On the Phone** and **On the Web.**

The high quality and value pricing of CVS brand products, which include approximately 1,500 items across a variety of categories, continue to be popular with our customers.

Front Store Solutions

Americans are more focused on healthy lifestyles than ever before, and the drugstore is their most accessible resource to facilitate that lifestyle. Our strategy for front store growth is multifaceted, designed to win new customers and build customer loyalty.

CVS is one of the top beauty retailers in the nation. We were the first to offer these new cosmetic lines from Oil of Olay and Neutrogena chainwide, enabling us to capture significant market share.

We are committed to being the first to bring new products to market, because the first-mover advantage creates significant market share. We were the first to offer the new Neutrogena® and Oil of Olay® lines of cosmetics chainwide, enabling us to gain significant market share. Market shares in virtually all of our core categories are on the rise, including vitamins, baby care, diet and nutrition, beauty, photo developing, film and batteries, among others.

We also are committed to introducing differentiated, unique-to-CVS products. Our exclusive collection of bean bag toys representing characters from the Rudolph the Red-Nosed Reindeer® television special is a good example. With the soaring popularity of toy collecting, it was no surprise that these toys sold rapidly in our stores and on our Web site.

We continue to be **first to market** with key products, and we have **more than doubled** the

The high-margin photo business has been the focus of substantial improvement efforts during the past year, resulting in significant growth. In 1999, we more than doubled the number of one-hour photo labs in our stores to 2,000 labs, and project a total of 3,000 by the end of the year 2000. The investment is paying off handsomely, with photo sales rising approximately 30 percent in 1999 and gross margins in this category among our highest. We are working in partnership with Kodak to develop a photo services business plan that will look well into the future, exploring such possibilities as enhanced in-store and Web-based digital photo services.

The CVS brand business is still another category where innovation has brought reward. We continue to introduce high-quality, excellent-value private label products that aim to lift sales of their entire category without cannibalizing the sales of leading brand products. We added 270 new CVS brand products in 1999 to raise the total number of products throughout the store to nearly 1,500. Our category focus for 2000 is cosmetics and bath items, where we intend to introduce superior quality products at affordable prices.

As a result of what we learned in integrating Arbor into our stores, we reduced some non-core departments to expand our seasonal offerings. The results have been very encouraging, with existing seasonal programs growing at twice the rate of overall front store sales.

Real Estate Solutions

The cornerstone of our plan for long-term growth is our capital commitment to increase the number and improve the quality of our retail locations. We are investing in achieving the optimum in retail positioning for the future and we are seeing promising results, all while we continue to deliver solid financial performance in the present.

For 1999 alone, we opened a record 433 new CVS stores, including about 300 CVS relocations. In addition, at year-end 1999, we had 12 ProCare apothecaries open and another eight under construction. We expect to open 400 to 450 new stores each year in the foreseeable future. To achieve this measure of success, we formed CVS Realty Co., a fully integrated captive development company led by a dedicated team of real estate professionals, affording CVS in-house expertise and the ability to take a more active role in every aspect of retail site development. This strategy, in combination with the strong sales generated by new stores, has enabled us to reduce our cost by $4 to $5 per square foot and to continually decrease our occupancy costs as a percent of sales.

Our real estate strategy involves capital investment on several different fronts. First, we are strengthening our position in existing markets with new stores. With our market research capabilities and our emphasis on selectivity and quality, our real estate experts continue to discover untapped opportunities for new store locations where existing drug outlets are inadequate to serve the population.

Additionally, we are building new stores in new markets. We are the No. 1 provider in 30 of the top 100 drugstore

CVS opened 433 new stores in 1999 and opened or began construction of 20 ProCare apothecaries. Plans call for the opening of 400-450 stores annually in existing and new markets.

number of one-hour photo labs to **2,000** labs, and project **3,000** by the end of the year 2000.

markets in the United States, yet we have no retail stores in nearly half of those 100 markets. As such, CVS is committed to entering at least two to three new markets every year.

In 2000, we are entering Tampa, Florida, the 13th largest drugstore market in the United States, and Grand Rapids, Michigan, which is a natural extension of our significant presence in metropolitan Detroit. The movement into Tampa is just the start of an aggressive expansion program in Florida, an attractive market because of its large population of older people and its overall population growth.

We are relocating existing stores to new sites where we know we can increase sales and our return on investment. Freestanding stores typically sell 25 to 30 percent more front store merchandise than stores in shopping centers, yet only 33 percent of our stores are in freestanding locations. We expect to increase that to approximately 80 percent over the next six to seven years.

Online Solutions

With our 4,100 retail stores and our fast-growing Web site at CVS.com, CVS enjoys the advantage of being the first “clicks and mortar” drugstore. We are well-positioned to be a leading healthcare player on the Internet, with plans to build the business that are both aggressive and prudent.

At CVS.com, customers can order prescriptions for pickup or mail delivery, order refills using the Express Refills feature, and buy general merchandise using a personalized shopping list feature. They can receive the latest health news, unparalleled general health information, and even join a health community as a result of our exclusive content agreement with Healtheon/WebMD. They also can ask our pharmacists questions and check for potentially harmful drug interactions as we create one place for all their healthcare needs.

With CVS.com, online customers can choose to have their prescriptions mailed to their homes from our fully automated mail service facility or pick them up at their nearby CVS store.

CVS.com has thousands of high-quality, over-the-counter medicines and general health products available for purchase. Additional offerings, such as greeting cards, beauty products, seasonal goods and enhanced digital photo services, will be available in the future.

With CVS.com, we can reach new markets and new customers, expanding CVS as a national pharmacy brand. And as we leverage new technology throughout our business, the possibilities for cross-selling and personalizing services are numerous.

CVS.com represents a significant competitive edge, because half of all pharmacy orders are for in-store pickup. Our customers can get both their chronic and acute health needs met any way they find most convenient *On the Corner* (in our 4,100 conveniently located stores), *On the Phone* (through our Rapid Refill system), or *On the Web*. And no matter which way a customer chooses, the information is completely integrated to provide a comprehensive drug utilization review and ensure the best health outcome possible.

We see the Internet as a high potential channel for CVS. We plan to capitalize on this opportunity by leveraging the advantages of our 4,100 stores, 55 million customers, our advertising and purchasing clout, our merchandising expertise, strong third-party relationships, and especially the trust of CVS/pharmacy.

With our **4,100 retail stores** and our fast-growing Web site at **CVS.com,** CVS enjoys the

CVS ProCare customers receive personalized, one-on-one counseling from pharmacists with knowledge of and expertise in complex disease states and conditions.

Specialty Care Solutions

Our specialty pharmacy business, CVS ProCare, is another example of how we leverage the strong assets of CVS into new, related areas. Our accessible points of care, our highly trained pharmacists and our expertise in finding cost-containment solutions for our managed care partners afford us an excellent position and potential in the specialty pharmacy business. We wanted to better address the special needs of certain customers who require unique products and services.

Announced in June 1999, CVS ProCare is committed to the complex and expensive drug therapies required by patients with a number of chronic diseases and conditions. These include HIV/AIDS, organ transplants, infertility and other conditions such as multiple sclerosis and growth hormone deficiency requiring biotechnology-based injectable products.

CVS ProCare reflects a new business model in specialty pharmacy, with its integrated retail and mail delivery system. We are the first with a state-of-the-art infrastructure that is equipped for the special handling requirements of drugs in the targeted disease states. We also will be the first with a national retail apothecary store network that is totally dedicated to these disease states and well-stocked with these unique inventory items. At year-end, we had 12 ProCare apothecary stores open and eight others under construction. Our goal is to have more than 100 nationwide within three to four years. This will enable us to cover the majority of the targeted patient population.

We have invested in the technology required for complex billing and benefit management and, most importantly, we can support the high level of counseling needed by specialty pharmacy patients. Our ProCare pharmacists are specially trained to provide one-on-one case management. In fact, ProCare has a 24-hour call-in number to assist patients with their needs.

advantage of being the **first** "clicks and mortar" drugstore to have a fully integrated pharmacy.

ProCare already holds a leading position in the $14 billion specialty pharmacy industry with a number of exclusive contracts for specialty pharmacy mail order business. ProCare has contracts with United Healthcare, PharmaCare and Merck-Medco that together provide exclusive access to the specialty pharmacy needs of nearly 70 million members or 25 percent of the U.S. population. The specialty pharmacy market is highly fragmented and served largely by independents, and we believe it is ripe for consolidation.

Community Solutions

Demonstrating its caring commitment to good health, CVS provides and supports a number of community programs that seek to nurture healthy life skills and to create opportunities to succeed.

The national partnership with Reach Out and Read (ROR) is an example of how we provide community services that promote better health and enable a more fulfilling life. ROR is a child literacy program that supplies age-appropriate books to children at their pediatric well visits. CVS Health Smarts℠ is another example. By supporting Healthy Families DC, CVS Health Smarts is offering new and expectant parents in the Washington, D.C. area support and information that promote child health, safety and learning readiness.

The CVS Innovation Grants Program works with elementary and secondary public schools to re-examine teaching approaches and explore innovative ways to help children learn. The program provides multiyear financial grants, on-site technical assistance, conferences and other opportunities for educators to share experiences with their colleagues. Other initiatives include support for heart disease and hypertension research, neighborhood projects, community sponsorships, United Way agencies and other local and national programs of every size and description.

"Care that touches everyone...one at a time" extends to our commitment to the community. CVS invests in health and education programs in our neighborhoods, providing resources, volunteers and financial support.

CVS **provides and supports** a number of programs that seek to nurture **healthy life skills.**

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We strongly recommend that you read our accompanying audited consolidated financial statements and footnotes along with this important discussion and analysis.

Results of Operations

Fiscal 1999, which ended on January 1, 2000, included 53 weeks, while fiscal 1998 and 1997, which ended on December 26, 1998 and December 27, 1997, respectively, included 52 weeks.

Net sales increased 18.5% in 1999 to $18.1 billion. This compares to increases of 11.1% in 1998 and 16.2% in 1997. Same-store sales, consisting of sales from stores that have been open for more than one year, rose 12.5% in 1999, 10.8% in 1998 and 9.7% in 1997. Pharmacy same-store sales increased 19.4% in 1999 and 16.5% in 1998 and 1997. Our pharmacy sales as a percentage of total net sales were 59% in 1999, 58% in 1998 and 55% in 1997. Our third party prescription sales as a percentage of total pharmacy sales were 87% in 1999, 84% in 1998 and 81% in 1997.

As you review our sales performance, we believe you should consider the following important information:

- Our pharmacy sales growth continued to benefit from our ability to attract and retain managed care customers, our ongoing program of purchasing prescription files from independent pharmacies and favorable industry trends. These trends include an aging American population; many "baby boomers" are now in their fifties and are consuming a greater number of prescription drugs. The increased use of pharmaceuticals as the first line of defense for healthcare and the introduction of a number of successful new prescription drugs also contributed to the growing demand for pharmacy services.

- Our front store sales growth was driven by strong performance in the health and beauty, photo, seasonal, and general merchandise categories.

- The increase in net sales in 1999 was positively affected by the 53rd week. Excluding the positive impact of the 53rd week, net sales increased 16.0% in 1999 when compared to 1998.

- The increase in net sales in 1998 was positively affected by our efforts to improve the performance of the Revco stores. To do this, we converted the retained Revco stores to the CVS store format and relocated certain stores. Our performance during the conversion period was positively affected by temporary promotional events.

- The increase in net sales in 1997 was positively affected by our acquisition of Big B, Inc., effective November 16, 1996. Excluding the positive impact of the Big B acquisition, net sales increased 11.3% in 1997 when compared to 1996. Please read Note 3 to the consolidated financial statements for other important information about the Big B acquisition.

- We continued to relocate our existing shopping center stores to larger, more convenient, freestanding locations. Historically, we have achieved significant improvements in customer count and net sales when we do this. The resulting increase in net sales has typically been driven by an increase in front store sales, which normally have a higher gross margin. We believe that our relocation program offers a significant opportunity for future growth, as only 33% of our existing stores are freestanding. We currently expect to have approximately 40% of our stores in freestanding locations by the end of 2000. Our long-term goal is to have 80% of our stores located in freestanding sites. We cannot, however, guarantee that future store relocations will deliver the same results as those historically achieved. Please read the "Cautionary Statement Concerning Forward-Looking Statements" section below.

Gross margin as a percentage of net sales was 26.9% in 1999. This compares to 27.0% in 1998 and 1997. Inventory shrinkage was 0.9% of net sales in 1999, compared to 0.8% of net sales in 1998 and 1997. As you review our gross margin performance, please remember to consider the impact of the following nonrecurring charges:

- During 1998, we recorded a $10.0 million charge to cost of goods sold to reflect markdowns on noncompatible Arbor merchandise, which resulted from the CVS/Arbor merger transaction. Please read Notes 2 and 3 to the consolidated financial statements for other important information about the CVS/Arbor merger.

- During 1997, we recorded a $75.0 million charge to cost of goods sold to reflect markdowns on noncompatible Revco merchandise, which resulted from the CVS/Revco merger transaction. Please read Notes 2 and 3 to the consolidated financial statements for other important information about the CVS/Revco merger.

If you exclude the effect of these nonrecurring charges, our comparable gross margin as a percentage of net sales was 26.9% in 1999, 27.1% in 1998 and 27.6% in 1997.

Why has our comparable gross margin rate been declining?

- Pharmacy sales are growing at a faster pace than front store sales. On average, our gross margin on pharmacy sales is lower than our gross margin on front store sales.

- Sales to customers covered by third party insurance programs have continued to increase and, thus, have become a larger part of our total pharmacy business. Our gross margin on third party sales has continued to decline largely due to the efforts of managed care organizations and other pharmacy benefit managers to reduce prescription drug costs. To address this trend, we have dropped and/or renegotiated a number of third party programs that fell below our minimum profitability standards. In the event this trend continues and we elect to drop additional programs and/or decide not to participate in future programs that fall below our minimum profitability standards, we may not be able to sustain our current rate of sales growth.

Total operating expenses were 20.6% of net sales in 1999. This compares to 22.1% in 1998 and 25.0% in 1997. As you review our performance in this area, please remember to consider the impact of the following nonrecurring charges:

- During 1998, we recorded a $147.3 million charge to operating expenses for direct and other merger-related costs pertaining to the CVS/Arbor merger transaction and related restructuring activities. In addition, we incurred $31.3 million of nonrecurring costs in connection with eliminating Arbor's information technology systems and Revco's noncompatible store merchandise fixtures. Please read Notes 2 and 3 to the consolidated financial statements for other important information about the CVS/Arbor merger.

- During 1997, we recorded a $337.1 million charge to operating expenses for direct and other merger-related costs pertaining to the CVS/Revco merger transaction and related restructuring activities. In addition, we incurred $54.3 million of nonrecurring costs in connection with eliminating Revco's information technology systems and removing Revco's noncompatible store merchandise fixtures. We also recorded a $31.0 million charge for certain costs associated with the restructuring of Big B, Inc. Please read Notes 2 and 3 to the consolidated financial statements for other important information about the CVS/Revco merger and Big B acquisition.

If you exclude the effect of the nonrecurring charges we incurred in 1998 and 1997, comparable operating expenses as a percentage of net sales were 20.6% in 1999, 20.9% in 1998 and 21.9% in 1997.

What have we done to improve our comparable total operating expenses as a percentage of net sales?

- Our strong sales performance has consistently allowed our net sales to grow at a faster pace than total operating expenses.

- Our information technology initiatives have led to greater productivity, which has resulted in lower operating costs and improved sales.

- We eliminated most of Arbor's existing corporate overhead in 1998 and most of Revco's in 1997.

As a result of combining the operations of CVS, Arbor and Revco, we were able to achieve substantial annual operating cost savings in 1998 and 1997. Although we are extremely proud of this accomplishment, we strongly advise you not to rely on the resulting operating expense improvement trend to predict our future performance.

Operating profit increased $383.6 million to $1.1 billion in 1999. This compares to $751.9 million in 1998 and $281.7 million in 1997. If you exclude the effect of the nonrecurring charges we recorded in gross margin and in total operating expenses, our comparable operating profit increased $195.0 million (or 20.7%) to $1.1 billion in 1999. This compares to $940.5 million in 1998 and $779.1 million in 1997. Comparable operating profit as a percentage of net sales was 6.3% in 1999, 6.2% in 1998 and 5.7% in 1997.

Interest expense, net consisted of the following:

		Fiscal Year	
In millions	**1999**	1998	1997
Interest expense	**$ 66.1**	$ 69.7	$ 59.1
Interest income	**(7.0)**	(8.8)	(15.0)
Interest expense, net	**$ 59.1**	$ 60.9	$ 44.1

The decrease in interest expense in 1999 was primarily due to the fact that we replaced $300 million of our commercial paper borrowings with unsecured senior notes that bear a lower interest rate than our commercial paper. The increase in interest expense in 1998 was primarily due to higher average borrowing levels when compared to 1997. The decrease in interest income in 1998 was primarily due to interest income recognized during 1997 on a note receivable that we received when we sold Kay-Bee Toys in 1996. This note was sold in 1997.

Income tax provision ~ Our effective income tax rate was 41.0% in 1999 compared to 44.4% in 1998 and 62.8% in 1997. Our effective income tax rates were higher in 1998 and 1997 because certain components of the nonrecurring charges we recorded in conjunction with the CVS/Arbor and CVS/Revco merger transactions were not deductible for income tax purposes.

Earnings from continuing operations before extraordinary item increased $250.6 million to $635.1 million (or $1.55 per diluted share) in 1999. This compares to $384.5 million (or $0.95 per diluted share) in 1998 and $88.4 million (or $0.19 per diluted share) in 1997. If you exclude the effect of the nonrecurring charges we recorded in cost of goods sold and in total operating expenses, our comparable earnings from continuing operations before extraordinary item increased 24.5% to $635.1 million (or $1.55 per diluted share) in 1999. This compares to $510.1 million (or $1.26 per diluted share) in 1998 and $419.2 million (or $1.05 per diluted share) in 1997.

Discontinued Operations ~ In November 1997, we completed the final phase of a comprehensive strategic restructuring program, under which we sold Marshalls, Kay-Bee Toys, Wilsons, This End Up and Bob's Stores. As part of this program, we also completed the spin-off of Footstar, Inc., which included Meldisco, Footaction and Thom McAn, completed the initial and secondary public offerings of Linens 'n Things and eliminated certain corporate overhead costs. During 1997, we sold our remaining investment in Linens 'n Things and recorded, as a component of discontinued operations, an after-tax gain of $38.2 million. In connection with recording this gain, we also recorded, as a component of discontinued operations, an after-tax charge of $20.7 million during 1997 to finalize our original liability estimates. Please read Note 4 to the consolidated financial statements for other important information about this program.

Extraordinary item ~ During 1997, we retired $865.7 million of the debt we absorbed when we acquired Revco. As a result, we recorded a charge for an extraordinary item, net of income taxes, of $17.1 million. The extraordinary item included the early retirement premiums we paid and the balance of our deferred financing costs.

Net earnings were $635.1 million (or $1.55 per diluted share) in 1999. This compares to $384.5 million (or $0.95 per diluted share) in 1998 and $88.8 million (or $0.19 per diluted share) in 1997.

Liquidity & Capital Resources

Liquidity ~ The Company has three primary sources of liquidity: cash provided by operations, commercial paper and uncommitted lines of credit. We generally finance our inventory and capital expenditure requirements with internally generated funds and commercial paper. We currently expect to continue to utilize our commercial paper program to support our working capital needs. In addition, we may elect to use long-term borrowings in the future to support our continued growth.

Our commercial paper program is supported by a $670 million, five-year unsecured revolving credit facility that expires on May 30, 2002, and a $530 million, 364-day unsecured revolving credit facility that expires on June 21, 2000. We can also obtain up to $35.0 million of short-term financing through various uncommitted lines of credit. As of January 1, 2000, we had $451.0 million of commercial paper outstanding at a weighted average interest rate of 6.2%. There were no borrowings outstanding under the uncommitted lines of credit as of January 1, 2000.

On February 11, 1999, we issued $300 million of 5.5% unsecured senior notes due February 15, 2004. The proceeds from the issuance were used to repay outstanding commercial paper borrowings.

Our credit facilities and unsecured senior notes contain customary restrictive financial and operating covenants. We do not believe that the restrictions contained in these covenants materially affect our financial or operating flexibility.

Capital Resources ~ Although there can be no assurance and assuming market interest rates remain favorable, we currently believe that we will continue to have access to capital at attractive interest rates in 2000. We further believe that our cash on hand and cash provided by operations, together with our ability to obtain additional short-term and long-term financing, will be sufficient to cover our future working capital needs, capital expenditures and debt service requirements for at least the next 12 months.

Net Cash Provided by Operations ~ Net cash provided by operations was $658.8 million in 1999. This compares to net cash provided by operations of $221.0 million in 1998 and net cash used in operations of $105.8 million in 1997. The improvement in net cash provided by operations was primarily the result of higher net earnings, improved working capital management and a reduction in cash payments associated with the Arbor and Revco mergers. You should be aware that cash flow from operations will continue to be negatively impacted by future payments associated with the Arbor and Revco mergers and the Company's strategic restructuring program. As of January 1, 2000, the future cash payments associated with these programs totaled $123.0 million. These payments primarily include: (i) $12.1 million for employee severance, which extends through 2000, (ii) $9.0 million for retirement benefits and related excess parachute payment excise taxes, which extend for a number of years to coincide with the future payment of retirement benefits, and (iii) $98.5 million for continuing lease obligations, which extend through 2020.

Capital Expenditures ~ Our capital expenditures totaled $493.5 million in 1999. This compared to $502.3 million in 1998 and $341.6 million in 1997. During 1999, we opened 146 new stores, relocated 299 existing stores and closed 170 stores. During 2000, we currently expect to open 425 stores, including 250 relocations. As of January 1, 2000, we operated 4,098 retail drugstores in 26 states and the District of Columbia.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." This statement, which establishes the accounting and financial reporting requirements for derivative instruments, requires companies to recognize derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. In May 1999, the Financial Accounting Standards Board delayed the implementation date for this statement by one year. We expect to adopt SFAS No. 133 in 2001. We currently are in the process of determining what impact, if any, this pronouncement will have on our consolidated financial statements.

Cautionary Statement Concerning Forward-Looking Statements

We have made forward-looking statements in this Annual Report that are subject to risks and uncertainties that could cause actual results to differ materially. For these statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. We strongly recommend that you become familiar with the specific risks and uncertainties that we have outlined for you under the caption "Cautionary Statement Concerning Forward-Looking Statements" in our Annual Report on Form 10-K for the fiscal year ended January 1, 2000.

Management's Responsibility for Financial Reporting

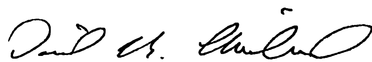
The integrity and objectivity of the financial statements and related financial information in this Annual Report are the responsibility of the management of the Company. The financial statements have been prepared in conformity with generally accepted accounting principles and include, when necessary, the best estimates and judgments of management.

The Company maintains a system of internal controls designed to provide reasonable assurance, at appropriate cost, that assets are safeguarded, transactions are executed in accordance with management's authorization, and the accounting records provide a reliable basis for the preparation of the financial statements. The system of internal accounting controls is continually reviewed by management and improved and modified as necessary in response to changing business conditions and the recommendations of the Company's internal auditors and independent auditors.

KPMG LLP, independent auditors, are engaged to render an opinion regarding the fair presentation of the consolidated financial statements of the Company. Their accompanying report is based upon an audit conducted in accordance with generally accepted auditing standards and included a review of the system of internal controls to the extent they considered necessary to support their opinion.

The Audit Committee of the Board of Directors, consisting solely of outside directors, meets periodically with management, internal auditors and the independent auditors to review matters relating to the Company's financial reporting, the adequacy of internal accounting controls, and the scope and results of audit work. The internal auditors and independent auditors have free access to the Audit Committee.

Thomas M. Ryan
Chairman of the Board and Chief Executive Officer



David B. Rickard
Executive Vice President and Chief Financial Officer

February 7, 2000

Independent Auditors' Report

Board of Directors and Shareholders
CVS Corporation:

We have audited the accompanying consolidated balance sheets of CVS Corporation and subsidiaries as of January 1, 2000 and December 26, 1998, and the related consolidated statements of operations, shareholders' equity, and cash flows for the fifty-three week period ended January 1, 2000 and the fifty-two week periods ended December 26, 1998 and December 27, 1997. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CVS Corporation and subsidiaries as of January 1, 2000 and December 26, 1998, and the results of their operations and their cash flows for the fifty-three week period ended January 1, 2000 and the fifty-two week periods ended December 26, 1998 and December 27, 1997, in conformity with generally accepted accounting principles.

KPMG LLP

KPMG LLP
Providence, Rhode Island

February 7, 2000

Consolidated Statements of Operations

In millions, except per share amounts	**January 1, 2000 (53 weeks)**	*Fiscal Year Ended* December 26, 1998 (52 weeks)	December 27, 1997 (52 weeks)
Net sales	**$18,098.3**	$ 15,273.6	$ 13,749.6
Cost of goods sold, buying and warehousing costs	**13,236.9**	11,144.4	10,031.3
Gross margin	**4,861.4**	4,129.2	3,718.3
Selling, general and administrative expenses	**3,448.0**	2,949.0	2,776.0
Depreciation and amortization	**277.9**	249.7	238.2
Merger, restructuring and other nonrecurring charges	**—**	178.6	422.4
Total operating expenses	**3,725.9**	3,377.3	3,436.6
Operating profit	**1,135.5**	751.9	281.7
Interest expense, net	**59.1**	60.9	44.1
Earnings from continuing operations before income tax provision and extraordinary item	**1,076.4**	691.0	237.6
Income tax provision	**441.3**	306.5	149.2
Earnings from continuing operations before extraordinary item	**635.1**	384.5	88.4
Discontinued operations:			
Gain on disposal, net of income tax provision of $12.4	**—**	—	17.5
Earnings from discontinued operations	**—**	—	17.5
Earnings before extraordinary item	**635.1**	384.5	105.9
Extraordinary item, loss related to early retirement of debt, net of income tax benefit of $11.4	**—**	—	(17.1)
Net earnings	**635.1**	384.5	88.8
Preference dividends, net of income tax benefit	**(14.7)**	(13.6)	(13.7)
Net earnings available to common shareholders	**$ 620.4**	$ 370.9	$ 75.1
Basic earnings per common share:			
Earnings from continuing operations before extraordinary item	**$ 1.59**	$ 0.96	$ 0.20
Earnings from discontinued operations	**—**	—	0.05
Extraordinary item, net of income tax benefit	**—**	—	(0.05)
Net earnings	**$ 1.59**	$ 0.96	$ 0.20
Weighted average common shares outstanding	**391.3**	387.1	377.2
Diluted earnings per common share:			
Earnings from continuing operations before extraordinary item	**$ 1.55**	$ 0.95	$ 0.19
Earnings from discontinued operations	**—**	—	0.05
Extraordinary item, net of income tax benefit	**—**	—	(0.05)
Net earnings	**$ 1.55**	$ 0.95	$ 0.19
Weighted average common shares outstanding	**408.9**	405.2	385.1
Dividends declared per common share	**$ 0.230**	$ 0.225	$ 0.220

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

In millions, except shares and per share amounts	**January 1, 2000**	December 26, 1998
Assets:		
Cash and cash equivalents	**$ 230.0**	$ 180.8
Accounts receivable, net	**699.3**	650.3
Inventories	**3,445.5**	3,190.2
Deferred income taxes	**139.4**	248.7
Other current assets	**93.8**	79.2
Total current assets	**4,608.0**	4,349.2
Property and equipment, net	**1,601.0**	1,351.2
Goodwill, net	**706.9**	724.6
Other assets	**359.5**	261.2
Total assets	**$ 7,275.4**	$ 6,686.2
Liabilities:		
Accounts payable	**$ 1,454.2**	$ 1,286.3
Accrued expenses	**967.4**	1,061.3
Short-term borrowings	**451.0**	771.1
Current portion of long-term debt	**17.3**	14.6
Total current liabilities	**2,889.9**	3,133.3
Long-term debt	**558.5**	275.7
Deferred income taxes	**27.2**	24.3
Other long-term liabilities	**120.1**	142.3
Commitments and contingencies (Note 12)		
Shareholders' equity:		
Preferred stock, $0.01 par value: authorized 120,619 shares; no shares issued or outstanding	**—**	—
Preference stock, series one ESOP convertible, par value $1.00: authorized 50,000,000 shares; issued and outstanding 5,164,000 shares at January 1, 2000, and 5,239,000 shares at December 26, 1998	**276.0**	280.0
Common stock, par value $0.01: authorized 1,000,000,000 shares; issued 403,047,000 shares at January 1, 2000, and 401,380,000 shares at December 26, 1998	**4.0**	4.0
Treasury stock, at cost: 11,051,000 shares at January 1, 2000, and 11,169,000 shares at December 26, 1998	**(258.5)**	(260.2)
Guaranteed ESOP obligation	**(257.0)**	(270.7)
Capital surplus	**1,371.7**	1,336.4
Retained earnings	**2,543.5**	2,021.1
Total shareholders' equity	**3,679.7**	3,110.6
Total liabilities and shareholders' equity	**$ 7,275.4**	$ 6,686.2

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

In millions	Shares: January 1, 2000	Shares: December 26, 1998	Shares: December 27, 1997	Dollars: January 1, 2000	Dollars: December 26, 1998	Dollars: December 27, 1997
Preference stock:						
Beginning of year	**5.2**	5.3	5.6	**$ 280.0**	$ 284.6	$ 298.6
Conversion to common stock	**—**	(0.1)	(0.3)	**(4.0)**	(4.6)	(14.0)
End of year	**5.2**	5.2	5.3	**276.0**	280.0	284.6
Common stock:						
Beginning of year	**401.4**	393.7	369.3	**4.0**	3.9	3.7
Stock options exercised and awards under stock plans	**1.0**	7.5	10.9	**—**	0.1	0.1
Other	**0.6**	0.2	13.5	**—**	—	0.1
End of year	**403.0**	401.4	393.7	**4.0**	4.0	3.9
Treasury stock:						
Beginning of year	**(11.2)**	(11.3)	(11.7)	**(260.2)**	(262.9)	(273.1)
Conversion of preference stock	**0.2**	0.2	0.5	**4.0**	4.2	12.2
Other	**(0.1)**	(0.1)	(0.1)	**(2.3)**	(1.5)	(2.0)
End of year	**(11.1)**	(11.2)	(11.3)	**(258.5)**	(260.2)	(262.9)
Guaranteed ESOP obligation:						
Beginning of year				**(270.7)**	(292.2)	(292.2)
Reduction of guaranteed ESOP obligation				**13.7**	21.5	—
End of year				**(257.0)**	(270.7)	(292.2)
Capital surplus:						
Beginning of year				**1,336.4**	1,154.0	941.2
Conversion of preference stock				**0.1**	0.3	1.8
Stock options exercised and awards under stock plans				**31.3**	176.2	195.9
Other				**3.9**	5.9	15.1
End of year				**1,371.7**	1,336.4	1,154.0
Retained earnings:						
Beginning of year				**2,021.1**	1,739.1	1,737.9
Net earnings				**635.1**	384.5	88.8
Dividends:						
Preference stock, net of income tax benefit				**(14.7)**	(13.6)	(13.7)
Common stock				**(90.0)**	(88.9)	(73.9)
Immaterial pooling of interests				**(8.0)**	—	—
End of year				**2,543.5**	2,021.1	1,739.1
Other:						
Beginning of year				**—**	—	(2.4)
Unrealized holding gain on investments, net				**—**	—	2.4
End of year				**—**	—	—
Total shareholders' equity				**$ 3,679.7**	$ 3,110.6	$ 2,626.5

Fiscal Year Ended

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

In millions	January 1, 2000 (53 weeks)	*Fiscal Year Ended* December 26, 1998 (52 weeks)	December 27, 1997 (52 weeks)
Cash flows from operating activities:			
Net earnings	**$ 635.1**	$ 384.5	$ 88.8
Adjustments required to reconcile net earnings to net cash provided by (used in) operating activities:			
Depreciation and amortization	**277.9**	249.7	242.6
Merger, restructuring and other nonrecurring charges	**—**	188.6	466.4
Deferred income taxes and other noncash items	**124.8**	80.6	(140.4)
Extraordinary item, net of income tax benefit	**—**	—	17.1
Change in assets and liabilities, excluding acquisitions:			
Increase in accounts receivable, net	**(48.9)**	(197.9)	(82.5)
Increase in inventories	**(255.0)**	(315.0)	(566.1)
Increase in other current assets	**(16.7)**	(18.5)	(18.3)
Increase in accounts payable	**166.8**	52.6	174.7
Decrease in accrued expenses	**(37.7)**	(134.5)	(232.3)
Decrease in other assets and other long-term liabilities	**(187.5)**	(69.1)	(55.8)
Net cash provided by (used in) operating activities	**658.8**	221.0	(105.8)
Cash flows from investing activities:			
Additions to property and equipment	**(493.5)**	(502.3)	(341.6)
Acquisitions, net of cash	**(33.6)**	(62.2)	—
Proceeds from sale of businesses and other property and equipment	**28.2**	50.5	192.7
Proceeds from sale of investments	**—**	—	309.7
Net cash (used in) provided by investing activities	**(498.9)**	(514.0)	160.8
Cash flows from financing activities:			
(Reductions in) additions to short-term borrowings	**(324.5)**	304.6	466.4
Proceeds from exercise of stock options	**20.4**	121.1	169.1
Additions to (reductions in) long-term debt	**298.1**	(41.9)	(917.2)
Dividends paid	**(104.7)**	(102.5)	(87.6)
Net cash (used in) provided by financing activities	**(110.7)**	281.3	(369.3)
Net increase (decrease) in cash and cash equivalents	**49.2**	(11.7)	(314.3)
Cash and cash equivalents at beginning of year	**180.8**	192.5	506.8
Cash and cash equivalents at end of year	**$ 230.0**	$ 180.8	$ 192.5

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1 2 3 4 5 6 7 8 9 10 11 12 13 14 15

Significant Accounting Policies

Description of business ~ CVS Corporation ("CVS" or the "Company") is principally in the retail drugstore business. As of January 1, 2000, the Company operated 4,098 retail drugstores and three mail order facilities located in 26 states and the District of Columbia. See Note 13 for further information about the Company's business segments.

Basis of presentation ~ The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany balances and transactions have been eliminated. Fiscal 1999, which ended on January 1, 2000, included 53 weeks, while fiscal 1998 and 1997, which ended on December 26, 1998, and December 27, 1997, respectively, included 52 weeks.

Use of estimates ~ The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Reclassifications ~ Certain reclassifications have been made to the consolidated financial statements of prior years to conform to the current year presentation.

Cash and cash equivalents ~ Cash and cash equivalents consist of cash and temporary investments with maturities of three months or less when purchased.

Accounts receivable ~ Accounts receivable are stated net of an allowance for uncollectible accounts of $41.1 million and $39.8 million as of January 1, 2000, and December 26, 1998, respectively. The balance primarily includes amounts due from third party providers (e.g., pharmacy benefit managers, insurance companies, governmental agencies and vendors).

Financial instruments ~ Financial instruments include cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and short-term borrowings. Due to the short-term nature of these instruments, the Company's carrying value approximates fair value.

Inventories ~ Inventories are stated at the lower of cost or market using the first-in, first-out method.

Property and equipment ~ Depreciation of property and equipment is computed on a straight-line basis, generally over the estimated useful lives of the asset or, when applicable, the term of the lease, whichever is shorter. Estimated useful lives generally range from 10 to 40 years for buildings and improvements, 3 to 10 years for fixtures and equipment and 3 to 10 years for leasehold improvements. Maintenance and repair costs are charged directly to expense as incurred. Major renewals or replacements that substantially extend the useful life of an asset are capitalized and depreciated.

Impairment of long-lived assets ~ The Company primarily groups and evaluates fixed and intangible assets at an individual store level, which is the lowest level at which individual cash flows can be identified. Goodwill is allocated to individual stores based on historical store contribution, which approximates store cash flow. Other intangible assets (i.e., favorable lease interests and prescription files) are typically store specific and, therefore, are directly assigned to individual stores. When evaluating assets for potential impairment, the Company first compares the carrying amount of the asset to the asset's estimated future cash flows (undiscounted and without interest charges). If the estimated future cash flows used in this analysis are less than the carrying amount of the asset, an impairment loss calculation is prepared. The impairment loss calculation compares the carrying amount of the asset to the asset's estimated future cash flows (discounted and with interest charges). If the carrying amount exceeds the asset's estimated future cash flows (discounted and with interest charges), an impairment loss is recorded.

Goodwill ~ Goodwill, which represents the excess of the purchase price over the fair value of net assets acquired, is amortized on a straight-line basis generally over periods of 40 years. Accumulated amortization was $105.0 million and $85.6 million as of January 1, 2000, and December 26, 1998, respectively. The Company evaluates goodwill for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. If the carrying amount of the goodwill exceeds the expected undiscounted future cash flows, the Company records an impairment loss.

Other assets ~ Other assets primarily include favorable leases, which are amortized on a straight-line basis over the life of the lease, and reorganization goodwill, which is amortized on a straight-line basis over 20 years. The reorganization goodwill is the value of Revco D.S., Inc., in excess of identifiable assets, as determined during its 1992 reorganization under Chapter 11 of the United States Bankruptcy Code. See Note 2 for further information about the Company's merger with Revco D.S., Inc.

Revenue recognition ~ The Company recognizes revenue from the sale of merchandise at the time the merchandise is sold. Service revenues from the Company's pharmacy benefit management segment are recognized at the time the service is provided.

Vendor allowances ~ The total value of any up-front or other periodic payments received from vendors that are linked to purchase commitments is initially deferred. The deferred amounts are then amortized to reduce cost of goods sold over the life of the contract based upon periodic purchase volume. The total value of any up-front or other periodic payments received from vendors that are not linked to purchase commitments is also initially deferred. The deferred amounts are then amortized to reduce cost of goods sold on a straight-line basis over the life of the related contract. Funds that are directly linked to advertising commitments are recognized as a reduction of advertising expense when the related advertising commitment is satisfied.

Store opening and closing costs ~ New store opening costs are charged directly to expense when incurred. When the Company closes a store, the estimated unrecoverable costs, including the remaining lease obligation, are charged to expense.

Stock-based compensation ~ The Company has adopted Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation." Under SFAS No. 123, companies can elect to account for stock-based compensation using a fair value based method or continue to measure compensation expense using the intrinsic value method prescribed in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." The Company has elected to continue to account for its stock-based compensation plans under APB Opinion No. 25. See Note 7 for further information about the Company's stock incentive plans.

Advertising costs ~ External costs incurred to produce media advertising are charged to expense when the advertising takes place.

Insurance ~ The Company is self-insured for general liability, workers' compensation and automobile liability claims up to $500,000. Third party insurance coverage is maintained for claims that exceed this amount. The Company's self-insurance accruals are calculated using standard insurance industry actuarial assumptions and the Company's historical claims experience.

Income taxes ~ Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes as well as for the deferred tax effects of tax credit carryforwards. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

Earnings per common share ~ Basic earnings per common share is computed by dividing: (i) net earnings, after deducting the after-tax dividends on the ESOP preference stock, by (ii) the weighted average number of common shares outstanding during the year (the "Basic Shares").

When computing diluted earnings per common share, the Company normally assumes that the ESOP preference stock is converted into common stock and all dilutive stock options are exercised. After the assumed ESOP preference stock conversion, the ESOP trust would hold common stock rather than ESOP preference stock and would receive common stock dividends (currently $0.23 per share) rather than ESOP preference stock dividends (currently $3.90 per share). Since the ESOP Trust uses the dividends it receives to service its debt, the Company would have to increase its contribution to the ESOP trust to compensate it for the lower dividends. This additional contribution would reduce the Company's net earnings, which in turn, would reduce the amounts that would be accrued under the Company's incentive compensation plans.

Diluted earnings per common share is computed by dividing: (i) net earnings, after accounting for the difference between the dividends on the ESOP preference stock and common stock and after making adjustments for the incentive compensation plans by (ii) Basic Shares plus the additional shares that would be issued assuming that all dilutive stock options are exercised and the ESOP preference stock is converted into common stock. In 1997, the assumed conversion of the ESOP preference stock would have increased diluted earnings per common share and, therefore, was not considered.

New Accounting Pronouncements ~ During fiscal 1999, the Company adopted American Institute of Certified Public Accountants Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." This statement defines which costs incurred to develop or purchase internal-use software should be capitalized and which costs should be expensed. The adoption of this statement did not have a material effect on the Company's consolidated financial statements.

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Business Combinations

CVS/Arbor Merger

On March 31, 1998, CVS completed a merger with Arbor Drugs, Inc. ("Arbor"), pursuant to which 37.8 million shares of CVS common stock were exchanged for all the outstanding common stock of Arbor (the "CVS/Arbor Merger"). Each outstanding share of Arbor common stock was exchanged for 0.6364 shares of CVS common stock. In addition, outstanding Arbor stock options were converted at the same exchange ratio into options to purchase 5.3 million shares of CVS common stock.

CVS/Revco Merger

On May 29, 1997, CVS completed a merger with Revco D.S., Inc. ("Revco"), pursuant to which 120.6 million shares of CVS common stock were exchanged for all the outstanding common stock of Revco (the "CVS/Revco Merger"). Each outstanding share of Revco common stock was exchanged for 1.7684 shares of CVS common stock. In addition, outstanding Revco stock options were converted at the same exchange ratio into options to purchase 6.6 million shares of CVS common stock.

The CVS/Arbor Merger and CVS/Revco Merger constituted tax-free reorganizations and have been accounted for as pooling of interests under APB Opinion No. 16, "Business Combinations." Accordingly, all prior period financial statements were restated to include the combined results of operations, financial position and cash flows of Arbor and Revco as if they had always been owned by CVS.

The Company also acquired other businesses that were accounted for as purchase business combinations and immaterial pooling of interests. These acquisitions did not have a material effect on the Company's consolidated financial statements either individually or in the aggregate. The results of operations of these businesses have been included in the consolidated financial statements since their respective dates of acquisition.

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Merger, Restructuring & Asset Impairment Charges

CVS/Arbor Charge

In accordance with APB Opinion No. 16, Emerging Issues Task Force ("EITF") Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)" and SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," CVS recorded a $147.3 million charge to operating expenses during the second quarter of 1998 for direct and other merger-related costs pertaining to the CVS/Arbor merger transaction and certain restructuring activities (the "CVS/Arbor Charge"). The Company also recorded a $10.0 million charge to cost of goods sold during the second quarter of 1998 to reflect markdowns on noncompatible Arbor merchandise.

Following is a summary of the significant components of the CVS/Arbor Charge:

In millions	
Merger transaction costs	$ 15.0
Restructuring costs:	
Employee severance and benefits	27.1
Exit costs:	
Noncancelable lease obligations	40.0
Duplicate facility	16.5
Asset write-offs	41.2
Contract cancellation costs	4.8
Other	2.7
Total	$147.3

Merger transaction costs included $12.0 million for estimated investment banker fees, $2.5 million for estimated professional fees, and $0.5 million for estimated filing fees, printing costs and other costs associated with furnishing information to shareholders.

Employee severance and benefits included $15.0 million for estimated excess parachute payment excise taxes and related income tax gross-ups, $11.0 million for estimated employee severance and $1.1 million for estimated employee outplacement costs. The excess parachute payment excise taxes and related income tax gross-ups relate to employment agreements that Arbor had in place with 22 senior executives. Employee severance and benefits and employee outplacement costs relate to 236 employees who were located in Arbor's Troy, Michigan corporate headquarters, including the 22 senior executives who were covered by employment agreements.

Exit Costs ~ In conjunction with the merger transaction, management made the decision to close Arbor's Troy, Michigan corporate headquarters and 55 Arbor store locations. As a result, the following exit plan was executed:

1. Arbor's Troy, Michigan corporate headquarters would be closed as soon as possible after the merger. Management anticipated that this facility would be closed by no later than December 31, 1998. Since this location was a leased facility, management returned the premises to the landlord at the conclusion of the current lease term, which extended through 1999. This facility was closed in December 1998.

2. Arbor's Troy, Michigan corporate headquarters employees would be terminated as soon as possible after the merger. Management anticipated that these employees would be terminated by no later than December 31, 1998. However, significant headcount reductions were planned and occurred throughout the transition period. As of December 31, 1998, all of the employees had been terminated.

3. The 55 Arbor store locations discussed above would be closed as soon as practical after the merger. At the time the exit plan was executed, management anticipated that these locations would be closed by no later than December 31, 1999. Since these locations were leased facilities, management planned to either return the premises to the respective landlords at the conclusion of the current lease term or negotiate an early termination of the contractual obligations. The Company did not immediately initiate the Arbor store closing process because the Revco store closing process (discussed below) was continuing to consume its store closing resources. To date, 41 of these locations have been closed or are in the process of being closed. Estimated store closing dates could be affected by the timing of new store openings, the availability of real estate in the Arbor markets and the availability of store closing resources.

Noncancelable lease obligations included $40.0 million for the estimated continuing lease obligations of the 55 Arbor store locations discussed above. As required by EITF Issue 88-10, "Costs Associated with Lease Modification or Termination," the estimated continuing lease obligations were reduced by estimated probable sublease rental income.

Duplicate facility included the estimated costs associated with Arbor's Troy, Michigan corporate headquarters during the shutdown period. This facility was considered to be a duplicate facility that was not required by the combined company. Immediately after the merger transaction, the Company assumed all decision-making responsibility for Arbor and Arbor's corporate employees. The combined company did not retain these employees since they were incremental to their CVS counterparts. During the shutdown period, these employees primarily worked on shutdown activities. The $16.5 million charge included $1.8 million for the estimated cost of payroll and benefits that would be incurred in connection with complying with the Federal Worker Adjustment and Retraining Act (the "WARN Act"), $6.6 million for the estimated cost of payroll and benefits that would be incurred in connection with shutdown activities, $1.5 million for the estimated cost of temporary labor that would be incurred in connection with shutdown activities and $6.6 million for the estimated occupancy-related costs that would be incurred in connection with closing the duplicate corporate headquarters facility.

Asset write-offs included $38.2 million for estimated fixed asset write-offs and $3.0 million for estimated intangible asset write-offs. The Company allocates goodwill to individual stores based on historical store contribution, which approximates store cash flow. Other intangibles (i.e., favorable lease interests and prescription files) are typically store specific and, therefore, are directly assigned to stores. The asset write-offs relate to the 55 store locations discussed above and the Troy, Michigan corporate headquarters. Management's decision to close the store locations was considered to be an event or change in circumstances as defined in SFAS No. 121. Since management intended to use these locations on a short-term basis during the shutdown period, impairment was measured using the "Assets to Be Held and Used" provisions of SFAS No. 121. The analysis was prepared at the individual store level, which is the lowest level at which individual cash flows can be identified. The analysis first compared the carrying amount of the store's assets to the store's estimated future cash flows (undiscounted and without interest charges) through the anticipated closing date. If the estimated future cash flows used in this analysis were less than the carrying amount of the store's assets, an impairment loss calculation was prepared. The impairment loss calculation compared the carrying value of the store's assets to the store's estimated future cash flows (discounted and with interest charges).

Management's decision to close Arbor's Troy, Michigan corporate headquarters was also considered to be an event or change in circumstances as defined in SFAS No. 121. Since management intended to dispose of these assets, impairment was measured using the "Assets to Be Disposed Of" provisions of SFAS No. 121. Since management intended to discard the assets located in this facility, their entire net book value was considered to be impaired.

Contract cancellation costs included $4.8 million for estimated termination fees and/or penalties associated with terminating various contracts that Arbor had in place prior to the merger, which would not be used by the combined company.

Other costs included $1.3 million for the estimated write-off of Arbor's Point-of-Sale software and $1.4 million for travel and related expenses that would be incurred in connection with closing Arbor's corporate headquarters and store facilities.

The above costs did not provide future benefit to the retained stores or corporate facilities.

Following is a reconciliation of the beginning and ending liability balances as of the respective balance sheet dates:

In millions	Merger Transaction Costs	Employee Severance & Benefits[1]	Noncancelable Lease Obligations[2]	Duplicate Facility	Asset Write-offs	Contract Cancellation Costs	Other	Total
CVS/Arbor Charge	$ 15.0	$ 27.1	$ 40.0	$ 16.5	$ 41.2	$ 4.8	$ 2.7	$147.3
Utilization – Cash	(15.9)	(13.8)	—	(15.1)	—	(1.2)	(3.4)	(49.4)
Utilization – Noncash	—	—	—	—	(41.2)	—	—	(41.2)
Transfer[3]	0.9	—	—	(1.4)	—	(0.2)	0.7	—
Balance at 12/26/98	—	13.3	40.0	—	—	3.4	—	56.7
Utilization – Cash	—	(3.0)	(2.7)	—	—	—	—	(5.7)
Balance at 01/1/00[4]	$ —	$ 10.3	$ 37.3	$ —	$ —	$ 3.4	$ —	$ 51.0

(1) Employee severance extends through 2000. Employee benefits extend for a number of years to coincide with the payment of excess parachute payment excise taxes and related income tax gross-ups.

(2) Noncancelable lease obligations extend through 2020.

(3) The transfers between the components of the plan were recorded in the same period that the changes in estimates were determined. These amounts are considered to be immaterial.

(4) The Company believes that the reserve balances as of January 1, 2000, are adequate to cover the remaining liabilities associated with the CVS/Arbor Charge.

CVS/Revco Charge

In accordance with APB Opinion No. 16, EITF Issue 94-3 and SFAS No. 121, CVS recorded a $337.1 million charge to operating expenses during the second quarter of 1997 for direct and other merger-related costs pertaining to the CVS/Revco merger transaction and certain restructuring activities (the "CVS/Revco Charge"). The Company also recorded a $75 million charge to cost of goods sold during the second quarter of 1997 to reflect markdowns on noncompatible Revco merchandise.

Following is a summary of the significant components of the CVS/Revco Charge:

In millions	
Merger transaction costs	$ 35.0
Restructuring costs:	
Employee severance and benefits	89.8
Exit costs:	
Noncancelable lease obligations	67.0
Duplicate facility	50.2
Asset write-offs	82.2
Contract cancellation costs	7.4
Other	5.5
Total	$337.1

Merger transaction costs included $22.0 million for estimated investment banker fees, $10.0 million for estimated professional fees, and $3.0 million for estimated filing fees, printing costs and other costs associated with furnishing information to shareholders.

Employee severance and benefits included $17.0 million for estimated excess parachute payment excise taxes and related income tax gross-ups, $53.7 million for estimated employee severance, $18.0 million for estimated incremental retirement benefits and $1.1 million for estimated employee outplacement costs. The excess parachute payment excise taxes and related income tax gross-ups relate to employment agreements that Revco had in place with 26 senior executives. Employee severance and benefits and employee outplacement costs relate to 1,195 employees who were located in Revco's Twinsburg, Ohio corporate headquarters, including the 26 senior executives who were covered by employment agreements. The incremental retirement benefits (i.e., enhanced SERP benefits) also resulted from the change in control.

Exit Costs ~ In conjunction with the merger transaction, management made the decision to close Revco's Twinsburg, Ohio corporate headquarters and 223 Revco store locations. As a result, the following exit plan was executed:

1. Revco's Twinsburg, Ohio corporate headquarters would be closed as soon as possible after the merger. Management anticipated that this facility would be closed by no later than December 31, 1997. The corporate headquarters complex included both leased and owned facilities. Management planned to return the leased facilities to the respective landlords at the conclusion of the current lease term and/or negotiate an early termination of the contractual obligations. Management intended to sell the owned facility. These facilities were closed in March 1998. The related continuing lease obligations extend through 2007. The owned facility was sold on May 8, 1998.

2. Revco's Twinsburg, Ohio corporate headquarters employees would be terminated as soon as possible after the merger. Management anticipated that these employees would be terminated by no later than December 31, 1997. However, significant headcount reductions at Revco were planned and occurred throughout the transition period. As of December 31, 1998, all of the above employees had been terminated.

3. The 223 Revco store locations discussed above would be closed as soon as practical after the merger. At the time the exit plan was executed, management anticipated that these stores would be closed by no later than December 31, 1998. Since these facilities were leased facilities, management planned to either return the premises to the respective landlords at the conclusion of the current lease term and/or negotiate an early termination of the contractual obligations. As of December 31, 1998, all of these locations have been closed.

Noncancelable lease obligations included $67.0 million for the estimated continuing lease obligations of the 223 Revco store locations discussed above. As required by EITF 88-10, the estimated continuing lease obligations were reduced by estimated probable sublease rental income.

Duplicate facility included the estimated costs associated with Revco's Twinsburg, Ohio corporate headquarters during the shutdown period. This facility was considered to be a duplicate facility that was not required by the combined company. Immediately after the merger transaction, the Company assumed all decision-making responsibility for Revco and Revco's corporate employees. The combined company did not retain these employees since they were incremental to their CVS counterparts. During the shutdown period, these employees primarily worked on shutdown activities. The $50.2 million charge included $10.4 million for the estimated cost of payroll and benefits that would be incurred in connection with complying with the WARN Act, $13.3 million for the estimated cost of payroll and benefits that would be incurred in connection with shutdown activities, $8.5 million for the estimated cost of temporary labor that would be incurred in connection with shutdown activities and $18.0 million for the estimated occupancy-related costs that would be incurred in connection with closing the duplicate corporate headquarters facility.

Asset write-offs included $40.3 million for estimated fixed asset write-offs and $41.9 million for estimated intangible asset write-offs. The Company allocates goodwill to individual stores based on historical store contribution, which approximates store cash flow. Other intangibles (i.e., favorable lease interests and prescription files) are typically store specific and, therefore, are directly assigned to stores. The asset write-offs relate to the 223 store locations discussed above and the Twinsburg, Ohio corporate headquarters. Management's decision to close the store locations was considered to be an event or change in circumstances as defined in SFAS No. 121. Since management intended to use these locations on a short-term basis

during the shutdown period, impairment was measured using the "Assets to Be Held and Used" provisions of SFAS No. 121. The analysis was prepared at the individual store level, which is the lowest level at which individual cash flows can be identified. The analysis first compared the carrying amount of the store's assets to the store's estimated future cash flows (undiscounted and without interest charges) through the anticipated closing date. If the estimated future cash flows used in this analysis were less than the carrying amount of the store's assets, an impairment loss calculation was prepared. The impairment loss calculation compared the carrying value of the store's assets to the store's estimated future cash flows (discounted and with interest charges).

Management's decision to close Revco's corporate headquarters was also considered to be an event or change in circumstances as defined in SFAS No. 121. Since management intended to dispose of these assets, impairment was measured using the "Assets to Be Disposed Of" provisions of SFAS No. 121. The impairment loss of $3.9 million for the facility that Revco owned was calculated by subtracting the carrying value of the facility from the estimated fair value less cost to sell. Since management intended to discard the remaining assets located in these facilities, their entire net book value was considered to be impaired.

Contract cancellation costs included $7.4 million for estimated termination fees and/or penalties associated with terminating various contracts that Revco had in place prior to the merger, which would not be used by the combined company.

Other costs included $3.5 million for estimated travel and related expenses that would be incurred in connection with closing Revco's corporate headquarters and $2.0 million for other miscellaneous charges associated with closing Revco's corporate headquarters.

The above costs did not provide future benefit to the retained stores or corporate facilities.

Following is a reconciliation of the beginning and ending liability balances as of the respective balance sheet dates:

In millions	Merger Transaction Costs	Employee Severance & Benefits[1]	Noncancelable Lease Obligations[2]	Duplicate Facility	Asset Write-offs	Contract Cancellation Costs	Other	Total
CVS/Revco Charge	$ 35.0	$ 89.8	$ 67.0	$ 50.2	$ 82.2	$ 7.4	$ 5.5	$ 337.1
Utilization – Cash	(32.1)	(37.4)	(0.9)	(37.6)	—	(5.1)	(5.5)	(118.6)
Utilization – Noncash	—	—	—	—	(82.2)	—	—	(82.2)
Balance at 12/27/97	2.9	52.4	66.1	12.6	—	2.3	—	136.3
Utilization – Cash	(0.3)	(40.0)	(17.0)	(11.8)	—	(2.3)	(3.4)	(74.8)
Transfer[3]	(2.6)	—	—	(0.8)	—	—	3.4	—
Balance at 12/26/98	—	12.4	49.1	—	—	—	—	61.5
Utilization – Cash	—	(3.4)	(9.9)	—	—	—	—	(13.3)
Balance at 01/1/00[4]	$ —	$ 9.0	$ 39.2	$ —	$ —	$ —	$ —	$ 48.2

(1) Employee severance extended through 1999. Employee benefits extend for a number of years to coincide with the payment of retirement benefits and excess parachute payment excise taxes and related income tax gross-ups.

(2) Noncancelable lease obligations extend through 2017.

(3) The transfers between the components of the plan were recorded in the same period that the changes in estimates were determined. These amounts are considered to be immaterial.

(4) The Company believes that the reserve balances as of January 1, 2000, are adequate to cover the remaining liabilities associated with the CVS/Revco Charge.

Big B Charge

In accordance with EITF Issue 94-3 and SFAS No. 121, the Company recorded a $31.0 million charge to operating expenses during the first quarter of 1997 for certain costs associated with the restructuring of Big B, Inc. (the "Big B Charge"), which the Company acquired in 1996. This charge included accrued liabilities related to store closings and duplicate corporate facilities, such as the cancellation of lease agreements and the write-down of unutilized fixed assets. Asset write-offs included in this charge totaled $5.1 million. The balance of the charge, $25.9 million, will require cash outlays of which $15.9 million and $10.0 million had been incurred as of January 1, 2000, and December 26, 1998, respectively. The remaining cash outlays primarily include noncancelable lease commitments, which extend through 2012. The above costs did not provide future benefit to the retained stores or corporate facilities.

Strategic Restructuring Program & Discontinued Operations

In November 1997, the Company completed the final phase of its comprehensive strategic restructuring program, first announced in October 1995 and subsequently refined in May 1996 and June 1997. The strategic restructuring program included: (i) the sale of Marshalls, Kay-Bee Toys, Wilsons, This End Up and Bob's Stores, (ii) the spin-off of Footstar, Inc., which included Meldisco, Footaction and Thom McAn, (iii) the initial and secondary public offerings of Linens 'n Things and (iv) the closing of the Company's administrative office facility located in Rye, New York.

The strategic restructuring program was completed without significant changes to the Board approved plan.

During the second quarter of 1997, the Company sold its remaining investment in Linens 'n Things and recorded, as a component of discontinued operations, a pre-tax gain of $65.0 million ($38.2 million after-tax). In connection with recording this gain, the Company also recorded, as a component of discontinued operations, a pre-tax charge of $35.0 million ($20.7 million after-tax) during the second quarter of 1997 (the "1997 Charge"). The charge resulted from the Company's decision to retain and close seven Bob's Stores, which were affecting the overall marketability of the Bob's Stores business and the anticipated timing of the sale. As a result of this decision, the Company recorded a liability for the continuing lease obligations associated with these locations. At the time of adopting the plan of disposal, the Company expected to sell the entire Bob's Stores business and believed it was likely that the sale could be consummated within 12 months.

Following is a summary of the beginning and ending liability balances as of the respective balance sheet dates:

In millions	Loss on Disposal	Noncancelable Lease Obligations[1]	Employee Severance[2]	Other	Total[3]
Balance at 12/28/96	$ 162.5	$ 55.5	$ 35.1	$ 4.8	$257.9
1997 Charge	—	35.0	—	—	35.0
Utilization	(192.9)	(20.4)	(22.0)	(4.8)	(240.1)
Transfers[4]	38.8	(32.8)	(6.0)	—	—
Balance at 12/27/97	8.4	37.3	7.1	—	52.8
Utilization	(8.4)	(7.3)	(2.4)	—	(18.1)
Balance at 12/26/98	—	30.0	4.7	—	34.7
Utilization	—	(8.0)	(2.9)	—	(10.9)
Balance at 01/1/00[5]	$ —	$ 22.0	$ 1.8	$ —	$ 23.8

(1) Noncancelable lease obligations extend through 2016.

(2) Employee severance extends through 2000.

(3) As of January 1, 2000, and December 26, 1998, there were no assets and $23.8 million and $34.7 million of liabilities, respectively, of the discontinued operations reflected in the accompanying consolidated balance sheets.

(4) At the time the decision was made to separate Bob's Stores from CVS, an estimated loss on disposal was recorded in the consolidated statements of operations within discontinued operations. That loss included certain estimates. At the time of the sale, the total loss on disposal remained unchanged. However, the components of the loss differed. The transfers between the components of the plan were made to reflect the nature of the remaining reserve. In conjunction with the sale, the buyer assumed primary responsibility for the continuing lease obligations and retained certain employees that could have otherwise been terminated.

(5) The Company believes that the reserve balances as of January 1, 2000, are adequate to cover the remaining liabilities associated with this program.

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Borrowings and Credit Agreements

Following is a summary of the Company's borrowings as of the respective balance sheet dates:

In millions	**January 1, 2000**	December 26, 1998
Commercial paper	**$ 451.0**	$ 736.6
ESOP note payable[1]	**257.0**	270.7
Uncommitted lines of credit	**—**	34.5
5.5% unsecured senior notes	**300.0**	—
Mortgage notes payable	**17.3**	16.1
Capital lease obligations	**1.5**	3.5
	1,026.8	1,061.4
Less:		
Short-term borrowings	**(451.0)**	(771.1)
Current portion of long-term debt	**(17.3)**	(14.6)
	$ 558.5	$ 275.7

(1) See Note 9 for further information about the Company's ESOP Plan.

The Company's commercial paper program is supported by a $670 million, five-year unsecured revolving credit facility, which expires on May 30, 2002, and a $530 million, 364-day unsecured revolving credit facility, which expires on June 21, 2000 (collectively, the "Credit Facilities"). The Credit Facilities require the Company to pay a quarterly facility fee of 0.07%, regardless of usage. The Company can also obtain up to $35.0 million of short-term financing through various uncommitted lines of credit. The weighted average interest rate for short-term borrowings was 6.2% as of January 1, 2000, and 5.7% as of December 26, 1998.

In February 1999, the Company issued $300 million of 5.5% unsecured senior notes due February 15, 2004. The proceeds from the issuance were used to repay outstanding commercial paper borrowings.

The Credit Facilities and unsecured senior notes contain customary restrictive financial and operating covenants. The covenants do not materially affect the Company's financial or operating flexibility.

During the second quarter of 1997, the Company extinguished $865.7 million of the debt it absorbed as part of the CVS/Revco Merger using cash on hand and commercial paper borrowings. As a result, the Company recorded an extraordinary loss, net of income taxes, of $17.1 million, which consisted of early retirement premiums and the write-off of unamortized deferred financing costs.

At January 1, 2000, the aggregate long-term debt maturing during the next five years is as follows: $17.3 million in 2000, $21.6 million in 2001, $26.5 million in 2002, $32.3 million in 2003, $323.5 million in 2004, $154.6 million in 2005 and thereafter.

1 2 3 4 5 6 7 8 9 10 11 12 13 14 15

Leases

The Company and its subsidiaries lease retail stores, warehouse facilities, office facilities and equipment under noncancelable operating leases typically over periods ranging from 5 to 20 years, along with options to renew over periods ranging from 5 to 15 years.

Following is a summary of the Company's net rental expense for operating leases for the respective fiscal years:

		Fiscal Year	
In millions	**1999**	1998	1997
Minimum rentals	**$ 572.4**	$ 459.1	$ 409.6
Contingent rentals	**64.8**	60.3	60.2
	637.2	519.4	469.8
Less: sublease income	**(13.2)**	(14.0)	(9.5)
	$ 624.0	$ 505.4	$ 460.3

Following is a summary of the future minimum lease payments under capital and operating leases as of January 1, 2000:

In millions	*Capital Leases*	*Operating Leases*
2000	$ 0.4	$ 474.1
2001	0.4	441.8
2002	0.4	406.0
2003	0.4	377.4
2004	0.4	347.5
Thereafter	1.6	3,159.1
	3.6	$ 5,205.9
Less: imputed interest	(2.1)	
Present value of capital lease obligations	$ 1.5	

During fiscal 1999, the Company entered into sale-leaseback transactions totaling $229 million as a means of financing a portion of its store development program. The properties were sold at net book value and were typically leased back over periods of 20 years. The resulting leases are being accounted for as operating leases and are included in the above tables.

Stock Incentive Plans

As of January 1, 2000, the Company had the following stock incentive plans, which include the pre-merger plans of Arbor and Revco. Effective with the mergers, all outstanding Arbor and Revco stock options were exchanged for options to purchase CVS common stock.

1997 Incentive Compensation Plan

The 1997 Incentive Compensation Plan (the "1997 ICP") superceded the 1990 Omnibus Stock Incentive Plan, the 1987 Stock Option Plan and the 1973 Stock Option Plan (collectively, the "Preexisting Plans"). Upon approval of the 1997 ICP, authority to make future grants under the Preexisting Plans was terminated, although previously granted awards remain outstanding in accordance with their terms and the terms of the Preexisting Plans.

As of January 1, 2000, the 1997 ICP provided for the granting of up to 23,382,245 shares of common stock in the form of stock options, stock appreciation rights, restricted shares, deferred shares and performance-based awards to selected officers, employees and directors of the Company. All grants under the 1997 ICP are awarded at fair market value on the date of grant. The right to exercise or receive these awards generally commences between one and five years from the date of the grant and expires not more than ten years after the date of the grant, provided that the holder continues to be employed by the Company. As of January 1, 2000, there were 17,915,519 shares available for future grants under the 1997 ICP.

Restricted shares issued under the 1997 ICP may not exceed 3.6 million shares. In fiscal 1999, 1998 and 1997, 14,402, 155,400 and 44,610 shares of restricted stock were granted at a weighted average grant date fair value of $50.88, $37.80 and $23.02, respectively. Participants are entitled to vote and receive dividends on their restricted shares, although they are subject to certain transfer restrictions. Compensation costs, which are recognized over the restricted period, totaled $2.3 million in 1999, $3.1 million in 1998 and $3.5 million in 1997.

The 1996 Directors Stock Plan

The 1996 Directors Stock Plan (the "1996 DSP") provides for the granting of up to 346,460 shares of common stock to the Company's nonemployee directors (the "Eligible Directors"). The 1996 DSP allows the Eligible Directors to elect to receive shares of common stock in lieu of cash compensation. Eligible Directors may also elect to defer compensation payable in common stock until their service as a director concludes. The 1996 DSP replaced the Company's 1989 Directors Stock Option Plan. As of January 1, 2000, there were 247,071 shares available for future grant under the 1996 DSP.

Following is a summary of the fixed stock option activity for the respective fiscal years:

	1999		1998		1997	
	Shares	***Weighted Average Exercise Price***	*Shares*	*Weighted Average Exercise Price*	*Shares*	*Weighted Average Exercise Price*
Outstanding at beginning of year	**11,982,122**	**$ 23.31**	16,070,146	$ 16.95	23,569,930	$ 13.96
Granted	**2,175,342**	**48.02**	3,119,410	37.16	3,695,530	23.62
Exercised	**(927,080)**	**18.87**	(7,137,027)	15.01	(10,756,726)	12.99
Canceled	**(265,784)**	**37.65**	(70,407)	26.48	(438,588)	14.48
Outstanding at end of year	**12,964,600**	**27.38**	11,982,122	23.31	16,070,146	16.95
Exercisable at end of year	**6,065,351**	**$ 17.92**	6,127,402	$ 17.16	11,729,688	$ 16.11

Following is a summary of the fixed stock options outstanding and exercisable as of January 1, 2000:

	Options Outstanding			*Options Exercisable*	
Range of Exercise Prices	*Number Outstanding*	*Weighted Average Remaining Life*	*Weighted Average Exercise Price*	*Number Exercisable*	*Weighted Average Exercise Price*
Under $15	516,927	5.3	$ 11.43	496,038	$ 11.83
$15.01 to $20.00	4,934,909	4.9	16.72	4,607,689	16.72
20.01 to 25.00	2,357,420	6.4	22.81	652,241	22.27
25.01 to 40.00	3,110,464	8.0	36.71	297,019	36.24
40.01 to 51.38	2,044,880	9.3	48.19	12,364	42.65
Total	12,964,600	6.6	$ 27.38	6,065,351	$ 17.92

The Company applies APB Opinion No. 25 to account for its stock incentive plans. Accordingly, no compensation cost has been recognized for stock options granted. Had compensation cost been recognized based on the fair value of stock options granted consistent with SFAS No. 123, net earnings and net earnings per common share ("EPS") would approximate the pro forma amounts shown below:

In millions, except per share amounts	Fiscal Year 1999	1998	1997
Net earnings:			
As reported	**$ 635.1**	$ 384.5	$ 88.8
Pro forma	**614.7**	359.0	70.6
Basic EPS:			
As reported	**$ 1.59**	$ 0.96	$ 0.20
Pro forma	**1.53**	0.89	0.15
Diluted EPS:			
As reported	**$ 1.55**	$ 0.95	$ 0.19
Pro forma	**1.50**	0.88	0.15

The fair value of each stock option grant was estimated using the Black-Scholes Option Pricing Model with the following assumptions:

	Fiscal Year 1999	1998	1997
Dividend yield	**0.58%**	0.40%	0.70%
Expected volatility	**25.86%**	22.49%	22.77%
Risk-free interest rate	**6.50%**	5.75%	5.50%
Expected life	**6.0**	7.0	5.5

1999 Employee Stock Purchase Plan

The 1999 Employee Stock Purchase Plan provides for the granting of up to 7,400,000 shares of common stock. The plan, which covers substantially all employees, gives employees the option to purchase common stock at the end of each six-month offering period, at a purchase price equal to 85% of the lower of the fair market value on the first day or the last day of the offering period.

Employees pay for the shares ratably over each offering period through payroll deductions. During 1999, options for 210,833 shares were exercised at an average price of $33.42.

8 Pension Plans and Other Postretirement Benefits

The Company sponsors a noncontributory defined benefit pension plan that covers certain full-time employees of Revco who are not covered by collective bargaining agreements. On September 20, 1997, the Company suspended future benefit accruals under this plan. As a result of the plan's suspension, the Company realized a $6.0 million curtailment gain in 1997. Benefits paid to retirees are based upon age at retirement, years of credited service and average compensation during the five-year period ending September 20, 1997. The plan is funded based on actuarial calculations and applicable federal regulations.

Pursuant to various labor agreements, the Company is also required to make contributions to certain union-administered pension and health and welfare plans that totaled $8.4 million, $7.5 million and $7.6 million in fiscal 1999, 1998 and 1997, respectively. The Company may be liable for its share of the plans' unfunded liabilities if the plans are terminated. The Company also has nonqualified supplemental executive retirement plans in place for certain key employees for whom it has purchased cost recovery variable life insurance.

Defined Contribution Plans

The Company sponsors a Profit Sharing Plan and a voluntary 401(k) Savings Plan that covers substantially all employees who meet plan eligibility requirements. The Company makes matching contributions consistent with the provisions of the plan. The Company also maintains a non-qualified, unfunded Deferred Compensation Plan for certain key employees. This plan provides participants the opportunity to defer portions of their compensation and receive matching contributions that they would have otherwise received under the 401(k) Savings Plan if not for certain restrictions and limitations under the Internal Revenue Code. The Company's contributions under the above defined contribution plans totaled $17.0 million, $26.4 million and $24.1 million in fiscal 1999, 1998 and 1997, respectively. The Company also sponsors an Employee Stock Ownership Plan. See Note 9 for further information about this plan.

Other Postretirement Benefits

The Company provides postretirement healthcare and life insurance benefits to retirees who meet eligibility requirements. The Company's funding policy is generally to pay covered expenses as they are incurred.

Following is a reconciliation of the benefit obligation, fair value of plan assets and funded status of the Company's defined benefit and other postretirement benefit plans as of the respective balance sheet dates:

	Defined Benefit Plans Fiscal Year		*Other Postretirement Benefits Fiscal Year*	
In millions	**1999**	1998	**1999**	1998
Change in benefit obligation:				
Benefit obligation at beginning of year	**$ 297.6**	$ 253.3	**$ 14.0**	$ 14.4
Service cost	**0.7**	0.5	**—**	—
Interest cost	**19.8**	19.5	**0.9**	1.0
Actuarial (gain) loss	**(40.3)**	49.3	**1.1**	0.5
Benefits paid	**(23.0)**	(25.0)	**(2.0)**	(1.9)
Benefit obligation at end of year	**$ 254.8**	$ 297.6	**$ 14.0**	$ 14.0
Change in plan assets:				
Fair value at beginning of year	**$ 223.1**	$ 201.5	**$ —**	$ —
Actual return on plan assets	**37.3**	28.4	**—**	—
Company contributions	**11.4**	18.2	**2.0**	1.9
Benefits paid	**(23.0)**	(25.0)	**(2.0)**	(1.9)
Fair value at end of year[1]	**$ 248.8**	$ 223.1	**$ —**	$ —
Funded status:				
Funded status	**$ (6.0)**	$ (74.5)	**$ (14.0)**	$ (14.0)
Unrecognized prior service cost	**1.1**	1.3	**(0.9)**	(1.0)
Unrecognized net (gain) loss	**(60.6)**	1.6	**0.8**	(0.3)
Accrued pension costs	**$ (65.5)**	$ (71.6)	**$ (14.1)**	$ (15.3)

(1) Plan assets consist primarily of mutual funds, common stock and insurance contracts.

Following is a summary of the net periodic pension cost for the defined benefit and other postretirement benefit plans for the respective fiscal years:

	Defined Benefit Plans			*Other Postretirement Benefits*		
In millions	**1999**	1998	1997	**1999**	1998	1997
Service cost[1]	**$ 0.7**	$ 0.5	$ 7.6	**$ —**	$ —	$ —
Interest cost on benefit obligation	**19.8**	19.5	19.2	**0.9**	1.0	1.0
Expected return on plan assets	**(16.6)**	(16.4)	(14.9)	**—**	—	—
Amortization of net loss (gain)	**1.3**	1.2	0.3	**—**	(0.2)	—
Amortization of prior service cost	**0.1**	0.1	0.3	**(0.1)**	(0.1)	(0.3)
Curtailment gain	**—**	—	(6.0)	**—**	—	—
Net periodic pension cost	**$ 5.3**	$ 4.9	$ 6.5	**$ 0.8**	$ 0.7	$ 0.7
Weighted average assumptions:						
Discount rate	**8.00%**	6.75%	7.25%	**7.75%**	6.75%	7.25%
Expected return on plan assets	**9.00%**	9.00%	9.00%	**—**	—	—
Rate of compensation increase	**4.00%**	4.50%	4.50%	**—**	—	—

(1) The decrease in total service cost is primarily due to the suspension of future benefit accruals under the Revco pension plan during 1997.

For measurement purposes, future healthcare costs are assumed to increase at an annual rate of 9.0%, decreasing to an annual growth rate of 5.0% in 2004 and thereafter. A one percent change in the assumed healthcare cost trend rate would change the accumulated postretirement benefit obligation by $0.9 million and the total service and interest costs by $0.1 million.

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Employee Stock Ownership Plan

The Company sponsors a defined contribution Employee Stock Ownership Plan (the "ESOP") that covers full-time employees with at least one year of service.

In 1989, the ESOP Trust borrowed $357.5 million through a 20-year note (the "ESOP Note"). The proceeds from the ESOP Note were used to purchase 6.7 million shares of Series One ESOP Convertible Preference Stock (the "ESOP Preference Stock") from the Company. Since the ESOP Note is guaranteed by the Company, the outstanding balance is reflected as long-term debt and a corresponding guaranteed ESOP obligation is reflected in shareholders' equity in the accompanying consolidated balance sheets.

Each share of ESOP Preference Stock has a guaranteed minimum liquidation value of $53.45, is convertible into 2.314 shares of common stock and is entitled to receive an annual dividend of $3.90 per share. The ESOP Trust uses the dividends received and contributions from the Company to repay the ESOP Note. As the ESOP Note is repaid, ESOP Preference Stock is allocated to participants based on: (i) the ratio of each year's debt service payment to total current and future debt service payments multiplied by (ii) the number of unallocated shares of ESOP Preference Stock in the plan. As of January 1, 2000, 5.2 million shares of ESOP Preference Stock were outstanding, of which 1.9 million shares were allocated to participants and the remaining 3.3 million shares were held in the ESOP Trust for future allocations.

Annual ESOP expense recognized is equal to (i) the interest incurred on the ESOP Note plus (ii) the higher of (a) the principal repayments or (b) the cost of the shares allocated, less (iii) the dividends paid. Similarly, the guaranteed ESOP obligation is reduced by the higher of (i) the principal payments or (ii) the cost of shares allocated.

Following is a summary of the ESOP activity as of the respective fiscal years:

In millions	**1999**	*Fiscal Year* 1998	1997
ESOP expense recognized	**$ 16.6**	$ 25.8	$ 13.8
Dividends paid	**20.1**	20.5	20.8
Cash contributions	**16.6**	25.8	22.9
Interest payments	**23.1**	24.9	26.4
ESOP shares allocated	**0.3**	0.4	0.4

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Income Taxes

The provision for income taxes consisted of the following for the respective fiscal years:

In millions		**1999**	*Fiscal Year* 1998	1997
Current:	Federal	**$ 289.6**	$ 197.3	$ 182.5
	State	**68.4**	41.4	68.5
		358.0	238.7	251.0
Deferred:	Federal	**72.6**	44.1	(75.0)
	State	**10.7**	23.7	(26.8)
		83.3	67.8	(101.8)
Total		**$ 441.3**	$ 306.5	$ 149.2

Following is a reconciliation of the statutory income tax rate to the Company's effective tax rate for the respective fiscal years:

	1999	*Fiscal Year* 1998	1997
Statutory income tax rate	**35.0%**	35.0%	35.0%
State income taxes, net of federal tax benefit	**4.8**	5.8	6.6
Goodwill and other	**1.2**	1.2	1.4
Effective tax rate before merger-related costs	**41.0**	42.0	43.0
Merger-related costs[1]	**—**	2.4	19.8
Effective tax rate	**41.0%**	44.4%	62.8%

(1) Includes state tax effect.

Following is a summary of the significant components of the Company's deferred tax assets and liabilities as of the respective balance sheet dates:

In millions	**January 1, 2000**	December 26, 1998
Deferred tax assets:		
Employee benefits	**$ 56.7**	$ 84.5
Other	**135.1**	185.5
Total deferred tax assets	**191.8**	270.0
Deferred tax liabilities:		
Accelerated depreciation	**(68.9)**	(44.0)
Inventory	**(10.7)**	(1.6)
Total deferred tax liabilities	**(79.6)**	(45.6)
Net deferred tax assets	**$ 112.2**	$ 224.4

Income taxes paid were $354.5 million, $102.6 million and $258.9 million for fiscal 1999, 1998 and 1997, respectively.

Based on historical pre-tax earnings, the Company believes it is more likely than not that the deferred tax assets will be realized.

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Supplemental Information

Following are the components of property and equipment included in the consolidated balance sheets as of the respective balance sheet dates:

In millions	**January 1, 2000**	December 26, 1998
Land	**$ 89.6**	$ 91.0
Buildings and improvements	**467.8**	296.8
Fixtures and equipment	**1,326.5**	1,171.8
Leasehold improvements	**518.5**	477.4
Capital leases	**2.2**	2.8
	2,404.6	2,039.8
Accumulated depreciation and amortization	**(803.6)**	(688.6)
	$ 1,601.0	$ 1,351.2

Following is a summary of the Company's noncash financing activities for the respective fiscal years:

In millions	**1999**	1998	1997
Fair value of assets acquired	**$ —**	$ 62.2	$ —
Cash paid	**—**	62.2	—
Liabilities assumed	**$ —**	$ —	$ —
Equity securities or notes received from sale of business	**$ —**	$ —	$ 52.0

Interest expense was $66.1 million, $69.7 million and $59.1 million and interest income was $7.0 million, $8.8 million and $15.0 million in fiscal 1999, 1998 and 1997, respectively. Interest paid totaled $69.0 million, $70.7 million and $58.4 million in fiscal 1999, 1998 and 1997, respectively.

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Commitments & Contingencies

In connection with certain business dispositions completed between 1991 and 1997, the Company continues to guarantee lease obligations for approximately 1,400 former stores. The Company is indemnified for these obligations by the respective purchasers. Assuming that each respective purchaser became insolvent, an event which the Company believes to be highly unlikely, management estimates that it could settle these obligations for approximately $1.0 billion as of January 1, 2000.

In the opinion of management, the ultimate disposition of these guarantees will not have a material adverse effect on the Company's consolidated financial condition, results of operations or future cash flows.

As of January 1, 2000, the Company had outstanding commitments to purchase $283.8 million of merchandise inventory for use in the normal course of business. The Company currently expects to satisfy these purchase commitments by 2002.

The Company is also a defendant in various lawsuits arising in the ordinary course of business. In the opinion of management and the Company's outside counsel, the ultimate disposition of these lawsuits, exclusive of potential insurance recoveries, will not have a material adverse effect on the Company's consolidated financial condition, results of operations or future cash flows.

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Business Segments

The Company currently operates four business segments: Retail Pharmacy, Pharmacy Benefit Management ("PBM"), Specialty Pharmacy and Internet Pharmacy. The Company's business segments are operating units that offer different products and services, and require distinct technology and marketing strategies.

The Retail Pharmacy segment, which includes 4,086 retail drugstores located in 24 states and the District of Columbia, operates under the CVS/pharmacy name. The Retail Pharmacy segment is the Company's only reportable segment.

The PBM segment provides a full range of prescription benefit management services to managed care and other organizations. These services include plan design and administration, formulary management, mail order pharmacy services, claims processing and generic substitution. The PBM segment operates under the PharmaCare Management Services name.

The Specialty Pharmacy segment, which includes a mail order facility and 12 retail pharmacies located in 9 states and the District of Columbia, operates under the CVS ProCare name. The Specialty Pharmacy segment focuses on supporting individuals who require complex and expensive drug therapies.

The Internet Pharmacy segment, which includes a mail order facility and a complete online retail pharmacy, operates under the CVS.com name.

The accounting policies of the segments are substantially the same as those described in Note 1. The Company evaluates segment performance based on operating profit before the effect of nonrecurring charges and gains and intersegment profits.

Following is a reconciliation of the significant components of the Retail Pharmacy segment's net sales for the respective fiscal years:

	1999	1998	1997
Pharmacy	**58.7%**	57.6%	54.7%
Front store	**41.3**	42.4	45.3
Total net sales	**100.0%**	100.0%	100.0%

Following is a reconciliation of the Company's business segments to the consolidated financial statements:

In millions	Retail Pharmacy Segment	All Other Segments	Intersegment Eliminations[1]	Other Adjustments[2]	Consolidated Totals
1999:					
Net sales	**$ 17,625.7**	**$ 888.4**	**$ (415.8)**	**$ —**	**$ 18,098.3**
Operating profit	**1,120.4**	**15.1**	**—**	**—**	**1,135.5**
Depreciation and amortization	**274.6**	**3.3**	**—**	**—**	**277.9**
Total assets	**7,146.1**	**173.4**	**(44.1)**	**—**	**7,275.4**
Capital expenditures	**477.1**	**16.4**	**—**	**—**	**493.5**
1998:					
Net sales	$ 15,081.1	$ 488.4	$ (295.9)	$ —	$ 15,273.6
Operating profit	927.8	12.7	—	(188.6)	751.9
Depreciation and amortization	248.6	1.1	—	—	249.7
Total assets	6,602.1	119.6	(35.5)	—	6,686.2
Capital expenditures	498.0	4.3	—	—	502.3
1997:					
Net sales	$ 13,649.4	$ 320.7	$ (220.5)	$ —	$ 13,749.6
Operating profit	771.2	7.9	—	(497.4)	281.7
Depreciation and amortization	237.8	0.4	—	—	238.2
Total assets	5,878.9	60.6	(19.0)	—	5,920.5
Capital expenditures	339.6	2.0	—	—	341.6

(1) Intersegment eliminations relate to intersegment sales and accounts receivables that occur when a Pharmacy Benefit Management segment customer uses a Retail Pharmacy segment store to purchase covered merchandise. When this occurs, both segments record the sale on a stand-alone basis.

(2) Other adjustments relate to the merger, restructuring and other nonrecurring charges. These charges are not considered when management assesses the stand-alone performance of the Company's business segments.

Reconciliation of Earnings Per Common Share

Following is a reconciliation of basic and diluted earnings per common share for the respective fiscal years:

In millions, except per share amounts	**1999**	*Fiscal Year* 1998	1997
Numerator for earnings per common share calculation:			
Earnings from continuing operations before extraordinary item	**$ 635.1**	$ 384.5	$ 88.4
Preference dividends, net of tax benefit	**(14.7)**	(13.6)	(13.7)
Earnings from continuing operations available to common shareholders, basic	**$ 620.4**	$ 370.9	$ 74.7
Earnings from discontinued operations	**—**	—	17.5
Extraordinary loss	**—**	—	(17.1)
Net earnings available to common shareholders, basic	**$ 620.4**	$ 370.9	$ 75.1
Earnings from continuing operations before extraordinary item	**$ 635.1**	$ 384.5	$ 88.4
Effect of dilutive securities:			
Preference dividends, net of tax benefit	**—**	—	(13.7)
Dilutive earnings adjustments	**—**	(0.8)	—
Earnings from continuing operations available to common shareholders, diluted	**$ 635.1**	$ 383.7	$ 74.7
Earnings from discontinued operations	**—**	—	17.5
Extraordinary loss	**—**	—	(17.1)
Net earnings available to common shareholders, diluted	**$ 635.1**	$ 383.7	$ 75.1
Denominator for earnings per common share calculation:			
Weighted average common shares, basic	**391.3**	387.1	377.2
Effect of dilutive securities:			
Preference stock	**10.7**	10.5	—
Stock options	**6.9**	7.6	7.9
Weighted average common shares, diluted	**408.9**	405.2	385.1
Basic earnings per common share:			
Earnings from continuing operations before extraordinary item	**$ 1.59**	$ 0.96	$ 0.20
Earnings from discontinued operations	**—**	—	0.05
Extraordinary item, net of tax benefit	**—**	—	(0.05)
Net earnings	**$ 1.59**	$ 0.96	$ 0.20
Diluted earnings per common share:			
Earnings from continuing operations before extraordinary item	**$ 1.55**	$ 0.95	$ 0.19
Earnings from discontinued operations	**—**	—	0.05
Extraordinary item, net of tax benefit	**—**	—	(0.05)
Net earnings	**$ 1.55**	$ 0.95	$ 0.19

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Quarterly Financial Information (Unaudited)

Following is a summary of the unaudited quarterly results of operations and common stock prices for the respective fiscal quarters:

Dollars in millions, except per share amounts	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Fiscal Year
Fiscal 1999:					
Net sales	**$ 4,240.5**	**$ 4,362.4**	**$ 4,311.8**	**$ 5,183.6**	**$ 18,098.3**
Gross margin	**1,169.4**	**1,190.4**	**1,141.1**	**1,360.5**	**4,861.4**
Operating profit	**293.2**	**290.2**	**219.7**	**332.4**	**1,135.5**
Net earnings	**164.6**	**162.6**	**121.6**	**186.3**	**635.1**
Net earnings per common share, basic	**0.41**	**0.41**	**0.30**	**0.47**	**1.59**
Net earnings per common share, diluted	**0.40**	**0.40**	**0.30**	**0.46**	**1.55**
Dividends per common share	**0.0575**	**0.0575**	**0.0575**	**0.0575**	**0.2300**
Stock price: (New York Stock Exchange)					
High	**56.44**	**52.06**	**53.00**	**45.75**	**56.44**
Low	**45.50**	**40.50**	**37.75**	**30.31**	**30.31**
Registered shareholders at year-end					**11,200**
Fiscal 1998:					
Net sales	$ 3,601.5	$ 3,755.9	$ 3,725.1	$ 4,191.1	$ 15,273.6
Gross margin	1,006.9	1,020.5	995.3	1,106.5	4,129.2
Operating profit	233.8	71.9	181.1	265.1	751.9
Net earnings	129.0	14.6	96.2	144.7	384.5
Net earnings per common share, basic	0.33	0.03	0.24	0.36	0.96
Net earnings per common share, diluted	0.32	0.03	0.23	0.36	0.95
Dividends per common share	0.0550	0.0550	0.0575	0.0575	0.2250
Stock price: (New York Stock Exchange)					
High	37.44	39.63	46.50	55.69	55.69
Low	31.06	33.38	36.38	42.06	31.06
Registered shareholders at year-end					10,500

Five-Year Financial Summary

In millions, except per share amounts	**1999 (53 weeks)**	1998 (52 weeks)	1997 (52 weeks)	1996 (52 weeks)	1995 (52 weeks)
			Fiscal Year		
Statement of operations data:					
Net sales	**$18,098.3**	$15,273.6	$13,749.6	$11,831.6	$10,513.1
Gross margin[1]	**4,861.4**	4,129.2	3,718.3	3,300.9	2,960.0
Selling, general & administrative	**3,448.0**	2,949.0	2,776.0	2,490.8	2,336.4
Depreciation and amortization	**277.9**	249.7	238.2	205.4	186.4
Merger, restructuring and other nonrecurring charges	**—**	178.6	422.4	12.8	165.5
Operating profit[2]	**1,135.5**	751.9	281.7	591.9	271.7
Other expense (income), net	**59.1**	60.9	44.1	(51.5)	114.0
Income tax provision	**441.3**	306.5	149.2	271.0	74.3
Earnings from continuing operations before extraordinary item[3]	**$ 635.1**	$ 384.5	$ 88.4	$ 372.4	$ 83.4
Per common share data:					
Earnings from continuing operations before extraordinary item:[3]					
Basic	**$ 1.59**	$ 0.96	$ 0.20	$ 0.98	$ 0.18
Diluted	**1.55**	0.95	0.19	0.95	0.18
Cash dividends per common share	**0.2300**	0.2250	0.2200	0.2200	0.7600
Balance sheet and other data:					
Total assets	**$ 7,275.4**	$ 6,686.2	$ 5,920.5	$ 6,014.9	$ 6,614.4
Long-term debt	**558.5**	275.7	290.4	1,204.8	1,056.3
Total shareholders' equity	**3,679.7**	3,110.6	2,626.5	2,413.8	2,567.4
Number of stores (at end of period)	**4,098**	4,122	4,094	4,204	3,715

(1) Gross margin includes the pre-tax effect of the following nonrecurring charges: (i) in 1998, $10.0 million ($5.9 million after-tax) related to the markdown of noncompatible Arbor merchandise and (ii) in 1997, $75.0 million ($49.9 million after-tax) related to the markdown of noncompatible Revco merchandise.

(2) Operating profit includes the pre-tax effect of the charges discussed in Note (1) above and the following merger, restructuring and other nonrecurring charges: (i) in 1998, $147.3 million ($101.3 million after-tax) related to the merger of CVS and Arbor and $31.3 million ($18.4 million after-tax) of nonrecurring costs incurred in connection with eliminating Arbor's information technology systems and Revco's noncompatible store merchandise fixtures, (ii) in 1997, $337.1 million ($229.8 million after-tax) related to the merger of CVS and Revco, $54.3 million ($32.0 million after-tax) of nonrecurring costs incurred in connection with eliminating Revco's information technology systems and noncompatible store merchandise fixtures and $31.0 million ($19.1 million after-tax) related to the restructuring of Big B, Inc., (iii) in 1996, $12.8 million ($6.5 million after-tax) related to the write-off of costs incurred in connection with the failed merger of Rite Aid Corporation and Revco and (iv) in 1995, $165.5 million ($97.7 million after-tax) related to the Company's strategic restructuring program and the early adoption of SFAS No. 121, and $49.5 million ($29.1 million after-tax) related to the Company changing its policy from capitalizing internally developed software costs to expensing the costs as incurred, outsourcing information technology functions and retaining former employees until their respective job functions were transitioned.

(3) Earnings from continuing operations before extraordinary item and earnings per common share from continuing operations before extraordinary item include the after-tax effect of the charges discussed in Notes (1) and (2) above and a $121.4 million ($72.1 million after-tax) gain realized during 1996 upon the sale of equity securities received from the sale of Marshalls.

Officers

Thomas M. Ryan
Chairman of the Board and
Chief Executive Officer
CVS Corporation

Charles C. Conaway
President and Chief Operating Officer
CVS Corporation

Chairman of the Board
PharmaCare Management Services, Inc.

David B. Rickard
Executive Vice President and
Chief Financial Officer
CVS Corporation

Larry J. Merlo
Executive Vice President – Stores
CVS Corporation

Lawrence J. Zigerelli
Executive Vice President – Marketing
CVS Corporation

Rosemary Mede
Senior Vice President – Human Resources
CVS Corporation

Douglas A. Sgarro
Senior Vice President – Administration
and Chief Legal Officer
CVS Corporation

President
CVS Realty Co.

Larry D. Solberg
Senior Vice President – Finance and Controller
CVS Corporation

Nancy R. Christal
Vice President – Investor Relations
CVS Corporation

Zenon P. Lankowsky
Secretary
CVS Corporation

Directors

Eugene Applebaum
President
Arbor Investments Group, LLC,
a consulting firm

Allan J. Bloostein[2]
President
Allan J. Bloostein Associates,
a consulting firm

W. Don Cornwell[1]
Chairman of the Board and
Chief Executive Officer
Granite Broadcasting Corporation

Thomas P. Gerrity[1]
Professor of Management and
Director of The E-Commerce Forum
The Wharton School of the
University of Pennsylvania

Stanley P. Goldstein
Retired; formerly Chairman of the Board
and Chief Executive Officer
CVS Corporation

Marian L. Heard[1]
President and Chief Executive Officer
United Way of Massachusetts Bay

Chief Executive Officer
United Ways of New England

William H. Joyce[1]
Chairman of the Board and
Chief Executive Officer
Union Carbide Corporation

Terry R. Lautenbach[2]
Retired; formerly Senior Vice President
International Business Machines Corporation

Terrence Murray[2]
Chairman and Chief Executive Officer
FleetBoston Financial Corporation

Sheli Z. Rosenberg[2]
President and Chief Executive Officer
Equity Group Investments, Inc.

Vice Chairman
Equity Group Investments, LLC

Thomas M. Ryan
Chairman of the Board and
Chief Executive Officer
CVS Corporation

Ivan G. Seidenberg
Chairman of the Board and
Chief Executive Officer
Bell Atlantic Corporation

(1) Member of the Audit Committee.
(2) Member of the Compensation Committee.

Shareholder Information

Corporate Headquarters
CVS Corporation
One CVS Drive, Woonsocket, RI 02895
(401) 765-1500

Annual Shareholders' Meeting
10:00 a.m. April 19, 2000
CVS Corporate Headquarters

Stock Market Listing
New York Stock Exchange
Symbol: CVS

Transfer Agent and Registrar
Questions regarding stock holdings, certificate replacement/transfer, dividends and address changes should be directed to:

The Bank of New York
Shareholder Relations Department – 11E
P.O. Box 11258
Church Street Station
New York, NY 10286
Toll-free: (877) CVSPLAN (287-7526)
E-mail: shareowner-svcs@bankofny.com

BuyDIRECT℠ – Direct Stock Purchase & Dividend Reinvestment Program
BuyDIRECT℠ provides a convenient and economical way for you to purchase your first shares or additional shares of CVS common stock. The program is sponsored and administered by The Bank of New York. For more information, including an enrollment form, please contact:

The Bank of New York at (877) 287-7526

Information Resources
The Company's Annual Report on Form 10-K will be sent without charge to any shareholder upon request by contacting:

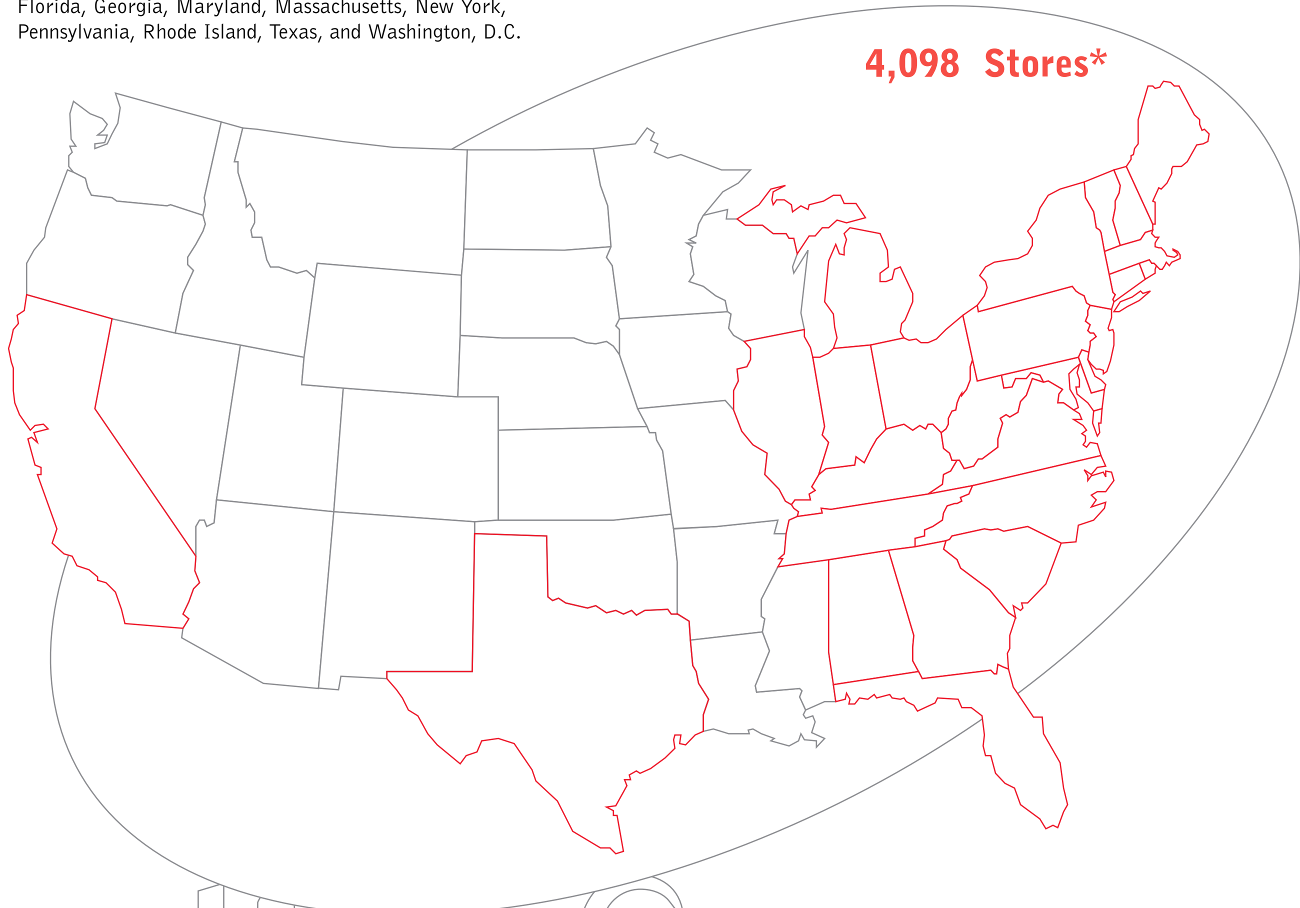
Nancy R. Christal
Vice President – Investor Relations
CVS Corporation
670 White Plains Road, Suite 210
Scarsdale, NY 10583
(800) 201-0938

In addition, financial reports and recent filings with the Securities and Exchange Commission, including our Form 10-K, as well as other Company information, are available via the Internet at http://www.cvs.com.

Store Count by State

140	Alabama	19	Maine	327	Pennsylvania
1	California	169	Maryland	53	Rhode Island
123	Connecticut	325	Massachusetts	183	South Carolina
3	Delaware	242	Michigan	142	Tennessee
21	Florida	28	New Hampshire	1	Texas
288	Georgia	196	New Jersey	2	Vermont
69	Illinois	387	New York	247	Virginia
280	Indiana	279	North Carolina	48	Washington, D.C.
71	Kentucky	396	Ohio	58	West Virginia

* Includes 12 CVS ProCare stores located in California, Florida, Georgia, Maryland, Massachusetts, New York, Pennsylvania, Rhode Island, Texas, and Washington, D.C.



On the Corner