

A photograph of a CVS pharmacy store at night. The building is illuminated from within, and the "CVS/pharmacy" sign is glowing in red. A large, illuminated sign on the right side of the building reads "CVS pharmacy" in red and "MinuteClinic is here" in white. A street lamp on the left is glowing brightly, creating a lens flare effect. The sky is a deep blue, and there is snow on the ground and rooftops. Several cars are parked in the lot in front of the store.

More good things ON THE HORIZON

## PHARMACY SALES

06		\$31.1
05		\$26.3
04		\$21.5

dollars in billions

## STOCK PRICE AT YEAR END

06		\$30.91
05		\$26.42
04		\$22.54

calendar year end

## FINANCIAL HIGHLIGHTS

<i>In millions, except per share figures</i>	2006 52 weeks	2005 52 weeks	% change
Sales	<b>\$ 43,813.8</b>	\$ 37,006.2	18.4%
Operating profit	<b>2,441.6</b>	2,019.5	20.9%
Net earnings	<b>1,368.9</b>	1,224.7	11.8%
Diluted earnings per common share	<b>1.60</b>	1.45	10.3%
Stock price at calendar year end	<b>30.91</b>	26.42	17.0%
Market capitalization at calendar year end	<b>25,479.1</b>	21,514.0	18.4%

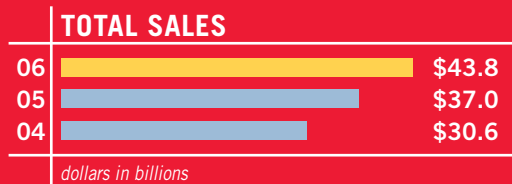
## STORE COUNT AT YEAR END

06		6,202
05		5,471
04		5,375

CVS/pharmacy and PharmaCare Specialty Pharmacy locations

## ANNUAL DIVIDENDS DECLARED

06		\$0.155
05		\$0.145
04		\$0.133



### AMERICA'S NO. 1 DRUGSTORE CHAIN

At the end of 2006, CVS Corporation operated 6,202 stores in 43 states and the District of Columbia. They included 6,150 CVS/pharmacy locations and 52 PharmaCare Specialty Pharmacy stores. PharmaCare is the nation's fourth-largest, full-service pharmacy benefits manager. Total CVS revenues approached \$44 billion in 2006, with approximately 70 percent generated through pharmacy sales. In fact, our CVS/pharmacy stores fill more than one in every seven retail prescriptions in the United States. Our 176,000 colleagues work hard to make things "CVS easy" for our customers – from the pharmacy and the front of the store to MinuteClinic, PharmaCare, and CVS.com.

Our company trades on the New York Stock Exchange under the ticker symbol "CVS."

### OUR VISION

We help people live longer, healthier, happier lives.

### OUR MISSION

We will be the easiest pharmacy retailer for customers to use.

### OUR VALUES FOR SUCCESS

- Respect for individuals
- Integrity
- Teamwork
- Openness to new ideas
- Commitment to flawless execution
- Passion for extraordinary customer service

### CONTRIBUTION TO SALES

*dollars in millions*



\* PharmaCare includes intercompany elimination



**Tom Ryan**, Chairman, President, and CEO

### **To Our Shareholders:**

I'm delighted to report on another year of significant accomplishments for CVS Corporation, highlighted by record revenues and earnings, substantial free cash flow generation, and continued organic growth. In June, we acquired 700 standalone Sav-on and Osco drugstores from Albertson's, Inc., providing immediate leadership in southern California, and we have made great progress in rapidly integrating and converting the stores to the CVS/pharmacy® brand. We also acquired MinuteClinic®, the pioneer and largest provider of retail healthcare in the United States, and have already nearly doubled the number of clinics as we execute our aggressive rollout across the nation. At year end, CVS operated 6,202 retail and specialty pharmacy stores, more than any other U.S. pharmacy retailer.

Total sales for 2006 rose 18.4 percent to a record \$43.8 billion. Meanwhile, net earnings per share climbed 10.3 percent to \$1.4 billion, or \$1.60 per diluted share. Same store sales increased 8.2 percent, rising 9.1 percent in the pharmacy and 6.2 percent in the front end. Gross margins also increased, largely due to significant generic drug introductions, increased private label penetration in the front of the store, and the use of our ExtraCare® loyalty program to focus promotional spending.

CVS generated approximately \$570 million in free cash flow. That has allowed us, among other things, to announce a 26 percent dividend increase for 2007. Our 176,000 CVS colleagues across the country helped us achieve these excellent results. I want to thank them all for their hard work in making things "CVS easy" for our customers.

Turning to our stock's performance, the 17.6 percent total return on CVS shares in 2006 outpaced that of both the S&P 500 Index and the Dow Jones Industrial Average (DJIA). Over the past three years, our shares returned 74 percent, significantly outperforming the 28 percent and 19 percent returns of the S&P 500 and the DJIA, respectively.

### **Successfully integrating our latest acquired stores**

Even with all the positive news outlined above, more good things are on the way in 2007 and beyond. We moved swiftly to integrate the Sav-on and Osco stores, completing the systems conversions in September 2006. The remodeling of the stores will be complete in March 2007. We've made these stores "CVS easy" by reducing shelf heights, resetting merchandise layouts, installing our hallmark CVS carpet, enhancing the lighting, and improving the signage.

More good things **ACROSS THE BOARD**

Sales trends have moved in line with expectations. We expect the numbers to climb with the introduction of the CVS brand to these markets and the disruption of the store conversions behind us. As noted at the time of purchase, the Sav-on and Osco stores were operationally in better shape than the Eckerd stores we acquired from J.C. Penney in 2004. Still, we are executing against a significant opportunity to produce higher-quality sales through improvements in merchandise assortment and category focus. We will also leverage the CVS ExtraCare card to encourage customer loyalty and increase sales and margins.

Looking at the former Eckerd stores acquired in 2004, same store sales increased 14 percent in 2006. The front end rose 13 percent, with the pharmacy up 15 percent. This impressive performance comes on top of the strong gains we posted in 2005. Although same store sales growth for these stores will moderate going forward, they are still expected to outpace our overall results for the foreseeable future.

Even as CVS completed two major acquisitions in as many years, organic square footage increased by 3.2 percent in 2006. We opened 265 stores, including 147 new locations and 118 relocations. Factoring in closings, we experienced net unit growth of 103 stores. We continued to expand in our newer, high-growth markets, including those in Florida and Texas as well as Las Vegas, Los Angeles, Chicago, Minneapolis, and Phoenix. All our new stores in these markets are running at or above plan, with both the front end and pharmacy performing well.

### **Benefiting from new opportunities in the pharmacy**

CVS/pharmacy stores now fill 16 percent of all U.S. retail drug prescriptions. The Medicare Part D prescription drug benefit and generic drug launches are among the positive industry factors contributing to our growth. Medicare Part D, rolled out in January 2006, has led to increased utilization of prescription drugs. Since enrolled seniors make the same co-payment regardless of the pharmacy they choose, many are opting for the convenience of the CVS/pharmacy located right in their neighborhoods. Despite a competitor's rollout of a \$4 program for selected generic drugs, we actually experienced a rise in net prescription transfers in from leading mass merchant retailers and continued to gain pharmacy share.

Use of generic drugs continues to climb, and they now account for more than 60 percent of prescriptions filled. Although their lower prices depress revenue growth, generics are more profitable and help fuel our margin gains. They also help reduce overall healthcare costs for patients and payors.

Our PharmaCare pharmacy benefits management (PBM) and specialty pharmacy business turned in an excellent performance in 2006. Revenue rose 24.6 percent to \$3.7 billion while operating profit increased by 43 percent. Prescription Pathways®, PharmaCare's Medicare Part D joint venture with Universal American Financial Corp., now administers prescription drug benefits for 460,000 seniors and Medicare-eligible individuals. That number places it among the nation's top 10 prescription drug plans for Medicare Part D beneficiaries.

### **Gaining share in the front end and broadening our healthcare offerings**

In the front of the store, our continued focus on the health, personal care, and beauty categories drove industry-leading same store sales growth. The average front-end transaction grew to approximately \$11 in 2006. Moreover, the ExtraCare loyalty program continued to increase in popularity with card use exceeding 63 percent of front-end sales.

Our acquisition of MinuteClinic, completed in September, allows CVS to provide customers with convenient, cost-effective, and high-quality care for common family ailments right in our stores. The high level of patient satisfaction received to date has solidified our belief that this is the right concept for consumers, payors, and providers. We made the decision to buy MinuteClinic, already a strategic partner, because we wanted control of its brand as well as personnel decisions, hours of operation, and expansion rate. Most importantly, we saw an opportunity to benefit from additional revenues and profits. Since the acquisition, we have almost doubled the number of MinuteClinics from 83 to 155 across 19 states. Furthermore, we plan to open approximately 300 MinuteClinics in 2007 with well over 2,500 CVS/pharmacy stores slated to have MinuteClinics over the long term.

### **Creating a company that serves payors and consumers more efficiently**

As this report goes to press, we are also close to a shareholder vote on our proposed merger of equals with Caremark Rx, Inc. If successful, the resulting entity, CVS/Caremark Corporation,

will combine our unmatched retail footprint and PharmaCare subsidiary with Caremark's leading PBM business. Together, we will create the nation's premier pharmacy services provider, broadening our respective healthcare missions and positioning ourselves to drive many of the changes that will reshape our industry in the coming years.

Shareholders of both companies have yet to vote on the merger, but we are optimistic about the outcome. Regardless, CVS/pharmacy and PharmaCare have proven how powerful a combined retail/PBM model can be. We will aggressively leverage these twin strengths in the future, because they will allow us to pursue new opportunities and help improve the delivery of healthcare in the United States. Consumers want convenience, choice, and to get more for their healthcare dollar. Employers and health plans want to give plan members access to a full range of integrated pharmacy services, promote better health outcomes, and control costs at the same time.

Managing the significant costs of specialty pharmacy care remains a critical area of concern for employers and other plan sponsors. We are well-positioned to address this issue through end-to-end participation – from plan design to delivery of value-added pharmacy services via face-to-face interaction with customers. We can accomplish this on a broader platform through our proposed merger with Caremark or through accelerated organic growth of our retail/PBM model. We will carefully evaluate all our opportunities to ensure that we help drive the changes necessary to improve our industry.

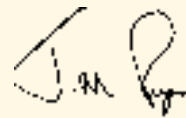
### **Supporting our next phase of growth with key promotions**

With the retail and healthcare environments changing rapidly, we've made some organizational changes to help ensure continued success. Most significantly, we promoted Larry Merlo and Chris Bodine to the roles of President of CVS/pharmacy – Retail, and President of CVS Health Services, respectively. Larry is a seasoned retail pharmacy executive with more than 28 years of experience. He has spent 16 of them with CVS. Larry has consistently delivered results in every position he has held within our company while never losing sight of our most important assets – our customers and our colleagues. Chris' retail and healthcare experience spans more than 20 years at CVS. He's a leader who has combined the ability to drive strategy and innovation with a focus on execution and results. Larry and Chris have the values, the vision, and the passion for customer service to help lead CVS in the years ahead.

At the board level, David Dorman and Richard Swift joined us as directors in 2006. David is the former Chairman of the Board and Chief Executive Officer of AT&T Corporation, and his knowledge and experience should serve us well. Dick is the former Chairman, President and CEO of Foster Wheeler, and he has also served as Chairman of the Financial Accounting Standards Advisory Council. As a new member of the Audit Committee, Dick only enhances the rigorous approach to financial reporting that our board has long made a priority.

After more than 12 years of dedicated service, Don Cornwell retired from the board. On behalf of CVS, I thank him for his valued contributions over the years. Don served with distinction on the board's Management Planning and Development Committee as well as the Audit Committee.

In closing, we have begun 2007 with a great deal of momentum and enthusiasm for the opportunities before us. Our core business is performing well as we work our way through the first quarter. Recent retail acquisitions have given us leading shares in high-growth markets, and we will leverage the CVS/pharmacy brand and our operational strength to drive growth. In MinuteClinic, we took an important step in broadening our healthcare offerings. Finally, our pending merger with Caremark would position us to be the low-cost provider and to offer payors, insurers, and consumers greater choice in prescription delivery and new, value-added services. We look forward to keeping you apprised of our progress, and thank you for your continued confidence.



**Thomas M. Ryan**

*Chairman of the Board, President, and Chief Executive Officer*

February 27, 2007

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**CVS Corporation enjoyed an outstanding year in 2006, and we see “more good things” on the horizon – for our customers and shareholders alike. We’re opening new stores in some of the nation’s fastest-growing markets, introducing even more consumers to our exclusive brands and the “CVS easy” shopping experience. Favorable demographics will continue to fuel pharmacy sales, and we have high hopes for the role that our MinuteClinic and PharmaCare subsidiaries will play in controlling health-care costs. Please turn the page and read more about all the good things to come at CVS...in 2007 and beyond.**

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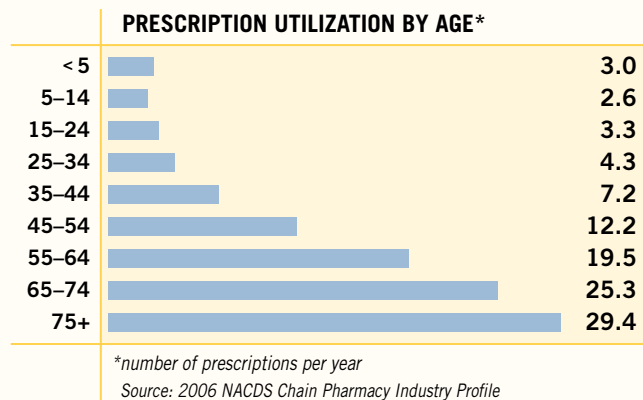
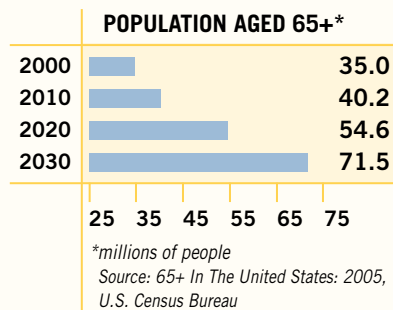
## CVS fills 16 percent of all U.S. retail drug prescriptions, and we stand to benefit from several long-term trends driving their increasing use.

According to industry sources, U.S. pharmacy sales are expected to continue growing at an annual rate of 5 to 8 percent for the foreseeable future. With more locations than any other U.S. pharmacy retailer, CVS stands to be among the chief beneficiaries of this long-term trend. An aging population, rising use of generic drugs, the Medicare Part D prescription drug benefit, and new discoveries are some of the key factors driving the greater demand for pharmaceuticals.

According to the U.S. Census Bureau, approximately 40 million people in the United States will be 65 or older by 2010 as baby boomers begin to reach that age group. That figure will jump to roughly 55 million in 2020, which should lead to significant growth in our industry. That's because this age group fills more than 25 prescriptions annually – 30 percent more than people between the ages of 55 and 64.

Furthermore, roughly \$50 billion in branded drug sales will lose patent protection over the next five years. The increasing availability of low-cost generics will translate into good news for CVS and the U.S. healthcare system in general. We benefit from the higher margins generic drugs provide. Their lower cost also puts many potentially life-saving medicines within reach of people who otherwise might not have found them affordable.

Meanwhile, we're doing our part to make it as easy as possible for our customers to order and pick up their prescriptions. More than 65 percent of CVS locations offer 24-hour or extended-hours service in the pharmacy, and approximately 55 percent of our stores offer drive-thru pharmacy windows. RapidRefill makes it easy to reorder prescriptions over the telephone or through CVS.com. Most importantly, approximately 20,000 highly trained CVS pharmacists stand ready to answer questions and provide helpful advice.





More good things FOR HEALTHY LIVING



**A selection of exclusive and leading brands, coupled with the benefits of our ExtraCare card, helped drive industry-leading same store sales growth in the front of the store.**

Stroll the aisles of a CVS/pharmacy and you will find a collection of exceptional brands not available at any other drugstore in the United States. In addition to our extensive line of over-the-counter medications and first aid items, they include skin care products in the beauty aisle from Lumene®, Avène®, and Vichy® as well as Essence of Beauty® and Skin Effects by Dr. Jeffrey Dover®. For new parents, we recently introduced a line of diapers, wipes, and other baby care products under the trusted Playskool® brand. Of course, CVS Gold Emblem® snack foods have become a popular choice for children's lunchboxes and the mid-day repast. Shoppers value such brands because they offer great quality at an affordable price. They also allow us to reap significantly higher margins in the front of the store. With CVS brand and exclusive products rising to 14 percent of front-store sales in 2006, that meant good news for our bottom line.

Along with our exclusive offerings, customers will find a complete selection of leading beauty, health, and personal care brands throughout the front of the store. Shoppers love choice, and it's one of the ways we make our stores "CVS easy." Customers also appreciate our in-store beauty advisors, digital photo labs, and the benefits of our ExtraCare loyalty program. By using the ExtraCare card with every purchase, shoppers take advantage of in-store sales while avoiding the hassle of clipping coupons. Moreover, cardholders receive ExtraBucks every quarter with their store receipts based on their purchases. Just like cash, ExtraBucks can be used for any front-end purchase.

In the front of the store, CVS topped the chain drugstore industry in 2006 with same store sales growth of 6.2 percent.



More good things AT YOUR FINGERTIPS

# minute clinic



More good things IN STORE



**Our pharmacy accounts for 70 percent of store sales, and MinuteClinic allows us to broaden the role CVS plays as a provider of healthcare services.**

For most families, a child’s ear infection or suspected strep throat usually means a trip to the family doctor or even the emergency room. Now, with MinuteClinics inside selected CVS/pharmacy locations, we’re making it “CVS easy” to treat common illnesses and receive routine vaccinations as well.

MinuteClinic has emerged as the U.S. leader in retail-based health clinics since its launch in 2000, and we purchased the company in 2006. With our pharmacy accounting for 70 percent of CVS store sales, the combination makes a lot of sense. For starters, MinuteClinic allows us to broaden the role CVS plays as a provider of healthcare services. Furthermore, our research shows that these clinics drive more traffic to our stores. Approximately 25 percent of MinuteClinic patients are new CVS/pharmacy customers.

Its clinicians – primarily nurse practitioners and physician’s assistants – have handled more than 750,000 patient visits to date. By focusing on a limited number of ailments that can be addressed quickly, MinuteClinics provide an ideal solution for professionals and parents with busy schedules. They are open seven days a week and do not require appointments. Moreover, visitors can scan a list of services and prices prior to treatment. For illnesses MinuteClinic doesn’t treat, the clinicians refer patients to their family doctor or provide a list of primary care physicians in the area for those who need them.

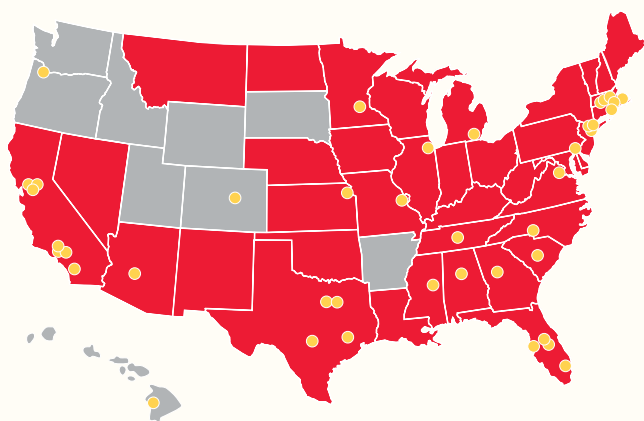
Competitive pricing also means that we at CVS are doing our part to lower the overall cost of healthcare for insurance plans and self-insured employers. In fact, some large U.S. companies now recognize the value of having MinuteClinics right on site, making it easier for employees to access care and helping employers boost productivity. We expect this trend to accelerate and contribute to the growth of MinuteClinic in the coming years.



## CVS is the nation's No.1 drugstore chain by store count, and our latest acquisition has propelled us to leadership positions in fast-growing Southern California markets.

It's easier than ever to find a CVS/pharmacy these days. That's because we've added some 2,000 locations over the past three years through a combination of organic growth and well-chosen acquisitions. With approximately 6,200 locations from coast to coast, we now operate more stores than any other U.S. drugstore chain. More than 60 percent are freestanding, making it "CVS easy" for customers to fill prescriptions, pick up some LifeFitness® vitamins, or just grab a pint of their favorite ice cream.

Our 2006 acquisition of approximately 700 standalone Sav-on and Osco drugstores propelled CVS to leadership positions throughout fast-growing Southern California and strengthened our presence in the Midwest. At the same time, our organic growth continued apace in key growth markets such as Chicago, Las Vegas, Minneapolis, and Phoenix. The combination of organic growth and acquisition added a hefty 23 percent to our retail square footage in 2006.



● CVS/pharmacy Markets ● PharmaCare Specialty Pharmacy Stores

We've rapidly integrated the former Sav-on and Osco locations, with the final store conversion scheduled for March 2007. Of course, we know a thing or two about making the most of an acquisition. With our 2004 purchase of approximately 1,200 former Eckerd stores – mainly in Florida and Texas – we seized on a significant opportunity to drive top-line growth, improve margins, and reduce inventory shrinkage. These stores have since delivered impressive results, and we expect them to continue outperforming our core business as we leverage a long-term turnaround opportunity.

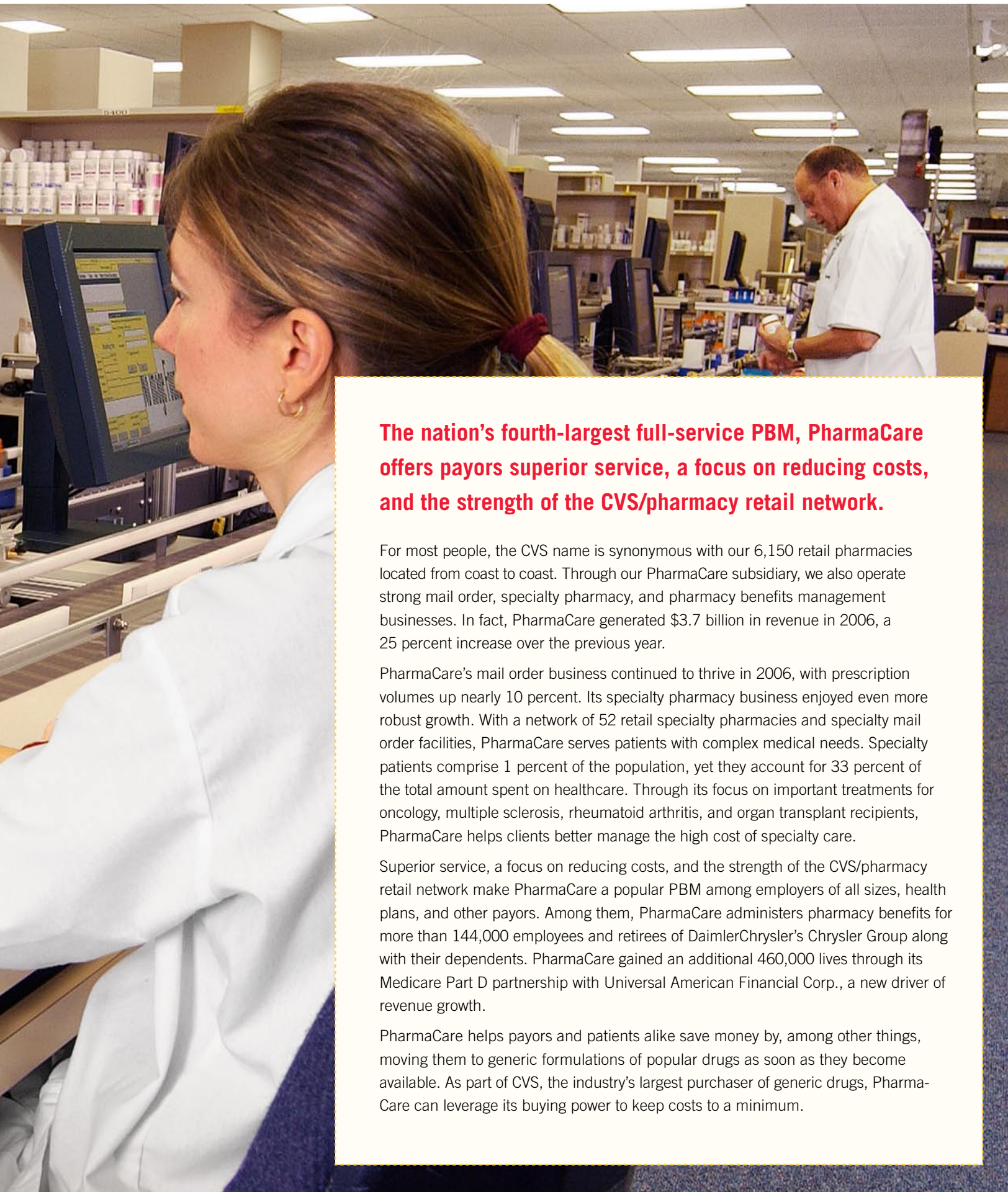
More CVS/pharmacy locations are on the way. We plan to open 275 new or relocated stores in 2007, adding another 3 percent to our total retail square footage.







More good things BEYOND OUR STORES



**The nation's fourth-largest full-service PBM, PharmaCare offers payors superior service, a focus on reducing costs, and the strength of the CVS/pharmacy retail network.**

For most people, the CVS name is synonymous with our 6,150 retail pharmacies located from coast to coast. Through our PharmaCare subsidiary, we also operate strong mail order, specialty pharmacy, and pharmacy benefits management businesses. In fact, PharmaCare generated \$3.7 billion in revenue in 2006, a 25 percent increase over the previous year.

PharmaCare's mail order business continued to thrive in 2006, with prescription volumes up nearly 10 percent. Its specialty pharmacy business enjoyed even more robust growth. With a network of 52 retail specialty pharmacies and specialty mail order facilities, PharmaCare serves patients with complex medical needs. Specialty patients comprise 1 percent of the population, yet they account for 33 percent of the total amount spent on healthcare. Through its focus on important treatments for oncology, multiple sclerosis, rheumatoid arthritis, and organ transplant recipients, PharmaCare helps clients better manage the high cost of specialty care.

Superior service, a focus on reducing costs, and the strength of the CVS/pharmacy retail network make PharmaCare a popular PBM among employers of all sizes, health plans, and other payors. Among them, PharmaCare administers pharmacy benefits for more than 144,000 employees and retirees of DaimlerChrysler's Chrysler Group along with their dependents. PharmaCare gained an additional 460,000 lives through its Medicare Part D partnership with Universal American Financial Corp., a new driver of revenue growth.

PharmaCare helps payors and patients alike save money by, among other things, moving them to generic formulations of popular drugs as soon as they become available. As part of CVS, the industry's largest purchaser of generic drugs, PharmaCare can leverage its buying power to keep costs to a minimum.



More good things FOR OUR COMMUNITIES

### **Making a positive difference in the lives of children.**

At CVS, we put a lot more than just stores into our communities. Through the CVS All Kids Can program, we're improving the lives of children with disabilities and giving them an opportunity to learn, play, and succeed in life. CVS funds the Easter Seals Therapeutic Day School and Autism Research Center in Chicago, partners with communities in Florida to complete Boundless™ Playgrounds, and works with schools such as Meeting Street in Providence, Rhode Island. This National Center of Excellence serves as a model of education and inclusion for all children. CVS also funds Easter Seals affiliates across the country, and we raise more than \$2 million annually to support St. Jude Children's Research Hospital in its efforts to cure pediatric cancer and other diseases. Our community efforts don't end there. Read about the CVS/pharmacy Charitable Trust and our many other programs at [www.cvs.com/corpinfo/community/index.html](http://www.cvs.com/corpinfo/community/index.html).

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion should be read in conjunction with our audited consolidated financial statements and our Cautionary Statement Concerning Forward-Looking Statements that are presented in this Annual Report.*

### OUR BUSINESS

Our Company is a leader in the retail drugstore industry in the United States. We sell prescription drugs and a wide assortment of general merchandise, including over-the-counter drugs, beauty products and cosmetics, film and photofinishing services, seasonal merchandise, greeting cards and convenience foods through our CVS/pharmacy® retail stores and online through CVS.com®. We also provide healthcare services through our 146 MinuteClinic healthcare clinics, located in 18 states, of which 129 are located within CVS retail drugstores. In addition, we provide pharmacy benefit management, mail order services and specialty pharmacy services through PharmaCare Management Services ("PharmaCare") and PharmaCare Pharmacy® stores. As of December 30, 2006, we operated 6,202 retail and specialty pharmacy stores in 43 states and the District of Columbia.

### PROPOSED CAREMARK MERGER

On November 1, 2006, we entered into a definitive agreement and plan of merger with Caremark Rx, Inc., ("Caremark"). The agreement is structured as a merger of equals under which Caremark shareholders will receive 1.670 shares of common stock, par value \$0.01 per share, of CVS for each share of common stock of Caremark, par value \$0.001 per share, issued and outstanding immediately prior to the effective time of the merger. The closing of the transaction, which is expected to occur during the first quarter of 2007, is subject to approval by the shareholders of both CVS and Caremark, as well as customary regulatory approvals, including review under the Hart-Scott-Rodino Act. Accordingly, there can be no assurance the merger will be completed.

Caremark is a leading pharmacy benefits manager in the United States. Caremark's operations involve the design and administration of programs aimed at reducing the costs and improving the safety, effectiveness and convenience of prescription drug use. Caremark operates a national retail pharmacy network with over 60,000 participating pharmacies (including CVS/pharmacy stores), 7 mail service pharmacies, 21 specialty mail service pharmacies and the industry's only repackaging plant regulated by the Food & Drug Administration. Through its Accordant® disease management offering, Caremark also provides disease management programs for 27 conditions. Twenty-one of these programs are accredited by the National Committee for Quality Assurance.

On December 18, 2006, Caremark received an unsolicited offer from a competing pharmacy benefits manager, Express Scripts, Inc. ("Express Scripts") pursuant to which Express Scripts offered to acquire all of the outstanding shares of Caremark for \$29.25 in cash and 0.426 shares of Express Scripts common stock for each share of Caremark common stock.

On December 20, 2006, the initial waiting period under the Hart-Scott-Rodino Act for the CVS/Caremark merger, expired without a request for additional information from the U.S. Federal Trade Commission.

On January 7, 2007, Caremark issued a press release announcing that its board of directors, after thorough consideration and consultation with its legal and financial advisers, had determined that the Express Scripts proposal did not constitute, and was not reasonably likely to lead to, a superior proposal under the terms of the merger agreement with CVS. Caremark further announced that its board of directors had unanimously concluded that pursuing discussions with Express Scripts was not in the best financial or strategic interests of Caremark and its shareholders.

On January 16, 2007, CVS and Caremark announced that Caremark shareholders would receive a special one-time cash dividend of \$2 per share upon or promptly after closing of the transaction. In addition, CVS and Caremark agreed that as promptly as practicable after the closing of the merger, an accelerated share repurchase transaction will be executed, whereby 150 million of the outstanding shares of the combined entity will be retired. On January 19, 2007, the Registration Statement on Form S-4 relating to the proposed merger was declared effective by the Securities and Exchange Commission (the "SEC"). In addition, a special meeting of Caremark shareholders to approve the merger was scheduled for February 20, 2007 and a special meeting of CVS shareholders to be held for the same purpose was scheduled for February 23, 2007.

On February 13, 2007, CVS and Caremark announced that the special one-time cash dividend payable to Caremark shareholders upon or promptly after closing of the transaction would be increased to \$6 per share. Caremark also announced that on February 12, 2007 its board of directors had declared the \$6 special cash dividend payable upon or promptly after closing of the merger to Caremark shareholders of record on the date immediately preceding the closing date of the merger. In connection with its declaration of such dividend, the Caremark board also unanimously reaffirmed its recommendation that Caremark shareholders vote "for" the merger with CVS at the Caremark special meeting of shareholders.

On February 13, 2007, the Court of Chancery of the State of Delaware determined that, to permit additional time for dissemination to Caremark shareholders of certain newly filed information, the Caremark special meeting of shareholders to approve the merger must be postponed to a date not earlier than March 9, 2007. On February 23, 2007, the Court of Chancery of the State of Delaware further delayed the Caremark shareholder vote until twenty days after Caremark makes supplemental disclosures regarding Caremark shareholders' right to seek appraisal and the structure of fees to be paid by Caremark to its financial advisors. The supplemental disclosures were mailed to Caremark shareholders on February 24, 2007, at which time Caremark announced that its special meeting of shareholders to approve the merger had been adjourned to March 16, 2007. On February 23, 2007, CVS announced that

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

its special meeting of shareholders to be held for the same purpose had been adjourned to March 9, 2007. In light of the Delaware court's ruling, CVS intends to once again adjourn the meeting to a later date in March and will inform shareholders of the new meeting date as promptly as possible.

The proposed merger would be accounted for using the purchase method of accounting under U.S. GAAP. Under the purchase method of accounting, CVS will be considered the acquirer of Caremark for accounting purposes and the total purchase price will be allocated to the assets acquired and liabilities assumed from Caremark based on their fair values as of the date of the completion of the merger and any excess of purchase price over those fair values will be recorded as goodwill. Our reported financial condition and results of operations issued after completion of the merger will reflect Caremark's balances and results after completion of the merger, but will not be restated retroactively to reflect the historical financial position or results of operations of Caremark. Following the completion of the merger, our earnings will reflect purchase accounting adjustments, including increased amortization expense for acquired intangible assets.

### ACQUIRED BUSINESS

On June 2, 2006, CVS acquired certain assets and assumed certain liabilities from Albertson's, Inc. ("Albertsons") for \$4.0 billion. The assets acquired and the liabilities assumed included approximately 700 standalone drugstores and a distribution center (collectively the "Standalone Drug Business"). CVS financed the acquisition of the Standalone Drug Business by issuing commercial paper and borrowing \$1.0 billion from a bridge loan facility. During the third quarter of 2006, CVS repaid a portion of the commercial paper used to finance the acquisition with the proceeds received from the issuance of \$800 million of 5.75% unsecured senior notes due August 15, 2011 and \$700 million of 6.125% unsecured senior notes due August 15, 2016. During the fourth quarter of 2006, CVS sold a substantial portion of the acquired real estate through a sale-leaseback transaction, the proceeds of which were used in retiring the bridge loan facility.

Please see Note 2 to our consolidated financial statements for further information on the Standalone Drug Business.

### RESULTS OF OPERATIONS AND INDUSTRY ANALYSIS

The Company's fiscal year is a 52 or 53 week period ending on the Saturday closest to December 31. Fiscal 2006, which ended on December 30, 2006, fiscal 2005, which ended on December 31, 2005, and fiscal 2004, which ended on January 1, 2005, each included 52 weeks. Unless otherwise noted, all references to years relate to these fiscal years.

### Net Revenues

The following table summarizes our revenue performance:

	2006	2005	2004
Net revenues <i>(in billions)</i>	\$ 43.8	\$ 37.0	\$ 30.6
Net revenue increase:			
Total	18.4%	21.0%	15.1%
Pharmacy	18.3%	22.0%	17.1%
Front store	18.7%	18.4%	10.5%
Same store sales increase: <sup>(1)</sup>			
Total	8.2%	6.5%	5.5%
Pharmacy	9.1%	7.0%	7.0%
Front store	6.2%	5.5%	2.3%
Pharmacy % of total revenue	69.6%	70.2%	70.0%
Third party % of pharmacy revenue	94.7%	94.1%	94.1%
Retail adjusted prescriptions filled <i>(in millions)</i>	513	450	375

<sup>(1)</sup> Same store sales do not include the sales results of the Standalone Drug Business. The Standalone Drug Business will be included in same store sales following the one-year anniversary of the acquisition, beginning in fiscal July 2007.

As you review our performance in this area, we believe you should consider the following important information:

- During 2006, total net revenues were significantly affected by the acquisition of the Standalone Drug Business. Excluding the revenues from the Standalone Drug Business, total revenues increased approximately 10.4% during 2006.
- During 2005, total net revenues were significantly affected by the July 31, 2004 acquisition of certain assets and certain assumed liabilities from J.C. Penney Company, Inc. and certain of its subsidiaries, including Eckerd Corporation ("Eckerd"). This acquisition included more than 1,200 Eckerd retail drugstores and Eckerd Health Services, which included Eckerd's mail order and pharmacy benefit management businesses (collectively, the "2004 Acquired Businesses"). Excluding the revenues from the 2004 Acquired Businesses, total net revenues increased approximately 8.4% and 5.2% during 2005 and 2004, respectively. Beginning in August 2005, same store sales include the acquired Eckerd stores, which increased total same store sales by approximately 110 basis points during 2006.
- Total net revenues from new stores accounted for approximately 130 basis points of our total net revenue percentage increase in 2006, and 160 basis points in 2005.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

- Total net revenues continued to benefit from our active relocation program, which moves existing in-line shopping center stores to larger, more convenient, freestanding locations. Historically, we have achieved significant improvements in customer count and net revenue when we do this. As such, our relocation strategy remains an important component of our overall growth strategy. As of December 30, 2006, approximately 61% of our existing stores were freestanding, compared to approximately 59% at December 31, 2005.
- During 2005, PharmaCare entered into certain risk-based or reinsurance arrangements in connection with providing pharmacy plan management services to prescription drug plans qualifying under Medicare Part D and a prescription benefit plan for State of Connecticut employees. Net premium revenue related to these contracts totaled \$380.1 million and \$91.6 million during 2006 and 2005, respectively.
- Pharmacy revenue growth continued to benefit from new market expansions, increased penetration in existing markets, the introduction in 2006 of a prescription drug benefit under Medicare Part D, our ability to attract and retain managed care customers 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 individual healthcare also contributed to the growing demand for pharmacy services. We believe these favorable industry trends will continue.
- Pharmacy revenue dollars continue to be negatively impacted in all years by the conversion of brand named drugs to equivalent generic drugs, which typically have a lower selling price. In addition, our pharmacy growth has also been adversely affected by the growth of the mail order channel, a decline in the number of significant new drug introductions, higher consumer co-payments and co-insurance arrangements and an increase in the number of over-the-counter remedies that had historically only been available by prescription. To address the growth in mail order, we may choose not to participate in certain prescription benefit programs that mandate filling maintenance prescriptions through a mail order service facility. In the event we elect to, for any reason, withdraw from current programs and/or decide not to participate in future programs, we may not be able to sustain our current rate of sales growth.

**Gross profit**, which includes net revenues less the cost of merchandise sold during the reporting period and the related purchasing costs, warehousing costs, delivery costs and actual and estimated inventory losses, as a percentage of net revenues was 27.3% in 2006. This compares to 26.8% in 2005 and 26.3% in 2004.

As you review our performance in this area, we believe you should consider the following important information:

- Front store revenues increased as a percentage of total revenues during 2006. On average our gross profit on front store revenues is higher than our gross profit on pharmacy revenues. Pharmacy revenues as a percentage of total revenues during 2006 were 69.6%, compared to 70.2% in 2005 and 70.0% in 2004.
- Our pharmacy gross profit rate continued to benefit from an increase in generic drug revenues in 2006, which normally yield a higher gross profit rate than equivalent brand name drug revenues. However, increased utilization of generic products has resulted in pressure to decrease reimbursement payments to pharmacies for generic drugs, causing a reduction in the generic profit rate. We expect this trend to continue.
- Sales to customers covered by third party insurance programs have continued to increase and, thus, have become a larger component of our total pharmacy business. On average, our gross profit on third party pharmacy revenues is lower than our gross profit on cash pharmacy revenues. Third party pharmacy revenues were 94.7% of pharmacy revenues in 2006, compared to 94.1% of pharmacy revenues in 2005 and 2004. We expect this trend to continue.
- The introduction of the new Medicare Part D benefit is resulting in increased utilization and decreased pharmacy gross profit rates as higher profit business (such as cash and state Medicaid customers) continued to migrate to Part D coverage during 2006.
- On February 8, 2006, the President signed into law the Deficit Reduction Act of 2005 (the "DRA"). The DRA seeks to reduce federal spending by altering Medicaid reimbursement formula for multi-source (i.e., generic) drugs. According to the Congressional Budget Office, retail pharmacies are expected to negotiate with individual states for higher dispensing fees to mitigate the adverse effect of these changes. These changes are currently scheduled to take effect late in the first quarter of 2007 and are expected to result in reduced Medicaid reimbursement rates for retail pharmacies. The extent of these reductions cannot be determined at this time.
- Our pharmacy gross profit rates have been adversely affected by the efforts of managed care organizations, pharmacy benefit managers, governmental and other third party payors to reduce their prescription costs. In the event this trend continues, we may not be able to sustain our current rate of revenue growth and gross profit dollars could be adversely impacted.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Total operating expenses**, which include store and administrative payroll, employee benefits, store and administrative occupancy costs, selling expenses, advertising expenses, administrative expenses and depreciation and amortization expense increased to 21.7% of net revenues in 2006, compared to 21.3% of net revenues in 2005 and 21.5% in 2004.

As you review our performance in this area, we believe you should consider the following important information:

- Total operating expenses increased \$60.7 million during 2006 as a result of the adoption of the Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment." In addition, total operating expenses increased due to costs incurred to integrate the Standalone Drug Business.
- Total operating expenses as a percentage of net revenues continued to be impacted by an increase in the sale of generic drugs, which typically have a lower selling price than their brand named equivalents.
- During the fourth quarter of 2006, we adopted Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). In connection with adopting SAB 108, we recorded adjustments, which collectively reduced total operating expenses by \$40.2 million (the "SAB 108 Adjustments"). Since the effects of the SAB 108 Adjustments were not material to 2006 or any previously reported fiscal year, they were recorded in the fourth quarter of 2006. For internal comparisons, management finds it useful to assess year-to-year performance excluding the SAB 108 Adjustments, which results in comparable 2006 total operating expenses as a percentage of net revenues of 21.8%.
- During the fourth quarter of 2004, we conformed our accounting for operating leases and leasehold improvements to the views expressed by the Office of the Chief Accountant of the Securities and Exchange Commission to the American Institute of Certified Public Accountants on February 7, 2005. As a result, we recorded a \$65.9 million non-cash pre-tax adjustment to total operating expenses, which represents the cumulative effect of the adjustment for a period of approximately 20 years (the "Lease Adjustment"). Since the Lease Adjustment was not material to 2004 or any previously reported fiscal year, the cumulative effect was recorded in the fourth quarter of 2004. For internal comparisons, management finds it useful to assess year-to-year performance excluding the Lease Adjustment, which results in comparable 2004 total operating expenses as a percentage of net revenues of 21.3%.
- Total operating expenses as a percentage of net revenues also increased during 2004 due to integration and incremental costs as a result of the acquisition of the 2004 Acquired Businesses. In addition, the acquired stores had lower average revenues per store during 2004, increasing operating expenses as a percentage of net sales.

**Interest expense, net** consisted of the following:

<i>In millions</i>	2006	2005	2004
Interest expense	\$ 231.7	\$ 117.0	\$ 64.0
Interest income	(15.9)	(6.5)	(5.7)
Interest expense, net	\$ 215.8	\$ 110.5	\$ 58.3

The increase in interest expense during 2006 and 2005 was due to a combination of higher interest rates and higher average debt balances resulting from the acquisitions of the Standalone Drug Business and the 2004 Acquired Businesses during 2006 and 2004, respectively.

**Income tax provision.** Our effective income tax rate was 38.5% in 2006, 35.8% in 2005 and 34.2% in 2004.

As you review our results in this area, we believe you should consider the following important information:

- The effective income tax rate was negatively impacted during 2006 due to the implementation of SFAS No. 123(R), as the compensation expense associated with our employee stock purchase plan is not deductible for income tax purposes unless, and until, any disqualifying dispositions occur.
- During the fourth quarters of 2006, 2005 and 2004, various events resulted in the Company recording reductions of previously recorded tax reserves through the income tax provision of \$11.0 million, \$52.6 million and \$60.0 million, respectively.
- For internal comparisons, management finds it useful to assess year-to-year performance excluding the impact of the tax benefit in 2006, 2005 and 2004 discussed above, and uses 39.0%, 38.6% and 38.5% as comparable effective tax rates for 2006, 2005 and 2004, respectively.

**Net earnings** increased \$144.2 million or 11.8% to \$1.4 billion (or \$1.60 per diluted share) in 2006. This compares to \$1.2 billion (or \$1.45 per diluted share) in 2005, and \$918.8 million (or \$1.10 per diluted share) in 2004. For internal comparisons, management finds it useful to assess year-to-year performance excluding the \$40.2 million (\$24.7 million after-tax) SAB 108 Adjustments and the tax reversal discussed above, and uses \$1.3 billion (or \$1.56 per diluted share) for comparable net earnings in 2006. In addition, management finds it useful to remove the \$52.6 million tax reserve reversal discussed above, and uses \$1.2 billion (or \$1.39 per diluted share) for comparable net earnings in 2005. Further, management finds it useful to remove the \$40.5 million after-tax effect of the \$65.9 million Lease Adjustment to total operating expense and the \$60.0 million tax reserve reversal, discussed above, and uses \$899.3 million (or \$1.08 per diluted share) for its internal comparisons in 2004.



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### LIQUIDITY & CAPITAL RESOURCES

We anticipate that our cash flow from operations, supplemented by commercial paper and long-term borrowings, will continue to fund the future growth of our business.

**Net cash provided by operating activities** increased to \$1.7 billion in 2006. This compares to \$1.6 billion in 2005 and \$0.9 billion in 2004. The increase in net cash provided by operations during 2006 primarily resulted from an increase in cash receipts from revenues. Fiscal 2005 reflected increased revenues and improved inventory management.

**Net cash used in investing activities** increased to \$4.6 billion in 2006. This compares to \$0.9 billion in 2005 and \$3.2 billion in 2004. The increase in net cash provided by investing activities was primarily due to the acquisition of the Standalone Drug Business. The decrease in net cash used in investing activities during 2005 related to a decrease in acquisitions, as 2004 included the acquisition of the 2004 Acquired Businesses. Gross capital expenditures totaled \$1.8 billion during 2006, compared to \$1.5 billion in 2005 and \$1.3 billion in 2004. During 2006, approximately 51% of our total capital expenditures were for new store construction, 30% for store expansion and improvements and 19% for technology and other corporate initiatives.

During 2007, we currently plan to invest over \$1.7 billion in gross capital expenditures, which will include spending for approximately 250–275 new or relocated stores.

Following is a summary of our store development activity for the respective years:

	2006	2005	2004
Total stores (beginning of year)	5,471	5,375	4,179
New and acquired stores	848	166	1,397
Closed stores	(117)	(70)	(201)
Total stores (end of year)	6,202	5,471	5,375
Relocated stores <sup>(1)</sup>	118	131	96

<sup>(1)</sup> Relocated stores are not included in new or closed store totals.

**Net cash provided by financing activities** was \$2.9 billion in 2006, compared to net cash used in financing activities of \$579.4 million in 2005 and net cash provided by financing activities of \$1.8 billion in 2004. The increase in net cash provided by financing activities was primarily due to the financing of the acquisition of the Standalone Drug Business, including issuance of the Notes (defined below), during the third quarter of 2006. This increase was offset partially by the repayment of the \$300 million, 5.625% unsecured senior notes, which matured during the first quarter of 2006. Fiscal 2005 reflected a reduction in short-term borrowings. During 2006, we paid common stock dividends totaling \$140.9 million, or \$0.155 per common share. In January 2007, our Board of Directors authorized a 26% increase in our annualized common stock dividend to \$0.195 per share for 2007.

We believe that our current 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 working capital needs, capital expenditures, debt service requirements and dividend requirements for at least the next twelve months and the foreseeable future.

We had \$1.8 billion of commercial paper outstanding at a weighted average interest rate of 5.3% as of December 30, 2006. In connection with our commercial paper program, we maintain a \$675 million, five-year unsecured back-up credit facility, which expires on June 11, 2009 and a \$675 million five-year unsecured back-up credit facility, which expires on June 2, 2010. In preparation for the consummation of the acquisition of the Standalone Drug Business, we entered into a \$1.4 billion, five-year unsecured back-up credit facility, which expires on May 12, 2011. The credit facilities allow for borrowings at various rates that are dependent in part on our public debt rating. As of December 30, 2006, we had no outstanding borrowings against the credit facilities.

On August 15, 2006, we issued \$800 million of 5.75% unsecured senior notes due August 15, 2011 and \$700 million of 6.125% unsecured senior notes due August 15, 2016 (collectively the "Notes"). The Notes pay interest semi-annually and may be redeemed at any time, in whole or in part at a defined redemption price plus accrued interest. Net proceeds from the Notes were used to repay a portion of the outstanding commercial paper issued to finance the Standalone Drug Business. To manage a portion of the risk associated with potential changes in market interest rates, during the second quarter of 2006, we entered into forward starting pay fixed rate swaps (the "Swaps"), with a notional amount of \$750 million. The Swaps settled in conjunction with the placement of the long-term financing. As of December 30, 2006, we had no freestanding derivatives in place.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In anticipation of the execution of the accelerated share repurchase upon consummation of the proposed merger with Caremark, we expect to enter into a \$1.25 billion, five-year unsecured back-up credit facility, in addition to a facility which will act as a bridge facility, with a value of \$5.0 billion. The bridge facility is expected to terminate upon the placement of longer-term financing.

Our credit facilities and unsecured senior notes contain customary restrictive financial and operating covenants. These covenants do not include a requirement for the acceleration of our debt maturities in the event of a downgrade in our credit rating. We do not believe that the restrictions contained in these covenants materially affect our financial or operating flexibility.

Our liquidity is based, in part, on maintaining investment-grade debt ratings. As of December 30, 2006, our long-term debt was rated "Baa2" by Moody's and "BBB+" by Standard & Poor's, and our commercial paper program was rated "P-2" by Moody's and "A-2" by Standard & Poor's, each on positive outlook. On February 13, 2007, Moody's placed our long-term debt and commercial paper program on stable outlook, while Standard and Poor's changed its outlook to developing. In assessing our credit strength, we believe that both Moody's and Standard & Poor's considered, among other things, our capital structure and financial policies as well as our consolidated balance sheet, our acquisition of the Standalone Drug Business, the entry into a definitive merger agreement with Caremark and other financial information. Although we currently believe our long-term debt ratings will remain investment grade, we cannot guarantee the future actions of Moody's and Standard & Poor's. Our debt ratings have a direct impact on our future borrowing costs, access to capital markets and new store operating lease costs.

### OFF-BALANCE SHEET ARRANGEMENTS

In connection with executing operating leases, we provide a guarantee of the lease payments. We finance a portion of our new store development through sale-leaseback transactions, which involve selling stores to unrelated parties and then leasing the stores back under leases that qualify and are accounted for as operating leases. We do not have any retained or contingent interests in the stores, nor do we provide any guarantees, other than a guarantee of the lease payments, in connection with the transactions. In accordance with generally accepted accounting principles, our operating leases are not reflected in our consolidated balance sheet.

Between 1991 and 1997, we sold or spun off a number of subsidiaries, including Bob's Stores, Linens 'n Things, Marshalls, Kay-Bee Toys, Wilsons, This End Up and Footstar. In many cases, when a former subsidiary leased a store, we provided a guarantee of the store's lease obligations. When the subsidiaries were disposed of, the guarantees remained in place, although each initial purchaser agreed to indemnify us for any lease obligations we were required to satisfy. If any of the purchasers were to become insolvent and failed to make the required payments under a store lease, we could be required to satisfy these obligations. Assuming that each respective purchaser became insolvent, and we were required to assume all of these lease obligations, we estimate that we could settle the obligations for approximately \$350 to \$400 million as of December 30, 2006. As of December 30, 2006, we guaranteed approximately 240 such store leases, with the maximum remaining lease term extending through 2022.

We currently believe that the ultimate disposition of any of the lease guarantees will not have a material adverse effect on our consolidated financial condition, results of operations or future cash flows.

Following is a summary of our significant contractual obligations as of December 30, 2006:

<i>In millions</i>	Payments Due by Period				
	Total	Within 1 Year	1-3 Years	3-5 Years	After 5 Years
Operating leases	\$ 19,875.0	\$ 1,445.7	\$ 2,740.5	\$ 2,674.0	\$ 13,014.8
Long-term debt	3,093.8	342.1	696.6	802.7	1,252.4
Purchase obligations	0.4	0.4	—	—	—
Other long-term liabilities reflected in our consolidated balance sheet	381.6	55.3	236.1	43.2	47.0
Capital lease obligations	120.9	2.3	5.4	6.8	106.4
	<b>\$ 23,471.7</b>	<b>\$ 1,845.8</b>	<b>\$ 3,678.6</b>	<b>\$ 3,526.7</b>	<b>\$ 14,420.6</b>

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in conformity with generally accepted accounting principles, which require management to make certain estimates and apply judgment. We base our estimates and judgments on historical experience, current trends and other factors that management believes to be important at the time the consolidated financial statements are prepared. On a regular basis, we review our accounting policies and how they are applied and disclosed in our consolidated financial statements. While we believe that the historical experience, current trends and other factors considered support the preparation of our consolidated financial statements in conformity with generally accepted accounting principles, actual results could differ from our estimates, and such differences could be material.

Our significant accounting policies are discussed in Note 1 to our consolidated financial statements. We believe the following accounting policies include a higher degree of judgment and/or complexity and, thus, are considered to be critical accounting policies. The critical accounting policies discussed below are applicable to both of our business segments. We have discussed the development and selection of our critical accounting policies with the Audit Committee of our Board of Directors and the Audit Committee has reviewed our disclosures relating to them.

#### Impairment of Long-Lived Assets

We account for the impairment of long-lived assets in accordance with SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets." As such, we evaluate the recoverability of long-lived assets, including intangible assets with finite lives, but excluding goodwill, which is tested for impairment using a separate test, whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. We group and evaluate long-lived assets for impairment at the individual store level, which is the lowest level at which individual cash flows can be identified. When evaluating long-lived assets for potential impairment, we first compare the carrying amount of the asset group to the individual store's estimated future cash flows (undiscounted and without interest charges).

If the estimated future cash flows are less than the carrying amount of the asset group, an impairment loss calculation is prepared. The impairment loss calculation compares the carrying amount of the asset group to the individual store's estimated future cash flows (discounted and with interest charges). If required, an impairment loss is recorded for the portion of the asset group's carrying value that exceeds the individual store's estimated future cash flows (discounted and with interest charges).

Our impairment loss calculation contains uncertainty since we must use judgment to estimate each store's future sales, profitability and cash flows. When preparing these estimates, we consider each store's historical results and current operating trends and our consolidated sales, profitability and cash flow results and forecasts.

These estimates can be affected by a number of factors including, but not limited to, general economic conditions, the cost of real estate, the continued efforts of third party organizations to reduce their prescription drug costs, the continued efforts of competitors to gain market share and consumer spending patterns.

The net book value of our long-lived assets, including intangible assets with finite lives, covered by this critical accounting policy was approximately \$6.7 billion as of December 30, 2006. During 2006, 2005 and 2004, we recorded pre-tax impairment losses totaling \$28 million, \$27 million and \$20 million, respectively. Although we believe we have sufficient current and historical information available to us to record reasonable estimates for impairment losses, it is possible that actual results could differ. In order to help you assess the risk, if any, associated with the uncertainties discussed above, we believe the \$8 million pre-tax difference between the high and low end of the three-year impairment loss range would be a reasonably likely annual increase or decrease in the impairment of long-lived assets.

We have not made any material changes to our impairment loss assessment methodology during the past three years.

#### Closed Store Lease Liability

We account for closed store lease termination costs in accordance with SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." As such, when a leased store is closed, we record a liability for the estimated present value of the remaining obligation under the non-cancelable lease, which includes future real estate taxes, common area maintenance and other charges, if applicable. The liability is reduced by estimated future sublease income.

The initial calculation and subsequent evaluations of our closed store lease liability contains uncertainty since we must use judgment to estimate the timing and duration of future vacancy periods, the amount and timing of future lump sum settlement payments and the amount and timing of potential future sublease income. When estimating these potential termination costs and their related timing, we consider a number of factors, which include, but are not limited to, historical settlement experience, the owner of the property, the location and condition of the property, the terms of the underlying lease, the specific marketplace demand and general economic conditions.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Our total closed store lease liability covered by this critical accounting policy was \$489.4 million as of December 30, 2006. This amount is net of \$246.6 million of estimated sublease income that is subject to the uncertainties discussed above. Although we believe we have sufficient current and historical information available to us to record reasonable estimates for sublease income, it is possible that actual results could differ. In order to help you assess the risk, if any, associated with the uncertainties discussed above, a ten percent (10%) pre-tax change in our estimated sublease income, which we believe is a reasonably likely change, would increase or decrease our total closed store lease liability by about \$24.7 million during 2006.

We have not made any material changes in the reserve methodology used to record closed store lease reserves during the past three years.

### Self-Insurance Liabilities

We are self-insured for certain losses related to general liability, workers' compensation and auto liability although we maintain stop loss coverage with third party insurers to limit our total liability exposure. We are also self-insured for certain losses related to health and medical liabilities.

The estimate of our self-insurance liability contains uncertainty since we must use judgment to estimate the ultimate cost that will be incurred to settle reported claims and unreported claims for incidents incurred but not reported as of the balance sheet date. When estimating our self-insurance liability we consider a number of factors, which include, but are not limited to, historical claim experience, demographic factors, severity factors and valuations provided by independent third party actuaries.

On a quarterly basis, we review our assumptions with our independent third party actuaries to determine that our self-insurance liability is adequate as it relates to our general liability, workers' compensation and auto liability. Similar reviews are conducted semi-annually to determine that our self-insurance liability is adequate for our health and medical liability.

Our total self-insurance liability covered by this critical accounting policy was \$290.4 million during 2006. Although we believe we have sufficient current and historical information available to us to record reasonable estimates for our self-insurance liability, it is possible that actual results could differ. In order to help you assess the risk, if any, associated with the uncertainties discussed above, a ten percent (10%) pre-tax change in our estimate for our self-insurance liability, which we believe is a reasonably likely change, would increase or decrease our self-insurance liability by about \$29.0 million during 2006.

We have not made any material changes in the accounting methodology used to establish our self-insurance liability during the past three years.

### Inventory

Our inventory is stated at the lower of cost or market on a first-in, first-out basis using the retail method of accounting to determine cost of sales and inventory in our stores, and the cost method of accounting to determine inventory in our distribution centers. Under the retail method, inventory is stated at cost, which is determined by applying a cost-to-retail ratio to the ending retail value of our inventory. Since the retail value of our inventory is adjusted on a regular basis to reflect current market conditions, our carrying value should approximate the lower of cost or market. In addition, we reduce the value of our ending inventory for estimated inventory losses that have occurred during the interim period between physical inventory counts. Physical inventory counts are taken on a regular basis in each location (other than the two recently constructed distribution centers, which perform a continuous cycle count process to validate the inventory balance on hand) to ensure that the amounts reflected in the consolidated financial statements are properly stated.

The accounting for inventory contains uncertainty since we must use judgment to estimate the inventory losses that have occurred during the interim period between physical inventory counts. When estimating these losses, we consider a number of factors, which include but are not limited to, historical physical inventory results on a location-by-location basis and current inventory loss trends.

Our total reserve for estimated inventory losses covered by this critical accounting policy was \$125.1 million as of December 30, 2006. Although we believe we have sufficient current and historical information available to us to record reasonable estimates for estimated inventory losses, it is possible that actual results could differ. In order to help you assess the aggregate risk, if any, associated with the uncertainties discussed above, a ten percent (10%) pre-tax change in our estimated inventory losses, which we believe is a reasonably likely change, would increase or decrease our total reserve for estimated inventory losses by about \$12.5 million during 2006.

We have not made any material changes in the accounting methodology used to establish our inventory loss reserves during the past three years.

Although we believe that the estimates discussed above are reasonable and the related calculations conform to generally accepted accounting principles, actual results could differ from our estimates, and such differences could be material.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### RECENT ACCOUNTING PRONOUNCEMENTS

We adopted SFAS No. 123(R), "Share-Based Payment," effective January 1, 2006. This statement established standards for accounting for transactions in which an entity exchanges its equity instruments for goods or services. The statement focused primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. The adoption of this statement resulted in a \$42.7 million reduction in net earnings for 2006. Please see Note 7 to our consolidated financial statements for additional information regarding stock-based compensation.

We adopted Financial Accounting Standards Board Staff Position ("FSP") No. FAS 13-1, "Accounting for Rental Costs Incurred during a Construction Period," effective January 1, 2006. This FSP addresses the accounting for rental costs associated with operating leases that are incurred during a construction period and requires rental costs associated with ground or building operating leases that are incurred during a construction period to be recognized as rental expense over the life of the lease. The adoption of this statement did not have a material impact on our consolidated results of operations, financial position or cash flows.

We adopted SAB No. 108, effective November 15, 2006. SAB No. 108 requires misstatements to be quantified based on their impact on each of the financial statements and related disclosures. The adoption of this statement resulted in a \$24.7 million increase in net earnings for 2006.

We adopted SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)," effective December 15, 2006. SFAS No. 158 requires an employer to recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status, measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year, and recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income and in a separate component of stockholder's equity. The adoption of this statement did not have a material impact on our consolidated results of operations, financial position or cash flows.

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109." FIN No. 48 clarifies the accounting and disclosure for uncertain tax positions, which relate to the uncertainty about how certain tax positions taken or expected to be taken on a tax return should be reflected in the financial statements before they are finally resolved with the taxing authorities. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. Although

we are still analyzing the impact of FIN No. 48, we do not believe the adoption will have a material impact on our consolidated results of operations and financial position.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurement." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures regarding fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently evaluating the impact that SFAS No. 157 may have on our consolidated results of operations and financial position.

### CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 (the "Reform Act") provides a safe harbor for forward-looking statements made by or on behalf of CVS Corporation. The Company and its representatives may, from time to time, make written or verbal forward-looking statements, including statements contained in the Company's filings with the Securities and Exchange Commission and in its reports to stockholders. Generally, the inclusion of the words "believe," "expect," "intend," "estimate," "project," "anticipate," "will" and similar expressions identify statements that constitute forward-looking statements.

All statements addressing operating performance of CVS Corporation or any subsidiary, events or developments that the Company expects or anticipates will occur in the future, including statements relating to sales growth, earnings or earnings per common share growth, free cash flow, debt rating, inventory levels, inventory turn and loss rates, store development, relocations and new market entries, as well as statements expressing optimism or pessimism about future operating results or events, are forward-looking statements within the meaning of the Reform Act.

The forward-looking statements are and will be based upon management's then-current views and assumptions regarding future events and operating performance, and are applicable only as of the dates of such statements. The Company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

By their nature, all forward-looking statements involve risks and uncertainties. Actual results may differ materially from those contemplated by the forward-looking statements for a number of reasons, including, but not limited to:

- Our ability to obtain CVS and Caremark stockholder approval for the merger with Caremark;

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

- Our ability to integrate successfully the Caremark business or as timely as expected and successfully retain key personnel;
  - Our ability to realize the revenues and synergies and other benefits from the merger as expected;
  - Litigation and regulatory risks associated with the Caremark and pharmacy benefit management industry generally;
  - The continued efforts of health maintenance organizations, managed care organizations, pharmacy benefit management companies and other third party payors to reduce prescription drug costs and pharmacy reimbursement rates, particularly with respect to generic pharmaceuticals;
  - The effect on pharmacy revenue and gross profit rates attributable to the introduction in 2006 of a new Medicare prescription drug benefit and the continued efforts by various government entities to reduce state Medicaid pharmacy reimbursement rates;
  - Risks related to the change in industry pricing benchmarks that could adversely affect our financial performance;
  - The growth of mail order pharmacies and changes to pharmacy benefit plans requiring maintenance medications to be filled exclusively through mail order pharmacies;
  - The effect on PharmaCare of increased competition in the pharmacy benefit management industry, a declining margin environment attributable to increased client demands for lower prices, enhanced service offerings and/or higher service levels and the possible termination of, or unfavorable modification to, contractual arrangements with key clients or providers;
  - The potential effect on PharmaCare's business results of entering into risk based or reinsurance arrangements in connection with providing pharmacy benefit plan management services. Risks associated with these arrangements include relying on actuarial assumptions that underestimate prescription utilization rates and/or costs for covered members;
  - Our ability to successfully integrate the Standalone Drug Business acquired from Albertsons in June 2006;
  - Our ability to expand MinuteClinic as expected;
  - The risks relating to adverse developments in the healthcare or pharmaceutical industry generally, including, but not limited to, developments in any investigation related to the pharmaceutical industry that may be conducted by governmental authorities;
  - Increased competition from other drugstore chains, supermarkets, discount retailers, membership clubs and Internet companies, as well as changes in consumer preferences or loyalties;
  - The frequency and rate of introduction of successful new prescription drugs;
  - Our ability to generate sufficient cash flows to support capital expansion and general operating activities;
  - Interest rate fluctuations and changes in capital market conditions or other events affecting our ability to obtain necessary financing on favorable terms;
  - Our ability to identify, implement and successfully manage and finance strategic expansion opportunities including entering new markets, acquisitions and joint ventures;
  - Our ability to establish effective advertising, marketing and promotional programs (including pricing strategies and price reduction programs implemented in response to competitive pressures and/or to drive demand);
  - Our ability to continue to secure suitable new store locations under acceptable lease terms;
  - Our ability to attract, hire and retain suitable pharmacists, nurse practitioners and management personnel;
  - Our ability to achieve cost efficiencies and other benefits from various operational initiatives and technological enhancements;
  - Litigation risks as well as changes in laws and regulations, including changes in accounting standards and taxation requirements (including tax rate changes, new tax laws and revised tax law interpretations);
  - The creditworthiness of the purchasers of businesses formerly owned by CVS and whose leases are guaranteed by CVS;
  - Fluctuations in inventory cost, availability and loss levels and our ability to maintain relationships with suppliers on favorable terms;
  - Our ability to implement successfully and to manage new computer systems and technologies;
  - The strength of the economy in general or in the markets served by CVS, including changes in consumer purchasing power and/or spending patterns; and
  - Other risks and uncertainties detailed from time to time in our filings with the Securities and Exchange Commission.
- The foregoing list is not exhaustive. There can be no assurance that the Company has correctly identified and appropriately assessed all factors affecting its business. Additional risks and uncertainties not presently known to the Company or that it currently believes to be immaterial also may adversely impact the Company. Should any risks and uncertainties develop into actual events, these developments could have material adverse effects on the Company's business, financial condition and results of operations. For these reasons, you are cautioned not to place undue reliance on the Company's forward-looking statements.

## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

We are responsible for establishing and maintaining effective internal control over financial reporting. Our Company's internal control over financial reporting includes those policies and procedures that pertain to the Company's ability to record, process, summarize and report a system of internal accounting controls and procedures to provide reasonable assurance, at an appropriate cost/benefit relationship, that the unauthorized acquisition, use or disposition of assets are prevented or timely detected and that transactions are authorized, recorded and reported properly to permit the preparation of financial statements in accordance with generally accepted accounting principles (GAAP) and receipt and expenditures are duly authorized. In order to ensure the Company's internal control over financial reporting is effective, management regularly assesses such controls and did so most recently for its financial reporting as of December 30, 2006.

We conduct an evaluation of the effectiveness of our internal controls over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. This evaluation included review of the documentation, evaluation of the design effectiveness and testing of the operating effectiveness of controls. Our system of internal control over financial reporting is enhanced by periodic reviews by our internal auditors, written policies and procedures and a written Code of Conduct adopted by our Company's Board of Directors, applicable to all employees of our Company. In addition, we have an internal Disclosure Committee, comprised of management from each functional area within the Company, which performs a separate review of our disclosure controls and procedures. There are inherent limitations in the effectiveness of any system of internal controls over financial reporting.

Based on our evaluation, we conclude our Company's internal control over financial reporting is effective and provides reasonable assurance that assets are safeguarded and that the financial records are reliable for preparing financial statements as of December 30, 2006.

KPMG LLP, independent registered public accounting firm, is appointed by the Board of Directors and ratified by our Company's shareholders. They were engaged to render an opinion regarding the fair presentation of our consolidated financial statements as well as conducting a review of the system of internal accounting controls. Their accompanying report is based upon an audit conducted in accordance with the Public Company Accounting Oversight Board (United States) and includes an attestation on management's assessment of internal controls over financial reporting.

February 27, 2007



**THE BOARD OF DIRECTORS AND SHAREHOLDERS  
CVS CORPORATION**

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that CVS Corporation and subsidiaries maintained effective internal control over financial reporting as of December 30, 2006, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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

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

In our opinion, management's assessment that CVS Corporation and subsidiaries maintained effective internal control over financial reporting as of December 30, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control – Integrated Framework* issued by COSO. Also, in our opinion, CVS Corporation and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 30, 2006, based on criteria established in *Internal Control – Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of CVS Corporation and subsidiaries as of December 30, 2006 and December 31, 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for the fifty-two week periods ended December 30, 2006, December 31, 2005 and January 1, 2005, and the related financial statement schedule, and our report dated February 27, 2007 expressed an unqualified opinion on those consolidated financial statements and related financial statement schedule. Such reports include an explanatory paragraph regarding the Company's adoption of Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," effective January 1, 2006.



KPMG LLP  
Providence, Rhode Island  
February 27, 2007



## CONSOLIDATED STATEMENTS OF OPERATIONS

<i>In millions, except per share amounts</i>	<b>Fiscal Year Ended Dec. 30, 2006 (52 weeks)</b>	Fiscal Year Ended Dec. 31, 2005 (52 weeks)	Fiscal Year Ended Jan. 1, 2005 (52 weeks)
Net revenues	\$ 43,813.8	\$ 37,006.2	\$ 30,594.3
Cost of goods sold, buying and warehousing costs	31,874.8	27,105.0	22,563.1
Gross profit	11,939.0	9,901.2	8,031.2
Selling, general and administrative expenses	8,764.1	7,292.6	6,079.7
Depreciation and amortization	733.3	589.1	496.8
Total operating expenses	9,497.4	7,881.7	6,576.5
Operating profit	2,441.6	2,019.5	1,454.7
Interest expense, net	215.8	110.5	58.3
Earnings before income tax provision	2,225.8	1,909.0	1,396.4
Income tax provision	856.9	684.3	477.6
Net earnings	1,368.9	1,224.7	918.8
Preference dividends, net of income tax benefit	13.9	14.1	14.2
Net earnings available to common shareholders	\$ 1,355.0	\$ 1,210.6	\$ 904.6
<b>Basic earnings per common share:</b>			
Net earnings	\$ 1.65	\$ 1.49	\$ 1.13
Weighted average common shares outstanding	820.6	811.4	797.2
<b>Diluted earnings per common share:</b>			
Net earnings	\$ 1.60	\$ 1.45	\$ 1.10
Weighted average common shares outstanding	853.2	841.6	830.8
<b>Dividends declared per common share</b>	\$ 0.1550	\$ 0.1450	\$ 0.1325

See accompanying notes to consolidated financial statements.

## CONSOLIDATED BALANCE SHEETS

<i>In millions, except shares and per share amounts</i>	Dec. 30, 2006	Dec. 31, 2005
<b>Assets:</b>		
Cash and cash equivalents	\$ 530.7	\$ 513.4
Accounts receivable, net	2,377.4	1,839.6
Inventories	7,108.9	5,719.8
Deferred income taxes	274.3	241.1
Other current assets	100.2	78.8
<b>Total current assets</b>	<b>10,391.5</b>	<b>8,392.7</b>
Property and equipment, net	5,333.6	3,952.6
Goodwill	3,195.2	1,789.9
Intangible assets, net	1,318.2	802.2
Deferred income taxes	90.8	122.5
Other assets	240.5	223.5
<b>Total assets</b>	<b>\$ 20,569.8</b>	<b>\$ 15,283.4</b>
<b>Liabilities:</b>		
Accounts payable	\$ 2,863.5	\$ 2,467.5
Accrued expenses	1,950.2	1,521.4
Short-term debt	1,842.7	253.4
Current portion of long-term debt	344.3	341.6
<b>Total current liabilities</b>	<b>7,000.7</b>	<b>4,583.9</b>
Long-term debt	2,870.4	1,594.1
Other long-term liabilities	781.1	774.2
Commitments and contingencies (Note 9)		
<b>Shareholders' equity:</b>		
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 3,990,000 shares at December 30, 2006 and 4,165,000 shares at December 31, 2005	213.3	222.6
Common stock, par value \$0.01: authorized 1,000,000,000 shares; issued 847,266,000 shares at December 30, 2006 and 838,841,000 shares at December 31, 2005	8.5	8.4
Treasury stock, at cost: 21,529,000 shares at December 30, 2006 and 24,533,000 shares at December 31, 2005	(314.5)	(356.5)
Guaranteed ESOP obligation	(82.1)	(114.0)
Capital surplus	2,198.4	1,922.4
Retained earnings	7,966.6	6,738.6
Accumulated other comprehensive loss	(72.6)	(90.3)
<b>Total shareholders' equity</b>	<b>9,917.6</b>	<b>8,331.2</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 20,569.8</b>	<b>\$ 15,283.4</b>

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

In millions	Shares			Dollars		
	Dec. 30, 2006	Dec. 31, 2005	Jan. 1, 2005	Dec. 30, 2006	Dec. 31, 2005	Jan. 1, 2005
<b>Preference stock:</b>						
Beginning of year	4.2	4.3	4.5	\$ 222.6	\$ 228.4	\$ 242.7
Conversion to common stock	(0.2)	(0.1)	(0.2)	(9.3)	(5.8)	(14.3)
End of year	4.0	4.2	4.3	213.3	222.6	228.4
<b>Common stock:</b>						
Beginning of year	838.8	828.6	820.4	8.4	8.3	8.2
Stock options exercised and awards	8.5	10.2	8.2	0.1	0.1	0.1
End of year	847.3	838.8	828.6	8.5	8.4	8.3
<b>Treasury stock:</b>						
Beginning of year	(24.5)	(26.6)	(29.6)	(356.5)	(385.9)	(428.6)
Purchase of treasury shares	0.1	–	–	(0.1)	(1.7)	(0.8)
Conversion of preference stock	0.8	0.5	1.2	11.7	7.3	17.9
Employee stock purchase plan issuance	2.1	1.6	1.8	30.4	23.8	25.6
End of year	(21.5)	(24.5)	(26.6)	(314.5)	(356.5)	(385.9)
<b>Guaranteed ESOP obligation:</b>						
Beginning of year				(114.0)	(140.9)	(163.2)
Reduction of guaranteed ESOP obligation				31.9	26.9	22.3
End of year				(82.1)	(114.0)	(140.9)
<b>Capital surplus:</b>						
Beginning of year				1,922.4	1,687.3	1,553.1
Conversion of preference stock				(2.4)	(1.5)	(3.6)
Stock option activity and awards				235.8	188.8	119.4
Tax benefit on stock options and awards				42.6	47.8	18.4
End of year				2,198.4	1,922.4	1,687.3
<b>Accumulated other comprehensive loss:</b>						
Beginning of year				(90.3)	(55.5)	(36.9)
Recognition of unrealized (loss)/gain on derivatives				(0.3)	2.9	(19.8)
Minimum pension liability adjustment				23.6	(37.7)	1.2
Pension liability adjustment to initially apply SFAS No.158, net of tax benefit				(5.6)	–	–
End of year				(72.6)	(90.3)	(55.5)
<b>Retained earnings:</b>						
Beginning of year				6,738.6	5,645.5	4,846.5
Net earnings				1,368.9	1,224.7	918.8
Preference stock dividends				(15.6)	(16.2)	(16.6)
Tax benefit on preference stock dividends				1.7	2.1	2.4
Common stock dividends				(127.0)	(117.5)	(105.6)
End of year				7,966.6	6,738.6	5,645.5
<b>Total shareholders' equity</b>				<b>\$ 9,917.6</b>	<b>\$ 8,331.2</b>	<b>\$ 6,987.2</b>
<b>Comprehensive income:</b>						
Net earnings				\$ 1,368.9	\$ 1,224.7	\$ 918.8
Recognition of unrealized (loss)/gain on derivatives				(0.3)	2.9	(19.8)
Minimum pension liability, net of income tax				23.6	(37.7)	1.2
<b>Comprehensive income</b>				<b>\$ 1,392.2</b>	<b>\$ 1,189.9</b>	<b>\$ 900.2</b>

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>In millions</i>	Fiscal Year Ended Dec. 30, 2006 (52 weeks)	Fiscal Year Ended Dec. 31, 2005 (52 weeks)	Fiscal Year Ended Jan. 1, 2005 (52 weeks)
<b>Cash flows from operating activities:</b>			
Cash receipts from revenues	\$ 43,273.7	\$ 36,923.1	\$ 30,545.8
Cash paid for inventory	(31,422.1)	(26,403.9)	(22,469.2)
Cash paid to other suppliers and employees	(9,065.3)	(8,186.7)	(6,528.5)
Interest and dividends received	15.9	6.5	5.7
Interest paid	(228.1)	(135.9)	(70.4)
Income taxes paid	(831.7)	(591.0)	(569.2)
<b>Net cash provided by operating activities</b>	<b>1,742.4</b>	<b>1,612.1</b>	<b>914.2</b>
<b>Cash flows from investing activities:</b>			
Additions to property and equipment	(1,768.9)	(1,495.4)	(1,347.7)
Proceeds from sale-leaseback transactions	1,375.6	539.9	496.6
Acquisitions (net of cash acquired) and other investments	(4,224.2)	12.1	(2,293.7)
Cash outflow from hedging activities	(5.3)	-	(32.8)
Proceeds from sale or disposal of assets	29.6	31.8	14.3
<b>Net cash used in investing activities</b>	<b>(4,593.2)</b>	<b>(911.6)</b>	<b>(3,163.3)</b>
<b>Cash flows from financing activities:</b>			
Additions to/(reductions in) short-term debt	1,589.3	(632.2)	885.6
Dividends paid	(140.9)	(131.6)	(119.8)
Proceeds from exercise of stock options	187.6	178.4	129.8
Excess tax benefits from stock-based compensation	42.6	-	-
Additions to long-term debt	1,500.0	16.5	1,204.1
Reductions in long-term debt	(310.5)	(10.5)	(301.5)
<b>Net cash provided by (used in) financing activities</b>	<b>2,868.1</b>	<b>(579.4)</b>	<b>1,798.2</b>
Net increase in cash and cash equivalents	17.3	121.1	(450.9)
Cash and cash equivalents at beginning of year	513.4	392.3	843.2
<b>Cash and cash equivalents at end of year</b>	<b>\$ 530.7</b>	<b>\$ 513.4</b>	<b>\$ 392.3</b>
<b>Reconciliation of net earnings to net cash provided by operating activities:</b>			
Net earnings	\$ 1,368.9	\$ 1,224.7	\$ 918.8
Adjustments required to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	733.3	589.1	496.8
Stock based compensation	69.9	-	-
Deferred income taxes and other non-cash items	98.2	13.5	(23.6)
Change in operating assets and liabilities providing/ (requiring) cash, net of effects from acquisitions:			
Accounts receivable, net	(540.1)	(83.1)	(48.4)
Inventories	(624.1)	(265.2)	(509.8)
Other current assets	(21.4)	(13.2)	35.7
Other assets	(17.2)	(0.1)	8.5
Accounts payable	396.7	192.2	109.4
Accrued expenses	328.9	(43.8)	(144.2)
Other long-term liabilities	(50.7)	(2.0)	71.0
<b>Net cash provided by operating activities</b>	<b>\$ 1,742.4</b>	<b>\$ 1,612.1</b>	<b>\$ 914.2</b>

See accompanying notes to consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1 SIGNIFICANT ACCOUNTING POLICIES

#### Description of Business

CVS Corporation (the “Company”) is a leader in the retail drugstore industry in the United States. The Company sells prescription drugs and a wide assortment of general merchandise, including over-the-counter drugs, beauty products and cosmetics, film and photo finishing services, seasonal merchandise, greeting cards and convenience foods, through its CVS/pharmacy® retail stores and online through CVS.com®. Also, healthcare services are provided through the 146 MinuteClinic healthcare clinics, located in 18 states, of which 129 are located within CVS retail drugstores. In addition, the Company provides pharmacy benefit management, mail order services and specialty pharmacy services through PharmaCare Management Services (“PharmaCare”) and PharmaCare Pharmacy® stores. As of December 30, 2006, the Company operated 6,202 retail and specialty pharmacy stores in 43 states and the District of Columbia.

#### 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.

#### Stock Split

On May 12, 2005, the Company’s Board of Directors authorized a two-for-one stock split, which was effected in the form of a dividend by the issuance of one additional share of common stock for each share of common stock outstanding. These shares were distributed on June 6, 2005 to shareholders of record as of May 23, 2005. All share and per share amounts presented herein have been restated to reflect the effect of the stock split.

#### Fiscal Year

The Company’s fiscal year is a 52 or 53 week period ending on the Saturday nearest to December 31. Fiscal 2006, which ended on December 30, 2006, fiscal 2005, which ended on December 31, 2005 and fiscal 2004, which ended on January 1, 2005, each included 52 weeks. Unless otherwise noted, all references to years relate to these fiscal years.

#### Reclassifications

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

#### 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.

#### 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 \$73.4 million and \$53.2 million as of December 30, 2006 and December 31, 2005, respectively. The balance primarily includes amounts due from third party providers (e.g., pharmacy benefit managers, insurance companies and governmental agencies) and vendors.

#### Fair Value of Financial Instruments

As of December 30, 2006, the Company’s financial instruments include cash and cash equivalents, accounts receivable, accounts payable and short-term debt. Due to the short-term nature of these instruments, the Company’s carrying value approximates fair value. The carrying amount and the estimated fair value of long-term debt was \$3.1 billion as of December 30, 2006. The carrying amount and the estimated fair value of long-term debt was \$1.9 billion as of December 31, 2005. The fair value of long-term debt was estimated based on rates currently offered to the Company for debt with similar terms and maturities. The Company had outstanding letters of credit, which guaranteed foreign trade purchases, with a fair value of \$6.8 million as of December 30, 2006, and \$9.5 million as of December 31, 2005. There were no outstanding investments in derivative financial instruments as of December 30, 2006 or December 31, 2005.

#### Inventories

Inventory is stated at the lower of cost or market on a first-in, first-out basis using the retail method of accounting to determine cost of sales and inventory in our stores, and the cost method of accounting to determine inventory in our distribution centers. Independent physical inventory counts are taken on a regular basis in each store and distribution center location (other than two recently constructed distribution centers, which perform a continuous cycle count process to validate the inventory balance on hand) to ensure that the amounts reflected in the accompanying consolidated financial statements are properly stated. During the interim period between physical inventory counts, the Company accrues for anticipated physical inventory losses on a location-by-location basis based on historical results and current trends.

#### Goodwill

The Company accounts for goodwill and intangibles under Statement of Financial Accounting Standards (“SFAS”) No. 142, “Goodwill and Other Intangible Assets.” As such, goodwill and other indefinite-lived assets are not amortized, but are subject to impairment reviews annually, or more frequently if necessary. See Note 3 for further information on goodwill.

#### Intangible Assets

Purchased customer lists are amortized on a straight-line basis over their estimated useful lives of up to 10 years. Purchased leases are amortized on a straight-line basis over the remaining life of the lease. See Note 3 for further information on intangible assets.

**Property and Equipment**

Property, equipment and improvements to leased premises are depreciated using the straight-line method over the estimated useful lives of the assets, or when applicable, the term of the lease, whichever is shorter. Estimated useful lives generally range from 10 to 40 years for buildings, building improvements and leasehold improvements and 5 to 10 years for fixtures and equipment. Repair and maintenance 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.

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

<i>In millions</i>	Dec. 30, 2006	Dec. 31, 2005
Land	\$ 601.3	\$ 322.4
Building and improvements	801.9	631.0
Fixtures and equipment	4,347.4	3,484.1
Leasehold improvements	1,828.5	1,496.7
Capitalized software	219.1	198.6
Capital leases	229.3	1.3
	8,027.5	6,134.1
Accumulated depreciation and amortization	(2,693.9)	(2,181.5)
	\$ 5,333.6	\$ 3,952.6

The Company capitalizes application development stage costs for significant internally developed software projects. These costs are amortized over a five-year period. Unamortized costs were \$75.5 million as of December 30, 2006 and \$84.3 million as of December 31, 2005.

**Impairment of Long-Lived Assets**

The Company accounts for the impairment of long-lived assets in accordance with SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets." As such, the Company groups and evaluates fixed and finite-lived intangible assets excluding goodwill, for impairment at the individual store level, which is the lowest level at which individual cash flows can be identified. When evaluating assets for potential impairment, the Company first compares the carrying amount of the asset group to the individual store'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 group, an impairment loss calculation is prepared. The impairment loss calculation compares the carrying amount of the asset group to the individual store's estimated fair value based on estimated future cash flows (discounted and with interest charges). If the carrying amount exceeds the individual store's estimated future cash flows (discounted and with interest charges), the loss is allocated to the long-lived assets of the group on a pro rata basis using the relative carrying amounts of those assets.

**Revenue Recognition**

For all sales other than third party pharmacy sales, the Company recognizes revenue from the sale of merchandise at the point of sale. For third party pharmacy sales, revenue is recognized at the time the prescription is filled, which is or approximates when the customer picks up the prescription. Customer returns are immaterial. Service revenue from the Company's pharmacy benefit management segment, which is recognized using the net method under Emerging Issues Task Force ("EITF") Issue No. 99-19, "Reporting Revenue Gross as a Principal Versus Net as an Agent," is recognized at the time the service is provided. Service revenue totaled \$194.5 million in 2006, \$201.8 million in 2005 and \$129.3 million in 2004.

Premium revenue from the Company's pharmacy benefit management segment is accounted for under SFAS No. 113, "Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts," and is recognized over the period of the contract in proportion to the amount of insurance coverage provided. Premiums collected in advance are deferred. Premium revenue totaled \$380.1 million in 2006 and \$91.6 million in 2005. There was no premium revenue in 2004.

**Insurance**

The Company is self-insured for certain losses related to general liability, workers' compensation and automobile liability. The Company obtains third party insurance coverage to limit exposure from these claims. The Company is also self-insured for certain losses related to health and medical liabilities.

The Company's self-insurance accruals, which include reported claims and claims incurred but not reported, are calculated using standard insurance industry actuarial assumptions and the Company's historical claims experience. During 2005, PharmaCare entered into certain risk-based or reinsurance arrangements in connection with providing pharmacy plan management services. Policies and contract claims include actual claims reported but not paid and estimates of healthcare services incurred but not reported. The estimated claims incurred but not reported are calculated using standard insurance industry actuarial assumptions based on historical data, current enrollment, health service utilization statistics and other related information and are provided by third party actuaries.

**Vendor Allowances**

The Company accounts for vendor allowances under the guidance provided by EITF Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor," and EITF Issue No. 03-10, "Application of EITF Issue No. 02-16 by Resellers to Sales Incentives Offered to Consumers by Manufacturers." Vendor allowances reduce the carrying cost of inventory unless they are specifically identified as a reimbursement for promotional programs and/or other services

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

provided. Funds that are directly linked to advertising commitments are recognized as a reduction of advertising expense in the selling, general and administrative expenses line when the related advertising commitment is satisfied. Any such allowances received in excess of the actual cost incurred also reduce the carrying cost of inventory. The total value of any upfront 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 purchase volume. The total value of any upfront 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. The total amortization of these upfront payments was not material to the accompanying consolidated financial statements.

### Store Opening and Closing Costs

New store opening costs, other than capital expenditures, are charged directly to expense when incurred. When the Company closes a store, the present value of estimated unrecoverable costs, including the remaining lease obligation less estimated sublease income and the book value of abandoned property and equipment, are charged to expense. The long-term portion of the lease obligations associated with store closings was \$418.0 million, \$406.3 million, and \$507.1 million in 2006, 2005 and 2004, respectively.

### Advertising Costs

Advertising costs are expensed when the related advertising takes place. Advertising costs, net of vendor funding, which is included in selling, general and administrative expenses, were \$265.3 million in 2006, \$206.6 million in 2005 and \$205.7 million in 2004.

### Interest Expense, Net

Interest expense was \$231.7 million, \$117.0 million and \$64.0 million, and interest income was \$15.9 million, \$6.5 million and \$5.7 million in 2006, 2005 and 2004, respectively. Capitalized interest totaled \$20.7 million in 2006, \$12.7 million in 2005 and \$10.4 million in 2004.

### Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss consists of a minimum pension liability, unrealized losses on derivatives and adjustment to initially apply SFAS No. 158. Due to the application of SFAS No. 158 in 2006, there was no minimum pension liability recorded as of December 30, 2006. In accordance with SFAS No. 158, the amount included in accumulated other comprehensive income related to the Company's pension and postretirement plans was \$87.4 million pre-tax (\$55.4 million after-tax) as of December 30, 2006. The minimum pension liability totaled \$117.0 million pre-tax (\$73.4 million after-tax) as of December 31, 2005. The unrealized loss on derivatives totaled \$27.2 million pre-tax (\$17.2 million after-tax) and \$26.7 million pre-tax (\$16.9 million after-tax) as of December 30, 2006 and December 31, 2005, respectively.

### Stock-Based Compensation

On January 1, 2006, the Company adopted SFAS No. 123(R), "Share-Based Payment," using the modified prospective transition method. Under this method, compensation expense is recognized for options granted on or after January 1, 2006, as well as any unvested options on the date of adoption. As allowed under the modified prospective transition method, prior period financial statements have not been restated. Prior to January 1, 2006, the Company accounted for its stock-based compensation plans under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. As such, no stock-based employee compensation costs were reflected in net earnings for options granted under those plans since they had an exercise price equal to the fair market value of the underlying common stock on the date of grant. See Note 7 for further information on stock-based compensation.

### Income Taxes

The Company provides for federal and state income taxes currently payable, as well as for those deferred because of timing differences between reported income and expenses for financial statement purposes versus tax purposes. Federal and state incentive tax credits are recorded as a reduction of 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. 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 recoverable or settled. The effect of a change in tax rates is recognized as income or expense in the period of the change.

### Earnings per Common Share

Basic earnings per common share is computed by dividing: (i) net earnings, after deducting the after-tax Employee Stock Ownership Plan ("ESOP") preference dividends, 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 assumes that the ESOP preference stock is converted into common stock and all dilutive stock awards 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 (\$0.1550 per share in 2006, \$0.1450 per share in 2005 and \$0.1325 per share in 2004) 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 awards are exercised and the ESOP preference stock is converted into common stock. Options to purchase 4.7 million, 6.9 million and 9.4 million shares of common stock were outstanding as of December 30, 2006, December 31, 2005 and January 1, 2005, respectively, but were not included in the calculation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares and, therefore, the effect would be antidilutive.

**New Accounting Pronouncements**

The Company adopted, SFAS No. 123(R), "Share-Based Payment," effective January 1, 2006. This statement established standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. The statement focused primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. The adoption of this statement resulted in a \$42.7 million reduction in net earnings for 2006. Please see Note 7 to the Company's consolidated financial statements for additional information regarding stock-based compensation.

The Company adopted FASB Staff Position ("FSP") No. FAS 13-1, "Accounting for Rental Costs Incurred during a Construction Period," effective January 1, 2006. The FSP addresses the accounting for rental costs associated with operating leases that are incurred during a construction period and requires rental costs associated with ground or building operating leases that are incurred during a construction period to be recognized as rental expense over the life of the lease. The adoption of this statement did not have a material impact on the Company's consolidated results of operations, financial position or cash flows.

The Company adopted the Securities and Exchange Commission (SEC) Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," effective November 15, 2006. SAB No. 108 requires misstatements to be quantified based on their impact on each of the financial statements and related disclosures. The adoption of this statement resulted in a \$24.7 million increase in net earnings for 2006.

The Company adopted SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)," effective December 15, 2006. SFAS No. 158 requires an employer to recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status, measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year, and recognize changes in the funded status of a defined benefit

postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income and in a separate component of shareholder's equity. The adoption of this statement did not have a material impact on the Company's consolidated results of operations, financial position or cash flows.

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109." FIN No. 48 clarifies the accounting and disclosure for uncertain tax positions, which relate to the uncertainty about how certain tax positions taken or expected to be taken on a tax return should be reflected in the financial statements before they are finally resolved with the taxing authorities. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. Although the Company is still analyzing the impact of FIN No. 48, it does not believe the adoption will have a material impact on its consolidated results of operations and financial position.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurement." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures regarding fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently evaluating the impact that SFAS No. 157 may have on its consolidated results of operations and financial position.

**2 ACQUISITION**

On June 2, 2006, CVS acquired certain assets and assumed certain liabilities from Albertson's, Inc. ("Albertsons") for \$4.0 billion. The Company believes that this acquisition is consistent with its long-term strategy of expanding its retail drugstore business in high-growth markets. The assets acquired and the liabilities assumed included approximately 700 standalone drugstores and a distribution center (collectively the "Standalone Drug Business"). CVS financed the acquisition of the Standalone Drug Business by issuing commercial paper and borrowing \$1.0 billion from a bridge loan facility. During the third quarter of 2006, CVS repaid a portion of the commercial paper used to finance the acquisition with the proceeds received from the issuance of \$800 million of 5.75% unsecured senior notes due August 15, 2011 and \$700 million of 6.125% unsecured senior notes due August 15, 2016. During the fourth quarter of 2006, CVS sold a substantial portion of the acquired real estate through a sale-leaseback transaction, the proceeds of which were used in retiring the bridge loan facility. The results of the operations of the Standalone Drug Business from June 2, 2006 through December 30, 2006, have been included in CVS' consolidated statements of operations for the period ended December 30, 2006.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Following is a summary of the estimated assets acquired and liabilities assumed, which includes estimated transaction costs, as of June 2, 2006. This estimate is preliminary and based on information that was available to management at the time the financial statements were prepared. Accordingly, the allocation will change and the impact of such changes could be material.

### Estimated Assets Acquired and Liabilities Assumed as of June 2, 2006

<i>In millions</i>	
Cash and cash equivalents	\$ 0.9
Inventories	765.0
Other current assets	14.1
<b>Total current assets</b>	<b>780.0</b>
Property and equipment	1,570.9
Goodwill	1,307.1
Intangible assets	595.0
Other assets	20.0
<b>Total assets acquired</b>	<b>4,273.0</b>
Accrued expenses <sup>(1) (2)</sup>	90.8
Short-term portion of capital leases	2.2
<b>Total current liabilities</b>	<b>93.0</b>
Other long-term liabilities <sup>(2)</sup>	176.9
<b>Total liabilities</b>	<b>269.9</b>
<b>Net assets acquired</b>	<b>\$ 4,003.1</b>

<sup>(1)</sup> Accrued expenses include \$6.2 million for the estimated severance, benefits and outplacement costs for approximately 970 employees of the Standalone Drug Business that have been or will be terminated. As of December 30, 2006, \$1.1 million of the liability has been settled with cash payments. The \$5.1 million remaining liability will require future cash payments through 2008.

<sup>(2)</sup> Accrued expenses include \$6.6 million, and Other long-term liabilities include \$57.0 million for the estimated costs associated with the non-cancelable lease obligations of 76 acquired stores the Company intends to close. As of December 30, 2006, 74 of these locations have been closed and \$4.9 million of this liability has been settled with cash payments. The \$59.6 million remaining liability, which includes \$0.9 million of interest accretion, will require future cash payments through 2033.

The following unaudited pro forma combined results of operations have been provided for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved by the combined companies for the periods presented or that will be achieved by the combined companies in the future:

<i>In millions, except per share amounts</i>	2006	2005
Pro forma: <sup>(1) (2)</sup>		
Net revenues	\$ 46,187.7	\$ 42,469.2
Net earnings	1,366.0	1,156.8
Basic earnings per share	\$ 1.65	\$ 1.41
Diluted earnings per share	1.60	1.37

<sup>(1)</sup> The unaudited pro forma combined results of operations assume that the acquisition of the Standalone Drug Business occurred at the beginning of each period presented. Such results have been prepared by adjusting the historical results of the Company to include the historical results of the Standalone Drug Business, the incremental interest expense and the impact of the preliminary purchase price allocation discussed above.

<sup>(2)</sup> The unaudited pro forma combined results of operations do not include any cost savings that may result from the combination of the Company and the Standalone Drug Business or any costs that will be incurred by the Company to integrate the Standalone Drug Business.

On July 31, 2004, the Company acquired certain assets and assumed certain liabilities from J.C. Penney Company, Inc. and certain of its subsidiaries, including Eckerd Corporation ("Eckerd"). The acquisition included more than 1,200 Eckerd retail drugstores and Eckerd Health Services, which includes Eckerd's mail order and pharmacy benefit management businesses (collectively, the "2004 Acquired Businesses"). The final purchase price, including transaction costs, was \$2.1 billion.

In conjunction with the acquisition, during fiscal 2004, the Company recorded a liability totaling \$54.7 million for the estimated costs associated with terminating various Eckerd contracts that were in place at the time of acquisition. As of December 30, 2006, \$45.5 million of this liability has been settled with cash payments. The \$7.8 million remaining liability will require future cash payments through 2009. The Company also recorded a \$10.5 million liability for the estimated severance, benefits and outplacement costs for 1,090 Eckerd employees that have or will be terminated. As of December 30, 2006, \$8.1 million of this liability has been settled with cash payments, representing full settlement of the obligation. In addition, the Company recorded a \$349.8 million liability for the estimated costs associated with the non-cancelable lease obligations of 296 Eckerd locations that the Company did not intend to operate. As of December 30, 2006, 294 of these locations have been closed and \$144.9 million of this liability has been settled with cash payments. The \$215.2 million remaining liability, which includes \$17.8 million of interest accretion, will require future cash payments through 2030. The Company believes that the remaining liabilities discussed above are adequate to cover the remaining costs associated with the related activities.

### 3

### GOODWILL AND OTHER INTANGIBLES

Goodwill represents the excess of the purchase price over the fair value of net assets acquired. The Company accounts for goodwill and intangibles under SFAS No. 142, "Goodwill and Other Intangible Assets." As such, goodwill and other indefinite-lived assets are not amortized, but are subject to annual impairment reviews, or more frequent reviews if events or circumstances indicate there may be an impairment. When evaluating goodwill for potential impairment, the Company first compares the fair value of the reporting unit, based on estimated future discounted cash flows, with its carrying amount. If the estimated fair value of the reporting unit is less than its carrying amount, an impairment loss calculation is prepared.

The impairment loss calculation compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. During the third quarter of 2006, the Company performed its required annual goodwill impairment test, which concluded there was no impairment of goodwill.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The carrying amount of goodwill was \$3,195.2 million and \$1,789.9 million as of December 30, 2006 and December 31, 2005, respectively. During 2006, gross goodwill increased primarily due to the acquisition of the Standalone Drug Business. There was no impairment of goodwill during 2006.

Intangible assets other than goodwill are required to be separated into two categories: finite-lived and indefinite-lived. Intangible assets with finite useful lives are amortized over their estimated useful lives, while intangible assets with indefinite useful lives are not amortized. The Company currently has no intangible assets with indefinite lives.

The increase in the gross carrying amount of the Company's amortizable intangible assets during 2006 was primarily due to the acquisition of the Standalone Drug Business. The amortization expense for intangible assets totaled \$161.2 million in 2006, \$128.6 million in 2005 and \$95.9 million in 2004. The anticipated annual amortization expense for these intangible assets is \$186.2 million in 2007, \$176.7 million in 2008, \$167.0 million in 2009, \$157.0 million in 2010 and \$148.6 million in 2011.

Following is a summary of the Company's amortizable intangible assets as of the respective balance sheet dates:

<i>In millions</i>	Dec. 30, 2006		Dec. 31, 2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Customer lists and Covenants not to compete	\$ 1,457.6	\$ (563.4)	\$ 1,152.4	\$ (435.9)
Favorable leases and Other	552.2	(128.2)	185.5	(99.8)
	\$ 2,009.8	\$ (691.6)	\$ 1,337.9	\$ (535.7)

## 4 BORROWING AND CREDIT AGREEMENTS

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

<i>In millions</i>	Dec. 30, 2006	Dec. 31, 2005
Commercial paper	\$ 1,842.7	\$ 253.4
5.625% senior notes due 2006	–	300.0
3.875% senior notes due 2007	300.0	300.0
4.0% senior notes due 2009	650.0	650.0
5.75% senior notes due 2011	800.0	–
4.875% senior notes due 2014	550.0	550.0
6.125% senior notes due 2016	700.0	–
8.52% ESOP notes due 2008 <sup>(1)</sup>	82.1	114.0
Mortgage notes payable	11.7	21.0
Capital lease obligations	120.9	0.7
	5,057.4	2,189.1
Less:		
Short-term debt	(1,842.7)	(253.4)
Current portion of long-term debt	(344.3)	(341.6)
	\$ 2,870.4	\$ 1,594.1

<sup>(1)</sup> See Note 6 for further information about the Company's ESOP Plan.

In connection with our commercial paper program, we maintain a \$675 million, five-year unsecured back-up credit facility, which expires on June 11, 2009 and a \$675 million five-year unsecured back-up credit facility, which expires on June 2, 2010. In preparation for the consummation of the acquisition of the Standalone Drug Business, we entered into a \$1.4 billion, five-year unsecured back-up credit facility,

which expires on May 12, 2011. The credit facilities allow for borrowings at various rates depending on the Company's public debt ratings and require the Company to pay a quarterly facility fee of 0.1%, regardless of usage. As of December 30, 2006, the Company had no outstanding borrowings against the credit facilities. The weighted average interest rate for short-term debt was 5.3% and 3.3% as of December 30, 2006 and December 31, 2005, respectively.

On August 15, 2006, the Company issued \$800 million of 5.75% unsecured senior notes due August 15, 2011 and \$700 million of 6.125% unsecured senior notes due August 15, 2016 (collectively the "Notes"). The Notes pay interest semi-annually and may be redeemed at any time, in whole or in part at a defined redemption price plus accrued interest. Net proceeds from the Notes were used to repay a portion of the outstanding commercial paper issued to finance the acquisition of the Standalone Drug Business.

To manage a portion of the risk associated with potential changes in market interest rates, during the second quarter of 2006 the Company entered into forward starting pay fixed rate swaps (the "Swaps"), with a notional amount of \$750 million. The Swaps settled in conjunction with the placement of the long-term financing, at a loss of \$5.3 million. The Company accounts for the above derivatives in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as modified by SFAS No. 138, "Accounting for Derivative Instruments and Certain Hedging Activities," which requires the resulting loss to be recorded in shareholders' equity as a component of accumulated other comprehensive loss. This unrealized loss will be amortized as a component of interest expense over the life of the related long-term financing. As of December 30, 2006, the Company had no freestanding derivatives in place.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

The aggregate maturities of long-term debt for each of the five years subsequent to December 30, 2006 are \$344.3 million in 2007, \$48.1 million in 2008, \$654.0 million in 2009, \$4.5 million in 2010 and \$805.0 million in 2011.

### 5 LEASES

The Company leases most of its retail locations and eight of its distribution centers under non-cancelable operating leases, whose initial terms typically range from 15 to 25 years, along with options that permit renewals for additional periods. The Company also leases certain equipment and other assets under non-cancelable operating leases, whose initial terms typically range from 3 to 10 years.

During 2004, the Company conformed its accounting for operating leases and leasehold improvements to the views expressed by the Office of the Chief Accountant of the Securities and Exchange Commission to the American Institute of Certified Public Accountants on February 7, 2005. As a result, the Company recorded a \$65.9 million non-cash pre-tax (\$40.5 million after-tax) adjustment to total operating expenses, which represents the cumulative effect of the adjustment for a period of approximately 20 years (the "Lease Adjustment"). Since the effect of the Lease Adjustment was not material to 2004 or any previously reported fiscal year, the cumulative effect was recorded in the fourth quarter of 2004.

Minimum rent is expensed on a straight-line basis over the term of the lease. In addition to minimum rental payments, certain leases require additional payments based on sales volume, as well as reimbursement for real estate taxes, common area maintenance and insurance, which are expensed when incurred.

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

<i>In millions</i>	2006	2005	2004
Minimum rentals	\$ 1,361.2	\$ 1,213.2	\$ 1,020.6
Contingent rentals	61.5	63.3	61.7
	1,422.7	1,276.5	1,082.3
Less: sublease income	(26.4)	(18.8)	(14.0)
	\$ 1,396.3	\$ 1,257.7	\$ 1,068.3

Following is a summary of the future minimum lease payments under capital and operating leases as of December 30, 2006:

<i>In millions</i>	Capital Leases	Operating Leases
2007	\$ 14.2	\$ 1,445.7
2008	14.2	1,394.4
2009	14.2	1,346.1
2010	14.3	1,453.3
2011	14.3	1,220.7
Thereafter	194.3	13,014.8
	\$ 265.5	\$ 19,875.0
Less: imputed interest	(144.6)	
Present value of capital lease obligations	\$ 120.9	\$ 19,875.0

The Company finances a portion of its store development program through sale-leaseback transactions. The properties are sold and the resulting leases qualify and are accounted for as operating leases. The Company does not have any retained or contingent interests in the stores, nor does the Company provide any guarantees, other than a guarantee of lease payments, in connection with the sale-leasebacks. Proceeds from sale-leaseback transactions totaled \$1,375.6 million in 2006, \$539.9 million in 2005 and \$496.6 million in 2004. The operating leases that resulted from these transactions are included in the above table.

### 6 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 issued and sold \$357.5 million of 20-year, 8.52% notes due December 31, 2008 (the "ESOP Notes"). The proceeds from the ESOP Notes 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 Notes are 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 4.628 shares of common stock and is entitled to receive an annual dividend of \$3.90 per share.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The ESOP Trust uses the dividends received and contributions from the Company to repay the ESOP Notes. As the ESOP Notes are 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 December 30, 2006, 4.0 million shares of ESOP Preference Stock were outstanding, of which 3.2 million shares were allocated to participants and the remaining 0.8 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 Notes 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 for the respective years:

<i>In millions</i>	2006	2005	2004
ESOP expense recognized	\$ 26.0	\$ 22.7	\$ 19.5
Dividends paid	15.6	16.2	16.6
Cash contributions	26.0	22.7	19.5
Interest payments	9.7	12.0	13.9
ESOP shares allocated	0.4	0.3	0.3

### 7 STOCK INCENTIVE PLANS

On January 1, 2006, the Company adopted SFAS No. 123(R), "Share-Based Payment," using the modified prospective transition method. Under this method, compensation expense is recognized for options granted on or after January 1, 2006 as well as any unvested options on the date of adoption. Compensation expense for unvested stock options outstanding at January 1, 2006 is recognized over the requisite service period based on the grant-date fair value of those options and awards as previously calculated under the SFAS No. 123(R) pro forma disclosure requirements. As allowed under the modified prospective transition method, prior period financial statements have not been restated. Prior to January 1, 2006, the Company accounted for its stock-based compensation plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. As such, no stock-based employee compensation costs were reflected in net earnings for options granted under those plans since they had an exercise price equal to the fair market value of the underlying common stock on the date of grant.

Compensation expense related to stock options, which includes the 1999 Employee Stock Purchase Plan ("ESPP") totaled \$60.7 million for 2006. The recognized tax benefit was \$18.0 million for 2006. Compensation expense related to restricted stock awards totaled \$9.2 million for 2006, compared to \$5.9 million for 2005. Compensation costs associated with the Company's share-based payments are included in selling, general and administrative expenses.

The following table includes the effect on net earnings and earnings per share if stock compensation costs had been determined consistent with the fair value recognition provisions of SFAS No. 123(R) for the respective periods:

<i>In millions, except per share amounts</i>	2005	2004
Net earnings, as reported	\$ 1,224.7	\$ 918.8
Add: Stock-based employee compensation expense included in reported net earnings, net of related tax effects <sup>(1)</sup>	4.8	1.5
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	48.6	40.2
Pro forma net earnings	\$ 1,180.9	\$ 880.1
Basic EPS:		
As reported	\$ 1.49	\$ 1.13
Pro forma	1.44	1.09
Diluted EPS:		
As reported	\$ 1.45	\$ 1.10
Pro forma	1.40	1.06

<sup>(1)</sup> Amounts represent the after-tax compensation costs for restricted stock grants and expense related to the acceleration of vesting of stock options on certain terminated employees.

The ESPP provides for the purchase of up to 14.8 million shares of common stock. Under the ESPP, eligible employees may 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. During 2006, 2.1 million shares of common stock were purchased at an average price of \$22.54 per share. As of December 30, 2006, 12.1 million shares of common stock have been issued under the ESPP since its inception.

The fair value of stock compensation expense associated with the Company's ESPP is estimated on the date of grant (i.e., the beginning of the offering period) using the Black-Scholes Option Pricing Model and is recorded as a liability, which is adjusted to reflect the fair value of the award at each reporting period until settlement date.

Following is a summary of the assumptions utilized in valuing the ESPP awards for each of the respective periods:

	2006	2005	2004
Dividend yield <sup>(1)</sup>	0.26%	0.26%	0.30%
Expected volatility <sup>(2)</sup>	26.00%	16.40%	17.40%
Risk-free interest rate <sup>(3)</sup>	5.08%	3.35%	2.50%
Expected life (in years) <sup>(4)</sup>	0.5	0.5	0.5

<sup>(1)</sup> Dividend yield is calculated based on semi-annual dividends paid and the fair market value of the Company's stock at the period end date.

<sup>(2)</sup> Expected volatility is based on the historical volatility of the Company's daily stock market prices over the previous six month period.

<sup>(3)</sup> Based on the Treasury constant maturity interest rate whose term is consistent with the expected term of ESPP options (six months).

<sup>(4)</sup> Based on semi-annual purchase period.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company's 1997 Incentive Compensation Plan (the "ICP") provides for the granting of up to 85.8 million shares of common stock in the form of stock options and other awards to selected officers, employees and directors of the Company. The ICP allows for up to 7.2 million restricted shares to be issued. The Company's restricted awards are considered nonvested share awards as defined under SFAS 123(R). The restricted awards require no payment from the employee and compensation cost is recorded based on the market price on the grant date, for which compensation expense is recognized on a straight-line basis over the requisite service period. The Company granted 5,000, 427,000 and 824,000 shares of restricted stock with a weighted average per share grant date fair value of \$28.71, \$24.80 and \$18.41, in 2006, 2005 and 2004, respectively. In addition, the Company granted 673,000 restricted stock units with a weighted average fair value of \$29.40 in 2006. The fair value of the restricted shares and units are expensed over the period during which the restrictions lapse. Compensation costs for restricted shares and units totaled \$9.2 million in 2006, \$5.9 million in 2005 and \$2.4 million in 2004.

In 2004, an amendment to the Company's ICP was approved by shareholders, allowing non-employee directors to receive awards under the ICP. Upon approval of this amendment to the ICP, all authority to make future grants under the Company's 1996 Directors Stock Plan was terminated, although previously granted awards remain outstanding in accordance with their terms and the terms of the 1996 Directors Stock Plan.

Following is a summary of the restricted share award activity under the ICP as of December 30, 2006:

<i>Shares in thousands</i>	Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2005	501	\$ 20.80
Granted	5	28.71
Vested	(197)	18.94
Forfeited	(3)	24.71
Nonvested at December 30, 2006	306	\$ 22.08

Following is a summary of the restricted unit award activity under the ICP as of December 30, 2006:

<i>Units in thousands</i>	Units	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2005	1,377	\$ 23.10
Granted	673	29.40
Vested	(16)	33.80
Forfeited	(25)	25.22
Nonvested at December 30, 2006	2,009	\$ 25.22

All grants under the ICP are awarded at fair market value on the date of grant. The fair value of stock options is estimated using the Black-Scholes Option Pricing Model and compensation expense is recognized on a straight-line basis over the requisite service period. Options granted prior to 2004 generally become exercisable over a four-year period from the grant date and expire ten years after the date of grant. Options granted during and subsequent to fiscal 2004 generally become exercisable over a three-year period from the grant date and expire seven years after the date of grant. As of December 30, 2006, there were 18.0 million shares available for future grants under the ICP.

SFAS No. 123(R) requires that the benefit of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under prior guidance. Excess tax benefits of \$42.6 million were included in financing activities in the accompanying consolidated statement of cash flow during 2006. Cash received from stock options exercised, which includes the ESPP, totaled \$187.6 million and the related tax benefits realized were \$42.6 million during 2006. Cash received from stock options exercised totaled \$178.4 million and the related tax benefits realized were \$46.6 million during 2005.

The total intrinsic value of options exercised during 2006 was \$117.8 million, compared to \$117.5 million and \$51.9 million in 2005 and 2004, respectively. The fair value of options exercised during 2006 was \$257.1 million, compared to \$263.3 million and \$156.8 million during 2005 and 2004, respectively.

The fair value of each stock option is estimated using the Black-Scholes Option Pricing Model based on the following assumptions at the time of grant:

	2006	2005	2004
Dividend yield <sup>(1)</sup>	0.50%	0.56%	0.65%
Expected volatility <sup>(2)</sup>	24.58%	34.00%	30.50%
Risk-free interest rate <sup>(3)</sup>	4.7%	4.3%	3.9%
Expected life <i>(in years)</i> <sup>(4)</sup>	4.2	5.7	6.6
Weighted average grant date fair value	\$ 8.46	\$ 8.46	\$ 6.47

<sup>(1)</sup> Dividend yield is based on annual dividends paid and the fair market value of the Company's stock at the period end date.

<sup>(2)</sup> Expected volatility is estimated utilizing the Company's historical volatility over a period equal to the expected life of each option grant after adjustments for infrequent events such as stock splits.

<sup>(3)</sup> The risk-free interest rate was selected based on yields from U.S. Treasury zero-coupon issues with a remaining term equal to the expected term of the options being valued.

<sup>(4)</sup> Expected life represents the number of years that the options are expected to be outstanding from grant date based on historical data of option holder exercise and termination behavior.

As of December 30, 2006, unrecognized compensation expense related to unvested options totaled \$66.3 million, which the Company expects to be recognized over a weighted average period of 1.4 years.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Following is a summary of the Company's stock option activity as of December 30, 2006:

<i>Shares in thousands</i>	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2005	43,617	\$ 18.82	–	\$ –
Granted	7,449	31.00	–	–
Exercised	(8,342)	16.69	–	–
Forfeited	(623)	21.55	–	–
Expired	(484)	21.68	–	–
Outstanding at December 30, 2006	41,617	21.35	4.72	410,957,209
Exercisable at December 30, 2006	26,773	\$ 19.57	4.16	\$ 308,035,407

Following is a summary of the stock options outstanding and exercisable as of December 30, 2006:

<i>Shares in thousands</i>	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
Range of Exercise Prices					
\$ 11.50 to \$ 14.96	12,644	5.49	\$ 13.70	10,239	\$ 13.96
14.97 to 18.66	8,378	3.02	17.50	6,707	17.47
18.67 to 25.00	7,598	4.17	22.21	4,073	22.04
25.01 to 30.26	11,047	5.17	30.14	5,753	30.25
30.27 to 33.95	49	7.51	32.34	–	–
33.96 to 34.41	1,901	6.59	34.41	1	34.41
Total	41,617	4.72	\$ 21.35	26,773	\$ 19.57

## 8

### PENSION PLANS AND OTHER POSTRETIREMENT BENEFITS

During 2006, the Company adopted SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)." SFAS No. 158 requires an employer to recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status, measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year, and recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income and in a separate component of stockholder's equity.

#### Defined Contribution Plans

The Company sponsors 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. At the participant's option, account balances, including the Company's matching contribution, can be moved without restriction among various investment options, including the Company's common stock. The Company also maintains a nonqualified, 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 \$63.7 million in 2006, \$64.9 million in 2005 and \$52.1 million in 2004. The Company also sponsors an Employee Stock Ownership Plan. See Note 6 for further information about this plan.

#### Other Postretirement Benefits

The Company provides postretirement healthcare and life insurance benefits to certain retirees who meet eligibility requirements. The Company's funding policy is generally to pay covered expenses as they are incurred. For retiree medical plan accounting, the Company reviews external data and its own historical trends for healthcare costs to determine the healthcare cost trend rates.

For measurement purposes, future healthcare costs are assumed to increase at an annual rate of 10.0%, decreasing to an annual growth rate of 5.0% in 2012 and thereafter. A one percent change in the assumed healthcare cost trend rate would change the accumulated postretirement benefit obligation by \$0.6 million and the total service and interest costs by \$0.03 million.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

During 2004, the Company adopted FAS 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." This statement requires disclosure of the effects of the Medicare Prescription Drug, Improvement and Modernization Act and an assessment of the impact of the federal subsidy on the accumulated postretirement benefit obligation and net periodic postretirement benefit cost. The adoption of this statement did not have a material impact on the Company's consolidated results of operations, financial position or related disclosures.

### PENSION PLANS

The Company sponsors a non-contributory defined benefit pension plan that covers certain full-time employees of Revco, D.S., Inc. who were not covered by collective bargaining agreements. On September 20, 1997, the Company suspended future benefit accruals under this plan. Benefits paid to retirees are based upon age at retirement, years of credited service and average compensation during the five-year period ended 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 \$37.6 million in 2006, \$15.4 million in

2005 and \$15.0 million in 2004. 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.

The Company uses an investment strategy, which emphasizes equities in order to produce higher expected returns, and in the long run, lower expected expense and cash contribution requirements. The pension plan assets allocation targets 70% equity and 30% fixed income.

Following is the pension plan asset allocation by major category for the respective years:

	2006	2005
Equity	72%	70%
Fixed Income	27%	29%
Other	1%	1%
	100%	100%

The equity investments primarily consist of large cap value and international value equity funds. The fixed income investments primarily consist of intermediate-term bond funds. The other category consists of cash and cash equivalents held for benefit payments.

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

In millions	Defined Benefit Plans			Other Postretirement Benefits		
	2006	2005	2004	2006	2005	2004
Service cost	\$ 1.7	\$ 0.7	\$ 0.9	\$ -	\$ -	\$ -
Interest cost on benefit obligation	24.0	21.4	20.5	0.6	0.6	0.7
Expected return on plan assets	(20.4)	(19.4)	(18.6)	-	-	-
Amortization of net loss (gain)	11.8	6.6	3.3	(0.1)	(0.2)	-
Amortization of prior service cost	0.1	0.1	0.1	(0.2)	(0.1)	(0.1)
Net periodic pension cost	\$ 17.2	\$ 9.4	\$ 6.2	\$ 0.3	\$ 0.3	\$ 0.6
<b>Actuarial assumptions used to determine net period pension cost:</b>						
Discount rate	5.75%	6.00%	6.25%	5.75%	6.00%	6.25%
Expected return on plan assets	8.50%	8.50%	8.50%	-	-	-
<b>Actuarial assumptions used to determine benefit obligations:</b>						
Discount rate	6.00%	5.75%	6.00%	5.75%	5.75%	6.00%
Expected return on plan assets	8.50%	8.50%	8.50%	-	-	-
Rate of compensation increase	4.00%	4.00%	4.00%	-	-	-

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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:

<i>In millions</i>	Defined Benefit Plans		Other Postretirement Benefits	
	Dec. 30, 2006	Dec. 31, 2005	Dec. 30, 2006	Dec. 31, 2005
<b>Change in benefit obligation:</b>				
Benefit obligation at beginning of year	\$ 421.2	\$ 352.9	\$ 10.7	\$ 12.1
Service cost	1.7	0.7	-	-
Interest cost	24.0	21.4	0.6	0.6
Actuarial (gain)/loss	(8.5)	65.1	0.3	(0.7)
Benefits paid	(19.4)	(18.9)	(1.4)	(1.3)
Benefit obligation at end of year	\$ 419.0	\$ 421.2	\$ 10.2	\$ 10.7
<b>Change in plan assets:</b>				
Fair value at beginning of year	\$ 275.6	\$ 255.2	\$ -	\$ -
Actual return on plan assets	37.6	19.2	-	-
Company contributions	19.8	20.1	1.5	1.3
Benefits paid	(19.4)	(18.9)	(1.5)	(1.3)
Fair value at end of year	\$ 313.6	\$ 275.6	\$ -	\$ -
<b>Funded status:</b>				
Funded status	\$ (105.4)	\$ (145.6)	\$ (10.2)	\$ (10.7)
Unrecognized prior service cost	N/A	0.3	N/A	(0.3)
Unrecognized loss (gain)	N/A	122.6	N/A	(0.2)
Net liability recognized	\$ (105.4)	\$ (22.7)	\$ (10.2)	\$ (11.2)
<b>Amounts recognized in the consolidated balance sheet:</b>				
Accrued benefit liability	\$ (105.4)	\$ (139.7)	\$ (10.2)	\$ (11.2)
Minimum pension liability	-	117.0	-	-
Net liability recognized	\$ (105.4)	\$ (22.7)	\$ (10.2)	\$ (11.2)

The changes in the balance sheet at December 30, 2006 arising from the adoption of SFAS No. 158 are set out below:

<i>In millions</i>	Before Implementation of SFAS No. 158	Changes Due to SFAS No. 158	After Implementation of SFAS No. 158
<b>Assets:</b>			
Non-current deferred income taxes	\$ 87.6	\$ 3.2	\$ 90.8
Total Asset recognized	\$ 20,566.6	\$ 3.2	\$ 20,569.8
<b>Liabilities and Stockholders' Equity:</b>			
Accrued expenses	\$ 1,949.9	\$ 0.3	\$ 1,950.2
Other long-term liabilities	772.6	8.5	781.1
Accumulated other comprehensive loss	(67.0)	(5.6)	(72.6)
Total liabilities and shareholders' equity	\$ 20,566.6	\$ 3.2	\$ 20,569.8

The discount rate is determined by examining the current yields observed on the measurement date of fixed-interest, high quality investments expected to be available during the period to maturity of the related benefits. The expected long-term rate of return is determined by using the target allocation and historical returns for each asset class.

The Company utilized a measurement date of December 31 to determine pension and other postretirement benefit measurements. The Company included \$3.5 million of accrued benefit liability in accrued expenses, while the remaining benefit liability was recorded in other long-term liabilities, as of December 30, 2006 and December 31, 2005. The accumulated benefit obligation for the defined benefit pension plans was \$410.4 million and \$415.3 million as of December 30, 2006 and December 31, 2005, respectively. The Company does not expect to make a contribution to the pension plan during the upcoming year. Estimated future benefit payments for the defined benefit plans and other postretirement benefit plans, respectively, are \$19.4 million and \$1.3 million in 2007, \$20.4 million and \$1.3 million in 2008, \$21.2 million and \$1.2 million in 2009, \$22.2 million and \$1.2 million in 2010, \$23.0 million and \$1.1 million in 2011 and \$151.3 million and \$4.7 million in aggregate for the following five years.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company recorded a pension liability of \$105.4 million as of December 30, 2006 as required by the provisions of SFAS No. 158. The Company recorded a minimum pension liability of \$117.0 million as of December 31, 2005, as required by SFAS No. 87. During 2005, the Company engaged its actuaries to perform a study to review the mortality experience of its defined benefit plans. As a result of the study, the Company changed the mortality table used to the 1994 Group Annuity Basic Table, projected to 2002 with Scale AA (the "2002 GATT Table"), which increased the minimum pension liability during 2005. A minimum pension liability is required when the accumulated benefit obligation exceeds the combined fair value of the underlying plan assets and accrued pension costs. The minimum pension liability adjustment is reflected in other long-term liabilities, long-term deferred income taxes and accumulated other comprehensive loss, which is included in shareholders' equity, in the accompanying consolidated balance sheet.

### 9

#### COMMITMENTS & CONTINGENCIES

Between 1991 and 1997, the Company sold or spun off a number of subsidiaries, including Bob's Stores, Linens 'n Things, Marshalls, Kay-Bee Toys, Wilsons, This End Up and Footstar. In many cases, when a former subsidiary leased a store, the Company provided a guarantee of the store's lease obligations. When the subsidiaries were disposed of, the Company's guarantees remained in place, although each initial purchaser has indemnified the Company for any lease obligations the Company was required to satisfy. If any of the purchasers or any of the former subsidiaries were to become insolvent and failed to make the required payments under a store lease, the Company could be required to satisfy these obligations. As of December 30, 2006, the Company guaranteed approximately 240 such store leases, with the maximum remaining lease term extending through 2022. Assuming that each respective purchaser became insolvent, and the Company was required to assume all of these lease obligations, management estimates that the Company could settle the obligations for approximately \$350 to \$400 million as of December 30, 2006.

Management believes the ultimate disposition of any of the guarantees will not have a material adverse effect on the Company's consolidated financial condition, results of operations or future cash flows.

The Rhode Island Attorney General's Office, the Rhode Island Ethics Commission, and the United States Attorney's Office for the District of Rhode Island have been investigating the business relationships between certain former members of the Rhode Island General Assembly and various Rhode Island companies, including Roger Williams Medical Center, Blue Cross & Blue Shield of Rhode Island and CVS.

In connection with the investigation of these business relationships, a former state senator was criminally charged by federal and state authorities, and pled guilty to federal and state charges. In January 2007, two CVS employees on administrative leave from the Company were indicted on federal charges relating to their involvement in entering into

a \$12,000 per year consulting agreement with the former state senator seven years ago. The indictment alleges that the two CVS employees concealed the true nature of the Company's relationship with the former state senator from other Company officials and others. CVS will continue to cooperate fully in this investigation, the timing and outcome of which cannot be predicted with certainty at this time.

The United States Department of Justice and several state attorneys general are investigating whether any civil or criminal violations resulted from certain practices engaged in by CVS and others in the pharmacy industry with regard to dispensing one of two different dosage forms of a generic drug under circumstances in which some state Medicaid programs at various times reimbursed one dosage form at a different rate from the other. The Company is in discussions with various governmental agencies involved to resolve this matter on a civil basis and without any admission or finding of any violation.

The enforcement staff of the United States Securities and Exchange Commission (the "SEC") has commenced an inquiry into matters related to the accounting for a transaction that occurred in 2000 (the "2000 Transaction"). Pursuant to the 2000 Transaction, the Company (i) made accounting entries reflecting the conveyance of certain excess plush toy collectible inventory to a third party; (ii) received a total of \$42.5 million in barter credits; and (iii) made a cash payment of \$12.5 million to the same third party.

In December 2005, the Audit Committee of the Company's Board of Directors engaged independent outside counsel to undertake an internal review of this matter (the "Internal Review"). In March 2006, based on the findings from the Internal Review, the Audit Committee reached certain conclusions regarding the 2000 Transaction. The Audit Committee concluded that various aspects of the Company's accounting for the 2000 Transaction were incorrect, although the Internal Review did not result in any adjustments to the financial statements included in this Annual Report. On March 10, 2006, the Audit Committee reported its findings to the Company's Board of Directors, which adopted those findings. Subsequent to the Audit Committee reaching these conclusions, the Company's Controller (who was also the Principal Accounting Officer) and the Company's Treasurer resigned their positions.

Over time, CVS has produced a large number of documents and other information requested by the SEC staff and has made a number of witnesses available for formal testimony. There are currently no outstanding requests for further documents or testimony from CVS.

The Company cannot predict the outcome or timing of the SEC inquiry, or of any related proceedings, although we do not believe that any of the above matters will have any material effect on the Company's results of operations or financial condition.

On November 1, 2006, CVS and Caremark Rx, Inc. announced that they have entered into a definitive merger agreement. Several actions relating to the proposed merger are now pending, some of which name CVS as a defendant.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In December 2006, Laurence M. Silverstein filed a purported class action lawsuit purportedly on behalf of Caremark stockholders relating to the proposed merger between Caremark and CVS in the United States District Court for the Middle District of Tennessee. The suit is brought against Caremark, its directors, CVS and CVS' chief executive officer. The complaint alleges, among other things, that the Caremark directors breached their fiduciary duties by entering into the proposed merger with CVS and that the CVS defendants aided and abetted such breaches of duty. The plaintiff seeks, among other things, preliminary and permanent injunctive relief to prevent the proposed merger, to direct the defendants to obtain a transaction that is in the best interests of Caremark, and to impose a constructive trust upon any benefits improperly received by the defendants. In January 2007, the plaintiff filed an amended class action complaint and moved for expedited discovery and preliminary injunctive relief. The amended class action complaint adds allegations that the joint proxy statement/prospectus filed on December 19, 2006 omits certain material information. On January 8, 2007, the court stayed the lawsuit. On January 10, 2007, the plaintiff moved to vacate the stay order. On January 19, 2007, that motion was denied.

The Louisiana Municipal Police Employees' Retirement System also filed a purported class action lawsuit purportedly on behalf of Caremark stockholders in the Delaware Court of Chancery against Caremark's directors and CVS. The complaint alleges, among other things, that the directors breached their fiduciary duties by entering into the proposed merger with CVS. The complaint also alleges that the joint proxy statement/prospectus filed on December 19, 2006 omits certain material information. The plaintiff seeks, among other things, preliminary and permanent injunctive relief to prevent the proposed merger. The lawsuit was amended in January 2007 to add the R.W. Grand Lodge of Free & Accepted Masons of Pennsylvania as a plaintiff and to add Caremark as a defendant. On February 12, 2007, Caremark filed a Form 8-K containing supplemental disclosures concerning the proposed merger between Caremark and CVS. That same day, plaintiffs moved to delay the Caremark shareholder meeting, then scheduled for February 20, 2007. On February 13, 2007, the court enjoined any shareholder vote concerning a merger between Caremark and any other party until at least March 9, 2007 in order to afford time for shareholders to fully consider the Caremark supplemental disclosures. A hearing on the plaintiffs' request for preliminary injunctive relief was held on February 16, 2007. On February 23, 2007, the Court denied plaintiff's motion for a preliminary injunction enjoining the planned merger between CVS and Caremark, but delayed the Caremark shareholder vote on the CVS merger until twenty days after Caremark makes supplemental disclosures regarding Caremark shareholders' right to seek appraisal and the structure of fees to be paid by Caremark to its financial advisors. The supplemental disclosures were mailed to Caremark shareholders on February 24, 2007.

In January 2007, Express Scripts, and Skadden, Arps, Slate, Meagher & Flom LLP ("Skadden"), filed a lawsuit in the Delaware Court of Chancery against Caremark, its directors, CVS and AdvancePCS. The complaint alleges, among other things, that the directors breached their fiduciary duties by entering into the proposed transaction with CVS. The plaintiffs seek, among other things, declaratory relief and preliminary and permanent injunctive relief to prevent the proposed merger. The plaintiffs also seek declaratory relief holding that Skadden's representation of Express Scripts does not violate Skadden's professional, ethical or contractual obligations. This lawsuit is proceeding on a coordinated basis with the earlier filed lawsuit in the Delaware Court of Chancery as described in the preceding paragraph.

In January 2007, Pirelli Armstrong Tire Corporation Retiree Medical Benefits Trust filed a shareholder derivative action in United States District Court for the Middle District of Tennessee on behalf of Caremark against the Caremark board of directors and CVS. The complaint alleges that the defendants disseminated misleading proxy materials and seeks preliminary and permanent injunctive relief. In particular, plaintiff seeks to enjoin the Caremark shareholder vote on the proposed merger until such time as defendants' failure to disclose material information is remedied, and all material information regarding the proposed transaction is made available to Caremark's shareholders. On January 24, 2007, plaintiff filed motions for a preliminary injunction and for expedited discovery. On January 30, 2007 those motions were denied and the case was stayed pending outcome of the Delaware litigation.

CVS believes the allegations pertaining to CVS in the shareholder lawsuits described herein are void of merit and intends to defend them vigorously.

The Company is also a party to other litigation arising in the normal course of its business, none of which is expected to be material to the Company.

### 10 INCOME TAXES

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

<i>In millions</i>	2006	2005	2004
<b>Current:</b>			
Federal	\$ 676.6	\$ 632.8	\$ 397.7
State	127.3	31.7	62.6
	<b>803.9</b>	664.5	460.3
<b>Deferred:</b>			
Federal	47.6	17.9	22.5
State	5.4	1.9	(5.2)
	<b>53.0</b>	19.8	17.3
<b>Total</b>	<b>\$ 856.9</b>	\$ 684.3	\$ 477.6

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	2006	2005	2004
Statutory income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal tax benefit	3.9	3.9	3.8
Other	0.1	(0.3)	(0.3)
Federal and net state reserve release	(0.5)	(2.8)	(4.3)
Effective tax rate	38.5%	35.8%	34.2%

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

<i>In millions</i>	Dec. 30, 2006	Dec. 31, 2005
<b>Deferred tax assets:</b>		
Lease and rents	\$ 265.8	\$ 258.3
Inventory	74.3	124.0
Employee benefits	82.4	60.8
Accumulated other comprehensive items	41.8	53.5
Retirement benefits	4.0	11.0
Allowance for bad debt	36.6	22.1
Amortization method	–	16.9
Other	68.5	38.7
NOL	26.3	4.7
Total deferred tax assets	599.7	590.0
<b>Deferred tax liabilities:</b>		
Accelerated depreciation	(233.7)	(226.4)
Amortization method	(0.9)	–
Total deferred tax liabilities	(234.6)	(226.4)
Net deferred tax assets	\$ 365.1	\$ 363.6

During the fourth quarters of 2005 and 2004, an assessment of tax reserves resulted in the Company recording reductions of previously recorded tax reserves through the income tax provision of \$52.6 million and \$60.0 million, respectively.

The Company believes it is more likely than not that the deferred tax assets included in the above table will be realized during future periods.

## 11 BUSINESS SEGMENTS

The Company currently operates two business segments, Retail Pharmacy and Pharmacy Benefit Management ("PBM").

The operating segments are segments of the Company for which separate financial information is available and for which operating results are evaluated regularly by executive management in deciding how to allocate resources and in assessing performance.

As of December 30, 2006, the Retail Pharmacy segment included 6,150 retail drugstores, the Company's online retail website, CVS.com® and its retail healthcare clinics. The clinics utilize nationally recognized medical protocols to diagnose and treat minor health conditions and are staffed by board-certified nurse practitioners and physician assistants. The retail healthcare clinics operate under the MinuteClinic® name and include 146 clinics located in 18 states, of which 129 are located within CVS retail drugstores. The retail drugstores are located in 40 states and the District of Columbia and operate under the CVS® or CVS/pharmacy® name.

The PBM segment provides a full range of prescription benefit management services to managed care providers and other organizations. These services include mail order pharmacy services, specialty pharmacy services, plan design and administration, formulary management and claims processing, as well as providing reinsurance services in conjunction with prescription drug benefit policies.

The specialty pharmacy business, which includes retail pharmacy products, primarily focuses on supporting individuals that require complex and expensive drug therapies. The PBM segment operates under the PharmaCare Management Services and PharmaCare Pharmacy® names and includes 52 retail pharmacies, located in 22 states and the District of Columbia.

Following is a reconciliation of the significant components of the Company's net revenues for the respective years:

	2006	2005	2004
Pharmacy	69.6%	70.2%	70.0%
Front store	30.4	29.8	30.0
	100.0%	100.0%	100.0%

The Company evaluates segment performance based on operating profit before the effect of non-recurring charges and gains and certain intersegment activities and charges, including pharmacy revenues reported by the retail segment that are directly related to premium revenues that are reported by the PBM segment. The accounting policies of the segments are substantially the same as those described in Note 1.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

<i>In millions</i>	Retail Pharmacy Segment	PBM Segment	Intersegment Eliminations	Consolidated Totals
<b>2006</b>				
Net revenues	\$ 40,285.6	\$ 3,683.7	\$ (155.5)	\$ 43,813.8
Operating profit	2,123.5	318.1		2,441.6
Depreciation and amortization	691.9	41.4		733.3
Total assets	19,038.8	1,531.0		20,569.8
Goodwill	2,572.4	622.8		3,195.2
Additions to property and equipment	1,750.5	18.4		1,768.9
<b>2005</b>				
Net revenues	\$ 34,094.6	\$ 2,956.2	\$ (44.6)	\$ 37,006.2
Operating profit	1,797.1	222.4		2,019.5
Depreciation and amortization	548.5	40.6		589.1
Total assets	13,878.5	1,404.9		15,283.4
Goodwill	1,152.4	637.5		1,789.9
Additions to property and equipment	1,471.3	24.1		1,495.4
<b>2004</b>				
Net revenues	\$ 28,728.7	\$ 1,865.6		\$ 30,594.3
Operating profit	1,320.8	133.9		1,454.7
Depreciation and amortization	471.1	25.7		496.8
Total assets	13,118.5	1,428.3		14,546.8
Goodwill	1,257.4	641.1		1,898.5
Additions to property and equipment	1,341.5	6.2		1,347.7

## 12 RECONCILIATION OF EARNINGS PER COMMON SHARE

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

<i>In millions, except per share amounts</i>	2006	2005	2004
<b>Numerator for earnings per common share calculation:</b>			
Net earnings	\$ 1,368.9	\$ 1,224.7	\$ 918.8
Preference dividends, net of income tax benefit	(13.9)	(14.1)	(14.2)
Net earnings available to common shareholders, basic	\$ 1,355.0	\$ 1,210.6	\$ 904.6
Net earnings	\$ 1,368.9	\$ 1,224.7	\$ 918.8
Dilutive earnings adjustment	(4.2)	(4.4)	(5.2)
Net earnings available to common shareholders, diluted	\$ 1,364.7	\$ 1,220.3	\$ 913.6
<b>Denominator for earnings per common share calculation:</b>			
Weighted average common shares, basic	820.6	811.4	797.2
Preference stock	18.8	19.5	20.4
Stock options	11.5	9.9	13.2
Restricted stock units	2.3	0.8	—
Weighted average common shares, diluted	853.2	841.6	830.8
<b>Basic earnings per common share:</b>			
Net earnings	\$ 1.65	\$ 1.49	\$ 1.13
<b>Diluted earnings per common share:</b>			
Net earnings	\$ 1.60	\$ 1.45	\$ 1.10

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 13 PROPOSED CAREMARK MERGER

On November 1, 2006, the Company entered into a definitive agreement and plan of merger with Caremark Rx, Inc., ("Caremark"). The agreement is structured as a merger of equals under which Caremark shareholders will receive 1.670 shares of common stock, par value \$0.01 per share, of CVS for each share of common stock of Caremark, par value \$0.001 per share, issued and outstanding immediately prior to the effective time of the merger. The closing of the transaction, which is expected to occur during the first quarter of 2007, is subject to approval by the shareholders of both CVS and Caremark, as well as customary regulatory approvals, including review under the Hart-Scott-Rodino Act. On December 20, 2006, the initial waiting period under the Hart-Scott-Rodino Act expired without a request for additional information from the U.S. Federal Trade Commission. On January 16, 2007, Caremark and CVS announced that Caremark shareholders would receive a special one-time cash dividend of \$2 per share upon closing of the transaction. In addition, CVS and Caremark agreed that as promptly as practicable after the closing of the merger, an accelerated share repurchase transaction will be executed whereby 150 million of the outstanding shares of the combined entity will be retired. On January 19, 2007, the

Registration Statement on Form S-4 relating to the proposed merger was declared effective by the Securities and Exchange Commission (the "SEC").

On February 13, 2007, Caremark and CVS announced that the special one-time cash dividend payable to Caremark shareholders upon closing of the transaction would be increased to \$6 per share. A special meeting of Caremark's shareholders to approve the merger is to be held on March 16, 2007 and a special meeting of CVS' shareholders for the same purpose will be held on a date later in March. The proposed merger will be accounted for using the purchase method of accounting under U.S. GAAP. Under the purchase method of accounting, CVS will be considered the acquirer of Caremark for accounting purposes and the total purchase price will be allocated to the assets acquired and liabilities assumed from Caremark based on their fair values as of the date of the completion of the merger and any excess of purchase price over those fair values will be recorded as goodwill. Our reported financial condition and results of operations issued after completion of the merger will reflect Caremark's balances and results after completion of the merger, but will not be restated retroactively to reflect the historical financial position or results of operations of Caremark. Following the completion of the merger, our earnings will reflect purchase accounting adjustments, including increased amortization expense for acquired intangible assets.

### 14 QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

<i>Dollars in millions, except per share amounts</i>	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Fiscal Year
<b>2006</b>					
Net revenues	\$ 9,979.2	\$ 10,561.4	\$ 11,206.9	\$ 12,066.3	\$ 43,813.8
Gross profit	2,649.0	2,844.4	3,080.3	3,365.3	11,939.0
Operating profit	560.5	595.0	536.8	749.3	2,441.6
Net earnings <sup>(1)</sup>	329.6	337.9	284.2	417.2	1,368.9
Net earnings per common share, basic <sup>(1)</sup>	0.40	0.41	0.34	0.50	1.65
Net earnings per common share, diluted <sup>(1)</sup>	0.39	0.40	0.33	0.49	1.60
Dividends per common share	0.03875	0.03875	0.03875	0.03875	0.15500
Stock price: (New York Stock Exchange)					
High	30.98	31.89	36.14	32.26	36.14
Low	26.06	27.51	29.85	27.09	26.06
Registered shareholders at year-end					12,360
<b>2005</b>					
Net revenues	\$ 9,182.2	\$ 9,121.6	\$ 8,970.4	\$ 9,732.0	\$ 37,006.2
Gross profit	2,380.8	2,417.4	2,401.0	2,702.0	9,901.2
Operating profit	499.8	477.7	438.9	603.1	2,019.5
Net earnings <sup>(2)</sup>	289.7	275.9	252.7	406.4	1,224.7
Net earnings per common share, basic <sup>(2)</sup>	0.35	0.34	0.31	0.49	1.49
Net earnings per common share, diluted <sup>(2)</sup>	0.34	0.33	0.30	0.48	1.45
Dividends per common share	0.03625	0.03625	0.03625	0.03625	0.14500
Stock price: (New York Stock Exchange)					
High	26.89	29.68	31.60	29.30	31.60
Low	22.02	25.02	27.67	23.89	22.02

<sup>(1)</sup> Net earnings and net earnings per common share for the fourth quarter and fiscal year 2006 include the after-tax effect of \$24.7 million as a result of the adoption of SAB No. 108 as discussed in Note 1 above.

<sup>(2)</sup> Net earnings and net earnings per common share for the fourth quarter and fiscal year 2005 include the after-tax effect of the reversal of \$52.6 million of previously recorded tax reserves as discussed in Note 10 above.

## FIVE-YEAR FINANCIAL SUMMARY

<i>In millions, except per share amounts</i>	<b>2006</b> (52 weeks)	2005 (52 weeks)	2004 (52 weeks)	2003 (53 weeks)	2002 (52 weeks)
<b>Statement of operations data:</b>					
Net revenues	<b>\$ 43,813.8</b>	\$ 37,006.2	\$ 30,594.3	\$ 26,588.0	\$ 24,181.5
Gross profit	<b>11,939.0</b>	9,901.2	8,031.2	6,863.0	6,068.8
Selling, general and administrative expenses <sup>(1) (2)</sup>	<b>8,764.1</b>	7,292.6	6,079.7	5,097.7	4,552.3
Depreciation and amortization <sup>(2)</sup>	<b>733.3</b>	589.1	496.8	341.7	310.3
Total operating expenses	<b>9,497.4</b>	7,881.7	6,576.5	5,439.4	4,862.6
Operating profit <sup>(3)</sup>	<b>2,441.6</b>	2,019.5	1,454.7	1,423.6	1,206.2
Interest expense, net	<b>215.8</b>	110.5	58.3	48.1	50.4
Income tax provision <sup>(4)</sup>	<b>856.9</b>	684.3	477.6	528.2	439.2
Net earnings <sup>(5)</sup>	<b>\$ 1,368.9</b>	\$ 1,224.7	\$ 918.8	\$ 847.3	\$ 716.6
<b>Per common share data:</b>					
Net earnings: <sup>(5)</sup>					
Basic	<b>\$ 1.65</b>	\$ 1.49	\$ 1.13	\$ 1.06	\$ 0.89
Diluted	<b>1.60</b>	1.45	1.10	1.03	0.88
Cash dividends per common share	<b>0.1550</b>	0.1450	0.1325	0.1150	0.1150
<b>Balance sheet and other data:</b>					
Total assets	<b>\$ 20,569.8</b>	\$ 15,283.4	\$ 14,546.8	\$ 10,543.1	\$ 9,645.3
Long-term debt (less current portion)	<b>2,870.4</b>	1,594.1	1,925.9	753.1	1,076.3
Total shareholders' equity	<b>9,917.6</b>	8,331.2	6,987.2	6,021.8	5,197.0
Number of stores (at end of period)	<b>6,202</b>	5,471	5,375	4,179	4,087

<sup>(1)</sup> In 2006, the Company adopted the Securities and Exchange Commission (SEC) Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." The adoption of this statement resulted in a \$40.2 million pre-tax (\$24.7 million after-tax) decrease in selling, general and administrative expenses for 2006.

<sup>(2)</sup> In 2004, the Company conformed its accounting for operating leases and leasehold improvements to the views expressed by the Office of the Chief Accountant of the Securities and Exchange Commission to the American Institute of Certified Public Accountants on February 7, 2005. As a result, the Company recorded a non-cash pre-tax adjustment of \$9.0 million (\$5.4 million after-tax) to selling, general and administrative expenses and \$56.9 million (\$35.1 million after-tax) to depreciation and amortization, which represents the cumulative effect of the adjustment for a period of approximately 20 years. Since the effect of this non-cash adjustment was not material to 2004, or any previously reported fiscal year, the cumulative effect was recorded in the fourth quarter of 2004.

<sup>(3)</sup> Operating profit includes the pre-tax effect of the charge discussed in Note (1) above and in 2004, \$65.9 million (\$40.5 million after-tax) charge relating to conforming the Company's accounting for operating leases and leasehold improvements.

<sup>(4)</sup> Income tax provision includes the effect of the following: (i) in 2005, a \$52.6 million reversal of previously recorded tax reserves through the tax provision principally based on resolving certain state tax matters, and (ii) in 2004, a \$60.0 million reversal of previously recorded tax reserves through the tax provision principally based on finalizing certain tax return years and on a 2004 court decision relevant to the industry.

<sup>(5)</sup> Net earnings and net earnings per common share include the after-tax effect of the charges and gains discussed in Notes (1), (2), (3) and (4) above.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM



### THE BOARD OF DIRECTORS AND SHAREHOLDERS CVS CORPORATION

We have audited the accompanying consolidated balance sheets of CVS Corporation and subsidiaries as of December 30, 2006 and December 31, 2005, and the related consolidated statements of operations, shareholders' equity and cash flows for the fifty-two week periods ended December 30, 2006, December 31, 2005 and January 1, 2005. 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 the standards of the Public Company Accounting Oversight Board (United States). 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 December 30, 2006 and December 31, 2005, and the results of their operations and their cash flows for the fifty-two week periods ended December 30, 2006, December 31, 2005 and January 1, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of CVS Corporation's internal control over financial reporting as of December 30, 2006, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 27, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

As discussed in Note 1 to the consolidated financial statements, CVS Corporation adopted the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" effective January 1, 2006.

**KPMG LLP**

KPMG LLP  
Providence, Rhode Island  
February 27, 2007

**OFFICERS**

**Thomas M. Ryan**

*Chairman of the Board, President, and Chief Executive Officer*

**David B. Rickard**

*Executive Vice President, Chief Financial Officer, and Chief Administrative Officer*

**Chris W. Bodine**

*Executive Vice President  
President, CVS Health Services*

**Larry J. Merlo**

*Executive Vice President  
President, CVS/pharmacy – Retail*

**Douglas A. Sgarro**

*Executive Vice President – Strategy  
and Chief Legal Officer  
President, CVS Realty Co.*

**V. Michael Ferdinandi**

*Senior Vice President – Human Resources  
and Corporate Communications*

**Paula A. Price**

*Senior Vice President – Finance and Controller*

**Nancy R. Christal**

*Vice President – Investor Relations*

**Carol A. DeNale**

*Vice President and Corporate Treasurer*

**Zenon P. Lankowsky**

*Secretary*

**OFFICERS' CERTIFICATIONS**

The Company has filed the required certifications under Section 302 of the Sarbanes-Oxley Act of 2002 regarding the quality of our public disclosures as Exhibits 31.1 and 31.2 to our annual report on Form 10-K for the fiscal year ended December 30, 2006. After our 2006 annual meeting of stockholders, the Company filed with the New York Stock Exchange the CEO certification regarding its compliance with the NYSE corporate governance listing standards as required by NYSE Rule 303A.12(a).

**DIRECTORS**

**David W. Dorman** <sup>(2)</sup> <sup>(3)</sup>

*Former Chairman of the Board  
and Chief Executive Officer  
AT&T Corporation*

**Thomas P. Gerrity** <sup>(3)</sup>

*Professor of Management  
The Wharton School of the  
University of Pennsylvania*

**Marian L. Heard** <sup>(1)</sup> <sup>(2)</sup> <sup>(3)</sup>

*President and Chief Executive Officer  
Oxen Hill Partners*

**William H. Joyce** <sup>(1)</sup> <sup>(3)</sup>

*Chairman of the Board and  
Chief Executive Officer  
Nalco Company*

**Terrence Murray** <sup>(2)</sup>

*Former Chairman of the Board  
and Chief Executive Officer  
FleetBoston Financial Corporation*

**Sheli Z. Rosenberg** <sup>(2)</sup> <sup>(3)</sup>

*Former President, Chief Executive Officer,  
and Vice Chairman  
Equity Group Investments, LLC*

**Thomas M. Ryan**

*Chairman of the Board, President, and  
Chief Executive Officer  
CVS Corporation*

**Richard J. Swift** <sup>(1)</sup>

*Former Chairman of the Board,  
President, and Chief Executive Officer  
Foster Wheeler Ltd.*

**Alfred J. Verrecchia** <sup>(1)</sup>

*President and Chief Executive Officer  
Hasbro, Inc.*

<sup>(1)</sup> Member of the Audit Committee.

<sup>(2)</sup> Member of the Management Planning and Development Committee.

<sup>(3)</sup> Member of the Nominating and Corporate Governance Committee.

**SHAREHOLDER INFORMATION**

**Corporate Headquarters**

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

**Annual Shareholders' Meeting**

May 9, 2007  
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  
P.O. Box 11258, Church Street Station  
New York, NY 10286  
Toll-free: (877) CVSPLAN (287-7526)  
E-mail: shareowner-svcs@bankofny.com

**Direct Stock Purchase/Dividend Reinvestment Program**

BuyDIRECT<sup>SM</sup> 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

**Financial and Other Company Information**

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://investor.cvs.com>.



# CVS<sup>®</sup> Corporation



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