

# Health is where the heart is.



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# We deliver value to all health care stakeholders.

The CVS Health “heart mark” is a ubiquitous presence across our enterprise, representing the unique value we provide to patients, payors, and providers alike. We accomplish this through our unmatched suite of leading assets and our success at integrating them to offer innovative health care solutions. This annual report describes some of the ways in which our model allows us to enhance access, improve health outcomes, and lower overall health care costs, while positioning CVS Health for long-term growth. We think you will agree that health really is where the heart is when seeking affordable, accessible, and effective care.

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## Our solutions reflect evolving health care needs.

In an era of rising costs, CVS Health is the optimal partner to deliver savings and help improve outcomes for all health care stakeholders.

In our retail pharmacies, innovations such as first-fill counseling, our signature Pharmacy Advisor® program, and ScriptSync® are just a few of the ways in which we drive best-in-class adherence rates and help improve outcomes for patients. Meanwhile, CVS Caremark® draws on a broad range of capabilities to manage costs for PBM clients. They include our

leadership in providing solutions to ensure that the patients we serve have access to the right drug at the lowest cost. We have led the way in formulary innovations and were the first PBM to exclude high-cost drugs from our formulary in favor of less expensive clinical equivalents. Specialty patients drive a large portion of health care costs, a trend that



Pharmacy Advisor has increased adherence by nearly

**10%**



Cost management solutions have lowered client trend to an average of only

**3.2%**



**\$9 billion**

in aggregate client savings driven by managed formularies since 2012

will accelerate as the population ages. To reduce costs and improve outcomes, CVS Specialty™ has moved well beyond a basic specialty offering. Our enhanced care management model includes, among other things, more than 250 rare-disease nurses, comorbidity management, symptom management, and social support. This high level of patient engagement results in fewer emergency room visits and hospitalizations and can produce up to an 11 percent reduction in the overall health care costs associated with a given managed condition.

## Complex patient and market issues require a broad set of interventions

### Patient Issues



Clinical complexity

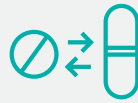


Multi-drug regimens

### Payor / Market Issues



Spend across pharmacy and medical benefits



Biosimilars



Pipeline of new drugs and indications



Emerging specialty provider models

**It takes all the pieces to see a complete picture of the patient.**

Through our integrated assets, we offer exclusive programs that provide an enhanced member experience and better results.

Take Maintenance Choice<sup>®</sup>, which offers PBM plan members the option of receiving their 90-day prescriptions by mail or by picking them up at their local CVS Pharmacy<sup>®</sup> location. The number of people enrolled continues to increase because of its convenience and ability to improve adherence rates. Specialty Connect<sup>®</sup> offers a similar benefit to patients with prescriptions for complex specialty medications. Through our Health Engagement Engine<sup>™</sup>, we seamlessly aggregate data from across the enterprise and other payor sources and combine

it with our clinical research to identify opportunities for improving clinical care. That enables our 36,000 pharmacists and clinicians to have important conversations with patients that help lead to better health outcomes and lower costs for payors. And regardless of the channel a patient chooses, our pharmacists have access to a single, unified record for prescriptions and care. Our digital assets are integrated as well, allowing patients to download a single app to manage all their prescription needs, including retail, mail, and specialty.

## We leverage our full circle of care for partners.

We can partner with all PBMs and health plans, leveraging our enterprise assets and capabilities to meet their individual needs.

The winners in pharmacy care will be those who keep patients the healthiest and deliver the greatest overall health care value. With CVS Pharmacy as the anchor of our suite of enterprise assets, we offer a compelling value proposition—especially in an era of consumer-directed health care. With our menu of pharmacy, long-term care, MinuteClinic, and infusion services, CVS Pharmacy can be the partner of choice for health plans and *all* PBMs, not just our own. Our new strategic relationship with OptumRx is a great example. In addition to a 90-day

in-store prescription offering, we will activate Health Tag messaging at point of sale and provide ExtraCare® health cards that offer savings to OptumRx members. In another example that highlights how we can partner with a non-PBM client, we used a combination of our retail assets and clinical programs to drive adherence and improve the client's Medicare Part D quality ratings. We integrated the client's clinical rules engine into our workflow so our pharmacists could counsel their members, implemented ScriptSync, and delivered clinical counseling through our call centers.



### 2.4 billion

adjusted prescriptions dispensed or managed annually



### 80%

of Medicare lives we serve are in either four- or five-star plans



### 2 million+

patients have enrolled in ScriptSync since its inception





**We see significant opportunity for long-term growth.**

We are focused on maximizing shareholder value through long-term growth, strong cash flow, and a disciplined approach to capital allocation.

CVS Health’s ability to aggregate lives and increase share across our enterprise dispensing channels—including retail, specialty, and long-term care—are cornerstones of our strategy for sustainable growth. Through CVS Caremark’s unique cost management and clinical capabilities, our covered lives have increased by more than 40 percent in just the past four years. We will continue to execute with excellence and drive efficiencies across our enterprise to remain a low-cost provider—and one that delivers exceptional service to patients. A streamlining

initiative now underway is expected to result in a total of nearly \$3 billion in savings from 2017 through 2021. Our integrated model also provides a platform for developing innovative clinical solutions to support patients along all stages of the care continuum. Through it all, we’ll operate with an enterprise mindset rather than focusing on the success of any one business. And thanks to the substantial cash that CVS Health generates, we can return significant value to shareholders through acquisitions and other strategic investments, dividends, and share repurchases.

**Our strategic business imperatives**



Aggregate lives



Grow share



Execute with excellence



Drive innovation



Enterprise focus

# Nurturing our communities is at the heart of what we do.

The three pillars of our *Prescription for a Better World* provide the framework for CVS Health's social responsibility initiatives.



**\$90 million+**

in community investments



**\$1 billion+**

spent on diverse suppliers



**56**

metric tons of unused medications collected



**\$113M**

worth of free medical services through Project Health

Through *Health in Action*, we donated more than \$90 million in charitable contributions, colleague volunteerism, gifts in-kind, and other community investments in 2016. The CVS Health Foundation and American Cancer Society awarded grants to 20 U.S. colleges and universities in 2016 as part of our Tobacco-Free Generation Campus Initiative. This \$3.6 million multi-year program will help accelerate and expand the implementation of 100 percent smoke- and tobacco-free campus policies. Turning to *Planet in Balance*, we announced this past year that we are working toward setting a science-based emission-reduction target focused on reducing emissions across our

supply chain. As a *Leader in Growth*, we've formed the GREENTeam Colleague Resource Group with the goal of making environmental sustainability a relevant part of every colleague's role and responsibility. The link between human health and the health of our planet is becoming increasingly apparent, and the GREENTeam inspires our colleagues to advance our leadership in this area.



# Financial highlights

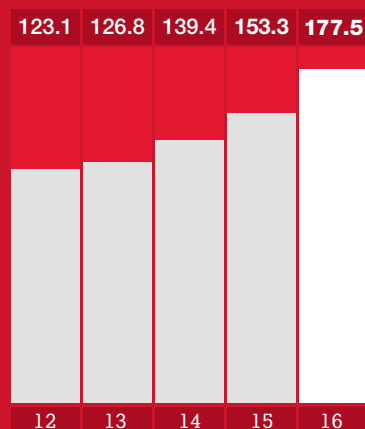
(in millions, except per share figures)

	2016	2015	% change
Net revenues	\$ 177,526	\$ 153,290	15.8%
Operating profit	\$ 10,338	\$ 9,454	9.3%
Net income	\$ 5,319	\$ 5,239	1.5%
Diluted EPS from continuing operations	\$ 4.91	\$ 4.62	6.2%
Free cash flow*	\$ 8,075	\$ 6,456	25.1%
Stock price at year-end	\$ 78.91	\$ 97.77	-19.3%
Market capitalization at year-end	\$ 84,153	\$ 107,635	-21.8%

\* Free cash flow is defined as net cash provided by operating activities less net additions to properties and equipment (i.e., additions to property and equipment plus proceeds from sale-leaseback transactions).

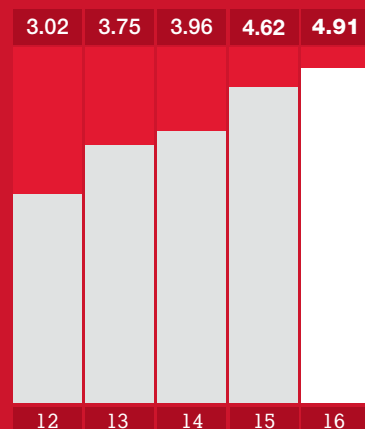
## Net revenue

in billions of dollars



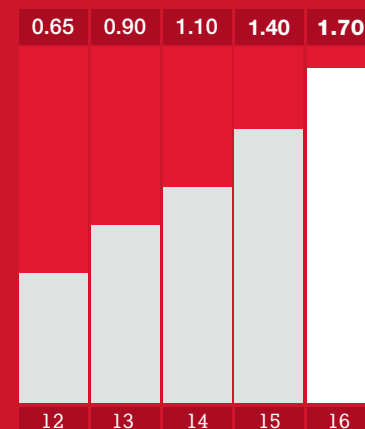
## Diluted EPS from continuing operations

in dollars



## Annual cash dividends

in dollars per common share





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## Dear Fellow Shareholders:

**Health care continues to evolve rapidly in the United States. Despite the ongoing changes as well as uncertainty surrounding health care reform, CVS Health believes that the winners in our industry will be those who drive more affordable, accessible, and effective care. We are uniquely positioned to meet any challenges head on and pivot as needed to address any policy changes.**

We continue to have the most extensive suite of enterprise assets, each of which would be a market leader on a standalone basis. Yet what really sets them apart is our ability, largely through technology, to integrate pharmacy care from the payor to the provider to the patient. Our success at integrating our assets enables us to offer innovative services and to deliver additional value to stakeholders. Products such as Maintenance Choice® and Specialty Connect® are unmatched in the marketplace. They remain the gold standard in giving patients choice while also delivering substantial savings to payors. Moreover, with our truly integrated assets, we have a full view of each patient and a single patient record for prescriptions and care regardless of the CVS Health channel used.

We think of our CVS Pharmacy® locations as the “front door of health care.” They give us a significant advantage in the marketplace as the *retailization* of health care continues, with consumer-directed health plans putting more incentive into the hands of patients to make cost-effective decisions regarding their health. Our research has found that face-to-face interactions are two to three times more effective than other interactions at increasing adherence and improving health outcomes. Importantly, CVS Health also owns the last mile in the delivery of care. Our unmatched touch points—from retail and mail to specialty, medical clinics, long-term care, and infusion—put us in direct contact with health care consumers every day.

**Larry J. Merlo**

President and Chief Executive Officer



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This letter will provide additional insight into these topics as well as update you on our results across the enterprise. We have many accomplishments to look back on, including a successful PBM selling season, superior specialty growth, and the progress we made at integrating the 2015 acquisitions of Omnicare and the pharmacies and clinics of Target. We also excelled at managing rising drug costs—or “trend.” As always, I’ll start with a brief overview of CVS Health’s financial performance and outlook.

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**Free cash flow totaled \$8.1 billion in 2016, and we returned \$6.3 billion to shareholders through dividends and share repurchases during the year.**

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**Robust cash flow provides a strong platform for future growth**

In 2016, we benefited from our ongoing focus on the three key financial pillars that we consider essential to maximizing shareholder value:

- Driving productive, long-term growth;
- Generating significant levels of free cash flow; and
- Optimizing capital allocation.

Net revenues for the year increased nearly 16 percent to a record \$177 billion, while adjusted earnings per share (EPS) rose 13 percent to \$5.84. The compound annual growth rate in operating profit and adjusted EPS puts us at the high end of the steady state growth targets we introduced in 2013.

We experienced strong organic prescription growth across the enterprise in 2016, augmented by the Omnicare and Target acquisitions. Moreover, the successful CVS Caremark® PBM selling season of 2015 led to growth in our membership base and claims in 2016.

That said, we do expect to experience some headwinds in the near term that will slow earnings growth in 2017, driven primarily by pharmacy network changes announced late in 2016 that are causing some retail prescriptions to migrate out of our pharmacies. Additionally, our entire

industry is facing uncertainty surrounding health care reform. All of these factors contributed to a 19 percent decline in CVS Health’s stock price in 2016, although we have still outperformed both the S&P 500 Index and the Dow Jones Industrial Average on a five- and 10-year basis.

We have already developed a four-point plan that will help us generate more robust levels of earnings growth in the years ahead. First, we will leverage our enterprise capabilities and CVS Pharmacy’s compelling retail value proposition to partner more broadly with other PBMs and health plans. Our recent announcement that OptumRx members now have the option to fill their 90-day prescriptions at a CVS Pharmacy is just one example.

Second, we will continue to innovate to bring new, integrated PBM products to market that capitalize on the benefits inherent in our integrated model. Take Maintenance Choice, which gives plan members the option of receiving their 90-day prescriptions in the mail or through in-store pickup. Its latest iteration, now in the pilot phase, brings convenience to the next level by offering same-day delivery within two to three hours to a member’s home or workplace.

Third, we have launched an enterprise streamlining initiative that we expect to result in nearly \$3 billion in cumulative savings by 2021. It includes enhancing the efficiency of our shared services functions, optimizing our pharmacy delivery platform, and rationalizing our store footprint. As part of the latter, we expect to close approximately 70 stores in 2017. Many are located close to our CVS Pharmacy locations within Target stores.

Finally, we have significant cash generation capabilities that provide us with a variety of ways to grow and return value to shareholders. Free cash flow totaled \$8.1 billion in 2016, and we returned \$6.3 billion to shareholders through dividends and share repurchases during the year. After increasing our quarterly dividend by 21 percent for 2016, our board of directors has approved an additional 18 percent increase for 2017. That marks our 14th consecutive year of increasing the dividend. We will also continue to repurchase shares, taking advantage of the recent decline in our stock price. Through dividends and share repurchases, we expect to allocate more than \$7 billion in 2017 to enhancing total returns for shareholders.

As exemplified by Omnicare and Target, we also use our cash flow for strategic acquisitions and other ventures that supplement our existing asset base and provide a platform for long-term growth. We will continue to identify

such opportunities in the future, always taking a disciplined approach to deploying capital. With well-laddered debt maturities and a high triple-B credit rating, we have a healthy balance sheet that provides flexibility and allows us to maximize shareholder value for the long term. In fact, we took advantage of the favorable interest rate environment in 2016 to reduce long-term debt levels and the associated interest expense.

**PBMs are a key part of the solution to reining in rising drug prices**

Before discussing CVS Caremark’s performance, I want to address the ongoing rhetoric around drug pricing. New launches at elevated price points and increasing prices of older drugs have contributed to a sense that government interventions are necessary. Some market participants have attempted to paint PBMs as “middle men” in the pharmacy supply chain, taking outsized profits at the expense of patients and payors. This is simply not true. PBMs are the solution, not the problem. That’s why both public and private payors continue to count on PBMs as indispensable partners that help to manage their drug trend.

Numerous evaluations from the Federal Trade Commission, Congressional Budget Office, and other government agencies have consistently concluded that PBMs operate in a highly efficient market and drive real savings to the health

care economy. And CVS Caremark’s array of cost management solutions have helped to reduce client costs, from an unmanaged gross trend of 11 percent to a managed trend of only 3.2 percent in 2016. In addition, a recent industry study showed that every dollar invested in PBM services returned \$6 in savings for clients and members. So, the value of PBMs is quantitatively pretty clear.

Now, it is a bigger challenge to negotiate lower prices when there is basically a single product in a category. So, we will continue to encourage the need to create competition within therapeutic classes as a solution to reducing the cost of drugs; whether it’s clearing out the FDA backlog of potential drug approvals, many of which are generics, or increasing the speed to market of new biosimilar agents.

**High satisfaction rates, integrated offerings, and trend management capabilities are driving growth in CVS Caremark’s book of business**

CVS Caremark’s integrated model continued to resonate in the marketplace, helping us achieve strong top- and bottom-line growth in 2016. In a highly competitive 2017 selling season, gross new business wins totaled \$7.9 billion. That represents more than half of all revenue from clients that switched PBMs. Health plans accounted for approximately two-thirds of our wins, with employers, unions, and government entities comprising the rest.

**We own the last mile of care through our unmatched patient touchpoints**



**No matter the road, we can shape behavior and drive outcomes**

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With our 97 percent retention rate, net new business for 2017 totaled \$4.4 billion. This new business provides an important platform to grow dispensing across the enterprise. As an example, let's look at payors that came on board in 2015. While their members filled 8.4 million retail prescriptions in one of our channels before these payors were clients, we expect their members to fill more than 29 million scripts through one of our channels in 2017. That will be an important driver of share gains.

Payors have different reasons for choosing CVS Caremark, from our high client and member satisfaction scores to our ability to control trend. We accomplish the latter in a variety of ways. Among them, CVS Health has been the industry leader in formulary innovations. In 2012, we became the first PBM to exclude high-cost drugs from our formulary in favor of less expensive clinical equivalents. In 2017, we will continue to lead the market in formulary strategy with the inclusion of biosimilars as a key component as well as a new indication-based formulary. We are also monitoring hyperinflationary drug pricing on a real-time basis, enabling rapid response to help reduce the impact on our clients.

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**The complexity of the market and the growing impact of specialty pharmacy on overall drug spending make our integrated PBM/specialty model more relevant than ever.**

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Complementing our partnership with health plans, we have broad expertise in government programs. SilverScript® is the nation's largest Medicare Part D (Med D) Prescription Drug Plan (PDP), and we are proud that it earned four stars on the government's annual quality measurement system for the second consecutive year.

SilverScript began 2017 with 5.5 million captive PDP lives, including Employee Group Waiver Plans, up 10 percent from the previous year. We serve and support a total of 12.3 million lives under management when you include the Med D and MA-PD offerings of more than 40 of our health plan clients. We provide these clients with operational and

consultative services that include making formulary and plan design recommendations. That has helped improve their star ratings and enabled them to grow faster than the market. While the Med D market has averaged 4.8 percent annual growth since 2013, our clients have seen their Med D membership rise by 7.6 percent.

**CVS Specialty's unique capabilities help us address the increasing complexity in the industry's fastest-growing sector**

Revenue from the specialty prescriptions we dispense and manage grew to \$50 billion in 2016. That is a 27 percent increase over 2015. Since 2013, our dispensed specialty revenue has grown at a compound annual growth rate of 26 percent, compared with 22 percent for the industry. Specialty remains the industry's fastest-growing sector, and our 28 percent share of the market leads our competitors by a wide margin.

Many factors have contributed to our strong performance. Payors value our capabilities in price as well as utilization and site of care management. And our NovoLogix® technology platform allows us to manage all specialty medications, including those paid under the medical benefit. Even our most sophisticated health plan clients who have been managing specialty on their own can realize incremental savings when they take advantage of our full range of management tools.

The complexity of the market and the growing impact of specialty pharmacy on overall drug spending make our integrated PBM/specialty model more relevant than ever. Adherence has risen by 11.4 percent among those enrolled in Specialty Connect®. Like Maintenance Choice, this product offers specialty patients the option of having their medications delivered by mail or to their CVS Pharmacy location for pick-up. Specialty Connect users choose the latter option 54 percent of the time.

Access to new drugs has also played an important role in our performance. Some of these drugs have had limited distribution, and manufacturers can be discriminating evaluators when choosing specialty pharmacy partners. We have secured access to 30 of the 35 limited distribution products generally used in our channels and that have launched in the past two years. That success is a testament to the level of service our specialty pharmacy offers. In 2017, we are rolling out an enhanced specialty model that will further streamline the entire prescription process for physicians and patients while lowering costs for payors.



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### CVS Pharmacy's industry-leading care programs and high adherence rates make us a valuable strategic partner

CVS Pharmacy same store prescription volumes rose by 3.6 percent in 2016, with same store pharmacy sales up 3.2 percent. With front store same store sales declining by 1.5 percent, total same store sales increased by 1.9 percent. CVS Pharmacy locations now fill more than 1 billion prescriptions annually, and we have captured a 23.8 percent share of U.S. retail prescriptions. Size, scale, and expertise matter in health care. We have more than 9,600 locations with 27,000 retail pharmacists and 73,000 pharmacy technicians who help patients get on—and stay on—their medications.

Non-adherence costs the U.S. health care system hundreds of billions of dollars each year. Our deep clinical expertise and industry-leading care programs drive best-in-class adherence rates. For example, we have demonstrated better adherence results than our key competitors for patients with diabetes, hypertension, and high cholesterol. Innovations such as first-fill counseling, our signature Pharmacy Advisor® program, and ScriptSync® are just a few of the programs that are driving these improved health outcomes.

The market innovations we are driving through our retail pharmacy's integration with CVS Caremark have certainly played an important role in our growth. That said, it's worth noting that 55 percent of retail prescription growth since 2013 has been driven by share gains with other payors. They value the clinical solutions/capabilities that CVS Pharmacy brings to market to keep their members healthy.

### We are successfully leveraging the Omnicare and Target acquisitions; MinuteClinic continues to enhance our value proposition

Now let me bring you up to date on our Omnicare and Target acquisitions. I'll start with Omnicare, the nation's leading provider of pharmacy services to the long-term care market. Omnicare dispenses approximately 100 million scripts annually to more than 1 million patients. We are using our retail footprint and extensive operational expertise to help improve efficiency and productivity in Omnicare's core business of serving skilled nursing facilities. For example, 77 percent of Omnicare's customers live within three miles of a CVS Pharmacy. That means we can fill prescriptions for them much more quickly in emergency situations. We have several initiatives underway as well to accelerate growth in the assisted living and independent living markets.

Moving on to Target, last year's acquisition of its nearly 1,700 pharmacies expanded our retail footprint by more than 20 percent. It also gave us a presence in new regions such as Seattle, Denver, Portland, and Salt Lake City. We have successfully completed the integration and are now focused on converting more of Target's 30 million weekly guests into CVS Pharmacy customers. We are making good progress and moving in the right direction, with script performance improving versus prior quarters. This is driven by the strength of our patient care programs as well as Maintenance Choice.

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**Our deep clinical expertise and industry-leading care programs drive best-in-class adherence rates for our patients.**

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The Target deal included the acquisition of nearly 80 retail clinics that we have since rebranded as MinuteClinic locations. In total, we operate more than 1,100 clinics across 33 states, three times more than our next-largest competitor. And MinuteClinic's nearly 3,000 nurse practitioners and physician assistants have logged more than 34 million patient visits to date.

MinuteClinic enhances the CVS Pharmacy value proposition in a variety of ways. Perhaps most importantly, it is up to 80 percent less expensive than other sites of care, such as the emergency room. In 2017, approximately 4 million CVS Caremark plan members will have an opportunity to benefit from the MinuteClinic Savings Strategy program. This integrated offering provides PBM members with reduced or zero co-pays. MinuteClinic is also partnering with health systems on population health strategies and engaging patients through a convenient and consumer-friendly experience. In fact, MinuteClinic and the Department of Veterans Affairs recently partnered to expand access to high-quality and convenient health care services for veterans in Northern California.

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**Health and Beauty, ExtraCare®, and digital initiatives drive front store performance**

In the front of the store, we have focused on ways of enhancing the pharmacy experience and driving profitable margin growth for the enterprise. Our emphasis on health and beauty—categories closely tied to pharmacy—helped us accomplish both. Health and beauty offer profit margins that are higher than the average of other front-store categories, and sales have grown at a compound annual growth rate of 3.5 percent since 2011. We also continued to have success with store brands, which offer higher margins than national brands and now comprise more than 22 percent of front-store sales. We believe that their penetration rate can reach 25 percent in the coming years.

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**Our digital offerings complement and leverage our brick-and-mortar locations to make the shopping experience even more convenient.**

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Among other front store initiatives, we have continued to shift our promotional dollars from mass circulars to digital and personalized offers. In particular, we have focused on the top 30 percent of customers that account for 75 percent of our margins. The ExtraCare loyalty program, now in its 19th year, helps us identify and engage these higher-value shoppers.

Our digital offerings complement and leverage our brick-and-mortar locations to make the shopping experience even more convenient. As an example, we launched CVS Curbside in roughly 4,000 stores across 40 markets in late 2016. With this new service, customers can use the CVS smartphone app to have purchases delivered to their car when they pull up to the store. For parents with young children or people with mobility issues, we believe that this is a compelling offering. We expect to add a similar option for pharmacy as well.

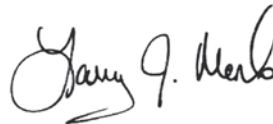
**Our social responsibility initiatives include a major anti-tobacco effort**

No discussion of CVS Health would be complete without acknowledging the broad and ambitious social responsibility initiatives underway across the enterprise. You can read about them in detail in our comprehensive 2016 corporate social responsibility (CSR) report, which will be available in May. I'll mention just a couple here.

We completed the removal of tobacco products from our stores in 2014. Through the *Be the First* initiative we launched in 2016, we have made a five-year, \$50 million commitment to help people lead tobacco-free lives. We are supporting education, advocacy, tobacco control, and healthy behavior programming in partnership with organizations uniquely positioned to tackle this public health challenge. In addition to our tobacco-related efforts, through Project Health we have provided more than \$113 million worth of free health services, such as biometric screenings and health insurance education, at select CVS Pharmacy locations throughout the United States and Puerto Rico. These efforts support our corporate purpose of helping people on their path to better health.

In closing, I want to thank our board of directors, our shareholders, and the 250,000 colleagues who have played a significant role in CVS Health's achievements. Because of them, we are able to deliver a compelling business model that offers benefits in savings, accessibility, and outcomes across the health care spectrum. If you haven't done so already, I encourage you to read the rest of this report to learn more about our unique capabilities.

Sincerely,



**Larry J. Merlo**  
President and Chief Executive Officer

February 9, 2017



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# 2016

## Financial Report

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# Management's Discussion and Analysis

## of Financial Condition and Results of Operations

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

### Overview of Our Business

CVS Health Corporation, together with its subsidiaries (collectively "CVS Health," the "Company," "we," "our" or "us"), is a pharmacy innovation company helping people on their path to better health. At the forefront of a changing health care landscape, the Company has an unmatched suite of capabilities and the expertise needed to drive innovations that will help shape the future of health care.

We are currently the only integrated pharmacy health care company with the ability to impact consumers, payors, and providers with innovative, channel-agnostic solutions. We have a deep understanding of their diverse needs through our unique integrated model, and we are bringing them innovative solutions that help increase access to quality care, deliver better health outcomes, and lower overall health care costs.

Through more than 9,700 retail locations, more than 1,100 walk-in health care clinics, a leading pharmacy benefits manager with nearly 90 million plan members, a dedicated senior pharmacy care business serving more than one million patients per year, expanding specialty pharmacy services and a leading stand-alone Medicare Part D prescription drug plan, we enable people, businesses, and communities to manage health in more affordable, effective ways. We are delivering break-through products and services, from advising patients on their medications at our CVS Pharmacy<sup>®</sup> locations, to introducing unique programs to help control costs for our clients at CVS Caremark<sup>®</sup>, to innovating how care is delivered to our patients with complex conditions through CVS Specialty<sup>™</sup>, to improving pharmacy care for the senior community through Omnicare<sup>®</sup>, or by expanding access to high-quality, low-cost care at CVS MinuteClinic<sup>®</sup>.

We have three reportable segments: Pharmacy Services, Retail/LTC and Corporate.

### Overview of Our Pharmacy Services Segment

Our Pharmacy Services business generates revenue from a full range of pharmacy benefit management ("PBM") solutions, including plan design offerings and administration, formulary management, Medicare Part D services, mail order pharmacy, specialty pharmacy and infusion services, retail pharmacy network management services, prescription management systems, clinical services, disease management services and medical spend management.

Our clients are primarily employers, insurance companies, unions, government employee groups, health plans, Medicare Part D plans, Managed Medicaid plans, plans offered on the public and private exchanges, other sponsors of health benefit plans, and individuals throughout the United States. A portion of covered lives primarily within the Managed Medicaid, health plan and employer markets have access to our services through public and private exchanges.

As a pharmacy benefits manager, we manage the dispensing of prescription drugs through our mail order pharmacies, specialty pharmacies, long-term care pharmacies and national network of more than 68,000 retail pharmacies, consisting of approximately 41,000 chain pharmacies (which includes our CVS Pharmacy<sup>®</sup> pharmacies) and 27,000 independent pharmacies, to eligible members in the benefit plans maintained by our clients and utilize our information systems to perform, among other things, safety checks, drug interaction screenings and brand-to-generic substitutions.

Our specialty pharmacies support individuals who require complex and expensive drug therapies. Our specialty pharmacy business includes mail order and retail specialty pharmacies that operate under the CVS Caremark<sup>®</sup>, CarePlus CVS Pharmacy<sup>™</sup>, Navarro<sup>®</sup> Health Services and Advanced Care Scripts ("ACS Pharmacy") names. Substantially all of our mail service specialty pharmacies have been accredited by The Joint Commission, which is an independent, not-for-profit organization that accredits and certifies health care organizations and programs in the United States. We also offer specialty infusion services and enteral nutrition services through Coram LLC and

its subsidiaries (collectively, “Coram”). With Specialty Connect<sup>®</sup>, which integrates our specialty pharmacy mail and retail capabilities, we provide members with disease-state specific counseling from our experienced specialty pharmacists and the choice to bring their specialty prescriptions to any CVS Pharmacy location. Whether submitted through our mail order pharmacy or at a CVS Pharmacy, all prescriptions are filled through the Company’s specialty mail order pharmacies, so all revenue from this specialty prescription services program is recorded within the Pharmacy Services Segment. Members then can choose to pick up their medication at their local CVS Pharmacy or have it sent to their home through the mail.

We also provide health management programs, which include integrated disease management for 18 conditions, through our Accordant<sup>®</sup> rare disease management offering. The majority of these integrated programs are accredited by the National Committee for Quality Assurance.

In addition, through our SilverScript Insurance Company (“SilverScript”) subsidiary, we are a national provider of drug benefits to eligible beneficiaries under the federal government’s Medicare Part D program. As of December 31, 2016, we provided Medicare Part D plan benefits to approximately 5.5 million beneficiaries through SilverScript, including our individual and employer group waiver plans.

The Pharmacy Services Segment operates under the CVS Caremark<sup>®</sup> Pharmacy Services, Caremark<sup>®</sup>, CVS Caremark<sup>™</sup>, CarePlus CVS Pharmacy<sup>™</sup>, Accordant<sup>®</sup>, SilverScript<sup>®</sup>, Coram<sup>®</sup>, CVS Specialty<sup>™</sup>, NovoLogix<sup>®</sup>, Navarro<sup>®</sup> Health Services and ACS Pharmacy names. As of December 31, 2016, the Pharmacy Services Segment operated 23 retail specialty pharmacy stores, 13 specialty mail order pharmacies, four mail order dispensing pharmacies, and 84 branches for infusion and enteral services, including approximately 73 ambulatory infusion suites and three centers of excellence, located in 41 states, Puerto Rico and the District of Columbia.

## Overview of Our Retail/LTC Segment

Our Retail/LTC Segment sells prescription drugs and a wide assortment of general merchandise, including over-the-counter drugs, beauty products and cosmetics, personal care products, convenience foods, photo finishing, seasonal merchandise and greeting cards. With the acquisition of Omnicare’s long-term care (“LTC”) operations, the Retail/LTC Segment now also includes the distribution of prescription drugs, related pharmacy consulting and other ancillary services to chronic care facilities and other care settings, as well as commercialization services which are provided under the name RxCrossroads<sup>®</sup>. Our Retail/LTC Segment derives the majority of its revenues through the sale of prescription drugs, which are dispensed by our more than 32,000 pharmacists. The role of our retail pharmacists is expanding from primarily dispensing prescriptions to also providing services, including flu vaccinations as well as face-to-face patient counseling with respect to adherence to drug therapies, closing gaps in care, and more cost-effective drug therapies. Our integrated pharmacy services model enables us to enhance access to care while helping to lower overall health care costs and improve health outcomes.

Our Retail/LTC Segment also provides health care services through our MinuteClinic<sup>®</sup> health care clinics. MinuteClinics are staffed by nurse practitioners and physician assistants who utilize nationally recognized protocols to diagnose and treat minor health conditions, perform health screenings, monitor chronic conditions, and deliver vaccinations. We believe our clinics provide high quality services that are affordable and convenient.

Our proprietary loyalty card program, ExtraCare<sup>®</sup>, has about 65 million active cardholders, making it one of the largest and most successful retail loyalty card programs in the country.

As of December 31, 2016, our Retail/LTC Segment included 9,709 retail stores (of which 7,980 were our stores that operated a pharmacy and 1,674 were our pharmacies located within Target stores) located in 49 states, the District of Columbia, Puerto Rico and Brazil operating primarily under the CVS Pharmacy<sup>®</sup>, CVS<sup>®</sup>, CVS Pharmacy y más<sup>®</sup>, Longs Drugs<sup>®</sup>, Navarro Discount Pharmacy<sup>®</sup> and Drogaria Onofre<sup>™</sup> names, 38 onsite pharmacies primarily operating under the CarePlus CVS Pharmacy<sup>™</sup>, CarePlus<sup>®</sup> and CVS Pharmacy<sup>®</sup> names, and 1,139 retail health care clinics

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operating under the MinuteClinic® name (of which 1,132 were located in our retail pharmacy stores or Target stores), and our online retail websites, CVS.com®, Navarro.com and Onofre.com.br. LTC operations are comprised of 152 spoke pharmacies that primarily handle new prescription orders, of which 32 are also hub pharmacies that use proprietary automation to support spoke pharmacies with refill prescriptions. LTC operates primarily under the Omnicare® and NeighborCare® names.

### Overview of Our Corporate Segment

The Corporate Segment provides management and administrative services to support the Company. The Corporate Segment consists of certain aspects of our executive management, corporate relations, legal, compliance, human resources, information technology and finance departments.

### Results of Operations

#### Summary of our Consolidated Financial Results

IN MILLIONS, EXCEPT PER SHARE AMOUNTS	YEAR ENDED DECEMBER 31,		
	2016	2015	2014
Net revenues	\$ 177,526	\$ 153,290	\$ 139,367
Cost of revenues	148,669	126,762	114,000
Gross profit	28,857	26,528	25,367
Operating expenses	18,519	17,074	16,568
Operating profit	10,338	9,454	8,799
Interest expense, net	1,058	838	600
Loss on early extinguishment of debt	643	—	521
Income before income tax provision	8,637	8,616	7,678
Income tax provision	3,317	3,386	3,033
Income from continuing operations	5,320	5,230	4,645
Income (loss) from discontinued operations, net of tax	(1)	9	(1)
Net income	5,319	5,239	4,644
Net income attributable to noncontrolling interest	(2)	(2)	—
Net income attributable to CVS Health	\$ 5,317	\$ 5,237	\$ 4,644
Diluted earnings per share:			
Income from continuing operations attributable to CVS Health	\$ 4.91	\$ 4.62	\$ 3.96
Income (loss) from discontinued operations attributable to CVS Health	\$ —	\$ 0.01	\$ —
Net income attributable to CVS Health	\$ 4.90	\$ 4.63	\$ 3.96

*Net revenues* increased \$24.2 billion in 2016 compared to 2015, and increased \$13.9 billion in 2015 compared to 2014. As you review our performance in this area, we believe you should consider the following important information:

- During 2016, net revenues in our Pharmacy Services Segment increased 19.5% and net revenues in our Retail/LTC Segment increased 12.6% compared to the prior year. The Retail/LTC Segment benefited from the 2015 acquisitions of Omnicare and the pharmacies and clinics of Target.

- During 2015, net revenues in our Pharmacy Services Segment increased by 13.5% and net revenues in our Retail/LTC Segment increased 6.2% compared to the prior year.
- In 2016 and 2015, the Pharmacy Services Segment continued to grow from net new business and specialty. The increase in our generic dispensing rates in both of our operating segments continued to have a negative effect on net revenue in 2016 as compared to 2015, as well as in 2015 as compared to 2014.

Please see the Segment Analysis later in this document for additional information about our net revenues.

**Gross profit** increased \$2.3 billion, or 8.8% in 2016, to \$28.9 billion, as compared to \$26.5 billion in 2015. Gross profit increased \$1.2 billion, or 4.6% in 2015, to \$26.5 billion, as compared to \$25.4 billion in 2014. Gross profit as a percentage of net revenues declined to 16.3%, as compared to 17.3% in 2015 and 18.2% in 2014.

- During 2016, gross profit in our Pharmacy Services Segment and Retail/LTC Segment increased by 12.9% and 7.9%, respectively, compared to the prior year. For the year ended December 31, 2016, gross profit as a percentage of net revenues in our Pharmacy Services Segment and Retail/LTC Segment was 4.9% and 29.3%, respectively.
- During 2015, gross profit in our Pharmacy Services Segment and Retail/LTC Segment increased by 9.6% and 3.4%, respectively, compared to the prior year. For the year ended December 31, 2015, gross profit as a percentage of net revenues in our Pharmacy Services Segment and Retail/LTC Segment was 5.2% and 30.5%, respectively.
- The increased weighting toward the Pharmacy Services Segment, which has a lower gross profit than the Retail/LTC Segment, resulted in a decline in consolidated gross profit as a percent of net revenues in 2016 as compared to 2015. In addition, gross profit for 2016 and 2015 has been negatively impacted by price compression in the Pharmacy Services Segment and reimbursement pressure in the Retail/LTC Segment.
- Our gross profit continued to benefit from the increased utilization of generic drugs, which normally yield a higher gross profit rate than equivalent brand name drugs, in both the Pharmacy Services and Retail/LTC segments for 2016 and 2015, partially offsetting the negative impacts described above.

Please see the Segment Analysis later in this document for additional information about our gross profit.

**Operating expenses** increased \$1.4 billion, or 8.5%, in the year ended December 31, 2016, as compared to the prior year. Operating expenses as a percent of net revenues declined to 10.4% in the year ended December 31, 2016 compared to 11.1% in the prior year. The increase in operating expense dollars in the year ended December 31, 2016 was primarily due to the acquisition of the Target pharmacy and clinic businesses in December 2015, the Omnicare acquisition in August 2015 and incremental store operating costs associated with a higher store count, partially offset by lower legal settlement costs in the year ended December 31, 2016. The improvement in operating expenses as a percentage of net revenues in 2016 is primarily due to expense leverage from net revenue growth.

Operating expenses increased \$506 million, or 3.0%, in the year ended December 31, 2015 as compared to the prior year. Operating expenses as a percent of net revenues declined to 11.1% in the year ended December 31, 2015 compared to 11.9% in the prior year. The increase in operating expense dollars in the year ended December 31, 2015 was primarily due to incremental store operating costs associated with a higher store count, the Omnicare acquisition in August 2015, the acquisition of the Target pharmacy and clinic businesses in December 2015 and a \$90 million legal charge in 2015 related to a disputed 1999 legal settlement. The improvement in operating expenses as a percentage of net revenues in 2015 is primarily due to expense leverage from net revenue growth.

Please see the Segment Analysis later in this document for additional information about operating expenses.

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*Interest expense, net* for the years ended December 31 consisted of the following:

IN MILLIONS	2016	2015	2014
Interest expense	\$ 1,078	\$ 859	\$ 615
Interest income	(20)	(21)	(15)
Interest expense, net	\$ 1,058	\$ 838	\$ 600

Net interest expense increased \$220 million during the year ended December 31, 2016, primarily due to the \$15 billion debt issuance in July 2015, the proceeds of which were used to fund the acquisitions of Omnicare and the pharmacies and clinics of Target, and the debt assumed from the Omnicare acquisition. See Note 5 “Borrowings and Credit Agreements” to the consolidated financial statements for additional information. During 2015, net interest expense increased by \$238 million, to \$838 million compared to 2014, primarily due to the amortization of bridge facility fees of \$52 million for the unsecured bridge facility that was entered into on May 2015 and was amortized to interest expense over the period the facility was outstanding, the \$15 billion debt issuance in July 2015, and the debt assumed in the Omnicare acquisition.

*Loss on early extinguishment of debt* During the year ended December 31, 2016, the Company purchased approximately \$4.2 billion aggregate principal amount of certain of its senior notes pursuant to its tender offer for such senior notes and option to redeem the outstanding senior notes (see Note 5 “Borrowings and Credit Agreements” to the consolidated financial statements). The Company paid a premium of \$583 million in excess of the debt principal, wrote off \$54 million of unamortized deferred financing costs and incurred \$6 million in fees, for a total loss on the early extinguishment of debt of \$643 million.

During the year ended December 31, 2014, the Company completed a \$2.0 billion tender offer and repurchase of certain Senior Notes. The Company paid a premium of \$490 million in excess of the debt principal in connection with the repurchase of the Senior Notes, wrote off \$26 million of unamortized deferred financing costs and incurred \$5 million in fees, for a total loss on early extinguishment of debt of \$521 million. See Note 5, “Borrowings and Credit Agreements” to the consolidated financial statements for additional information.

*Income tax provision* Our effective income tax rate was 38.4%, 39.3% and 39.5% in 2016, 2015 and 2014, respectively. The effective income tax rate was lower in 2016 compared to 2015 primarily due to the resolution of income tax matters in open tax years through 2012, as well as other permanent items. The effective income tax rate was lower in 2015 compared to 2014 primarily due to certain permanent items in 2014.

*Income (loss) from discontinued operations* In connection with certain business dispositions completed between 1991 and 1997, the Company retained guarantees on store lease obligations for a number of former subsidiaries, including Linens ‘n Things, which filed for bankruptcy in 2008. The Company’s loss from discontinued operations includes lease-related costs required to satisfy its Linens ‘n Things lease guarantees. We incurred a loss from discontinued operations, net of tax, of \$1 million in both 2016 and 2014. The Company’s income from discontinued operations in 2015 of \$9 million, net of tax, was related to the release of certain store lease guarantees due to the settlement of a dispute with a landlord.

See Note 1 “Significant Accounting Policies—Discontinued Operations” to the consolidated financial statements for additional information about discontinued operations and Note 11 “Commitments and Contingencies” for additional information about our lease guarantees.



## Segment Analysis

We evaluate the performance of our Pharmacy Services and Retail/LTC segments based on net revenues, gross profit and operating profit before the effect of nonrecurring charges and gains and certain intersegment activities. The Company evaluates the performance of its Corporate Segment based on operating expenses before the effect of nonrecurring charges and gains, and certain intersegment activities. The following is a reconciliation of the Company's business segments to the consolidated financial statements:

IN MILLIONS	Pharmacy Services Segment <sup>(1)(2)</sup>	Retail/LTC Segment <sup>(2)</sup>	Corporate Segment	Intersegment Eliminations <sup>(2)</sup>	Consolidated Totals
<b>2016:</b>					
Net revenues	<b>\$ 119,963</b>	<b>\$ 81,100</b>	<b>\$ —</b>	<b>\$ (23,537)</b>	<b>\$ 177,526</b>
Gross profit <sup>(3)</sup>	<b>5,901</b>	<b>23,738</b>	<b>—</b>	<b>(782)</b>	<b>28,857</b>
Operating profit (loss) <sup>(4)(5)(6)</sup>	<b>4,672</b>	<b>7,281</b>	<b>(894)</b>	<b>(721)</b>	<b>10,338</b>
<b>2015:</b>					
Net revenues	\$ 100,363	\$ 72,007	\$ —	\$ (19,080)	\$ 153,290
Gross profit	5,227	21,992	—	(691)	26,528
Operating profit (loss) <sup>(5)(6)</sup>	3,989	7,130	(1,037)	(628)	9,454
<b>2014:</b>					
Net revenues	\$ 88,440	\$ 67,798	\$ —	\$ (16,871)	\$ 139,367
Gross profit	4,771	21,277	—	(681)	25,367
Operating profit (loss)	3,514	6,762	(796)	(681)	8,799

(1) Net revenues of the Pharmacy Services Segment include approximately \$10.5 billion, \$8.9 billion and \$8.1 billion of Retail/LTC Co-Payments for 2016, 2015 and 2014, respectively. See Note 1 "Significant Accounting Policies—Revenue Recognition" to the consolidated financial statements for additional information about Retail/LTC Co-Payments.

(2) Intersegment eliminations relate to intersegment revenue generating activities that occur between the Pharmacy Services Segment and the Retail/LTC Segment. These occur in the following ways: when members of Pharmacy Services Segment clients ("members") fill prescriptions at our retail pharmacies to purchase covered products, when members enrolled in programs such as Maintenance Choice ® elect to pick up maintenance prescriptions at one of our retail pharmacies instead of receiving them through the mail, or when members have prescriptions filled at our long-term care pharmacies. When these occur, both the Pharmacy Services and Retail/LTC segments record the revenues, gross profit and operating profit on a standalone basis.

(3) The Retail/LTC Segment gross profit for the year ended December 31, 2016 includes \$46 million of acquisition-related integration costs. The integration costs are related to the acquisitions of Omnicare and the pharmacies and clinics of Target.

(4) The Pharmacy Services Segment operating profit for the year ended December 31, 2016 includes the reversal of an accrual of \$88 million in connection with a legal settlement.

(5) The Retail/LTC Segment operating profit for the 2016 and 2015 include \$281 million and \$64 million, respectively, of acquisition-related integration costs. The integration costs are related to the acquisitions of Omnicare and the pharmacies and clinics of Target. Operating profit for the year ended December 31, 2016 also includes a \$34 million asset impairment charge in connection with planned store closures in 2017 related to our enterprise streamlining initiative.

(6) The Corporate Segment operating loss for the year ended December 31, 2016 includes integration costs of \$10 million related to the acquisitions of Omnicare and the pharmacies and clinics of Target. For the year ended December 31, 2015, the Corporate Segment operating loss includes \$156 million of acquisition-related transaction and integration costs related to the acquisitions of Omnicare and the pharmacies and clinics of Target and a \$90 million charge related to a legacy lawsuit challenging the 1999 legal settlement by MedPartners of various securities class actions and a related derivative claim.

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### Pharmacy Services Segment

The following table summarizes our Pharmacy Services Segment's performance for the respective periods:

	YEAR ENDED DECEMBER 31,		
IN MILLIONS	2016	2015	2014
Net revenues	\$ 119,963	\$ 100,363	\$ 88,440
Gross profit	\$ 5,901	\$ 5,227	\$ 4,771
Gross profit % of net revenues	4.9%	5.2%	5.4%
Operating expenses <sup>(3)</sup>	\$ 1,229	\$ 1,238	\$ 1,257
Operating expenses % of net revenues	1.0%	1.2%	1.4%
Operating profit	\$ 4,672	\$ 3,989	\$ 3,514
Operating profit % of net revenues	3.9%	4.0%	4.0%
Net revenues:			
Mail choice <sup>(1)</sup>	\$ 42,783	\$ 37,828	\$ 31,081
Pharmacy network <sup>(2)</sup>	\$ 76,848	\$ 62,240	\$ 57,122
Other	\$ 332	\$ 295	\$ 237
Pharmacy claims processed:			
Total	1,230.0	1,011.9	932.0
Mail choice <sup>(1)</sup>	89.5	85.7	82.4
Pharmacy network <sup>(2)</sup>	1,140.5	926.2	849.6
Generic dispensing rate:			
Total	85.4%	83.7%	82.2%
Mail choice <sup>(1)</sup>	78.2%	76.4%	74.6%
Pharmacy network <sup>(2)</sup>	85.9%	84.4%	83.0%
Mail choice penetration rate	18.0%	20.6%	21.4%

(1) Mail choice is defined as claims filled at a Pharmacy Services mail facility, which includes specialty mail claims inclusive of Specialty Connect<sup>®</sup> claims filled at retail, as well as prescriptions filled at our retail pharmacies under the Maintenance Choice<sup>®</sup> program.

(2) Pharmacy network net revenues, claims processed and generic dispensing rates do not include Maintenance Choice, which are included within the mail choice category. Pharmacy network is defined as claims filled at retail and specialty retail pharmacies, including our retail pharmacies and long-term care pharmacies, but excluding Maintenance Choice activity.

(3) The Pharmacy Services Segment operating expenses for the year ended December 31, 2016 includes the reversal of an accrual of \$88 million in connection with a legal settlement.

**Net revenues** in our Pharmacy Services Segment increased \$19.6 billion, or 19.5%, to \$120.0 billion for the year ended December 31, 2016, as compared to the prior year. The increase is primarily due to increased pharmacy network claims, growth in specialty pharmacy, including the growth in Medicare Part D, addition of ACS Pharmacy through the acquisition of Omnicare, and inflation, partially offset by increased generic dispensing and price compression.

Net revenues increased \$11.9 billion, or 13.5%, to \$100.4 billion for the year ended December 31, 2015, as compared to the prior year. The increase is primarily due to growth in specialty pharmacy, driven by new clients, increased volume from new products and the addition of ACS Pharmacy through the acquisition of Omnicare, as well as inflation and increased pharmacy network claims. Conversely, the increase in our generic dispensing rate had a negative impact on our revenue in 2015, as it did in 2014.

As you review our Pharmacy Services Segment's revenue performance, we believe you should also consider the following important information about the business:

- Our mail choice claims processed increased 4.4% to 89.5 million claims in the year ended December 31, 2016, compared to 85.7 million claims in the prior year. The increase in mail choice claims was driven by growth in specialty pharmacy claims, increase in net new business, and continuing adoption of our Maintenance Choice offerings. During 2015, our mail choice claims processed increased 4.0% to 85.7 million claims. The increase in mail choice claims was driven by net new business, specialty and continuing adoption of our Maintenance Choice offerings.
- During 2016 and 2015, our average revenue per mail choice claim increased by 8.3% and 17.0%, compared to 2015 and 2014, respectively. The increase in both years was primarily due to growth in specialty pharmacy and inflation.
- Our pharmacy network claims processed increased 23.1% to 1,140.5 million claims in the year ended December 31, 2016, compared to 926.2 million claims in the prior year. This increase was primarily due to volume from net new business. During 2015, our pharmacy network claims processed increased 9.0% to 926.2 million compared to 849.6 million pharmacy network claims processed in 2014. This increase was primarily due to net new business.
- During 2016 and 2015, our average revenue per pharmacy network claim processed remained flat.
- Our mail choice generic dispensing rate was 78.2%, 76.4% and 74.6% in the years ended December 31, 2016, 2015 and 2014, respectively. Our pharmacy network generic dispensing rate increased to 85.9% in the year ended December 31, 2016, compared to 84.4% in the prior year. During 2015, our pharmacy network generic dispensing rate increased to 84.4% compared to our pharmacy network generic dispensing rate of 83.0% in 2014. These continued increases in mail choice and pharmacy network generic dispensing rates were primarily due to the impact of new generic drug introductions, and our continuous efforts to encourage plan members to use generic drugs when they are available. We believe our generic dispensing rates will continue to increase in future periods, albeit at a slower pace. This increase will be affected by, among other things, the number of new brand and generic drug introductions and our success at encouraging plan members to utilize generic drugs when they are available and clinically appropriate.

**Gross profit** in our Pharmacy Services Segment includes net revenues less cost of revenues. Cost of revenues includes (i) the cost of pharmaceuticals dispensed, either directly through our mail service and specialty retail pharmacies or indirectly through our pharmacy network, (ii) shipping and handling costs and (iii) the operating costs of our mail service dispensing pharmacies, customer service operations and related information technology support.

Gross profit increased \$674 million, or 12.9%, to \$5.9 billion in the year ended December 31, 2016, as compared to the prior year. Gross profit as a percentage of net revenues decreased to 4.9% for the year ended December 31, 2016, compared to 5.2% in the prior year. The increase in gross profit dollars in the year ended December 31, 2016 was primarily due to growth in specialty pharmacy, growth in Medicare Part D lives, higher generic dispensing and favorable purchasing economics, partially offset by price compression. The decrease in gross profit as a percentage of net revenues was primarily due to changes in the mix of our business and continued price compression, partially offset by favorable generic dispensing and purchasing economics.

Gross profit increased \$456 million, or 9.6% to \$5.2 billion in the year ended December 31, 2015, as compared to the prior year. Gross profit as a percentage of net revenues decreased to 5.2% for the year ended December 31, 2015, compared to 5.4% in the prior year. The increase in gross profit dollars in the year ended December 31, 2015

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## Management's Discussion and Analysis

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was primarily due to volume increases and higher generic dispensing, as well as favorable purchasing and rebate economics, partially offset by price compression. The decrease in gross profit as a percentage of net revenues was primarily due to price compression, partially offset by favorable generic dispensing, as well as favorable purchasing and rebate economics.

As you review our Pharmacy Services Segment's performance in this area, we believe you should consider the following important information about the business:

- Our efforts to (i) retain existing clients, (ii) obtain new business and (iii) maintain or improve the rebates and/or discounts we received from manufacturers, wholesalers and retail pharmacies continue to have an impact on our gross profit dollars and gross profit as a percentage of net revenues. In particular, competitive pressures in the PBM industry have caused us and other PBMs to continue to share with clients a larger portion of rebates and/or discounts received from pharmaceutical manufacturers. In addition, market dynamics and regulatory changes have limited our ability to offer plan sponsors pricing that includes retail network "differential" or "spread," and we expect these trends to continue. The "differential" or "spread" is any difference between the drug price charged to plan sponsors, including Medicare Part D plan sponsors, by a PBM and the price paid for the drug by the PBM to the dispensing provider.
- Our gross profit as a percentage of revenues benefited from the increase in our total generic dispensing rate, which increased to 85.4% and 83.7% in 2016 and 2015, respectively, compared to our generic dispensing rate of 82.2% in 2014. These increases were primarily due to new generic drug introductions and our continual efforts to encourage plan members to use clinically appropriate generic drugs when they are available. We expect these trends to continue, albeit at a slower pace. The increased use by patients of generic drugs has also resulted in third party payors augmenting their efforts to reduce reimbursement payments for prescriptions. This trend, which we expect to continue, reduces the benefit we realize from brand to generic product conversions.

*Operating expenses* in our Pharmacy Services Segment, which include selling, general and administrative expenses, depreciation and amortization related to selling, general and administrative activities and administrative payroll, employee benefits and occupancy costs, decreased to 1.0% of net revenues in 2016, compared to 1.2% in 2015 and 1.4% in 2014.

As you review our Pharmacy Services Segment's performance in this area, we believe you should consider the following important information about the business:

- Operating expenses decreased \$9 million or 0.7% in the year ended December 31, 2016, compared to the prior year. The decrease in operating expense dollars is primarily due to an \$88 million reversal of an accrual in connection with a legal settlement, partially offset by an increase in costs associated with the growth of our business.
- Operating expenses decreased \$19 million or 1.5%, to \$1.2 billion, in the year ended December 31, 2015, compared to the prior year. The decrease in operating expense dollars is primarily due to lower integration costs from the Coram acquisition which occurred in January 2014, partially offset by the addition of ACS Pharmacy from the Omnicare acquisition in August 2015. Operating expenses as a percentage of net revenues improved slightly from 1.4% in 2014 to 1.2% in 2015.

## Retail/LTC Segment

The following table summarizes our Retail/LTC Segment's performance for the respective periods:

IN MILLIONS	YEAR ENDED DECEMBER 31,		
	2016	2015	2014
Net revenues	\$ 81,100	\$ 72,007	\$ 67,798
Gross profit <sup>(1)</sup>	\$ 23,738	\$ 21,992	\$ 21,277
Gross profit % of net revenues	29.3%	30.5%	31.4%
Operating expenses <sup>(2)</sup>	\$ 16,457	\$ 14,862	\$ 14,515
Operating expenses % of net revenues	20.3%	20.6%	21.4%
Operating profit	\$ 7,281	\$ 7,130	\$ 6,762
Operating profit % of net revenues	9.0%	9.9%	10.0%
Prescriptions filled (90 Day = 3 prescriptions) <sup>(3)</sup>	1,223.5	1,031.6	935.9
Net revenue increase (decrease):			
Total	12.6%	6.2%	3.3%
Pharmacy	15.9%	9.5%	5.1%
Front Store	0.3%	(2.5)%	(2.5)%
Total prescription volume (90 Day = 3 prescriptions) <sup>(3)</sup>	18.6%	10.2%	5.2%
Same store sales increase (decrease) <sup>(4)</sup> :			
Total	1.9%	1.7%	2.1%
Pharmacy	3.2%	4.5%	4.8%
Front Store <sup>(5)</sup>	(1.5)%	(5.0)%	(4.0)%
Prescription volume (90 Day = 3 prescriptions) <sup>(3)</sup>	3.6%	4.8%	4.1%
Generic dispensing rates	85.7%	84.5%	83.1%
Pharmacy % of net revenues	75.0%	72.9%	70.7%

(1) Gross profit for the year ended December 31, 2016 includes \$46 million of acquisition-related integration costs related to the acquisitions of Omnicare and the pharmacies and clinics of Target.

(2) Operating expenses for the years ended December 31, 2016 and 2015, include \$235 million and \$64 million, respectively, of acquisition-related integration costs related to the acquisitions of Omnicare and the pharmacies and clinics of Target. Operating expenses for the year ended December 31, 2016 also includes a \$34 million asset impairment charge in connection with planned store closures in 2017 related to our enterprise streamlining initiative.

(3) Includes the adjustment to convert 90-day, non-specialty prescriptions to the equivalent of three 30-day prescriptions. This adjustment reflects the fact that these prescriptions include approximately three times the amount of product days supplied compared to a normal prescription.

(4) Same store sales and prescriptions exclude revenues from MinuteClinic, and revenue and prescriptions from stores in Brazil, from LTC operations and from commercialization services.

(5) Front store same store sales would have been approximately 520 basis points higher for the year ended December 31, 2015 if tobacco and the estimated associated basket sales were excluded from the year ended December 31, 2014.

**Net revenues** increased approximately \$9.1 billion, or 12.6%, to \$81.1 billion for the year ended December 31, 2016, as compared to the prior year. This increase was primarily driven by the acquisitions of the pharmacies and clinics of Target and new stores, which accounted for approximately 640 basis points of our total net revenue percentage increase during the year, the acquisition of Omnicare's LTC operations and a same store sales increase of 1.9%. Net revenues increased approximately \$4.2 billion, or 6.2%, to \$72.0 billion for the year ended December 31, 2015, as compared to the prior year. This increase was primarily driven by the acquisition of LTC, a same store sales increase of 1.7%, and net revenues from new and acquired stores, which accounted for approximately 160 basis points of our total net revenue percentage increase during the year.

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As you review our Retail/LTC Segment's performance in this area, we believe you should consider the following important information about the business:

- Front store same store sales declined 1.5% in the year ended December 31, 2016, as compared to the prior year. The decrease is primarily driven by softer customer traffic and efforts to rationalize promotional strategies, partially offset by an increase in basket size.
- Pharmacy same store sales rose 3.2% in the year ended December 31, 2016, as compared to the prior year. Pharmacy same store sales were positively impacted by same store script growth of 3.6%, as well as approximately 20 basis points due to an additional day in 2016 related to leap year for the year ended December 31, 2016. Due to marketplace changes in the latter half of 2016, we expect script growth to be negatively impacted for the next several quarters by restricted network relationships that exclude CVS Pharmacy.
- Pharmacy revenues continue to be negatively impacted by the conversion of brand name drugs to equivalent generic drugs, which typically have a lower selling price. Pharmacy same store sales were negatively impacted by approximately 360 and 390 basis points for the years ended December 31, 2016 and 2015, respectively, due to recent generic introductions. The generic dispensing rate grew to 85.7% for the year ended December 31, 2016, compared to 84.5% in the prior year. In addition, our pharmacy revenue growth has also been negatively affected by the mix of drugs sold, continued reimbursement pressure and the lack of significant new brand name drug introductions.
- As of December 31, 2016, we operated 9,709 retail stores, including the 1,674 locations in Target stores, compared to 9,655 retail stores as of December 31, 2015, and 7,822 retail stores as of December 31, 2014. Total net revenues from new and acquired stores contributed approximately 6.4%, 1.6% and 1.1% to our total net revenue percentage increase in 2016, 2015, and 2014, respectively. The majority of the increase in 2016 was primarily due to the addition of the pharmacies of Target in December 2015.
- Pharmacy revenue continued to benefit from the increased utilization by Medicare Part D beneficiaries, our ability to attract and retain managed care customers, the increased use of pharmaceuticals by an aging population and as the first line of defense for individual health care.

**Gross profit** in our Retail/LTC Segment 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.

Gross profit increased \$1.7 billion, or 7.9%, to approximately \$23.7 billion in the year ended December 31, 2016, as compared to the prior year. Gross profit as a percentage of net revenues decreased to 29.3% in year ended December 31, 2016, from 30.5% in 2015. Gross profit increased \$715 million, or 3.4%, to approximately \$22.0 billion in the year ended December 31, 2015, as compared to the prior year. Gross profit as a percentage of net revenues decreased to 30.5% in year ended December 31, 2015, from 31.4% in 2014.

The increase in gross profit dollars in the year ended December 31, 2016, was primarily driven by the addition of the pharmacies and clinics of Target and LTC, as well as same store sales, partially offset by continued reimbursement pressure. The decrease in gross profit as a percentage of net revenues was primarily driven by a decline in pharmacy margins due to continued reimbursement pressure and the mix effect of lower margins from the acquisitions of the pharmacies and clinics of Target and LTC, partially offset by increased front store margins. Front store margins increased due to changes in the mix of products sold and efforts to rationalize promotional strategies. The increase in gross profit dollars in the year ended December 31, 2015, was primarily driven by the addition of LTC, same store sales and new store sales, increased generic dispensing, as well as favorable purchasing economics, partially offset by continued reimbursement pressure.



As you review our Retail/LTC Segment's performance in this area, we believe you should consider the following important information about the business:

- Front store revenues as a percentage of total net revenues for the years ended December 31, 2016, 2015 and 2014 were 23.6%, 26.5% and 28.8%, respectively. On average, our gross profit on front store revenues is generally higher than our gross profit on pharmacy revenues. Pharmacy revenues as a percentage of total net revenues increased approximately 210, 220 and 120 basis points in the years ended December 31, 2016, 2015 and 2014, respectively. This was due to pharmacy revenues growing faster than front store revenues, largely driven by the acquisitions of the pharmacies and clinics of Target and LTC. The mix effect from a higher proportion of pharmacy sales had a negative effect on our overall gross profit as a percentage of net revenues for the years ended December 31, 2016, 2015 and 2014, respectively. This negative effect was partially offset by an increase in generic drugs dispensed, an improved front store gross margin rate, which includes efforts to rationalize promotional strategies.
- During 2016 and 2015, our front store gross profit as a percentage of net revenues increased compared to the prior year. In both years, the increase reflects a change in the mix of products sold, including store brand products, as a result of our efforts to rationalize promotional strategies. The increase in 2015 was also partially due to the removal of tobacco products from our stores in late 2014.
- Our pharmacy gross profit rates have been adversely affected by the efforts of managed care organizations, PBMs and governmental and other third-party payors to reduce their prescription drug costs, including the use of restrictive networks, as well as changes in the mix of our business within the pharmacy portion of the Retail/LTC Segment. In the event the reimbursement pressure accelerates, we may not be able to sustain our current rate of revenue growth and gross profit dollars could be adversely impacted. The increased use of generic drugs has positively impacted our gross profit but has resulted in third-party payors augmenting their efforts to reduce reimbursement payments to retail pharmacies for prescriptions. This trend, which we expect to continue, reduces the benefit we realize from brand to generic product conversions.

**Operating expenses** in our Retail/LTC Segment include store payroll, store employee benefits, store occupancy costs, selling expenses, advertising expenses, depreciation and amortization expense and certain administrative expenses.

Operating expenses increased \$1.6 billion, or 10.7% to \$16 billion, or 20.3% as a percentage of net revenues, in the year ended December 31, 2016, as compared to \$14.9 billion, or 20.6% as a percentage of net revenues, in the prior year. Operating expenses increased \$347 million, or 2.4%, to \$14.9 billion, or 20.6% as a percentage of net revenues, in the year ended December 31, 2015, as compared to \$14.5 billion, or 21.4% as a percentage of net revenues, in the prior year. Operating expenses as a percentage of net revenues for the year ended December 31, 2016 improved primarily due to expense leverage from net revenue growth. The increase in operating expense dollars for the year ended December 31, 2016, was primarily due to the addition of the pharmacies and clinics within Target stores and LTC, including acquisition-related integration costs of \$235 million, and incremental store operating costs associated with operating more stores. Operating expenses for the year ended December 31, 2016, includes a gain from a legal settlement with certain credit card companies of \$32 million and an asset impairment charge of \$34 million in connection with planned store closures in 2017 related to our enterprise streamlining initiative. Additionally, in April 2016, the Retail/LTC Segment made a charitable contribution of \$32 million to the CVS Foundation to fund future charitable giving. The CVS Foundation is a non-profit entity that focuses on health, education and community involvement programs. The charitable contribution was recorded as an operating expense in the year ended December 31, 2016. Operating expenses as a percentage of net revenues for the year ended December 31, 2015 improved primarily due to higher legal costs in the prior year and leverage gained from the addition of LTC net revenues. The increase in operating expense dollars for the year ended December 31, 2015, was primarily due to the addition of LTC, including acquisition-related integration costs of \$64 million, and incremental store operating costs associated with operating more stores.

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### Corporate Segment

*Operating expenses* decreased \$143 million, or 13.8%, to \$894 million in the year ended December 31, 2016, as compared to the prior year. Operating expenses increased \$241 million, or 30.3%, to \$1.0 billion in the year ended December 31, 2015. Operating expenses within the Corporate Segment include executive management, corporate relations, legal, compliance, human resources, information technology and finance-related costs. The decrease in operating expenses for the year ended December 31, 2016 was primarily due to acquisition-related transaction and integration costs associated with the acquisition of Omnicare that occurred in August 2015, and the acquisition of the pharmacies and clinics of Target that occurred in December 2015. Acquisition-related integration costs for the year ended December 31, 2016 were \$10 million. The increase in operating expenses in the year ended December 31, 2015 was primarily due to acquisition-related transaction and integration costs of \$156 million associated with the acquisitions of Omnicare and pharmacies and clinics of Target, as well as a \$90 million charge related to a legacy lawsuit challenging the 1999 settlement by MedPartners of various securities class actions and a related derivative claim.

### Liquidity and Capital Resources

We maintain a level of liquidity sufficient to allow us to meet our cash needs in the short-term. Over the long-term, we manage our cash and capital structure to maximize shareholder return, maintain our financial position and maintain flexibility for future strategic initiatives. We continuously assess our working capital needs, debt and leverage levels, capital expenditure requirements, dividend payouts, potential share repurchases and future investments or acquisitions. We believe our operating cash flows, commercial paper program, credit facilities, sale-leaseback program, as well as any potential future borrowings, will be sufficient to fund these future payments and long-term initiatives.

The change in cash and cash equivalents is as follows:

IN MILLIONS	YEAR ENDED DECEMBER 31,		
	2016	2015	2014
Net cash provided by operating activities	\$ 10,069	\$ 8,412	\$ 8,137
Net cash used in investing activities	(2,470)	(13,420)	(4,045)
Net cash provided by (used in) financing activities	(6,689)	5,006	(5,694)
Effect of exchange rate changes on cash and cash equivalents	2	(20)	(6)
Net increase (decrease) in cash and cash equivalents	\$ 912	\$ (22)	\$ (1,608)

*Net cash provided by operating activities* increased by \$1.7 billion in 2016 and \$275 million in 2015. The increase in 2016 was primarily due to the timing of payments for our Medicare Part D operations. The increase in 2015 was primarily due to increased net income partially offset by various changes in working capital.

*Net cash used in investing activities* decreased by \$11.0 billion in 2016 and increased by \$9.4 billion in 2015. The decrease in 2016 and increase in 2015 were primarily due to the \$9.6 billion paid for the acquisition of Omnicare and the \$1.9 billion paid for the acquisition of the pharmacies and clinics of Target in 2015, compared to the \$2.1 billion paid for the Coram acquisition in 2014.

In 2016, gross capital expenditures totaled approximately \$2.2 billion, a decrease of approximately \$143 million compared to the prior year. During 2016, approximately 31% of our total capital expenditures were for new store construction, 20% were for store, fulfillment and support facilities expansion and improvements and 49% were for technology and other corporate initiatives. Gross capital expenditures totaled approximately \$2.4 billion and \$2.1 billion during 2015 and 2014, respectively. During 2015, approximately 36% of our total capital expenditures were for new store construction, 21% were for store, fulfillment and support facilities expansion and improvements and 43% were for technology and other corporate initiatives.

Proceeds from sale-leaseback transactions totaled \$230 million in 2016. This compares to \$411 million in 2015 and \$515 million in 2014. Under the sale-leaseback transactions, the properties are generally sold at net book value, which generally approximates fair value, and the resulting leases generally qualify and are accounted for as operating leases. The specific timing and amount of future sale-leaseback transactions will vary depending on future market conditions and other factors.

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

	2016 <sup>(2)</sup>	2015 <sup>(2)</sup>	2014 <sup>(2)</sup>
Total stores (beginning of year)	9,665	7,866	7,702
New and acquired stores <sup>(1)</sup>	132	1,833	187
Closed stores <sup>(1)</sup>	(47)	(34)	(23)
Total stores (end of year)	9,750	9,665	7,866
Relocated stores	50	58	60

(1) Relocated stores are not included in new or closed store totals.

(2) Includes retail drugstores, certain onsite pharmacy stores, specialty pharmacy stores and pharmacies within Target stores.

**Net cash used in financing activities** was \$6.7 billion in 2016 versus net cash provided by financing activities of \$5.0 billion in 2015. The difference of \$11.7 billion is primarily due to lower long-term borrowings and higher net repayments of short and long-term debt in 2016. Net cash provided by financing activities was \$5.0 billion in 2015 versus net cash used in financing activities of \$5.7 billion in 2014. The difference of \$10.7 billion was primarily due to higher net borrowings in 2015, including the \$14.8 billion in net proceeds received from the July 2015 debt issuance, partially offset by an increase in share repurchases in 2015 of \$1.0 billion.

**Share repurchase programs** The following share repurchase programs were authorized by the Company's Board of Directors:

IN BILLIONS

Authorization Date	Authorized	Remaining
November 2, 2016 ("2016 Repurchase Program")	\$ 15.0	\$ 15.0
December 15, 2014 ("2014 Repurchase Program")	\$ 10.0	\$ 3.2
December 17, 2013 ("2013 Repurchase Program")	\$ 6.0	\$ —

The share Repurchase Programs, each of which was effective immediately, permit the Company to effect repurchases from time to time through a combination of open market repurchases, privately negotiated transactions, accelerated share repurchase ("ASR") transactions, and/or other derivative transactions. The 2016 and 2014 Repurchase Programs may be modified or terminated by the Board of Directors at any time.

Pursuant to the authorization under the 2014 Repurchase Program, effective August 29, 2016, the Company entered into two fixed dollar ASRs with Barclays Bank PLC ("Barclays") for a total of \$3.6 billion. Upon payment of the \$3.6 billion purchase price on January 6, 2017, the Company received a number of shares of its common stock equal to 80% of the \$3.6 billion notional amount of the ASRs or approximately 36.1 million shares at a price of \$80.34 per share, which were placed into treasury stock in January 2017. At the conclusion of the ASRs, the Company may receive additional shares equal to the remaining 20% of the \$3.6 billion notional amount. The ultimate number of shares the Company may receive will fluctuate based on changes in the daily volume-weighted average price of the Company's stock over a period beginning on January 6, 2017 and ending on or before July 6, 2017. If the mean daily volume-weighted average price of the Company's common stock, less a discount (the "forward

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price”), during the ASRs falls below \$80.34 per share, the Company will receive a higher number of shares from Barclays. If the forward price rises above \$80.34 per share, the Company will either receive fewer shares from Barclays or, potentially have an obligation to Barclays which, at the Company’s option, could be settled in additional cash or by issuing shares. Under the terms of the ASRs, the maximum number of shares that could be received or delivered is 90.1 million.

Pursuant to the authorization under the 2014 Repurchase Program, effective December 11, 2015, the Company entered into a \$725 million fixed dollar ASR with Barclays. Upon payment of the \$725 million purchase price on December 14, 2015, the Company received a number of shares of its common stock equal to 80% of the \$725 million notional amount of the ASR or approximately 6.2 million shares. The initial 6.2 million shares of common stock delivered to the Company by Barclays were placed into treasury stock in December 2015. The ASR was accounted for as an initial treasury stock transaction of \$580 million and a forward contract of \$145 million. The forward contract was classified as an equity instrument and was recorded within capital surplus on the consolidated balance sheet. On January 28, 2016, the Company received 1.4 million shares of common stock, representing the remaining 20% of the \$725 million notional amount of the ASR, thereby concluding the ASR. The remaining 1.4 million shares of common stock delivered to the Company by Barclays were placed into treasury stock in January 2016 and the forward contract was reclassified from capital surplus to treasury stock.

Pursuant to the authorization under the 2013 Repurchase Programs, effective January 2, 2015, the Company entered into a \$2.0 billion fixed dollar ASR agreement with J.P. Morgan Chase Bank (“JP Morgan”). Upon payment of the \$2.0 billion purchase price on January 5, 2015, the Company received a number of shares of its common stock equal to 80% of the \$2.0 billion notional amount of the ASR agreement or approximately 16.8 million shares, which were placed into treasury stock in January 2015. On May 1, 2015, the Company received approximately 3.1 million shares of common stock, representing the remaining 20% of the \$2.0 billion notional amount of the ASR, thereby concluding the ASR. The remaining 3.1 million shares of common stock delivered to the Company by JP Morgan were placed into treasury stock in May 2015. The ASR was accounted for as an initial treasury stock transaction of \$1.6 billion and a forward contract of \$0.4 billion. The forward contract was classified as an equity instrument and was initially recorded within capital surplus on the consolidated balance sheet and was reclassified to treasury stock upon the settlement of the ASR in May 2015.

In the ASR transactions described above, the initial repurchase of the shares and delivery of the remainder of the shares to conclude the ASR, resulted in an immediate reduction of the outstanding shares used to calculate the weighted average common shares outstanding for basic and diluted earnings per share.

During the year ended December 31, 2016, the Company repurchased an aggregate of 47.5 million shares of common stock for approximately \$4.5 billion under the 2014 Repurchase Program. As of December 31, 2016, there remained an aggregate of approximately \$18.2 billion available for future repurchases under the 2016 and 2014 Repurchase Programs, \$3.6 billion of which was used for the ASR effective January 6, 2017 described previously. As of December 31, 2015, the 2013 Repurchase Program was complete.

**Short-term borrowings** The Company had approximately \$1.9 billion of commercial paper outstanding at a weighted average interest rate of 1.22% as of December 31, 2016. In connection with its commercial paper program, the Company maintains a \$1.0 billion, five-year unsecured back-up credit facility, which expires on May 23, 2018, a \$1.25 billion, five-year unsecured back-up credit facility, which expires on July 24, 2019, and a \$1.25 billion, five-year unsecured back-up credit facility, which expires on July 1, 2020. The credit facilities allow for borrowings at various rates that are dependent, in part, on the Company’s public debt ratings and require the Company to pay a weighted average quarterly facility fee of approximately 0.03%, regardless of usage. As of December 31, 2016, there were no borrowings outstanding under the back-up credit facilities.

On January 3, 2017, the Company entered into a \$2.5 billion revolving credit facility. The credit facility allows for borrowings at various rates that are dependent, in part, on the Company's debt ratings and require the Company to pay a weighted average quarterly facility fee of approximately 0.03%, regardless of usage. The maximum available under the credit facility decreases by \$750 million on both March 31, 2017 and June 30, 2017 and by \$500 million on September 30, 2017. The credit facility expires on December 31, 2017.

On May 20, 2015, in connection with the acquisition of Omnicare, the Company entered into a \$13 billion unsecured bridge loan facility. The Company paid approximately \$52 million in fees in connection with the facility. The fees were capitalized and amortized as interest expense over the period the bridge facility was outstanding. The bridge loan facility expired on July 20, 2015 upon the Company's issuance of unsecured senior notes with an aggregate principal of \$15 billion as discussed below. The bridge loan facility fees became fully amortized in July 2015.

**Long-term borrowings** On May 16, 2016, the Company issued \$1.75 billion aggregate principal amount of 2.125% unsecured senior notes due June 1, 2021 and \$1.75 billion aggregate principal amount of 2.875% unsecured senior notes due June 1, 2026 (collectively, the "2016 Notes") for total proceeds of approximately \$3.5 billion, net of discounts and underwriting fees. The 2016 Notes pay interest semi-annually and may be redeemed, in whole at any time, or in part from time to time, at the Company's option at a defined redemption price plus accrued and unpaid interest to the redemption date. The net proceeds of the 2016 Notes were used for general corporate purposes and to repay certain corporate debt.

On May 16, 2016, the Company announced tender offers for (1) any and all of its 5.75% Senior Notes due 2017, its 6.60% Senior Notes due 2019 and its 4.75% Senior Notes due 2020 (collectively, the "Any and All Notes") and (2) up to \$1.5 billion aggregate principal amount of its 6.25% Senior Notes due 2027, its 6.125% Senior Notes due 2039, its 5.75% Senior Notes due 2041, the 5.00% Senior Notes due 2024 issued by its wholly-owned subsidiary, Omnicare, Inc. ("Omnicare"), the 4.75% Senior Notes due 2022 issued by Omnicare, its 4.875% Senior Notes due 2035 and its 3.875% Senior Notes due 2025 (collectively, the "Maximum Tender Offer Notes" and together with the Any and All Notes, the "Notes"). On May 31, 2016, the Company increased the aggregate principal amount of the tender offers for the Maximum Tender Offer Notes to \$2.25 billion. The Company purchased approximately \$835 million aggregate principal amount of the Any and All Notes and \$2.25 billion aggregate principal amount of the Maximum Tender Offer Notes pursuant to the tender offers, which expired on June 13, 2016. The Company paid a premium of \$486 million in excess of the debt principal in connection with the purchase of the Notes, wrote off \$50 million of unamortized deferred financing costs and incurred \$6 million in fees, for a total loss on the early extinguishment of debt of \$542 million which was recorded in income from continuing operations in the consolidated statement of income for the year ended December 31, 2016.

On June 27, 2016, the Company notified the holders of the remaining Any and All Notes that the Company was exercising its option to redeem the outstanding Any and All Notes pursuant to the terms of the Any and All Notes and the Indenture dated as of August 15, 2006, between the Company and The Bank of New York Mellon Trust Company, N.A. Approximately \$1.1 billion aggregate principal amount of Any and All Notes was redeemed on July 27, 2016. The Company paid a premium of \$97 million in excess of the debt principal and wrote off \$4 million of unamortized deferred financing costs, for a total loss on early extinguishment of debt of \$101 million during the year ended December 31, 2016.

The Company recorded a total loss on the early extinguishment of debt of \$643 million which was recorded in the income from continuing operations in the consolidated statement of income for the year ended December 31, 2016.

On July 20, 2015, the Company issued an aggregate of \$2.25 billion of 1.9% unsecured senior notes due 2018 ("2018 Notes"), an aggregate of \$2.75 billion of 2.8% unsecured senior notes due 2020 ("2020 Notes"), an aggregate of \$1.5 billion of 3.5% unsecured senior notes due 2022 ("2022 Notes"), an aggregate of \$3 billion of 3.875% unsecured senior notes due 2025 ("2025 Notes"), an aggregate of \$2 billion of 4.875% unsecured senior notes



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due 2035 ("2035 Notes"), and an aggregate of \$3.5 billion of 5.125% unsecured senior notes due 2045 ("2045 Notes" and, together with the 2018 Notes, 2020 Notes, 2022 Notes, 2025 Notes and 2035 Notes, the "Notes") for total proceeds of approximately \$14.8 billion, net of discounts and underwriting fees. The Notes pay interest semi-annually and contain redemption terms which allow or require the Company to redeem the Notes at a defined redemption price plus accrued and unpaid interest at the redemption date. The net proceeds of the Notes were used to fund the Omnicare acquisition and the acquisition of the pharmacies and clinics of Target. The remaining proceeds were used for general corporate purposes.

Upon the closing of the Omnicare acquisition in August 2015, the Company assumed the long-term debt of Omnicare that had a fair value of approximately \$3.1 billion, \$2.0 billion of which was previously convertible into Omnicare shares that holders were able to redeem subsequent to the acquisition. During the period from August 18, 2015 to December 31, 2015, all but \$5 million of the \$2.0 billion of previously convertible debt was redeemed and repaid and approximately \$0.4 billion in Omnicare term debt assumed was repaid for total repayments of Omnicare debt of approximately \$2.4 billion in 2015.

The remaining principal of the Omnicare debt assumed was comprised of senior unsecured notes with an aggregate principal amount of \$700 million (\$400 million of 4.75% senior notes due 2022 and \$300 million of 5% senior notes due 2024). In September 2015, the Company commenced exchange offers for the 4.75% senior notes due 2022 and the 5% senior notes due 2024 to exchange all validly tendered and accepted notes issued by Omnicare for notes to be issued by the Company. This offer expired on October 20, 2015 and the aggregate principal amounts of \$388 million of the 4.75% senior notes due 2022 and \$296 million of the 5% senior notes due 2024 were validly tendered and exchanged for notes issued by the Company. The Company recorded this exchange transaction as a modification of the original debt instruments. Consequently, no gain or loss on extinguishment was recognized in the Company's consolidated income statement as a result of this exchange transaction and the issuance costs of the new debt were expensed as incurred.

On August 7, 2014, the Company issued \$850 million of 2.25% unsecured senior notes due August 12, 2019 and \$650 million of 3.375% unsecured senior notes due August 12, 2024 (collectively, the "2014 Notes") for total proceeds of approximately \$1.5 billion, net of discounts and underwriting fees. The 2014 Notes pay interest semi-annually and may be redeemed, in whole at any time, or in part from time to time, at the Company's option at a defined redemption price plus accrued and unpaid interest to the redemption date. The net proceeds of the 2014 Notes were used for general corporate purposes and to repay certain corporate debt.

On August 7, 2014, the Company announced tender offers for any and all of the 6.25% Senior Notes due 2027, and up to a maximum amount of the 6.125% Senior Notes due 2039, the 5.75% Senior Notes due 2041 and the 5.75% Senior Notes due 2017, for up to an aggregate principal amount of \$1.5 billion. On August 21, 2014, the Company increased the aggregate principal amount of the tender offers to \$2.0 billion and completed the repurchase for the maximum amount on September 4, 2014. The Company paid a premium of \$490 million in excess of the debt principal in connection with the tender offers, wrote off \$26 million of unamortized deferred financing costs and incurred \$5 million in fees, for a total loss on the early extinguishment of debt of \$521 million. The loss was recorded in income from continuing operations in the consolidated statement of income for the year ended December 31, 2014.

During the year ended December 31, 2014, the Company repurchased the remaining \$41 million of outstanding Enhanced Capital Advantage Preferred Securities ("ECAPS") at par. The fees and write-off of deferred issuance costs associated with the early extinguishment of the ECAPS were immaterial.

Our credit facilities and unsecured senior notes (see Note 5 "Borrowings and Credit Agreements" to the consolidated financial statements) 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 the restrictions contained in these covenants materially affect our financial or operating flexibility. As of December 31, 2016, the Company is in compliance with all debt covenants.

As of December 31, 2016 and 2015, we had no outstanding derivative financial instruments.

**Debt Ratings** As of December 31, 2016, our long-term debt was rated “Baa1” by Moody’s with a stable outlook and “BBB+” by Standard & Poor’s with a stable outlook, and our commercial paper program was rated “P-2” by Moody’s and “A-2” by Standard & Poor’s. 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 historical acquisition activity 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/or 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.

**Quarterly Cash Dividend Increase** In December 2016, our Board of Directors authorized an 18% increase in our quarterly common stock cash dividend to \$0.50 per share effective in 2017. This increase equates to an annual dividend rate of \$2.00 per share. In December 2015, our Board of Directors authorized a 21% increase in our quarterly common stock cash dividend to \$0.425 per share. This increase equated to an annual dividend rate of \$1.70 per share. In December 2014, our Board of Directors authorized a 27% increase in our quarterly common stock cash dividend to \$0.35 per share. This increase equated to an annual dividend rate of \$1.40 per share.

## Off-Balance Sheet Arrangements

In connection with executing operating leases, we provide a guarantee of the lease payments. We also 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 generally qualify and are accounted for as operating leases. We do not have any retained or contingent interests in the stores, and we do not 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 on our consolidated balance sheets.

Between 1991 and 1997, we sold or spun off a number of subsidiaries, including Bob’s Stores, Linens ‘n Things, Marshalls, Kay-Bee Toys, 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 agreed to indemnify 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 31, 2016, we guaranteed approximately 87 such store leases (excluding the lease guarantees related to Linens ‘n Things), with the maximum remaining lease term extending through 2047. Management believes the ultimate disposition of any of the remaining lease guarantees will not have a material adverse effect on the Company’s consolidated financial condition or future cash flows. Please see “Income (loss) from discontinued operations” previously in this document for further information regarding our guarantee of certain Linens ‘n Things’ store lease obligations.

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Below is a summary of our significant contractual obligations as of December 31, 2016:

IN MILLIONS	Total	PAYMENTS DUE BY PERIOD			
		2017	2018 to 2019	2020 to 2021	Thereafter
Operating leases	\$ 27,346	\$ 2,458	\$ 4,570	\$ 3,950	\$ 16,368
Lease obligations from discontinued operations	19	7	7	5	—
Capital lease obligations	1,314	74	143	141	956
Contractual lease obligations with Target <sup>(1)</sup>	1,737	—	—	—	1,737
Long-term debt	25,204	21	4,350	5,050	15,783
Interest payments on long-term debt <sup>(2)</sup>	11,385	916	1,724	1,480	7,265
Other long-term liabilities reflected in our consolidated balance sheet	806	76	377	112	241
	\$ 67,811	\$ 3,552	\$ 11,171	\$ 10,738	\$ 42,350

(1) The Company leases pharmacy and clinic space from Target. See Note 6 "Leases" to the consolidated financial statements for additional information regarding the lease arrangements with Target. Amounts related to the operating and capital leases with Target are reflected within the operating leases and capital lease obligations above. Amounts due in excess of the remaining estimated economic lives of the buildings are reflected herein assuming equivalent stores continue to operate through the term of the arrangements.

(2) Interest payments on long-term debt are calculated on outstanding balances and interest rates in effect on December 31, 2016.

### 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 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 "Significant Accounting Policies" 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. 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.

### Revenue Recognition

#### Pharmacy Services Segment

Our Pharmacy Services Segment sells prescription drugs directly through our mail service dispensing pharmacies and indirectly through our retail pharmacy network. We recognize revenues in our Pharmacy Services Segment from prescription drugs sold by our mail service dispensing pharmacies and under retail pharmacy network contracts where we are the principal using the gross method at the contract prices negotiated with our clients. Net revenue from our Pharmacy Services Segment includes: (i) the portion of the price the client pays directly to us, net of any volume-related or other discounts paid back to the client, (ii) the price paid to us ("Mail Co-Payments") or a third party pharmacy in our retail pharmacy network ("Retail Co-Payments") by individuals included in our clients' benefit plans, and (iii) administrative fees for retail pharmacy network contracts where we are not the principal. Sales taxes are not included in revenue.

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We recognize revenue in the Pharmacy Services Segment when: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the seller's price to the buyer is fixed or determinable, and (iv) collectability is reasonably assured. The following revenue recognition policies have been established for the Pharmacy Services Segment.

- Revenues generated from prescription drugs sold by mail service dispensing pharmacies are recognized when the prescription is delivered. At the time of delivery, the Pharmacy Services Segment has performed substantially all of its obligations under its client contracts and does not experience a significant level of returns or reshipments.
- Revenues generated from prescription drugs sold by third party pharmacies in the Pharmacy Services Segment's retail pharmacy network and associated administrative fees are recognized at the Pharmacy Services Segment's point-of-sale, which is when the claim is adjudicated by the Pharmacy Services Segment's online claims processing system.

We determine whether we are the principal or agent for our retail pharmacy network transactions on a contract by contract basis. In the majority of our contracts, we have determined we are the principal due to us: (i) being the primary obligor in the arrangement, (ii) having latitude in establishing the price, changing the product or performing part of the service, (iii) having discretion in supplier selection, (iv) having involvement in the determination of product or service specifications, and (v) having credit risk. Our obligations under our client contracts for which revenues are reported using the gross method are separate and distinct from our obligations to the third party pharmacies included in our retail pharmacy network contracts. Pursuant to these contracts, we are contractually required to pay the third party pharmacies in our retail pharmacy network for products sold, regardless of whether we are paid by our clients. Our responsibilities under these client contracts typically include validating eligibility and coverage levels, communicating the prescription price and the co-payments due to the third party retail pharmacy, identifying possible adverse drug interactions for the pharmacist to address with the physician prior to dispensing, suggesting clinically appropriate generic alternatives where appropriate and approving the prescription for dispensing. Although we do not have credit risk with respect to Retail Co-Payments or inventory risk related to retail network claims, we believe that all of the other indicators of gross revenue reporting are present. For contracts under which we act as an agent, we record revenues using the net method.

We deduct from our revenues the manufacturers' rebates that are earned by our clients based on their members' utilization of brand-name formulary drugs. We estimate these rebates at period-end based on actual and estimated claims data and our estimates of the manufacturers' rebates earned by our clients. We base our estimates on the best available data at period-end and recent history for the various factors that can affect the amount of rebates due to the client. We adjust our rebates payable to clients to the actual amounts paid when these rebates are paid or as significant events occur. We record any cumulative effect of these adjustments against revenues as identified, and adjust our estimates prospectively to consider recurring matters. Adjustments generally result from contract changes with our clients or manufacturers, differences between the estimated and actual product mix subject to rebates or whether the product was included in the applicable formulary. We also deduct from our revenues pricing guarantees and guarantees regarding the level of service we will provide to the client or member as well as other payments made to our clients. Because the inputs to most of these estimates are not subject to a high degree of subjectivity or volatility, the effect of adjustments between estimated and actual amounts have not been material to our results of operations or financial position.

We participate in the federal government's Medicare Part D program as a PDP through our SilverScript subsidiary. Our net revenues include insurance premiums earned by the PDP, which are determined based on the PDP's annual bid and related contractual arrangements with CMS. The insurance premiums include a beneficiary premium, which is the responsibility of the PDP member, but which is subsidized by CMS in the case of low-income members, and a direct premium paid by CMS. Premiums collected in advance are initially deferred as accrued expenses and are then recognized ratably as revenue over the period in which members are entitled to receive benefits.

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In addition to these premiums, our net revenues include co-payments, coverage gap benefits, deductibles and co-insurance (collectively, the "Member Co-Payments") related to PDP members' actual prescription claims. In certain cases, CMS subsidizes a portion of these Member Co-Payments and we are paid an estimated prospective Member Co-Payment subsidy, each month. The prospective Member Co-Payment subsidy amounts received from CMS are also included in our net revenues. We assume no risk for these amounts, which represented 5.9%, 6.3% and 6.4% of consolidated net revenues in 2016, 2015 and 2014, respectively. If the prospective Member Co-Payment subsidies received differ from the amounts based on actual prescription claims, the difference is recorded in either accounts receivable or accrued expenses. We account for fully insured CMS obligations and Member Co-Payments (including the amounts subsidized by CMS) using the gross method consistent with our revenue recognition policies for Mail Co-Payments and Retail Co-Payments. We have recorded estimates of various assets and liabilities arising from our participation in the Medicare Part D program based on information in our claims management and enrollment systems. Significant estimates arising from our participation in the Medicare Part D program include: (i) estimates of low-income cost subsidy, reinsurance amounts and coverage gap discount amounts ultimately payable to or receivable from CMS based on a detailed claims reconciliation, (ii) an estimate of amounts payable to CMS under a risk-sharing feature of the Medicare Part D program design, referred to as the risk corridor and (iii) estimates for claims that have been reported and are in the process of being paid or contested and for our estimate of claims that have been incurred but have not yet been reported. Actual amounts of Medicare Part D-related assets and liabilities could differ significantly from amounts recorded. Historically, the effect of these adjustments has not been material to our results of operations or financial position.

#### **Retail/LTC Segment**

**Retail Pharmacy** We recognize revenue from the sale of front store merchandise at the time the merchandise is purchased by the retail customer and recognize revenue from the sale of prescription drugs when the prescription is picked up by the customer. Customer returns are not material. Sales taxes are not included in revenue.

**Long-term Care** We recognize revenue when products are delivered or services are rendered or provided to our customers, prices are fixed and determinable, and collection is reasonably assured. A significant portion of our revenues from sales of pharmaceutical and medical products are reimbursed by the federal Medicare Part D program and, to a lesser extent, state Medicaid programs. Payments for services rendered to patients covered by these programs are generally less than billed charges. We monitor our revenues and receivables from these reimbursement sources, as well as other third party insurance payors, and record an estimated contractual allowance for sales and receivable balances at the revenue recognition date, to properly account for anticipated differences between billed and reimbursed amounts. Accordingly, the total net revenues and receivables reported in our consolidated financial statements are recorded at the amount expected to be ultimately received from these payors. Since billing functions for a portion of our revenue systems are largely computerized, enabling on-line adjudication at the time of sale to record net revenues, our exposure in connection with estimating contractual allowance adjustments is limited primarily to unbilled and initially rejected Medicare, Medicaid and third party claims (typically approved for reimbursement once additional information is provided to the payor). For the remaining portion of our revenue systems, the contractual allowance is estimated for all billed, unbilled and initially rejected Medicare, Medicaid and third party claims. We evaluate several criteria in developing the estimated contractual allowances on a monthly basis, including historical trends based on actual claims paid, current contract and reimbursement terms, and changes in customer base and payor/product mix. Contractual allowance estimates are adjusted to actual amounts as cash is received and claims are settled, and the aggregate impact of these resulting adjustments was not significant to our results of operations. Further, we do not expect the impact of changes in estimates related to unsettled contractual allowance amounts from Medicare, Medicaid and third party payors as of December 31, 2016 to be significant to our future consolidated results of operations, financial position and cash flows.

Patient co-payments associated with Medicare Part D, certain state Medicaid programs, Medicare Part B and certain third party payors are typically not collected at the time products are delivered or services are rendered, but are billed to the individuals as part of our normal billing procedures and subject to our normal accounts receivable collections procedures.

**Health Care Clinics** for services provided by our health care clinics, revenue recognition occurs for completed services provided to patients, with adjustments taken for third party payor contractual obligations and patient direct bill historical collection rates.

**Loyalty Program** our customer loyalty program, ExtraCare®, is comprised of two components, ExtraSavings™ and ExtraBucks® Rewards. ExtraSavings coupons redeemed by customers are recorded as a reduction of revenue when redeemed. ExtraBucks Rewards are accrued as a charge to cost of revenues when earned, net of estimated breakage. We determine breakage based on our historical redemption patterns.

## **Allowances for Doubtful Accounts**

Accounts receivable primarily includes amounts due from third party providers (e.g., pharmacy benefit managers, insurance companies, governmental agencies and long-term care facilities), clients, members and private pay customers, as well as vendors and manufacturers. We provide a reserve for accounts receivable considered to be at increased risk of becoming uncollectible by establishing an allowance to reduce the carrying value of such receivables to their estimated net realizable value. We establish this allowance for doubtful accounts and consider such factors as historical collection experience, (i.e., payment history and credit losses) and creditworthiness, specifically identified credit risks, aging of accounts receivable by payor category, current and expected economic conditions and other relevant factors. We regularly review our allowance for doubtful accounts for appropriateness. Judgment is used to assess the collectability of account balances and the economic ability of a customer to pay.

Our allowance for doubtful accounts as of December 31, 2016 was \$286 million, compared with \$161 million as of December 31, 2015. Our allowance for doubtful accounts represented 2.3% and 1.3% of gross receivables (net of contractual allowance adjustments) as of December 31, 2016 and 2015, respectively. Unforeseen future developments could lead to changes in our provision for doubtful accounts levels and future allowance for doubtful accounts percentages. For example, a one percentage point increase in the allowance for doubtful accounts as a percentage of gross receivables as of December 31, 2016 would result in an increase to the provision of doubtful accounts of approximately \$126 million.

Given our experience, we believe that our aggregate reserves for potential losses are adequate, but if any of our larger customers were to unexpectedly default on their obligations, our overall allowances for doubtful accounts may prove to be inadequate. In particular, if economic conditions worsen, the payor mix shifts significantly or reimbursement rates are adversely affected, we may adjust our allowance for doubtful accounts accordingly, and our accounts receivable collections, cash flows, financial position and results of operations could be adversely affected.

## **Vendor Allowances and Purchase Discounts**

### **Pharmacy Services Segment**

Our Pharmacy Services Segment receives purchase discounts on products purchased. Contractual arrangements with vendors, including manufacturers, wholesalers and retail pharmacies, normally provide for the Pharmacy Services Segment to receive purchase discounts from established list prices in one, or a combination, of the following forms: (i) a direct discount at the time of purchase, (ii) a discount for the prompt payment of invoices or (iii) when products are purchased indirectly from a manufacturer (e.g., through a wholesaler or retail pharmacy), a discount (or rebate) paid subsequent to dispensing. These rebates are recognized when prescriptions are dispensed

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and are generally calculated and billed to manufacturers within 30 days of the end of each completed quarter. Historically, the effect of adjustments resulting from the reconciliation of rebates recognized to the amounts billed and collected has not been material to the results of operations. We account for the effect of any such differences as a change in accounting estimate in the period the reconciliation is completed. The Pharmacy Services Segment also receives additional discounts under its wholesaler contracts if it exceeds contractually defined purchase volumes. In addition, the Pharmacy Services Segment receives fees from pharmaceutical manufacturers for administrative services. Purchase discounts and administrative service fees are recorded as a reduction of "Cost of revenues".

#### Retail/LTC Segment

Vendor allowances received by the Retail/LTC Segment reduce the carrying cost of inventory and are recognized in cost of revenues when the related inventory is sold, unless they are specifically identified as a reimbursement of incremental costs for promotional programs and/or other services provided. Amounts that are directly linked to advertising commitments are recognized as a reduction of advertising expense (included in operating expenses) 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 revenues 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 revenues on a straight-line basis over the life of the related contract.

We have not made any material changes in the way we account for vendor allowances and purchase discounts during the past three years.

#### Inventory

Inventories are valued at the lower of cost or market using the weighted average cost method.

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 store and a continuous cycle count process is the primary procedure used to validate the inventory balances on hand in each distribution center and mail facility to ensure that the amounts reflected in the accompanying 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 physical inventory loss trends.

Our total reserve for estimated inventory losses covered by this critical accounting policy was \$283 million as of December 31, 2016. 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 \$28 million as of December 31, 2016.

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.

#### Goodwill and Intangible Assets

Identifiable intangible assets consist primarily of trademarks, client contracts and relationships, favorable leases and covenants not to compete. These intangible assets arise primarily from the determination of their respective fair market values at the date of acquisition.



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Amounts assigned to identifiable intangible assets, and their related useful lives, are derived from established valuation techniques and management estimates. Goodwill represents the excess of amounts paid for acquisitions over the fair value of the net identifiable assets acquired.

We evaluate the recoverability of certain long-lived assets, including intangible assets with finite lives, but excluding goodwill and intangible assets with indefinite lives which are tested for impairment using separate tests, whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. We group and evaluate these long-lived assets for impairment at the lowest level at which individual cash flows can be identified. When evaluating these long-lived assets for potential impairment, we first compare the carrying amount of the asset group to the asset group'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 asset group'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 asset group's estimated future cash flows (discounted and with interest charges). Our long-lived asset impairment loss calculation contains uncertainty since we must use judgment to estimate each asset group's future sales, profitability and cash flows. When preparing these estimates, we consider 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 and regulatory conditions, efforts of third party organizations to reduce their prescription drug costs and/or increased member co-payments, the continued efforts of competitors to gain market share and consumer spending patterns.

Goodwill and indefinitely-lived intangible assets are subject to annual impairment reviews, or more frequent reviews if events or circumstances indicate that the carrying value may not be recoverable.

Indefinitely-lived intangible assets are tested by comparing the estimated fair value of the asset to its carrying value. If the carrying value of the asset exceeds its estimated fair value, an impairment loss is recognized and the asset is written down to its estimated fair value.

Our indefinitely-lived intangible asset impairment loss calculation contains uncertainty since we must use judgment to estimate the fair value based on the assumption that in lieu of ownership of an intangible asset, the Company would be willing to pay a royalty in order to utilize the benefits of the asset. Value is estimated by discounting the hypothetical royalty payments to their present value over the estimated economic life of the asset. These estimates can be affected by a number of factors including, but not limited to, general economic conditions, availability of market information as well as the profitability of the Company.

Goodwill is tested for impairment on a reporting unit basis using a two-step process. The first step of the impairment test is to identify potential impairment by comparing the reporting unit's fair value with its net book value (or carrying amount), including goodwill. The fair value of our reporting units is estimated using a combination of the discounted cash flow valuation model and comparable market transaction models. If the fair value of the reporting unit exceeds its carrying amount, the reporting unit's goodwill is not considered to be impaired and the second step of the impairment test is not performed. If the carrying amount of the reporting unit exceeds its fair value, the second step of the impairment test is performed to measure the amount of impairment loss, if any. The second step of the impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of the goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to that excess.

The determination of the fair value of our reporting units requires the Company to make significant assumptions and estimates. These assumptions and estimates primarily include, but are not limited to, the selection of appropriate peer group companies; control premiums and valuation multiples appropriate for acquisitions in the industries in which the Company competes; discount rates, terminal growth rates; and forecasts of revenue, operating profit,

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depreciation and amortization, capital expenditures and future working capital requirements. When determining these assumptions and preparing these estimates, we consider each reporting unit's historical results and current operating trends and our consolidated revenues, profitability and cash flow results, forecasts and industry trends. Our estimates can be affected by a number of factors including, but not limited to, general economic and regulatory conditions, our market capitalization, efforts of third party organizations to reduce their prescription drug costs and/or increase member co-payments, the continued efforts of competitors to gain market share and consumer spending patterns.

The carrying value of goodwill and other intangible assets covered by this critical accounting policy was \$38.2 billion and \$13.5 billion as of December 31, 2016, respectively. We did not record any impairment losses related to goodwill or other intangible assets during 2016, 2015 or 2014. During the third quarter of 2016, we performed our required annual impairment tests of goodwill and indefinitely-lived trademarks. The goodwill impairment tests resulted in the fair values of our Pharmacy Services and Retail Pharmacy reporting units exceeding their carrying values by significant margins. The fair values of our LTC and RxCrossroads reporting units exceeded their carrying values by 7% and 12%, respectively. The balance of goodwill for our LTC and RxCrossroads reporting units at December 31, 2016 was approximately \$6.4 billion and \$0.6 billion, respectively.

Although we believe we have sufficient current and historical information available to us to test for impairment, it is possible that actual results could differ from the estimates used in our impairment tests.

We have not made any material changes in the methodologies utilized to test the carrying values of goodwill and intangible assets for impairment during the past three years.

### Closed Store Lease Liability

We account for closed store lease termination costs when a leased store is closed. When a leased store is closed, we record a liability for the estimated present value of the remaining obligation under the noncancelable 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 contain 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.

Our total closed store lease liability covered by this critical accounting policy was \$183 million as of December 31, 2016. This amount is net of \$98 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 \$10 million as of December 31, 2016.

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

During the year ending December 31, 2017, we intend to close approximately 70 retail stores and expect to take a charge of approximately \$225 million associated with the remaining lease obligations of such stores.

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## 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 other standard insurance industry actuarial assumptions. On a quarterly basis, we review our self-insurance liability to determine if it is adequate as it relates to our general liability, workers' compensation and auto liability. Similar reviews are conducted semi-annually to determine if our self-insurance liability is adequate for our health and medical liability.

Our total self-insurance liability covered by this critical accounting policy was \$670 million as of December 31, 2016. 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 \$67 million as of December 31, 2016.

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

## Income Taxes

Income taxes are accounted for using the asset and liability method. Deferred tax assets and liabilities are established for any temporary differences between financial and tax reporting bases and are adjusted as needed to reflect changes in the enacted tax rates expected to be in effect when the temporary differences reverse. The deferred tax assets are reduced, if necessary, by a valuation allowance to the extent future realization of those losses, deductions or other tax benefits is sufficiently uncertain.

Significant judgment is required in determining the provision for income taxes and the related taxes payable and deferred tax assets and liabilities since, in the ordinary course of business, there are transactions and calculations where the ultimate tax outcome is uncertain. Additionally, our tax returns are subject to audit by various domestic and foreign tax authorities that could result in material adjustments based on differing interpretations of the tax laws. Although we believe that our estimates are reasonable and are based on the best available information at the time we prepare the provision, actual results could differ from these estimates resulting in a final tax outcome that may be materially different from that which is reflected in our consolidated financial statements.

The tax benefit from an uncertain tax position is recognized only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the consolidated financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon settlement. Interest and/or penalties related to uncertain tax positions are recognized in income tax expense. Significant judgment is required in determining our uncertain tax positions. We have established accruals for uncertain tax positions using our best judgment and adjust these accruals, as warranted, due to changing facts and circumstances.

## New Accounting Pronouncements

See Note 1 "Significant Accounting Policies" to the consolidated financial statements for a description of New Accounting Pronouncements applicable to the Company.

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### Cautionary Statement Concerning Forward-Looking Statements

This annual report contains forward-looking statements within the meaning of the federal securities laws. In addition, 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 U.S. Securities and Exchange Commission ("SEC") and in its reports to stockholders, press releases, webcasts, conference calls, meetings and other communications. Generally, the inclusion of the words "believe," "expect," "intend," "estimate," "project," "anticipate," "will," "should" and similar expressions identify statements that constitute forward-looking statements. All statements addressing operating performance of CVS Health Corporation or any subsidiary, events or developments that the Company expects or anticipates will occur in the future, including statements relating to corporate strategy; revenue growth; earnings or earnings per common share growth; adjusted earnings or adjusted earnings per common share growth; free cash flow; debt ratings; inventory levels; inventory turn and loss rates; store development; relocations and new market entries; retail pharmacy business, sales trends and operations; PBM business, sales trends and operations; specialty pharmacy business, sales trends and operations; LTC pharmacy business, sales trends and operations; the Company's ability to attract or retain customers and clients; Medicare Part D competitive bidding, enrollment and operations; new product development; and the impact of industry and regulatory developments, as well as statements expressing optimism or pessimism about future operating results or events, are forward-looking statements within the meaning of the federal securities laws.

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 as described in our SEC filings, including those set forth in the Risk Factors section within the 2016 Annual Report on Form 10-K, and including, but not limited to:

- *Risks relating to the health of the economy in general and in the markets we serve, which could impact consumer purchasing power, preferences and/or spending patterns, drug utilization trends, the financial health of our PBM and LTC clients, retail and specialty pharmacy payors or other payors doing business with the Company and our ability to secure necessary financing, suitable store locations and sale-leaseback transactions on acceptable terms.*
- *Efforts to reduce reimbursement levels and alter health care financing practices, including pressure to reduce reimbursement levels for generic drugs.*
- *The possibility of PBM and LTC client loss and/or the failure to win new PBM and LTC business, including as a result of failure to win renewal of expiring contracts, contract termination rights that may permit clients to terminate a contract prior to expiration and early or periodic renegotiation of pricing by clients prior to expiration of a contract.*
- *The possibility of loss of Medicare Part D business and/or failure to obtain new Medicare Part D business, whether as a result of the annual Medicare Part D competitive bidding process or otherwise.*
- *Risks related to the frequency and rate of the introduction of generic drugs and brand name prescription products.*
- *Risks of declining gross margins attributable to increased competitive pressures, increased client demand for lower prices, enhanced service offerings and/or higher service levels and market dynamics and, with respect to the PBM industry, regulatory changes that impact our ability to offer plan sponsors pricing that includes the use of retail "differential" or "spread" or the use of maximum allowable cost pricing.*

- *Regulatory changes, business changes and compliance requirements and restrictions that may be imposed by Centers for Medicare and Medicaid Services (“CMS”), Office of Inspector General or other government agencies relating to the Company’s participation in Medicare, Medicaid and other federal and state government-funded programs, including sanctions and remedial actions that may be imposed by CMS on our Medicare Part D business.*
- *Risks and uncertainties related to the timing and scope of reimbursement from Medicare, Medicaid and other government-funded programs, including the possible impact of sequestration, the impact of other federal budget, debt and deficit negotiations and legislation that could delay or reduce reimbursement from such programs and the impact of any closure, suspension or other changes affecting federal or state government funding or operations.*
- *Possible changes in industry pricing benchmarks used to establish pricing in many of our PBM and LTC client contracts, pharmaceutical purchasing arrangements, retail network contracts, specialty payor agreements and other third party payor contracts.*
- *Efforts to increase reimbursement rates in PBM pharmacy networks and to inhibit the ability of PBMs to audit network pharmacies for fraud, waste and abuse.*
- *Risks related to increasing oversight of PBM activities by state departments of insurance.*
- *A highly competitive business environment, including the uncertain impact of increased consolidation in the PBM industry, the possibility of combinations, joint ventures or other collaboration between PBMs and retailers, uncertainty concerning the ability of our retail pharmacy business to secure and maintain contractual relationships with PBMs and other payors on acceptable terms, uncertainty concerning the ability of our PBM business to secure and maintain competitive access, pricing and other contract terms from retail network pharmacies in an environment where some PBM clients are willing to consider adopting narrow or more restricted retail pharmacy networks, and the possibility of our retail stores or specialty pharmacies being excluded from narrow or restricted networks.*
- *The Company’s ability to timely identify or effectively respond to changing consumer preferences and spending patterns, an inability to expand the products being purchased by our customers, or the failure or inability to obtain or offer particular categories of products.*
- *Risks relating to our ability to secure timely and sufficient access to the products we sell from our domestic and/or international suppliers, including limited distribution drugs.*
- *Reform of the U.S. health care system, including ongoing implementation of ACA and the possible repeal and replacement of all or parts of ACA, continuing legislative efforts, regulatory changes and judicial interpretations impacting our health care system and the possibility of shifting political and legislative priorities related to reform of the health care system in the future.*
- *Risks related to changes in legislation, regulation and government policy (including through the use of Executive Orders) that could significantly impact our business and the health care and retail industries, including the possibility of major developments in tax policy or trade relations, such as the disallowance of tax deductions for imported merchandise or the imposition of unilateral tariffs on imported products.*
- *Risks relating to any failure to properly maintain our information technology systems, our information security systems and our infrastructure to support our business and to protect the privacy and security of sensitive customer and business information.*
- *Risks related to compliance with a broad and complex regulatory framework, including compliance with new and existing federal, state and local laws and regulations relating to health care, network pharmacy reimbursement and auditing, accounting standards, corporate securities, tax, environmental and other laws and regulations affecting our business.*

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- *Risks related to litigation, government investigations and other legal proceedings as they relate to our business, the pharmacy services, retail pharmacy, LTC pharmacy or retail clinic industries, or to the health care industry generally.*
- *The risk that any condition related to the closing of any proposed acquisition may not be satisfied on a timely basis or at all, including the inability to obtain required regulatory approvals of any proposed acquisition, or on the terms desired or anticipated; the risk that such approvals may result in the imposition of conditions that could adversely affect the resulting combined company or the expected benefits of any proposed transaction; and the risk that the proposed transactions fail to close for any other reason.*
- *The possibility that the anticipated synergies and other benefits from any acquisition by us will not be realized, or will not be realized within the expected time periods.*
- *The risks and uncertainties related to our ability to integrate the operations, products, services and employees of any entities acquired by us and the effect of the potential disruption of management's attention from ongoing business operations due to any pending acquisitions.*
- *The accessibility or availability of adequate financing on a timely basis and on reasonable terms.*
- *Risks related to the outcome of any legal proceedings related to, or involving any entity that is a part of, any proposed acquisition contemplated by us.*
- *Other risks and uncertainties detailed from time to time in our filings with the SEC.*

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 a material adverse effect 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.



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## Management's Report on Internal Control Over Financial Reporting

We are responsible for establishing and maintaining adequate 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 receipts 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 31, 2016.

We conducted an assessment of the effectiveness of our internal controls over financial reporting based on the criteria set forth in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework). 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 assessment, 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 31, 2016.

Ernst & Young 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 an audit of internal control over financial reporting. Their accompanying reports are based upon audits conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States).

February 9, 2017

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## Report of Ernst & Young LLP, Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of CVS Health Corporation

We have audited CVS Health Corporation's internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). CVS Health Corporation'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 included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on 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, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, 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, CVS Health Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of CVS Health Corporation as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2016 of CVS Health Corporation and our report dated February 9, 2017 expressed an unqualified opinion thereon.

*Ernst & Young LLP*

Boston, Massachusetts  
February 9, 2017

# Consolidated Statements of Income

YEAR ENDED DECEMBER 31,

IN MILLIONS, EXCEPT PER SHARE AMOUNTS

	2016	2015	2014
Net revenues	\$ 177,526	\$ 153,290	\$ 139,367
Cost of revenues	148,669	126,762	114,000
Gross profit	28,857	26,528	25,367
Operating expenses	18,519	17,074	16,568
Operating profit	10,338	9,454	8,799
Interest expense, net	1,058	838	600
Loss on early extinguishment of debt	643	—	521
Income before income tax provision	8,637	8,616	7,678
Income tax provision	3,317	3,386	3,033
Income from continuing operations	5,320	5,230	4,645
Income (loss) from discontinued operations, net of tax	(1)	9	(1)
Net income	5,319	5,239	4,644
Net income attributable to noncontrolling interest	(2)	(2)	—
Net income attributable to CVS Health	\$ 5,317	\$ 5,237	\$ 4,644
Basic earnings per share:			
Income from continuing operations attributable to CVS Health	\$ 4.93	\$ 4.65	\$ 3.98
Income (loss) from discontinued operations attributable to CVS Health	\$ —	\$ 0.01	\$ —
Net income attributable to CVS Health	\$ 4.93	\$ 4.66	\$ 3.98
Weighted average shares outstanding	1,073	1,118	1,161
Diluted earnings per share:			
Income from continuing operations attributable to CVS Health	\$ 4.91	\$ 4.62	\$ 3.96
Income (loss) from discontinued operations attributable to CVS Health	\$ —	\$ 0.01	\$ —
Net income attributable to CVS Health	\$ 4.90	\$ 4.63	\$ 3.96
Weighted average shares outstanding	1,079	1,126	1,169
Dividends declared per share	\$ 1.70	\$ 1.40	\$ 1.10

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Comprehensive Income

YEAR ENDED DECEMBER 31,

IN MILLIONS

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net income	<b>\$ 5,319</b>	\$ 5,239	\$ 4,644
Other comprehensive income (loss):			
Foreign currency translation adjustments, net of tax	<b>38</b>	(100)	(35)
Net cash flow hedges, net of tax	<b>2</b>	2	4
Pension and other postretirement benefits, net of tax	<b>13</b>	(43)	(37)
Total other comprehensive income (loss)	<b>53</b>	(141)	(68)
Comprehensive income	<b>5,372</b>	5,098	4,576
Comprehensive income attributable to noncontrolling interest	<b>(2)</b>	(2)	—
Comprehensive income attributable to CVS Health	<b>\$ 5,370</b>	\$ 5,096	\$ 4,576

See accompanying notes to consolidated financial statements.

# Consolidated Balance Sheets

DECEMBER 31,

IN MILLIONS, EXCEPT PER SHARE AMOUNTS

	2016	2015
<b>Assets:</b>		
Cash and cash equivalents	\$ 3,371	\$ 2,459
Short-term investments	87	88
Accounts receivable, net	12,164	11,888
Inventories	14,760	14,001
Other current assets	660	722
<b>Total current assets</b>	<b>31,042</b>	29,158
Property and equipment, net	10,175	9,855
Goodwill	38,249	38,106
Intangible assets, net	13,511	13,878
Other assets	1,485	1,440
<b>Total assets</b>	<b>\$ 94,462</b>	\$ 92,437
<b>Liabilities:</b>		
Accounts payable	\$ 7,946	\$ 7,490
Claims and discounts payable	9,451	7,653
Accrued expenses	6,937	6,829
Short-term debt	1,874	—
Current portion of long-term debt	42	1,197
<b>Total current liabilities</b>	<b>26,250</b>	23,169
Long-term debt	25,615	26,267
Deferred income taxes	4,214	4,217
Other long-term liabilities	1,549	1,542
Commitments and contingencies (Note 11)	—	—
Redeemable noncontrolling interest	—	39
<b>Shareholders' equity:</b>		
CVS Health shareholders' equity:		
Preferred stock, par value \$0.01: 0.1 shares authorized; none issued or outstanding	—	—
Common stock, par value \$0.01: 3,200 shares authorized; 1,705 shares issued and 1,061 shares outstanding at December 31, 2016 and 1,699 shares issued and 1,101 shares outstanding at December 31, 2015	17	17
Treasury stock, at cost: 643 shares at December 31, 2016 and 597 shares at December 31, 2015	(33,452)	(28,886)
Shares held in trust: 1 share at December 31, 2016 and 2015	(31)	(31)
Capital surplus	31,618	30,948
Retained earnings	38,983	35,506
Accumulated other comprehensive income (loss)	(305)	(358)
<b>Total CVS Health shareholders' equity</b>	<b>36,830</b>	37,196
Noncontrolling interest	4	7
<b>Total shareholders' equity</b>	<b>36,834</b>	37,203
<b>Total liabilities and shareholders' equity</b>	<b>\$ 94,462</b>	\$ 92,437

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

YEAR ENDED DECEMBER 31,

IN MILLIONS	2016	2015	2014
Cash flows from operating activities:			
Cash receipts from customers	\$ 172,310	\$ 148,954	\$ 132,406
Cash paid for inventory and prescriptions dispensed by retail network pharmacies	(142,511)	(122,498)	(105,362)
Cash paid to other suppliers and employees	(15,550)	(14,162)	(15,344)
Interest received	20	21	15
Interest paid	(1,140)	(629)	(647)
Income taxes paid	(3,060)	(3,274)	(2,931)
Net cash provided by operating activities	10,069	8,412	8,137
Cash flows from investing activities:			
Purchases of property and equipment	(2,224)	(2,367)	(2,136)
Proceeds from sale-leaseback transactions	230	411	515
Proceeds from sale of property and equipment and other assets	37	35	11
Acquisitions (net of cash acquired) and other investments	(539)	(11,475)	(2,439)
Purchase of available-for-sale investments	(65)	(267)	(157)
Maturity of available-for-sale investments	91	243	161
Net cash used in investing activities	(2,470)	(13,420)	(4,045)
Cash flows from financing activities:			
Increase (decrease) in short-term debt	1,874	(685)	685
Proceeds from issuance of long-term debt	3,455	14,805	1,483
Repayments of long-term debt	(5,943)	(2,902)	(3,100)
Purchase of noncontrolling interest in subsidiary	(39)	—	—
Payment of contingent consideration	(26)	(58)	—
Dividends paid	(1,840)	(1,576)	(1,288)
Proceeds from exercise of stock options	224	299	421
Excess tax benefits from stock-based compensation	72	127	106
Repurchase of common stock	(4,461)	(5,001)	(4,001)
Other	(5)	(3)	—
Net cash (used in) provided by financing activities	(6,689)	5,006	(5,694)
Effect of exchange rate changes on cash and cash equivalents	2	(20)	(6)
Net increase (decrease) in cash and cash equivalents	912	(22)	(1,608)
Cash and cash equivalents at the beginning of the year	2,459	2,481	4,089
Cash and cash equivalents at the end of the year	\$ 3,371	\$ 2,459	\$ 2,481
Reconciliation of net income to net cash provided by operating activities:			
Net income	\$ 5,319	\$ 5,239	\$ 4,644
Adjustments required to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	2,475	2,092	1,931
Stock-based compensation	222	230	165
Loss on early extinguishment of debt	643	—	521
Deferred income taxes and other noncash items	153	(266)	(58)
Change in operating assets and liabilities, net of effects from acquisitions:			
Accounts receivable, net	(243)	(1,594)	(737)
Inventories	(742)	(1,141)	(770)
Other current assets	35	355	(383)
Other assets	(43)	2	9
Accounts payable and claims and discounts payable	2,189	2,834	1,742
Accrued expenses	59	765	1,060
Other long-term liabilities	2	(104)	13
Net cash provided by operating activities	\$ 10,069	\$ 8,412	\$ 8,137

See accompanying notes to consolidated financial statements.



## Consolidated Statements of Shareholders' Equity

IN MILLIONS	SHARES YEAR ENDED DECEMBER 31,			DOLLARS YEAR ENDED DECEMBER 31,		
	2016	2015	2014	2016	2015	2014
Common stock:						
Beginning of year	1,699	1,691	1,680	\$ 17	\$ 17	\$ 17
Stock options exercised and issuance of stock awards	6	8	11	—	—	—
End of year	1,705	1,699	1,691	\$ 17	\$ 17	\$ 17
Treasury stock:						
Beginning of year	(597)	(550)	(500)	\$(28,886)	\$ (24,078)	\$ (20,169)
Purchase of treasury shares	(47)	(48)	(51)	(4,606)	(4,856)	(4,001)
Employee stock purchase plan issuances	1	1	1	40	48	92
End of year	(643)	(597)	(550)	\$(33,452)	\$ (28,886)	\$ (24,078)
Shares held in trust:						
Balance at beginning and end of year	(1)	(1)	(1)	\$ (31)	\$ (31)	\$ (31)
Capital surplus:						
Beginning of year				\$ 30,948	\$ 30,418	\$ 29,777
Stock option activity, stock awards and other				449	533	535
Excess tax benefit on stock options and stock awards				76	142	106
2015 accelerated share repurchase not settled until 2016				145	(145)	—
End of year				\$ 31,618	\$ 30,948	\$ 30,418
Retained earnings:						
Beginning of year				\$ 35,506	\$ 31,849	\$ 28,493
Changes in inventory accounting principles				—	(4)	—
Net income attributable to CVS Health				5,317	5,237	4,644
Common stock dividends				(1,840)	(1,576)	(1,288)
End of year				\$ 38,983	\$ 35,506	\$ 31,849
Accumulated other comprehensive loss:						
Beginning of year				\$ (358)	\$ (217)	\$ (149)
Foreign currency translation adjustments, net of tax				38	(100)	(35)
Net cash flow hedges, net of tax				2	2	4
Pension and other postretirement benefits, net of tax				13	(43)	(37)
End of year				\$ (305)	\$ (358)	\$ (217)
Total CVS Health shareholders' equity				\$ 36,830	\$ 37,196	\$ 37,958
Noncontrolling interest:						
Beginning of year				\$ 7	\$ 5	\$ —
Business combinations				—	1	5
Capital contributions				1	2	—
Net income attributable to noncontrolling interest <sup>(1)</sup>				1	1	—
Distributions				(5)	(2)	—
End of year				\$ 4	\$ 7	\$ 5
Total shareholders' equity				\$ 36,834	\$ 37,203	\$ 37,963

(1) Excludes \$1 million attributable to redeemable noncontrolling interest in 2016 and 2015 (See Note 1 "Significant Accounting Policies").

See accompanying notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

## 1 | Significant Accounting Policies

**Description of business** CVS Health Corporation and its subsidiaries (the “Company”) is the largest integrated pharmacy health care provider in the United States based upon revenues and prescriptions filled. The Company currently has three reportable business segments, Pharmacy Services, Retail/LTC and Corporate, which are described below.

**Pharmacy Services Segment (the “PSS”)** The PSS provides a full range of pharmacy benefit management services including plan design offerings and administration, formulary management, Medicare Part D services, mail order, specialty pharmacy and infusion services, retail pharmacy network management services, prescription management systems, clinical services, disease management services and medical spend management. The Company’s clients are primarily employers, insurance companies, unions, government employee groups, health plans, Medicare Part D, Managed Medicaid plans, plans offered on the public and private exchanges, and other sponsors of health benefit plans and individuals throughout the United States.

As a pharmacy benefits manager, the PSS manages the dispensing of pharmaceuticals through the Company’s mail order pharmacies and national network of more than 68,000 retail pharmacies, consisting of approximately 41,000 chain pharmacies and 27,000 independent pharmacies, to eligible members in the benefits plans maintained by the Company’s clients and utilizes its information systems to perform, among other things, safety checks, drug interaction screenings and brand to generic substitutions.

The PSS’ specialty pharmacies support individuals that require complex and expensive drug therapies. The specialty pharmacy business includes mail order and retail specialty pharmacies that operate under the CVS Caremark®, CarePlus CVS Pharmacy™, Navarro® Health Services and Advanced Care Scripts (“ACS Pharmacy”) names. In January 2014, the Company enhanced its offerings of specialty infusion services and began offering enteral nutrition services through Coram LLC and its subsidiaries (collectively, “Coram”). In August 2015, the Company further expanded its specialty offerings with the acquisition of ACS Pharmacy which was part of the Omnicare, Inc. (“Omnicare”) acquisition. See Note 2 “Acquisitions.”

The PSS also provides health management programs, which include integrated disease management for 18 conditions, through the Company’s Accordant® rare disease management offering.

In addition, through the Company’s SilverScript Insurance Company (“SilverScript”) subsidiary, the PSS is a national provider of drug benefits to eligible beneficiaries under the federal government’s Medicare Part D program.

The PSS generates net revenues primarily by contracting with clients to provide prescription drugs to plan members. Prescription drugs are dispensed by the mail order pharmacies, specialty pharmacies and national network of retail pharmacies. Net revenues are also generated by providing additional services to clients, including administrative services such as claims processing and formulary management, as well as health care related services such as disease management.

The PSS operates under the CVS Caremark® Pharmacy Services, Caremark®, CVS Caremark™, CarePlus CVS Pharmacy™, Accordant®, SilverScript®, Coram®, CVS Specialty™, NovoLogix®, Navarro® Health Services and ACS Pharmacy names. As of December 31, 2016, the PSS operated 23 retail specialty pharmacy stores, 13 specialty mail order pharmacies and four mail order dispensing pharmacies, and 84 branches for infusion and enteral services, including 73 ambulatory infusion suites and three centers of excellence, located in 41 states, Puerto Rico and the District of Columbia.

**Retail/LTC Segment (the “RLS”)** The RLS sells prescription drugs and a wide assortment of general merchandise, including over-the-counter drugs, beauty products and cosmetics, personal care products, convenience foods, photo finishing services, seasonal merchandise, and greeting cards, through the Company’s CVS Pharmacy®, CVS®, CVS Pharmacy y más®, Longs Drugs®, Navarro Discount Pharmacy® and Drogeria Onofre™ retail stores and online through CVS.com®, Navarro.com and Onofre.com.br.

The RLS also provides health care services through its MinuteClinic® health care clinics. MinuteClinics are staffed by nurse practitioners and physician assistants who utilize nationally recognized protocols to diagnose and treat minor health conditions, perform health screenings, monitor chronic conditions and deliver vaccinations.

With the acquisition of Omnicare, the RLS now provides long-term care (“LTC”) operations, which is comprised of providing the distribution of pharmaceuticals, related pharmacy consulting and other ancillary services to chronic care facilities and other care settings, as well as commercialization services which are provided under the name RxCrossroads®. With the December 2015 acquisition of the pharmacies and clinics of Target Corporation (“Target”), the Company added 1,672 pharmacies and approximately 79 clinics.

As of December 31, 2016, the retail pharmacy business included 9,709 retail stores (of which 7,980 were our stores that operated a pharmacy and 1,674 were our pharmacies located within a Target store) located in 49 states, the District of Columbia, Puerto Rico and Brazil operating primarily under the CVS Pharmacy, CVS, CVS Pharmacy y más®, Longs Drugs, Navarro Discount Pharmacy and Drogeria Onofre names, the online retail websites, CVS.com, Navarro.com and Onofre.com.br, and 1,139 retail health care clinics operating under the MinuteClinic name (of which 1,053 were located in our retail pharmacy stores, 79 were located in Target stores and seven were located in corporate campuses or other locations). LTC operations is comprised of 152 spoke pharmacies that primarily handle new prescription orders and 32 hub pharmacies that use proprietary automation to support spoke pharmacies with refill prescriptions. LTC operates primarily under the Omnicare® and NeighborCare® names.

**Corporate Segment** The Corporate Segment provides management and administrative services to support the Company. The Corporate Segment consists of certain aspects of the Company’s executive management, corporate relations, legal, compliance, human resources, information technology and finance departments.

**Principles of consolidation** The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries and variable interest entities (“VIEs”) for which the Company is the primary beneficiary. All material intercompany balances and transactions have been eliminated.

The Company continually evaluates its investments to determine if they represent variable interests in a VIE. If the Company determines that it has a variable interest in a VIE, the Company then evaluates if it is the primary beneficiary of the VIE. The evaluation is a qualitative assessment as to whether the Company has the ability to direct the activities of a VIE that most significantly impact the entity’s economic performance. The Company consolidates a VIE if it is considered to be the primary beneficiary.

Assets and liabilities of VIEs for which the Company is the primary beneficiary were not significant to the Company’s consolidated financial statements. VIE creditors do not have recourse against the general credit of the Company.

**Use of estimates** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

**Fair value hierarchy** The Company utilizes the three-level valuation hierarchy for the recognition and disclosure of fair value measurements. The categorization of assets and liabilities within this hierarchy is based upon the lowest level of input that is significant to the measurement of fair value. The three levels of the hierarchy consist of the following:

- Level 1 - Inputs to the valuation methodology are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

## Notes to Consolidated Financial Statements

- Level 2 - Inputs to the valuation methodology are quoted prices for similar assets and liabilities in active markets, quoted prices in markets that are not active or inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the instrument.
- Level 3 - Inputs to the valuation methodology are unobservable inputs based upon management's best estimate of inputs market participants could use in pricing the asset or liability at the measurement date, including assumptions about risk.

**Cash and cash equivalents** Cash and cash equivalents consist of cash and temporary investments with maturities of three months or less when purchased. The Company invests in short-term money market funds, commercial paper and time deposits, as well as other debt securities that are classified as cash equivalents within the accompanying consolidated balance sheets, as these funds are highly liquid and readily convertible to known amounts of cash. These investments are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices.

**Short-term investments** The Company's short-term investments consist of certificates of deposit with initial maturities of greater than three months when purchased that mature in less than one year from the balance sheet date. These investments, which were classified as available-for-sale within Level 1 of the fair value hierarchy, were carried at fair value, which approximated their historical cost at December 31, 2016 and 2015.

**Fair value of financial instruments** As of December 31, 2016, the Company's financial instruments include cash and cash equivalents, short-term and long-term investments, accounts receivable, accounts payable, contingent consideration liability and short-term debt. Due to the nature of these instruments, the Company's carrying value approximates fair value. The carrying amount and estimated fair value of total long-term debt was \$25.7 billion and \$26.5 billion, respectively, as of December 31, 2016. The fair value of the Company's long-term debt was estimated based on quoted rates currently offered in active markets for the Company's debt, which is considered Level 1 of the fair value hierarchy. There were no outstanding derivative financial instruments as of December 31, 2016 and 2015.

**Foreign currency translation and transactions** For local currency functional currency, assets and liabilities are translated at end-of-period rates while revenues and expenses are translated at average rates in effect during the period. Equity is translated at historical rates and the resulting cumulative translation adjustments are included as a component of accumulated other comprehensive income (loss).

For U.S. dollar functional currency locations, foreign currency assets and liabilities are remeasured into U.S. dollars at end-of-period exchange rates, except for non-monetary balance sheet accounts, which are remeasured at historical exchange rates. Revenue and expense are remeasured at average exchange rates in effect during each period, except for those expenses related to the nonmonetary balance sheet amounts, which are remeasured at historical exchange rates. Gains or losses from foreign currency remeasurement are included in income.

Gains and losses arising from foreign currency transactions and the effects of remeasurements were not material for all periods presented.

**Accounts receivable** Accounts receivable are stated net of an allowance for doubtful accounts. The accounts receivable balance primarily includes amounts due from third party providers (e.g., pharmacy benefit managers, insurance companies, governmental agencies and long-term care facilities), clients, members and private pay customers, as well as vendors and manufacturers. Charges to bad debt are based on both historical write-offs and specifically identified receivables.

The activity in the allowance for doubtful accounts receivable for the years ended December 31 is as follows:

IN MILLIONS	2016	2015	2014
Beginning balance	\$ 161	\$ 256	\$ 256
Additions charged to bad debt expense	221	216	185
Write-offs charged to allowance	(96)	(311)	(185)
Ending balance	\$ 286	\$ 161	\$ 256

**Inventories** Inventories are stated at the lower of weighted average cost or market. Physical inventory counts are taken on a regular basis in each retail store and long-term care pharmacy and a continuous cycle count process is the primary procedure used to validate the inventory balances on hand in each distribution center and mail facility 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.

**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 3 to 10 years for fixtures, equipment and internally developed software. 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. Application development stage costs for significant internally developed software projects are capitalized and depreciated.

The following are the components of property and equipment at December 31:

IN MILLIONS	2016	2015
Land	\$ 1,734	\$ 1,635
Building and improvements	3,226	3,168
Fixtures and equipment	10,956	10,001
Leasehold improvements	4,494	4,015
Software	2,392	2,217
	22,802	21,036
Accumulated depreciation and amortization	(12,627)	(11,181)
Property and equipment, net	\$ 10,175	\$ 9,855

The gross amount of property and equipment under capital leases was \$547 million and \$528 million as of December 31, 2016 and 2015, respectively. Accumulated amortization of property and equipment under capital lease was \$119 million and \$97 million as of December 31, 2016 and 2015, respectively. Amortization of property and equipment under capital lease is included within depreciation expense. Depreciation expense totaled \$1.7 billion in 2016, \$1.5 billion in 2015 and \$1.4 billion in 2014.

**Goodwill and other indefinitely-lived assets** Goodwill and other indefinitely-lived assets are not amortized, but are subject to impairment reviews annually, or more frequently if necessary. See Note 3 “Goodwill and Other Intangibles” for additional information on goodwill and other indefinitely-lived assets.

**Intangible assets** Purchased customer contracts and relationships are amortized on a straight-line basis over their estimated useful lives between 9 and 20 years. 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 “Goodwill and Other Intangibles” for additional information about intangible assets.

# Notes to Consolidated Financial Statements

**Impairment of long-lived assets** The Company groups and evaluates fixed and finite-lived intangible assets for impairment at the lowest level at which individual cash flows can be identified, whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. If indicators of impairment are present, the Company first compares the carrying amount of the asset group to the estimated future cash flows associated with the asset group (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 asset group'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 asset group's estimated future cash flows (discounted and with interest charges).

**Redeemable noncontrolling interest** As a result of the acquisition of Omnicare in August 2015, the Company obtained a 73% ownership interest in limited liability company ("LLC"). Due to the change in control in Omnicare, the noncontrolling member of the LLC had the contractual right to put its membership interest to the Company at fair value. Consequently, the noncontrolling interest in the LLC was recorded as a redeemable noncontrolling interest at fair value. During 2016, the noncontrolling shareholder of the LLC exercised its option to sell its ownership interest and the Company purchased the noncontrolling interest in the LLC for approximately \$39 million.

Below is a summary of the changes in redeemable noncontrolling interest for the years ended December 31:

IN MILLIONS	2016	2015
Beginning balance	\$ 39	\$ —
Acquisition of noncontrolling interest	—	39
Net income attributable to noncontrolling interest	1	1
Distributions	(2)	(1)
Purchase of noncontrolling interest	(39)	—
Reclassification to capital surplus in connection with purchase of noncontrolling interest	1	—
Ending balance	\$ —	\$ 39

## Revenue Recognition

### PHARMACY SERVICES SEGMENT

The PSS sells prescription drugs directly through its mail service dispensing pharmacies and indirectly through its retail pharmacy network. The PSS recognizes revenue from prescription drugs sold by its mail service dispensing pharmacies and under retail pharmacy network contracts where it is the principal using the gross method at the contract prices negotiated with its clients. Net revenues include: (i) the portion of the price the client pays directly to the PSS, net of any volume-related or other discounts paid back to the client (see "Drug Discounts" below), (ii) the price paid to the PSS by client plan members for mail order prescriptions ("Mail Co-Payments") and the price paid to retail network pharmacies by client plan members for retail prescriptions ("Retail Co-Payments"), and (iii) administrative fees for retail pharmacy network contracts where the PSS is not the principal as discussed below. Sales taxes are not included in revenue.

Revenue is recognized when: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the seller's price to the buyer is fixed or determinable, and (iv) collectability is reasonably assured. The following revenue recognition policies have been established for the PSS:

- Revenues generated from prescription drugs sold by mail service dispensing pharmacies are recognized when the prescription is delivered. At the time of delivery, the PSS has performed substantially all of its obligations under its client contracts and does not experience a significant level of returns or reshipments.



- Revenues generated from prescription drugs sold by third party pharmacies in the PSS' retail pharmacy network and associated administrative fees are recognized at the PSS' point-of-sale, which is when the claim is adjudicated by the PSS online claims processing system.

The PSS determines whether it is the principal or agent for its retail pharmacy network transactions on a contract by contract basis. In the majority of its contracts, the PSS has determined it is the principal due to it: (i) being the primary obligor in the arrangement, (ii) having latitude in establishing the price, changing the product or performing part of the service, (iii) having discretion in supplier selection, (iv) having involvement in the determination of product or service specifications, and (v) having credit risk. The PSS' obligations under its client contracts for which revenues are reported using the gross method are separate and distinct from its obligations to the third party pharmacies included in its retail pharmacy network contracts. Pursuant to these contracts, the PSS is contractually required to pay the third party pharmacies in its retail pharmacy network for products sold, regardless of whether the PSS is paid by its clients. The PSS' responsibilities under its client contracts typically include validating eligibility and coverage levels, communicating the prescription price and the co-payments due to the third party retail pharmacy, identifying possible adverse drug interactions for the pharmacist to address with the prescriber prior to dispensing, suggesting generic alternatives where clinically appropriate and approving the prescription for dispensing. Although the PSS does not have credit risk with respect to Retail Co-Payments or inventory risk related to retail network claims, management believes that all of the other applicable indicators of gross revenue reporting are present. For contracts under which the PSS acts as an agent, revenue is recognized using the net method.

**Drug Discounts** The PSS deducts from its revenues any rebates, inclusive of discounts and fees, earned by its clients. Rebates are paid to clients in accordance with the terms of client contracts, which are normally based on fixed rebates per prescription for specific products dispensed or a percentage of manufacturer discounts received for specific products dispensed. The liability for rebates due to clients is included in "Claims and discounts payable" in the accompanying consolidated balance sheets.

**Medicare Part D** The PSS, through its SilverScript subsidiary, participates in the federal government's Medicare Part D program as a Prescription Drug Plan ("PDP"). Net revenues include insurance premiums earned by the PDP, which are determined based on the PDP's annual bid and related contractual arrangements with the Centers for Medicare and Medicaid Services ("CMS"). The insurance premiums include a direct premium paid by CMS and a beneficiary premium, which is the responsibility of the PDP member, but which is subsidized by CMS in the case of low-income members. Premiums collected in advance are initially deferred in accrued expenses and are then recognized in net revenues over the period in which members are entitled to receive benefits.

In addition to these premiums, net revenues include co-payments, coverage gap benefits, deductibles and co-insurance (collectively, the "Member Co-Payments") related to PDP members' actual prescription claims. In certain cases, CMS subsidizes a portion of these Member Co-Payments and pays the PSS an estimated prospective Member Co-Payment subsidy amount each month. The prospective Member Co-Payment subsidy amounts received from CMS are also included in net revenues. SilverScript assumes no risk for these amounts. If the prospective Member Co-Payment subsidies received differ from the amounts based on actual prescription claims, the difference is recorded in either accounts receivable or accrued expenses.

The PSS accounts for CMS obligations and Member Co-Payments (including the amounts subsidized by CMS) using the gross method consistent with its revenue recognition policies for Mail Co-Payments and Retail Co-Payments (discussed previously in this document).

## Notes to Consolidated Financial Statements

### RETAIL/LTC SEGMENT

**Retail Pharmacy** The retail drugstores recognize revenue at the time the customer takes possession of the merchandise. Customer returns are not material. Revenue generated from the performance of services in the RLS' health care clinics is recognized at the time the services are performed. Sales taxes are not included in revenue.

**Long-term Care** Revenue is recognized when products are delivered or services are rendered or provided to the customer, prices are fixed and determinable, and collection is reasonably assured. A significant portion of the revenues from sales of pharmaceutical and medical products are reimbursed by the federal Medicare Part D program and, to a lesser extent, state Medicaid programs. Payments for services rendered to patients covered by these programs are generally less than billed charges. The Company monitors its revenues and receivables from these reimbursement sources, as well as other third party insurance payors, and record an estimated contractual allowance for sales and receivable balances at the revenue recognition date, to properly account for anticipated differences between billed and reimbursed amounts. Accordingly, the total net sales and receivables reported in the Company's consolidated financial statements are recorded at the amount expected to be ultimately received from these payors. Since billing functions for a portion of the Company's revenue systems are largely computerized, enabling on-line adjudication at the time of sale to record net revenues, the Company's exposure in connection with estimating contractual allowance adjustments is limited primarily to unbilled and initially rejected Medicare, Medicaid and third party claims (typically approved for reimbursement once additional information is provided to the payor). For the remaining portion of the Company's revenue systems, the contractual allowance is estimated for all billed, unbilled and initially rejected Medicare, Medicaid and third party claims. The Company evaluates several criteria in developing the estimated contractual allowances on a monthly basis, including historical trends based on actual claims paid, current contract and reimbursement terms, and changes in customer base and payor/product mix. Contractual allowance estimates are adjusted to actual amounts as cash is received and claims are settled, and the aggregate impact of these resulting adjustments was not significant to our results of operations for any of the periods presented.

Patient co-payments associated with Medicare Part D, certain state Medicaid programs, Medicare Part B and certain third party payors are typically not collected at the time products are delivered or services are rendered, but are billed to the individuals as part of our normal billing procedures and subject to our normal accounts receivable collections procedures.

**Health Care Clinics** For services provided by our health care clinics, revenue recognition occurs for completed services provided to patients, with adjustments taken for third party payor contractual obligations and patient direct bill historical collection rates.

**Loyalty Program** The Company's customer loyalty program, ExtraCare<sup>®</sup>, is comprised of two components, ExtraSavings<sup>™</sup> and ExtraBucks<sup>®</sup> Rewards. ExtraSavings coupons redeemed by customers are recorded as a reduction of revenue when redeemed. ExtraBucks Rewards are accrued as a charge to cost of revenues when earned, net of estimated breakage. The Company determines breakage based on historical redemption patterns.

See Note 12 "Segment Reporting" for additional information about the revenues of the Company's business segments.

### Cost of revenues

**Pharmacy Services Segment** The PSS' cost of revenues includes: (i) the cost of prescription drugs sold during the reporting period directly through its mail service dispensing pharmacies and indirectly through its retail pharmacy network, (ii) shipping and handling costs, and (iii) the operating costs of its mail service dispensing pharmacies and client service operations and related information technology support costs including depreciation and amortization. The cost of prescription drugs sold component of cost of revenues includes: (i) the cost of the prescription drugs

purchased from manufacturers or distributors and shipped to members in clients' benefit plans from the PSS' mail service dispensing pharmacies, net of any volume-related or other discounts (see "Vendor allowances and purchase discounts" below) and (ii) the cost of prescription drugs sold (including Retail Co-Payments) through the PSS' retail pharmacy network under contracts where it is the principal, net of any volume-related or other discounts.

**Retail/LTC Segment** The RLS' cost of revenues includes: the cost of merchandise sold during the reporting period and the related purchasing costs, warehousing and delivery costs (including depreciation and amortization) and actual and estimated inventory losses.

See Note 12 "Segment Reporting" for additional information about the cost of revenues of the Company's business segments.

### **Vendor allowances and purchase discounts**

The Company accounts for vendor allowances and purchase discounts as follows:

**Pharmacy Services Segment** The PSS receives purchase discounts on products purchased. The PSS' contractual arrangements with vendors, including manufacturers, wholesalers and retail pharmacies, normally provide for the PSS to receive purchase discounts from established list prices in one, or a combination, of the following forms: (i) a direct discount at the time of purchase, (ii) a discount for the prompt payment of invoices, or (iii) when products are purchased indirectly from a manufacturer (e.g., through a wholesaler or retail pharmacy), a discount (or rebate) paid subsequent to dispensing. These rebates are recognized when prescriptions are dispensed and are generally calculated and billed to manufacturers within 30 days of the end of each completed quarter. Historically, the effect of adjustments resulting from the reconciliation of rebates recognized to the amounts billed and collected has not been material to the PSS' results of operations. The PSS accounts for the effect of any such differences as a change in accounting estimate in the period the reconciliation is completed. The PSS also receives additional discounts under its wholesaler contracts if it exceeds contractually defined annual purchase volumes. In addition, the PSS receives fees from pharmaceutical manufacturers for administrative services. Purchase discounts and administrative service fees are recorded as a reduction of "Cost of revenues".

**Retail/LTC Segment** Vendor allowances received by the RLS reduce the carrying cost of inventory and are recognized in cost of revenues when the related inventory is sold, unless they are specifically identified as a reimbursement of incremental costs for promotional programs and/or other services provided. Amounts that are directly linked to advertising commitments are recognized as a reduction of advertising expense (included in operating expenses) 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 revenues 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 revenues 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.

**Insurance** The Company is self-insured for certain losses related to general liability, workers' compensation and auto 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.

## Notes to Consolidated Financial Statements

**Facility opening and closing costs** New facility opening costs, other than capital expenditures, are charged directly to expense when incurred. When the Company closes a facility, 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 facility closings was \$181 million and \$217 million in 2016 and 2015, respectively.

**Advertising costs** Advertising costs are expensed when the related advertising takes place. Advertising costs, net of vendor funding (included in operating expenses), were \$216 million, \$221 million and \$212 million in 2016, 2015 and 2014, respectively.

**Interest expense, net** The following are the components of net interest expense for the years ended December 31:

IN MILLIONS	2016	2015	2014
Interest expense	\$ 1,078	\$ 859	\$ 615
Interest income	(20)	(21)	(15)
Interest expense, net	\$ 1,058	\$ 838	\$ 600

Capitalized interest totaled \$13 million, \$12 million and \$19 million in 2016, 2015 and 2014, respectively.

**Shares held in trust** The Company maintains grantor trusts, which held approximately one million shares of its common stock at December 31, 2016 and 2015, respectively. These shares are designated for use under various employee compensation plans. Since the Company holds these shares, they are excluded from the computation of basic and diluted shares outstanding.

**Accumulated other comprehensive income** Accumulated other comprehensive income (loss) consists of changes in the net actuarial gains and losses associated with pension and other postretirement benefit plans, losses on derivatives from cash flow hedges executed in previous years associated with the issuance of long-term debt, and foreign currency translation adjustments. The amount included in accumulated other comprehensive loss related to the Company's pension and postretirement plans was \$284 million pre-tax (\$173 million after-tax) as of December 31, 2016 and \$305 million pre-tax (\$186 million after-tax) as of December 31, 2015. The net impact on cash flow hedges totaled \$9 million pre-tax (\$5 million after-tax) and \$14 million pre-tax (\$7 million after-tax) as of December 31, 2016 and 2015, respectively. Cumulative foreign currency translation adjustments at December 31, 2016 and 2015 were \$127 million and \$165 million, respectively.

Changes in accumulated other comprehensive income (loss) by component are shown below:

IN MILLIONS	YEAR ENDED DECEMBER 31, 2016 <sup>(1)</sup>			
	Foreign Currency	Losses on Cash Flow Hedges	Pension and Other Postretirement Benefits	Total
Balance, December 31, 2015	\$ (165)	\$ (7)	\$ (186)	\$ (358)
Other comprehensive income before reclassifications	38	—	—	38
Amounts reclassified from accumulated other comprehensive income <sup>(2)</sup>	—	2	13	15
Net other comprehensive income	38	2	13	53
<b>Balance, December 31, 2016</b>	<b>\$ (127)</b>	<b>\$ (5)</b>	<b>\$ (173)</b>	<b>\$ (305)</b>

YEAR ENDED DECEMBER 31, 2015 <sup>(1)</sup>

IN MILLIONS	Foreign Currency	Losses on Cash Flow Hedges	Pension and Other Postretirement Benefits	Total
Balance, December 31, 2014	\$ (65)	\$ (9)	\$ (143)	\$ (217)
Other comprehensive income (loss) before reclassifications	(100)	—	(56)	(156)
Amounts reclassified from accumulated other comprehensive income <sup>(2)</sup>	—	2	13	15
Net other comprehensive income (loss)	(100)	2	(43)	(141)
Balance, December 31, 2015	\$ (165)	\$ (7)	\$ (186)	\$ (358)

(1) All amounts are net of tax.

(2) The amounts reclassified from accumulated other comprehensive income for cash flow hedges are recorded within interest expense, net on the consolidated statement of income. The amounts reclassified from accumulated other comprehensive income for pension and other postretirement benefits are included in operating expenses on the consolidated statement of income.

**Stock-based compensation** Stock-based compensation is measured at the grant date based on the fair value of the award and is recognized as expense over the applicable requisite service period of the stock award (generally 3 to 5 years) using the straight-line method.

**Variable interest entity** In July 2014, the Company and Cardinal Health, Inc. (“Cardinal”) established Red Oak Sourcing, LLC (“Red Oak”), a generic pharmaceutical sourcing entity in which the Company and Cardinal each own 50%. The Red Oak arrangement has an initial term of ten years. Under this arrangement, the Company and Cardinal contributed their sourcing and supply chain expertise to Red Oak and agreed to source and negotiate generic pharmaceutical supply contracts for both companies through Red Oak; however, Red Oak does not own or hold inventory on behalf of either company. No physical assets (e.g., property and equipment) were contributed to Red Oak by either company and minimal funding was provided to capitalize Red Oak.

The Company has determined that it is the primary beneficiary of this variable interest entity because it has the ability to direct the activities of Red Oak. Consequently, the Company consolidates Red Oak in its consolidated financial statements within the Retail/LTC Segment.

Cardinal is required to pay the Company 39 quarterly payments beginning in October 2014. As milestones are met, the quarterly payments increase. The Company received approximately \$163 million, \$122 million and \$26 million from Cardinal during the years ended December 31, 2016, 2015 and 2014, respectively. The payments reduce the Company’s carrying value of inventory and are recognized in cost of revenues when the related inventory is sold. Revenues associated with Red Oak expenses reimbursed by Cardinal for the years ended December 31, 2016, 2015 and 2014, as well as amounts due to or due from Cardinal at December 31, 2016 and 2015 were immaterial.

**Related party transactions** The Company has an equity method investment in SureScripts, LLC (“SureScripts”), which operates a clinical health information network. The Pharmacy Services and Retail/LTC segments utilize this clinical health information network in providing services to its client plan members and retail customers. The Company expensed fees of approximately \$39 million in the year ended December 31, 2016, and \$50 million in the years ended December 31, 2015 and 2014, for the use of this network. The Company’s investment in and equity in earnings of SureScripts for all periods presented is immaterial.

## Notes to Consolidated Financial Statements

The Company has an equity method investment in Heartland Healthcare Services (“Heartland”). Heartland operates several long-term care pharmacies in four states. Heartland paid the Company approximately \$140 million and \$25 million for pharmaceutical inventory purchases during the years ended December 31, 2016 and 2015, respectively. Additionally, the Company performs certain collection functions for Heartland and then passes those customer cash collections to Heartland. The Company’s investment in and equity in earnings of Heartland as of and for the years ended December 31, 2016 and 2015, is immaterial.

In 2016 and 2014, the Company made charitable contributions of \$32 million and \$25 million, respectively, to the CVS Foundation (the “Foundation”) to fund future giving. The Foundation is a non-profit entity managed by employees of the Company that focuses on health, education and community involvement programs. The charitable contributions were recorded as operating expenses in the Company’s consolidated statements of income for the years ended December 31, 2016 and 2014.

**Income taxes** The Company accounts for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the consolidated financial statements. Under this method, deferred tax assets and liabilities are determined on the basis of the differences between the consolidated financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year or years in which the differences are expected to reverse. The effect of a change in the tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

The Company recognizes net deferred tax assets to the extent that it believes these assets are more likely than not to be realized. In making such a determination, the Company considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies, and results of recent operations. To the extent that the Company does not consider it more likely than not that a deferred tax asset will be recovered, a valuation allowance is established.

The Company records uncertain tax positions on the basis of a two-step process whereby (1) the Company determines whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, the Company recognizes the largest amount of tax benefit that is more than 50% likely to be realized upon ultimate settlement with the related tax authority.

Interest and/or penalties related to uncertain tax positions are recognized in income tax expense.

**Discontinued operations** In connection with certain business dispositions completed between 1991 and 1997, the Company retained guarantees on store lease obligations for a number of former subsidiaries, including Bob’s Stores and Linens ‘n Things which filed for bankruptcy in 2016 and 2008, respectively. The Company’s loss from discontinued operations in 2016 and 2014 includes lease-related costs which the Company believes it will likely be required to satisfy pursuant to its lease guarantees. The Company’s income from discontinued operations in 2015 of \$9 million, net of tax, was related to the release of certain store lease guarantees due to a settlement with a landlord.

Below is a summary of the results of discontinued operations for the years ended December 31:

IN MILLIONS	2016	2015	2014
Income (loss) from discontinued operations	\$ (2)	\$ 15	\$ (1)
Income tax expense	1	(6)	—
Income (loss) from discontinued operations, net of tax	\$ (1)	\$ 9	\$ (1)



**Earnings per common share** Earnings per share is computed using the two-class method. Options to purchase 6.7 million, 2.7 million and 2.1 million shares of common stock were outstanding as of December 31, 2016, 2015 and 2014, 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** In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers* (Topic 606). ASU 2014-09 outlines a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. In March 2016, the FASB issued ASU 2016-08, "*Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)*," which amends the principal-versus-agent implementation guidance and in April 2016 the FASB issued ASU 2016-10, "*Identifying Performance Obligations and Licensing*," which amends the guidance in those areas in the new revenue recognition standard. Both ASUs were issued in response to feedback received from the FASB-International Accounting Standards Board joint revenue recognition transition resource group. This new standard could impact the timing and amounts of revenue recognized. The new revenue standard is effective for annual reporting periods (including interim reporting periods within those periods) beginning January 1, 2018. Early adoption of the standard in 2017 is permitted; however, the Company does not intend to early adopt the new standard. Companies have the option of using either a full retrospective or a modified retrospective approach to adopt the guidance. The Company formed a project team to assess and implement the new standard. While the Company is continuing to assess all of the potential impacts of the new standard including the potential impact from recent acquisitions, the Company does not expect the implementation of the standard will have a material effect on the Company's consolidated results of operations, cash flows or financial position. The Company intends to adopt the new standard on a modified retrospective basis.

In July 2015, the FASB issued ASU 2015-11, *Inventory*, which amends ASU Topic 330. This ASU simplifies current accounting treatments by requiring entities to measure most inventories at "the lower of cost and net realizable value" rather than using lower of cost or market. This guidance does not apply to inventories measured using the last-in, first-out method or the retail inventory method. This ASU is effective prospectively for annual periods beginning after December 15, 2016 and interim periods thereafter with early adoption permitted. Upon transition, entities must disclose the accounting change. The Company is evaluating the effect of adopting this new accounting guidance but does not expect the adoption will have a material impact on the Company's results of operations, financial position or cash flows.

In November 2015, the FASB issued ASU 2015-17, *Income Taxes* (Topic 740). The new guidance simplifies the presentation of deferred income taxes by requiring that deferred tax assets and liabilities be classified as noncurrent in a classified statement of financial position. The updated standard is effective for the Company beginning on January 1, 2017 with early application permitted as of the beginning of any interim or annual reporting period. The Company elected to early adopt this standard as of January 1, 2016 and has, accordingly, reclassified the current deferred tax assets to noncurrent deferred tax liabilities for all periods presented. The following is a reconciliation of the effect of the reclassification on the Company's consolidated balance sheet as of December 31, 2015:

IN MILLIONS	As Previously Reported	Adjustments	As Revised
Deferred tax assets - current	\$ 1,220	\$ (1,220)	\$ —
Total current assets	30,378	(1,220)	29,158
Total assets	93,657	(1,220)	92,437
Deferred tax liabilities - noncurrent	5,437	(1,220)	4,217
Total liabilities and shareholders' equity	93,657	(1,220)	92,437

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## Notes to Consolidated Financial Statements

In February 2016, the FASB issued ASU 2016-02, *Leases* (Topic 842). Lessees will be required to recognize a right-of-use asset and a lease liability for virtually all of their leases (other than leases that meet the definition of a short-term lease). The liability will be equal to the present value of lease payments. The asset will be based on the liability, subject to adjustment, such as for initial direct costs. For income statement purposes, a dual model was retained, requiring leases to be classified as either operating or finance leases. Operating leases will result in straight-line expense (similar to current operating leases) while finance leases will result in a front-loaded expense pattern (similar to current capital leases). Lessor accounting is similar to the current model, but updated to align with certain changes to the lessee model (e.g., certain definitions, such as initial direct costs, have been updated) and the new revenue recognition standard. The standard is effective for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The Company believes that the new standard will have a material impact on its consolidated balance sheet. The Company is currently evaluating the effect that implementation of this standard will have on the Company's consolidated results of operations, cash flows, financial position and related disclosures.

In March 2016, the FASB issued ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*, which amends Accounting Standard Codification Topic 718, *Compensation—Stock Compensation*, in three areas. (1) The new guidance eliminates accounting for tax benefits and deficiencies through equity to the extent of previous windfalls, and then to the income statement. The new requirement is to record all tax benefits and deficiencies through the income statement. This amendment is required to be applied prospectively. The amendment also requires the presentation of excess tax benefits on the statements of cash flows as operating activities, a change which may be applied prospectively or retrospectively at the election of the Company. The amendment requires the presentation of employee taxes paid on the statement of cash flows when an employer withholds shares for tax withholding purposes as financing activities, a change which must be applied retrospectively. (2) The new guidance also permits companies to withhold an amount up to the employees' maximum individual tax rate in the relevant jurisdiction without resulting in liability classification of the award. (3) Finally, the new guidance provides companies with an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures can be estimated, as required today, or recognized when they occur. If elected, the change to recognize forfeitures when they occur needs to be adopted using a modified retrospective approach, with a cumulative effect adjustment recorded to beginning retained earnings. The ASU is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that annual reporting period. The Company is currently evaluating the effect of adopting this new accounting guidance.

In August 2016, the FASB issued ASU No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 is intended to add or clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows and to eliminate the diversity in practice related to such classifications. The guidance in ASU 2016-15 is required for annual reporting periods beginning after December 15, 2017, with early adoption permitted. The Company is currently evaluating the effect on its consolidated statement of cash flows of adopting this new accounting guidance.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows*, which amends ASU Topic 230. This ASU requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. As a result, entities will no longer be required to present transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. When cash, cash equivalents, restricted cash and restricted cash equivalents are presented in more than one line item on the balance sheet, the new guidance requires a reconciliation of the totals in the statement of cash flows to the related captions in the balance sheet. Entities will also have to disclose the nature of their restricted cash and restricted cash equivalent balances. The guidance is effective for fiscal years beginning after December 15, 2017 and interim periods within those years. Early adoption is permitted. Entities are required to apply the guidance retrospectively. The Company is currently evaluating the effect of adopting this new accounting guidance.

## 2 | Acquisitions

### Omnicare Acquisition

On August 18, 2015, the Company acquired 100% of the outstanding common shares and voting interests of Omnicare, for \$98 per share for a total of \$9.6 billion and assumed long-term debt with a fair value of approximately \$3.1 billion. Omnicare is a leading health care services company that specializes in the management of complex pharmaceutical care. Omnicare's long-term care ("LTC") business is the nation's largest provider of pharmaceuticals, related pharmacy consulting and other ancillary services to chronic care facilities and other care settings. In addition, Omnicare has a specialty pharmacy business operating primarily under the name of ACS Pharmacy, and provides commercialization services under the name of RxCrossroads®. The Company includes LTC and the commercialization services business in the Retail/LTC Segment, and includes the specialty pharmacy business in its Pharmacy Services Segment. The Company acquired Omnicare to expand its operations in dispensing prescription drugs to assisted-living and long-term care facilities, and to broaden its presence in the specialty pharmacy business as the Company seeks to serve a greater percentage of the growing senior patient population in the United States.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the date of acquisition:

IN MILLIONS	
Current assets (including cash of \$298)	\$ 1,657
Property and equipment	313
Goodwill	9,139
Intangible assets	3,962
Other noncurrent assets	63
Current liabilities	(773)
Long-term debt	(3,110)
Deferred income tax liabilities	(1,498)
Other noncurrent liabilities	(69)
Redeemable noncontrolling interest	(39)
Total consideration	\$ 9,645

The goodwill represents future economic benefits expected to arise from the Company's expanded presence in the pharmaceutical care market, the assembled workforce acquired, expected purchasing and revenue synergies, as well as operating efficiencies and cost savings. Goodwill of \$8.7 billion was allocated to the Retail/LTC Segment and the remaining goodwill of \$0.4 billion was allocated to the Pharmacy Services Segment. Approximately \$0.4 billion of the goodwill is deductible for income tax purposes. Intangible assets acquired include customer relationships and trade names of \$3.9 billion and \$74 million, respectively, with estimated weighted average useful lives of 19.1 and 2.9 years, respectively, and 18.8 years in total.

During the year ended December 31, 2015, the Company incurred transaction costs of \$70 million associated with the acquisition of Omnicare that were recorded within operating expenses.

The Company's consolidated results of operations for the year ended December 31, 2015, include \$2.6 billion of net revenues and net income of \$61 million associated with the operating results of Omnicare from August 18, 2015 to December 31, 2015. These Omnicare operating results include severance costs and accelerated stock-based compensation.

## Notes to Consolidated Financial Statements

The following unaudited pro forma information presents a summary of the Company's combined results of operations for the years ended December 31, 2015 and 2014, as if the Omnicare acquisition and the related financing transactions had occurred on January 1, 2014. The following pro forma financial information is not necessarily indicative of the results of operations as they would have been had the transactions been effected on the assumed date, nor is it necessarily an indication of trends in future results for a number of reasons, including, but not limited to, differences between the assumptions used to prepare the pro forma information, basic shares outstanding and dilutive equivalents, cost savings from operating efficiencies, potential synergies, and the impact of incremental costs incurred in integrating the businesses.

IN MILLIONS, EXCEPT PER SHARE DATA	YEAR ENDED DECEMBER 31,	
	2015	2014
Total revenues	\$ 156,798	\$ 144,836
Income from continuing operations	5,277	4,522
Basic earnings per share from continuing operations	\$ 4.70	\$ 3.88
Diluted earnings per share from continuing operations	\$ 4.66	\$ 3.85

Pro forma income from continuing operations for the year ended December 31, 2015, excludes \$135 million related to severance costs, accelerated stock-based compensation and transaction costs incurred in connection with the Omnicare acquisition. Pro forma income from continuing operations for the year ended December 31, 2014, includes a \$521 million loss on the early extinguishment of debt recorded by CVS Health.

### Target Pharmacy Acquisition

On December 16, 2015, the Company acquired the pharmacy and clinic businesses of Target for approximately \$1.9 billion, plus contingent consideration of up to \$60 million based on future prescription growth over a three year period. The Company acquired Target's 1,672 pharmacies which operate in 47 states and will operate them through a store-within-a-store format, branded as CVS Pharmacy. The Company also acquired 79 Target clinic locations which were rebranded as MinuteClinic. The Company acquired the Target pharmacy and clinic businesses primarily to expand the geographic reach of its retail pharmacy business.

The fair values of the assets acquired at the date of acquisition were approximately as follows:

IN MILLIONS	
Accounts receivable	\$ 2
Inventories	467
Property and equipment	9
Intangible assets	490
Goodwill	900
Total cash consideration	\$ 1,868

Intangible assets acquired include customer relationships with an estimated useful life of 13 years. The goodwill represents future economic benefits expected to arise from the Company's expanded geographic presence in the retail pharmacy market, the assembled workforce acquired, expected purchasing and revenue synergies, as well as operating efficiencies and cost savings. The goodwill is deductible for income tax purposes. No liability for any potential contingent consideration has been recorded based on current projections for future prescription growth over the relevant period.

In connection with the closing of the transaction, the Company and Target entered into pharmacy and clinic operating and master lease agreements. See Note 6 “Leases” of the consolidated financial statements for disclosures of the Company’s leasing arrangements.

During the year ended December 31, 2015, the Company incurred transaction costs of approximately \$26 million associated with the acquisition that were recorded within operating expenses. The results of the Target pharmacies and clinics are included in the Company’s Retail/LTC Segment beginning on December 16, 2015. Pro forma financial information for this acquisition is not presented as such results are immaterial to the Company’s consolidated financial statements.

### 3 | Goodwill and Other Intangibles

Goodwill and other indefinitely-lived assets are not amortized, but are subject to annual impairment reviews, or more frequent reviews if events or circumstances indicate an impairment may exist.

When evaluating goodwill for potential impairment, the Company first compares the fair value of its reporting units to their respective carrying amounts. The Company estimates the fair value of its reporting units using a combination of a future discounted cash flow valuation model and a comparable market transaction model. 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 a reporting unit’s goodwill with the carrying amount of its goodwill. If the carrying amount of the goodwill exceeds the implied fair value, an impairment loss is recognized in an amount equal to the excess. During the third quarter of 2016, the Company performed its required annual goodwill impairment tests. The Company concluded there were no goodwill impairments as of the testing date.

Below is a summary of the changes in the carrying amount of goodwill by segment for the years ended December 31, 2016 and 2015:

IN MILLIONS	Pharmacy Services	Retail/LTC	Total
Balance, December 31, 2014	\$ 21,234	\$ 6,908	\$ 28,142
Acquisitions	452	9,554	10,006
Foreign currency translation adjustments	—	(40)	(40)
Other <sup>(1)</sup>	(1)	(1)	(2)
Balance, December 31, 2015	21,685	16,421	38,106
Acquisitions	—	126	126
Foreign currency translation adjustments	—	17	17
Other <sup>(1)</sup>	(48)	48	—
<b>Balance, December 31, 2016</b>	<b>\$ 21,637</b>	<b>\$ 16,612</b>	<b>\$ 38,249</b>

(1) “Other” represents immaterial purchase accounting adjustments for acquisitions.

Indefinitely-lived intangible assets are tested for impairment by comparing the estimated fair value of the asset to its carrying value. The Company estimates the fair value of its indefinitely-lived trademark using the relief from royalty method under the income approach. If the carrying value of the asset exceeds its estimated fair value, an impairment loss is recognized and the asset is written down to its estimated fair value. During the third quarter of 2016, the Company performed its annual impairment test of the indefinitely-lived trademark and concluded there was no impairment as of the testing date. The carrying amount of its indefinitely-lived trademark was \$6.4 billion as of December 31, 2016 and 2015.

## Notes to Consolidated Financial Statements

The Company amortizes intangible assets with finite lives over the estimated useful lives of the respective assets, which have a weighted average useful life of 15.5 years. The weighted average useful life of the Company's customer contracts and relationships and covenants not to compete is 15.5 years. The weighted average life of the Company's favorable leases and other intangible assets is 15.9 years. Amortization expense for intangible assets totaled \$795 million, \$611 million and \$518 million in 2016, 2015 and 2014, respectively. The anticipated annual amortization expense for these intangible assets for the next five years is as follows:

IN MILLIONS	
2017	\$ 780
2018	748
2019	704
2020	534
2021	473

The following table is a summary of the Company's intangible assets as of December 31:

IN MILLIONS	2016			2015		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Trademark (indefinitely-lived)	\$ 6,398	\$ —	\$ 6,398	\$ 6,398	\$ —	\$ 6,398
Customer contracts and relationships and covenants not to compete	11,485	(4,802)	6,683	10,594	(4,092)	6,502
Favorable leases and other	1,123	(693)	430	1,595	(617)	978
	<b>\$ 19,006</b>	<b>\$ (5,495)</b>	<b>\$ 13,511</b>	<b>\$ 18,587</b>	<b>\$ (4,709)</b>	<b>\$ 13,878</b>

### 4 | Share Repurchase Programs

The following share Repurchase Programs were authorized by the Company's Board of Directors:

IN BILLIONS	Authorized	Remaining
Authorization Date		
November 2, 2016 ("2016 Repurchase Program")	\$ 15.0	\$ 15.0
December 15, 2014 ("2014 Repurchase Program")	\$ 10.0	\$ 3.2
December 17, 2013 ("2013 Repurchase Program")	\$ 6.0	\$ —
September 19, 2012 ("2012 Repurchase Program")	\$ 6.0	\$ —

The share Repurchase Programs, each of which was effective immediately, permit the Company to effect repurchases from time to time through a combination of open market repurchases, privately negotiated transactions, accelerated share repurchase ("ASR") transactions, and/or other derivative transactions. The 2016 and 2014 Repurchase Programs may be modified or terminated by the Board of Directors at any time.

Pursuant to the authorization under the 2014 Repurchase Program, effective August 29, 2016, the Company entered into two fixed dollar ASRs with Barclays Bank PLC ("Barclays") for a total of \$3.6 billion. Upon payment of the \$3.6 billion purchase price on January 6, 2017, the Company received a number of shares of its common stock equal to 80% of the \$3.6 billion notional amount of the ASRs or approximately 36.1 million shares at a price of \$80.34 per share, which were placed into treasury stock in January 2017. At the conclusion of the ASRs, the Company may receive additional shares equal to the remaining 20% of the \$3.6 billion notional amount. The ultimate



number of shares the Company may receive will fluctuate based on changes in the daily volume-weighted average price of the daily volume-weighted average price of the Company's common stock, less a discount (the "forward price"), during the ASRs falls below \$80.34 per share, the Company will receive a higher number of shares from Barclays. If the forward price rises above \$80.34 per share, the Company will either receive fewer shares from Barclays or, potentially have an obligation to Barclays which, at the Company's option, could be settled in additional cash or by issuing shares. Under the terms of the ASRs, the maximum number of shares that could be received or delivered is 90.1 million.

Pursuant to the authorization under the 2014 Repurchase Program, effective December 11, 2015, the Company entered into a \$725 million fixed dollar ASR with Barclays. Upon payment of the \$725 million purchase price on December 14, 2015, the Company received a number of shares of its common stock equal to 80% of the \$725 million notional amount of the ASR or approximately 6.2 million shares. The initial 6.2 million shares of common stock delivered to the Company by Barclays were placed into treasury stock in December 2015. The ASR was accounted for as an initial treasury stock transaction of \$580 million and a forward contract of \$145 million. The forward contract was classified as an equity instrument and was recorded within capital surplus on the consolidated balance sheet. On January 28, 2016, the Company received 1.4 million shares of common stock, representing the remaining 20% of the \$725 million notional amount of the ASR, thereby concluding the ASR. The remaining 1.4 million shares of common stock delivered to the Company by Barclays were placed into treasury stock in January 2016 and the forward contract was reclassified from capital surplus to treasury stock.

Pursuant to the authorization under the 2013 Repurchase Programs, effective January 2, 2015, the Company entered into a \$2.0 billion fixed dollar ASR agreement with J.P. Morgan Chase Bank ("JP Morgan"). Upon payment of the \$2.0 billion purchase price on January 5, 2015, the Company received a number of shares of its common stock equal to 80% of the \$2.0 billion notional amount of the ASR agreement or approximately 16.8 million shares, which were placed into treasury stock in January 2015. On May 1, 2015, the Company received approximately 3.1 million shares of common stock, representing the remaining 20% of the \$2.0 billion notional amount of the ASR, thereby concluding the ASR. The remaining 3.1 million shares of common stock delivered to the Company by JP Morgan were placed into treasury stock in May 2015. The ASR was accounted for as an initial treasury stock transaction of \$1.6 billion and a forward contract of \$0.4 billion. The forward contract was classified as an equity instrument and was initially recorded within capital surplus on the consolidated balance sheet and was reclassified to treasury stock upon the settlement of the ASR in May 2015.

In the ASR transactions described above, the initial repurchase of the shares and delivery of the remainder of the shares to conclude the ASR, resulted in an immediate reduction of the outstanding shares used to calculate the weighted average common shares outstanding for basic and diluted earnings per share.

During the year ended December 31, 2016, the Company repurchased an aggregate of 47.5 million shares of common stock for approximately \$4.5 billion under the 2014 Repurchase Program. As of December 31, 2016, there remained an aggregate of approximately \$18.2 billion available for future repurchases under the 2016 and 2014 Repurchase Programs.

During the year ended December 31, 2015, the Company repurchased an aggregate of 48.0 million shares of common stock for approximately \$5.0 billion under the 2013 and 2014 Repurchase Programs. As of December 31, 2015, there remained an aggregate of approximately \$7.7 billion available for future repurchases under the 2014 Repurchase Program and the 2013 Repurchase Program was complete.

During the year ended December 31, 2014, the Company repurchased an aggregate of 51.4 million shares of common stock for approximately \$4.0 billion under the 2013 and 2012 Repurchase Programs. As of December 31, 2014, there remained an aggregate of approximately \$12.7 billion available for future repurchases under the 2014 and 2013 Repurchase Programs. As of December 31, 2014, the 2012 Repurchase Program was complete.

## Notes to Consolidated Financial Statements

### 5 | Borrowings and Credit Agreements

The following table is a summary of the Company's borrowings as of December 31:

IN MILLIONS	2016	2015
Short-term debt		
Commercial paper	\$ 1,874	\$ —
Long-term debt		
1.2% senior notes due 2016	—	750
6.125% senior notes due 2016	—	421
5.75% senior notes due 2017	—	1,080
1.9% senior notes due 2018	2,250	2,250
2.25% senior notes due 2018	1,250	1,250
2.25% senior notes due 2019	850	850
6.6% senior notes due 2019	—	394
2.8% senior notes due 2020	2,750	2,750
4.75% senior notes due 2020	—	450
2.125% senior notes due 2021	1,750	—
4.125% senior notes due 2021	550	550
2.75% senior notes due 2022	1,250	1,250
3.5% senior notes due 2022	1,500	1,500
4.75% senior notes due 2022	399	400
4% senior notes due 2023	1,250	1,250
3.375% senior notes due 2024	650	650
5% senior notes due 2024	299	300
3.875% senior notes due 2025	2,828	3,000
2.875% senior notes due 2026	1,750	—
6.25% senior notes due 2027	372	453
3.25% senior exchange debentures due 2035	1	5
4.875% senior notes due 2035	652	2,000
6.125% senior notes due 2039	447	734
5.75% senior notes due 2041	133	493
5.3% senior notes due 2043	750	750
5.125% senior notes due 2045	3,500	3,500
Capital lease obligations	648	644
Other	23	20
Total debt principal	27,726	27,694
Debt premiums	33	39
Debt discounts and deferred financing costs	(228)	(269)
	27,531	27,464
Less:		
Short-term debt (commercial paper)	(1,874)	—
Current portion of long-term debt	(42)	(1,197)
Long-term debt	\$ 25,615	\$ 26,267

The Company had approximately \$1.9 billion of commercial paper outstanding at a weighted average interest rate of 1.22% as of December 31, 2016. In connection with its commercial paper program, the Company maintains a \$1.0 billion, five-year unsecured back-up credit facility, which expires on May 23, 2018, a \$1.25 billion, five-year unsecured back-up credit facility, which expires on July 24, 2019, and a \$1.25 billion, five-year unsecured back-up credit facility, which expires on July 1, 2020. The credit facilities allow for borrowings at various rates that are dependent, in part, on the Company's public debt ratings and require the Company to pay a weighted average quarterly facility fee of approximately 0.03%, regardless of usage. As of December 31, 2016, there were no borrowings outstanding under the back-up credit facilities.

On January 3, 2017, the Company entered into a \$2.5 billion revolving credit facility. The credit facility allows for borrowings at various rates that are dependent, in part, on the Company's debt ratings and require the Company to pay a weighted average quarterly facility fee of approximately 0.03%, regardless of usage. The maximum available under the credit facility decreases by \$750 million on both March 31, 2017 and June 30, 2017 and by \$500 million on September 30, 2017. The credit facility expires on December 31, 2017.

On May 16, 2016, the Company issued \$1.75 billion aggregate principal amount of 2.125% unsecured senior notes due June 1, 2021 and \$1.75 billion aggregate principal amount of 2.875% unsecured senior notes due June 1, 2026 (collectively, the "2016 Notes") for total proceeds of approximately \$3.5 billion, net of discounts and underwriting fees. The 2016 Notes pay interest semi-annually and may be redeemed, in whole at any time, or in part from time to time, at the Company's option at a defined redemption price plus accrued and unpaid interest to the redemption date. The net proceeds of the 2016 Notes were used for general corporate purposes and to repay certain corporate debt.

On May 16, 2016, the Company announced tender offers for (1) any and all of its 5.75% Senior Notes due 2017, its 6.60% Senior Notes due 2019 and its 4.75% Senior Notes due 2020 (collectively, the "Any and All Notes") and (2) up to \$1.5 billion aggregate principal amount of its 6.25% Senior Notes due 2027, its 6.125% Senior Notes due 2039, its 5.75% Senior Notes due 2041, the 5.00% Senior Notes due 2024 issued by its wholly-owned subsidiary, Omnicare, Inc. ("Omnicare"), the 4.75% Senior Notes due 2022 issued by Omnicare, its 4.875% Senior Notes due 2035 and its 3.875% Senior Notes due 2025 (collectively, the "Maximum Tender Offer Notes" and together with the Any and All Notes, the "Notes"). On May 31, 2016, the Company increased the aggregate principal amount of the tender offers for the Maximum Tender Offer Notes to \$2.25 billion. The Company purchased approximately \$835 million aggregate principal amount of the Any and All Notes and \$2.25 billion aggregate principal amount of the Maximum Tender Offer Notes pursuant to the tender offers, which expired on June 13, 2016. The Company paid a premium of \$486 million in excess of the debt principal in connection with the purchase of the Notes, wrote off \$50 million of unamortized deferred financing costs and incurred \$6 million in fees, for a total loss on the early extinguishment of debt of \$542 million which was recorded in income from continuing operations in the consolidated statement of income for the year ended December 31, 2016.

On June 27, 2016, the Company notified the holders of the remaining Any and All Notes that the Company was exercising its option to redeem the outstanding Any and All Notes pursuant to the terms of the Any and All Notes and the Indenture dated as of August 15, 2006, between the Company and The Bank of New York Mellon Trust Company, N.A. Approximately \$1.1 billion aggregate principal amount of Any and All Notes was redeemed on July 27, 2016. The Company paid a premium of \$97 million in excess of the debt principal and wrote off \$4 million of unamortized deferred financing costs, for a total loss on early extinguishment of debt of \$101 million during the year ended December 31, 2016.

The Company recorded a total loss on the early extinguishment of debt of \$643 million which was recorded in the income from continuing operations in the consolidated statement of income for the year ended December 31, 2016.

## Notes to Consolidated Financial Statements

On May 20, 2015, in connection with the acquisition of Omnicare, the Company entered into a \$13 billion unsecured bridge loan facility. The Company paid approximately \$52 million in fees in connection with the facility. The fees were capitalized and amortized as interest expense over the period the bridge facility was outstanding. The bridge loan facility expired on July 20, 2015 upon the Company's issuance of unsecured senior notes with an aggregate principal of \$15 billion as discussed below. The bridge loan facility fees became fully amortized in July 2015.

On July 20, 2015, the Company issued an aggregate of \$2.25 billion of 1.9% unsecured senior notes due 2018 ("2018 Notes"), an aggregate of \$2.75 billion of 2.8% unsecured senior notes due 2020 ("2020 Notes"), an aggregate of \$1.5 billion of 3.5% unsecured senior notes due 2022 ("2022 Notes"), an aggregate of \$3 billion of 3.875% unsecured senior notes due 2025 ("2025 Notes"), an aggregate of \$2 billion of 4.875% unsecured senior notes due 2035 ("2035 Notes"), and an aggregate of \$3.5 billion of 5.125% unsecured senior notes due 2045 ("2045 Notes" and, together with the 2018 Notes, 2020 Notes, 2022 Notes, 2025 Notes and 2035 Notes, the "Notes") for total proceeds of approximately \$14.8 billion, net of discounts and underwriting fees. The Notes pay interest semi-annually and contain redemption terms which allow or require the Company to redeem the Notes at a defined redemption price plus accrued and unpaid interest at the redemption date. The net proceeds of the Notes were used to fund the Omnicare acquisition and the acquisition of the pharmacies and clinics of Target. The remaining proceeds were used for general corporate purposes.

Upon the closing of the Omnicare acquisition in August 2015, the Company assumed the long-term debt of Omnicare that had a fair value of approximately \$3.1 billion, \$2.0 billion of which was previously convertible into Omnicare shares that holders were able to redeem subsequent to the acquisition. During the period from August 18, 2015 to December 31, 2015, all but \$5 million of the \$2.0 billion of previously convertible debt was redeemed and repaid and approximately \$0.4 billion in Omnicare term debt assumed was repaid for total repayments of Omnicare debt of approximately \$2.4 billion in 2015.

The remaining principal of the Omnicare debt assumed was comprised of senior unsecured notes with an aggregate principal amount of \$700 million (\$400 million of 4.75% senior notes due 2022 and \$300 million of 5% senior notes due 2024). In September 2015, the Company commenced exchange offers for the 4.75% senior notes due 2022 and the 5% senior notes due 2024 to exchange all validly tendered and accepted notes issued by Omnicare for notes to be issued by the Company. This offer expired on October 20, 2015 and the aggregate principal amounts of \$388 million of the 4.75% senior notes due 2022 and \$296 million of the 5% senior notes due 2024 were validly tendered and exchanged for notes issued by the Company. The Company recorded this exchange transaction as a modification of the original debt instruments. Consequently, no gain or loss on extinguishment was recognized in the Company's consolidated income statement as a result of this exchange transaction and the issuance costs of the new debt were expensed as incurred.

On August 7, 2014, the Company issued \$850 million of 2.25% unsecured senior notes due August 12, 2019 and \$650 million of 3.375% unsecured senior notes due August 12, 2024 (collectively, the "2014 Notes") for total proceeds of approximately \$1.5 billion, net of discounts and underwriting fees. The 2014 Notes pay interest semi-annually and may be redeemed, in whole at any time, or in part from time to time, at the Company's option at a defined redemption price plus accrued and unpaid interest to the redemption date. The net proceeds of the 2014 Notes were used for general corporate purposes and to repay certain corporate debt.

On August 7, 2014, the Company announced tender offers for any and all of the 6.25% Senior Notes due 2027, and up to a maximum amount of the 6.125% Senior Notes due 2039, the 5.75% Senior Notes due 2041 and the 5.75% Senior Notes due 2017, for up to an aggregate principal amount of \$1.5 billion. On August 21, 2014, the Company increased the aggregate principal amount of the tender offers to \$2.0 billion and completed the repurchase for the maximum amount on September 4, 2014. The Company paid a premium of \$490 million in excess of the debt principal in connection with the tender offers, wrote off \$26 million of unamortized deferred financing costs and incurred \$5 million in fees, for a total loss on the early extinguishment of debt of \$521 million. The loss was recorded in income from continuing operations in the consolidated statement of income for the year ended December 31, 2014.

During the year ended December 31, 2014, the Company repurchased the remaining \$41 million of outstanding Enhanced Capital Advantage Preferred Securities (“ECAPS”) at par. The fees and write-off of deferred issuance costs associated with the early extinguishment of the ECAPS were immaterial.

The credit facilities, back-up 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. As of December 31, 2016, the Company is in compliance with all debt covenants.

The following is a summary of the Company’s required principal debt repayments, excluding unamortized debt discounts, deferred financing costs and debt premiums, due during each of the next five years and thereafter, as of December 31, 2016:

IN MILLIONS	
2017	\$ 1,916
2018	3,521
2019	872
2020	2,774
2021	2,326
Thereafter	16,317
<b>Total</b>	<b>\$ 27,726</b>

## 6 | Leases

The Company leases most of its retail and mail order locations, 11 of its distribution centers and certain corporate offices under noncancelable operating leases, typically with initial terms of 15 to 25 years and with options that permit renewals for additional periods. The Company also leases certain equipment and other assets under noncancelable operating leases, typically with initial terms of 3 to 10 years. In December 2015, in connection with the acquisition of the pharmacy and clinic businesses of Target, the Company entered into lease agreements with Target for the pharmacy and clinic space within Target stores. Given that the noncancelable contractual term of the pharmacy lease arrangement exceeds the remaining estimated economic life of the buildings being leased, the Company concluded for accounting purposes that the lease term was the remaining economic life of the buildings. Consequently, most of the individual pharmacy leases are capital leases. Approximately \$0.3 billion of capital lease obligations were recorded in connection with this transaction.

Minimum rent on operating leases 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.

The following table is a summary of the Company’s net rental expense for operating leases for the years ended December 31:

IN MILLIONS	2016	2015	2014
Minimum rentals	<b>\$ 2,418</b>	\$ 2,317	\$ 2,320
Contingent rentals	<b>35</b>	34	36
	<b>2,453</b>	2,351	2,356
Less: sublease income	<b>(24)</b>	(22)	(21)
	<b>\$ 2,429</b>	\$ 2,329	\$ 2,335

## Notes to Consolidated Financial Statements

The following table is a summary of the future minimum lease payments under capital and operating leases as of December 31, 2016:

IN MILLIONS	Capital Leases	Operating Leases <sup>(1)</sup>
2017	\$ 74	\$ 2,458
2018	72	2,361
2019	71	2,209
2020	71	2,040
2021	70	1,910
Thereafter	956	16,368
Total future lease payments <sup>(2)</sup>	1,314	\$ 27,346
Less: imputed interest	(666)	
Present value of capital lease obligations	\$ 648	

(1) Future operating lease payments have not been reduced by minimum sublease rentals of \$176 million due in the future under noncancelable subleases.

(2) The Company leases pharmacy and clinic space from Target. Amounts related to such capital and operating leases are reflected above. Amounts due in excess of the remaining estimated economic life of the buildings of approximately \$1.7 billion are not reflected herein since the estimated economic life of the buildings is shorter than the contractual term of the lease arrangement.

The Company finances a portion of its store development program through sale-leaseback transactions. The properties are generally sold at net book value, which generally approximates fair value, and the resulting leases generally qualify and are accounted for as operating leases. The operating leases that resulted from these transactions are included in the above table. The Company does not have any retained or contingent interests in the stores and does not provide any guarantees, other than a guarantee of lease payments, in connection with the sale-leaseback transactions. Proceeds from sale-leaseback transactions totaled \$230 million in 2016, \$411 million in 2015 and \$515 million in 2014.

### 7 | Medicare Part D

The Company offers Medicare Part D benefits through SilverScript, which has contracted with CMS to be a PDP and, pursuant to the Medicare Prescription Drug, Improvement and Modernization Act of 2003, must be a risk-bearing entity regulated under state insurance laws or similar statutes.

SilverScript is a licensed domestic insurance company under the applicable laws and regulations. Pursuant to these laws and regulations, SilverScript must file quarterly and annual reports with the National Association of Insurance Commissioners ("NAIC") and certain state regulators, must maintain certain minimum amounts of capital and surplus under a formula established by the NAIC and must, in certain circumstances, request and receive the approval of certain state regulators before making dividend payments or other capital distributions to the Company. The Company does not believe these limitations on dividends and distributions materially impact its financial position.

The Company has recorded estimates of various assets and liabilities arising from its participation in the Medicare Part D program based on information in its claims management and enrollment systems. Significant estimates arising from its participation in this program include: (i) estimates of low-income cost subsidy, reinsurance amounts, and coverage gap discount amounts ultimately payable to or receivable from CMS based on a detailed claims reconciliation that will occur in the following year; (ii) an estimate of amounts receivable from or payable to CMS under a risk-sharing feature of the Medicare Part D program design, referred to as the risk corridor and (iii) estimates for claims that have been reported and are in the process of being paid or contested and for our estimate of claims that have been incurred but have not yet been reported.



## 8 | Pension Plans and Other Postretirement Benefits

### Defined Contribution Plans

The Company sponsors voluntary 401(k) savings plans that cover all employees who meet plan eligibility requirements. The Company makes matching contributions consistent with the provisions of the plans.

At the participant's option, account balances, including the Company's matching contribution, can be transferred without restriction among various investment options, including the Company's common stock fund under one of the defined contribution plans. 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 eligible compensation and receive matching contributions equivalent to what they could have received under the CVS Health 401(k) Plan absent certain restrictions and limitations under the Internal Revenue Code. The Company's contributions under the above defined contribution plans were \$295 million, \$251 million and \$238 million in 2016, 2015 and 2014, respectively.

### Defined Benefit Pension Plans

As of December 31, 2016 and 2015, the Company sponsored seven defined benefit pension plans. Two of the plans are tax-qualified plans that are funded based on actuarial calculations and applicable federal laws and regulations. The other five plans are unfunded nonqualified supplemental retirement plans. As of December 31, 2014, the Company sponsored nine defined benefit pension plans. Four of the plans were tax-qualified plans and the other five plans were unfunded nonqualified supplemental retirement plans. Most of the plans were frozen in prior periods.

On September 30, 2015, the Company's Board of Directors approved a resolution to merge the four tax-qualified defined benefit plans that existed in 2014 and terminate the resulting merged plan. The merger was effective September 30, 2015 and the merged plan termination was effective December 31, 2015. The settlement of the terminated plan is expected to occur around the third quarter of 2017. The pension liability for the terminated plan will be settled in either lump sum payments or purchased annuities. Since the amount of the settlement depends on a number of factors determined as of the liquidation date, including the annuity pricing interest rate environment, lump sum election rates, and asset experience, the Company is currently unable to determine the ultimate cost of the settlement. However, based on current market rates the one-time settlement charge at final liquidation is estimated to be in the range of approximately \$175 million to \$225 million.

The following tables outline the change in benefit obligations and plan assets over the comparable periods:

IN MILLIONS	2016	2015
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 844	\$ 796
Acquisition	—	8
Interest cost	27	31
Actuarial loss	13	45
Benefit payments	(37)	(36)
Settlements	(3)	—
Benefit obligation at end of year	\$ 844	\$ 844

## Notes to Consolidated Financial Statements

IN MILLIONS	2016	2015
Change in plan assets:		
Fair value of plan assets at the beginning of the year	\$ 613	\$ 635
Acquisitions	—	5
Actual return on plan assets	26	(13)
Employer contributions	25	22
Benefit payments	(37)	(36)
Settlements	(3)	—
Fair value of plan assets at the end of the year	624	613
Funded status	\$ (220)	\$ (231)

The components of net periodic benefit costs for the years ended December 31 are shown below:

IN MILLIONS	2016	2015	2014
Components of net periodic benefit cost:			
Interest cost	\$ 27	\$ 31	\$ 32
Expected return on plan assets	(32)	(33)	(31)
Amortization of net loss	32	21	16
Settlement loss	—	—	3
Service cost	—	—	1
Net periodic pension cost	\$ 27	\$ 19	\$ 21

### Pension Plan Assumptions

The Company uses a series of actuarial assumptions to determine the benefit obligations and the net benefit costs. 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 on a plan by plan basis. The discount rate for the merged qualified plan that has been terminated is determined by examining the current assumed lump sum and annuity purchase rates. The expected long-term rate of return on plan assets is determined by using the plan's target allocation and historical returns for each asset class on a plan by plan basis. Certain of the Company's pension plans use assumptions on expected compensation increases of plan participants. These increases are determined by an actuarial analysis of the plan participants, their expected compensation increases, and the duration of their earnings period until retirement. Each of these assumptions is reviewed as plan characteristics change and on an annual basis with input from senior pension and financial executives and the Company's external actuarial consultants.

The discount rate for determining plan benefit obligations was 4.0% in 2016 and 4.25% in 2015 for all plans except the terminated qualified plan. The discount rate for the terminated qualified plan was 3.09% and 3.25% in 2016 and 2015, respectively. The expected long-term rate of return for the plans ranged from 4.0% to 5.5% in 2016 and ranged from 5.75% to 6.75% in 2015. The rate of compensation increases for certain of the plans with active participants ranged from 4.0% to 6.0% in 2016 and 2015.

## Return on Plan Assets

The Company's investment strategy is liability management driven. The qualified pension plan asset allocations targets are to hold fixed income investments based upon this strategy. As of December 31, 2016, investment allocations for the two qualified defined benefit plans range from 80% to 100% in fixed income and 0% to 20% in equities. The following tables show the fair value allocation of plan assets by asset category as of December 31, 2016 and 2015.

FAIR VALUE OF PLAN ASSETS AT DECEMBER 31, 2016

IN MILLIONS	Level 1	Level 2	Level 3	Total
Cash and money market funds	\$ 8	\$ —	\$ —	\$ 8
Fixed income funds	3	580	—	583
Equity mutual funds	33	—	—	33
Total assets at fair value	\$ 44	\$ 580	\$ —	\$ 624

FAIR VALUE OF PLAN ASSETS AT DECEMBER 31, 2015

IN MILLIONS	Level 1	Level 2	Level 3	Total
Cash and money market funds	\$ 10	\$ —	\$ —	\$ 10
Fixed income funds	4	484	—	488
Equity mutual funds	115	—	—	115
Total assets at fair value	\$ 129	\$ 484	\$ —	\$ 613

As of December 31, 2016, the Company's qualified defined benefit pension plan assets consisted of 5% equity, 94% fixed income and 1% money market securities of which 7% were classified as Level 1 and 93% as Level 2 in the fair value hierarchy. The Company's qualified defined benefit pension plan assets as of December 31, 2015 consisted of 19% equity, 79% fixed income and 2% money market securities of which 21% were classified as Level 1 and 79% as Level 2 in the fair value hierarchy.

The Company continued to have no investments in Level 3 alternative investments during the years ended December 31, 2016 and 2015.

## Cash Flows

The Company contributed \$25 million, \$22 million and \$42 million to the pension plans during 2016, 2015 and 2014, respectively. The Company plans to make approximately \$39 million in contributions to the pension plans during 2017. These contributions include contributions made to certain nonqualified benefit plans for which there is no funding requirement. The Company estimates the following future benefit payments which are calculated using the same actuarial assumptions used to measure the benefit obligation as of December 31, 2016:

IN MILLIONS	
2017 <sup>(1)</sup>	\$ 39
2018	52
2019	50
2020	49
2021	61
Thereafter	236

(1) Excludes any payments associated with the ultimate settlement of the terminated plan discussed above.

# Notes to Consolidated Financial Statements

## Multiemployer Pension Plans

The Company also contributes to a number of multiemployer pension plans under the terms of collective-bargaining agreements that cover its union-represented employees. The risks of participating in these multiemployer plans are different from single-employer pension plans in the following aspects: (i) assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers, (ii) if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers, and (iii) if the Company chooses to stop participating in some of its multiemployer plans, the Company may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

None of the multiemployer pension plans in which the Company participates are individually significant to the Company. Total Company contributions to multiemployer pension plans were \$15 million in 2016 and \$14 million in 2015 and 2014.

## Other Postretirement Benefits

The Company provides postretirement health care 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 health care costs to determine the health care cost trend rates. As of December 31, 2016 and 2015, the Company's other postretirement benefits have an accumulated postretirement benefit obligation of \$24 million and \$33 million, respectively. Net periodic benefit costs related to these other postretirement benefits were \$1 million, \$2 million and \$1 million in 2016, 2015 and 2014, respectively.

Pursuant to various collective bargaining agreements, the Company also contributes to multiemployer health and welfare plans that cover certain union-represented employees. The plans provide postretirement health care and life insurance benefits to certain employees who meet eligibility requirements. Total Company contributions to multiemployer health and welfare plans were \$52 million, \$60 million and \$58 million in 2016, 2015 and 2014, respectively.

## 9 | Stock Incentive Plans

Stock-based compensation is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period of the stock award (generally three to five years) using the straight-line method. The following table is a summary of stock-based compensation for each of the respective periods:

IN MILLIONS	2016	2015	2014
Stock options <sup>(1)</sup>	\$ 79	\$ 90	\$ 103
Restricted stock awards <sup>(2)</sup>	143	140	62
Total stock-based compensation	\$ 222	\$ 230	\$ 165

(1) Includes the Employee Stock Purchase Plan (the "ESPP")

(2) Stock-based compensation for the year ended December 31, 2015 includes \$38 million associated with accelerated vesting of restricted stock replacement awards issued to Omnicare executives who were terminated subsequent to the acquisition.

The recognized tax benefit was \$22 million, \$26 million and \$33 million for 2016, 2015 and 2014, respectively.

The ESPP provides for the purchase of up to 30 million shares of common stock. Under the ESPP in 2016, eligible employees could purchase common stock at the end of each six month offering period at a purchase price equal to 90% of the lower of the fair market value on the first day or the last day of the offering period. Prior to 2016, the purchase price was equal to 85% of the lower of the fair market value on the first day or the last day of the offering period. During 2016, approximately 1 million shares of common stock were purchased under the provisions of the ESPP at an average price of \$84.68 per share. As of December 31, 2016, approximately 12 million shares of common stock were available for issuance under the ESPP.

The fair value of stock-based compensation associated with the ESPP is estimated on the date of grant (the first day of the six month offering period) using the Black-Scholes option pricing model.

The following table is a summary of the assumptions used to value the ESPP awards for each of the respective periods:

	2016	2015	2014
Dividend yield <sup>(1)</sup>	<b>0.88%</b>	0.71%	0.75%
Expected volatility <sup>(2)</sup>	<b>20.64%</b>	13.92%	14.87%
Risk-free interest rate <sup>(3)</sup>	<b>0.45%</b>	0.11%	0.08%
Expected life (in years) <sup>(4)</sup>	<b>0.5</b>	0.5	0.5
Weighted-average grant date fair value	<b>\$ 14.98</b>	\$ 18.72	\$ 13.74

(1) The dividend yield is calculated based on semi-annual dividends paid and the fair market value of the Company's stock at the grant date.

(2) The expected volatility is based on the historical volatility of the Company's daily stock market prices over the previous six month period.

(3) The risk-free interest rate is based on the Treasury constant maturity interest rate whose term is consistent with the expected term of ESPP options (i.e., six months).

(4) The expected life is based on the semi-annual purchase period.

The terms of the Company's Incentive Compensation Plan ("ICP") provide for grants of annual incentive and long-term performance awards to executive officers and other officers and employees of the Company or any subsidiary of the Company. Payment of such annual incentive and long-term performance awards will be in cash, stock, other awards or other property, at the discretion of the Management Planning and Development Committee of the Company's Board of Directors. The ICP allows for a maximum of 74 million shares to be reserved and available for grants. The ICP is the only compensation plan under which the Company grants stock options, restricted stock and other stock-based awards to its employees, with the exception of the Company's ESPP. As of December 31, 2016, there were approximately 18 million shares available for future grants under the ICP.

The Company's restricted awards are considered nonvested share awards and require no payment from the employee. Compensation cost is recorded based on the market price of the Company's common stock on the grant date and is recognized on a straight-line basis over the requisite service period. The Company granted 1,992,000, 2,695,000 and 2,708,000 restricted stock units with a weighted average fair value of \$103.26, \$100.81 and \$73.60 in 2016, 2015 and 2014, respectively. As of December 31, 2016, there was \$327 million of total unrecognized compensation cost related to the restricted stock units that are expected to vest. These costs are expected to be recognized over a weighted-average period of 2.29 years. The total fair value of restricted shares vested during 2016, 2015 and 2014 was \$218 million, \$164 million and \$57 million, respectively.

## Notes to Consolidated Financial Statements

The following table is a summary of the restricted stock unit and restricted share award activity for the year ended December 31, 2016.

UNITS IN THOUSANDS	Units	Weighted Average Grant Date Fair Value
Nonvested at beginning of year	5,418	\$ 59.22
Granted	1,992	\$ 103.26
Vested	(2,219)	\$ 102.47
Forfeited	(316)	\$ 89.71
Nonvested at end of year	4,875	\$ 55.56

All grants under the ICP are awarded at fair value on the date of grant. The fair value of stock options is estimated using the Black-Scholes option pricing model and stock-based compensation is recognized on a straight-line basis over the requisite service period. Stock options granted generally become exercisable over a four-year period from the grant date. Stock options generally expire seven years after the grant date.

Excess tax benefits of \$72 million, \$127 million and \$106 million were included in financing activities in the accompanying consolidated statements of cash flow during 2016, 2015 and 2014, respectively. Cash received from stock options exercised, which includes the ESPP, totaled \$224 million, \$299 million and \$421 million during 2016, 2015 and 2014, respectively. The total intrinsic value of stock options exercised was \$244 million, \$394 million and \$372 million in 2016, 2015 and 2014, respectively. The total fair value of stock options vested during 2016, 2015 and 2014 was \$298 million, \$334 million and \$292 million, 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:

	2016	2015	2014
Dividend yield <sup>(1)</sup>	1.62%	1.37%	1.47%
Expected volatility <sup>(2)</sup>	17.22%	18.07%	19.92%
Risk-free interest rate <sup>(3)</sup>	1.24%	1.24%	1.35%
Expected life (in years) <sup>(4)</sup>	4.2	4.2	4.0
Weighted-average grant date fair value	\$ 13.00	\$ 14.01	\$ 11.04

(1) The dividend yield is based on annual dividends paid and the fair market value of the Company's stock at the grant date.

(2) The expected volatility is estimated using 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.

(3) The risk-free interest rate is 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.

(4) The expected life represents the number of years the options are expected to be outstanding from grant date based on historical option holder exercise experience.

As of December 31, 2016, unrecognized compensation expense related to unvested options totaled \$79 million, which the Company expects to be recognized over a weighted-average period of 1.79 years. After considering anticipated forfeitures, the Company expects approximately 11 million of the unvested stock options to vest over the requisite service period.



The following table is a summary of the Company's stock option activity for the year ended December 31, 2016:

SHARES IN THOUSANDS	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2015	24,341	\$ 42.17		
Granted	4,343	\$ 104.62		
Exercised	(4,328)	\$ 42.07		
Forfeited	(768)	\$ 85.34		
Expired	(313)	\$ 39.73		
<b>Outstanding at December 31, 2016</b>	<b>23,275</b>	<b>\$ 68.60</b>	<b>3.69</b>	<b>\$ 427,311,414</b>
Exercisable at December 31, 2016	<b>12,196</b>	<b>\$ 49.22</b>	<b>2.35</b>	<b>\$ 375,563,490</b>
Vested at December 31, 2016 and expected to vest in the future	<b>22,734</b>	<b>\$ 67.86</b>	<b>3.64</b>	<b>\$ 426,628,851</b>

## 10 | Income Taxes

The income tax provision for continuing operations consisted of the following for the years ended December 31:

IN MILLIONS	2016	2015	2014
Current:			
Federal	\$ 2,803	\$ 3,065	\$ 2,581
State	511	555	495
	<b>3,314</b>	3,620	3,076
Deferred:			
Federal	5	(180)	(43)
State	(2)	(54)	—
	<b>3</b>	(234)	(43)
Total	<b>\$ 3,317</b>	\$ 3,386	\$ 3,033

The following table is a reconciliation of the statutory income tax rate to the Company's effective income tax rate for continuing operations for the years ended December 31:

	2016	2015	2014
Statutory income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal tax benefit	4.1	4.0	4.3
Other	(0.7)	0.3	0.2
Effective income tax rate	<b>38.4%</b>	39.3%	39.5%

## Notes to Consolidated Financial Statements

The Company has \$4.2 billion of net deferred tax liabilities as of December 31, 2016 and 2015. The following table is a summary of the components of the Company's deferred tax assets and liabilities as of December 31:

IN MILLIONS	2016	2015
Deferred tax assets:		
Lease and rents	\$ 375	\$ 378
Inventory	57	99
Employee benefits	400	359
Allowance for doubtful accounts	301	279
Retirement benefits	65	105
Net operating loss and capital loss carryforwards	125	115
Deferred income	144	83
Other	336	498
Valuation allowance	(135)	(115)
Total deferred tax assets	1,668	1,801
Deferred tax liabilities:		
Depreciation and amortization	(5,882)	(6,018)
Total deferred tax liabilities	(5,882)	(6,018)
Net deferred tax liabilities	\$ (4,214)	\$ (4,217)

The Company assesses positive and negative evidence to determine whether it is more likely than not some portion of a deferred tax asset would not be realized. When it would not, a valuation allowance is established for such portion of a deferred tax asset.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

IN MILLIONS	2016	2015	2014
Beginning balance	\$ 338	\$ 188	\$ 117
Additions based on tax positions related to the current year	68	57	32
Additions based on tax positions related to prior years	70	122	70
Reductions for tax positions of prior years	(100)	(11)	(15)
Expiration of statutes of limitation	(22)	(13)	(15)
Settlements	(47)	(5)	(1)
Ending balance	\$ 307	\$ 338	\$ 188

The Company and most of its subsidiaries are subject to U.S. federal income tax as well as income tax of numerous state and local jurisdictions. The Company is a participant in the Compliance Assurance Process ("CAP"), which is a voluntary program offered by the Internal Revenue Service ("IRS") under which participating taxpayers work collaboratively with the IRS to identify and resolve potential tax issues through open, cooperative and transparent interaction prior to the filing of their federal income tax. The IRS is currently examining the Company's 2015 and 2016 consolidated U.S. federal income tax returns.

The Company and its subsidiaries are also currently under income tax examinations by a number of state and local tax authorities. As of December 31, 2016, no examination has resulted in any proposed adjustments that would result in a material change to the Company's results of operations, financial condition or liquidity.

Substantially all material state and local income tax matters have been concluded for fiscal years through 2010. Certain state exams will be concluded and certain state statutes will lapse in 2017, and the change in the balance of our uncertain tax positions will be immaterial. In addition, it is reasonably possible that the Company's unrecognized tax benefits could change within the next twelve months due to the anticipated conclusion of various examinations with the IRS for various years. An estimate of the range of the possible change cannot be made at this time.

The Company recognizes interest accrued related to unrecognized tax benefits and penalties in income tax expense. The Company recognized interest of approximately \$10 million in 2016, \$5 million in 2015 and \$6 million in 2014. The Company had approximately \$30 million and \$16 million accrued for interest and penalties as of December 31, 2016 and 2015, respectively.

There are no material uncertain tax positions as of December 31, 2016 the ultimate deductibility of which is highly certain but for which there is uncertainty about the timing. If there were, any such items would impact deferred tax accounting only, not the annual effective income tax rate, and would accelerate the payment of cash to the taxing authority to a period earlier than expected.

As of December 31, 2016, the total amount of unrecognized tax benefits that, if recognized, would affect the effective income tax rate is approximately \$276 million, after considering the federal benefit of state income taxes.

## **11 | Commitments and Contingencies**

### **Lease Guarantees**

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 agreed to indemnify 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 31, 2016, the Company guaranteed approximately 87 such store leases (excluding the lease guarantees related to Linens 'n Things, which are discussed in Note 1 "Significant Accounting Policies"), with the maximum remaining lease term extending through 2047.

In April 2016, the parent entity of Bob's Stores filed for Chapter 11 bankruptcy protection. As described above, the Company, through one or more of its affiliates, is alleged to have guaranteed certain of the Bob's Stores' leases (the "Bob's Leases"). On June 20, 2016, the bankruptcy court approved the sale of substantially all of the assets of Bob's Stores and certain other assets to a new entity ("Buyer"), which designated Buyer's affiliate Bob's Stores, LLC, a Delaware limited liability company ("New Bob's"), to acquire substantially all of the assets of Bob's Stores.

The Company, through its subsidiary, CVS Pharmacy, Inc., and New Bob's entered into an agreement in October 2016, pursuant to which, in exchange for an immaterial payment to be made by CVS Pharmacy, Inc., New Bob's agreed to accept the assignment of the Bob's Leases and to be bound by certain restrictions regarding renewals, extensions and modifications to the Bob's Leases. The Company believed these restrictions would potentially reduce the Company's exposure to liability under guarantees of the Bob's Leases in the future. The bankruptcy court approved the assignment of the Bob's Leases to New Bob's on November 7, 2016, and all of the Bob's Leases were assigned to New Bob's.

On February 5, 2017, New Bob's and certain of its affiliates (collectively, the "Debtors") filed for Chapter 11 bankruptcy protection. Certain documents filed in connection with the Debtors' bankruptcy case suggest that the Debtors may enter into an asset purchase agreement with Sports Direct Retail Ltd. ("Sports Direct"), for Sports Direct to serve as an initial bidder in an asset sale process to be conducted pursuant to Section 363 of the Bankruptcy Code. The Company will monitor the Debtors' bankruptcy proceedings.

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## Notes to Consolidated Financial Statements

### Legal Matters

The Company is a party to legal proceedings, investigations and claims in the ordinary course of its business, including the matters described below. The Company records accruals for outstanding legal matters when it believes it is probable that a loss will be incurred and the amount can be reasonably estimated. The Company evaluates, on a quarterly basis, developments in legal matters that could affect the amount of any accrual and developments that would make a loss contingency both probable and reasonably estimable. If a loss contingency is not both probable and estimable, the Company does not establish an accrued liability. None of the Company's accruals for outstanding legal matters are material individually or in the aggregate to the Company's financial position.

The Company's contingencies are subject to significant uncertainties, including, among other factors: (i) the procedural status of pending matters; (ii) whether class action status is sought and certified; (iii) whether asserted claims or allegations will survive dispositive motion practice; (iv) the extent of potential damages, fines or penalties, which are often unspecified or indeterminate; (v) the impact of discovery on the legal process; (vi) whether novel or unsettled legal theories are at issue; (vii) the settlement posture of the parties, and/or (viii) in the case of certain government agency investigations, whether a sealed *qui tam* lawsuit ("whistleblower" action) has been filed and whether the government agency makes a decision to intervene in the lawsuit following investigation.

Except as otherwise noted, the Company cannot predict with certainty the timing or outcome of the legal matters described below, and is unable to reasonably estimate a possible loss or range of possible loss in excess of amounts already accrued for these matters.

- *In re Pharmacy Benefit Managers Antitrust Litigation* (U.S. District Court for the Eastern District of Pennsylvania) (consolidating *North Jackson Pharmacy, Inc. et al v. Caremark Rx Inc. et al.* (U.S. District Court for the Northern District of Alabama)). Beginning in August 2003, various lawsuits were filed by pharmacies alleging that various PBMs were violating certain antitrust laws. In October 2003, two independent pharmacies, North Jackson Pharmacy, Inc. and C&C, Inc. filed three putative class action complaints seeking treble damages and injunctive relief against Caremark (the term "Caremark" as used herein refers to one or more PBM subsidiaries of the Company, as applicable). In August 2006, the Judicial Panel on Multidistrict Litigation issued an order transferring all related PBM antitrust cases, including the North Jackson Pharmacy cases, to the United States District Court for the Eastern District of Pennsylvania for coordinated and consolidated proceedings with the cases originally filed in that court. The consolidated action is now known as *In re Pharmacy Benefit Managers Antitrust Litigation*. On January 18, 2017, the court denied the plaintiffs' motion for class certification filed against Caremark, denied a similar motion filed against another PBM, and decertified classes that had been previously certified against other PBMs.
- *Indiana State District Council of Laborers and HOD Carriers Pension and Welfare Fund v. Omnicare, Inc. et al.* (U.S. District Court for the Eastern District of Kentucky). In February 2006, two substantially similar putative class action lawsuits were filed and subsequently consolidated. The consolidated complaint was filed against Omnicare, three of its officers and two of its directors and purported to be brought on behalf of all open-market purchasers of Omnicare common stock from August 3, 2005 through July 27, 2006, as well as all purchasers who bought shares of Omnicare common stock in Omnicare's public offering in December 2005. The complaint alleged violations of the Securities Exchange Act of 1934 and Section 11 of the Securities Act of 1933 and sought, among other things, compensatory damages and injunctive relief. After dismissals and appeals to the United States Court of Appeals for the Sixth Circuit, the United States Supreme Court remanded the case to the district court. In October 2016, Omnicare filed an answer to plaintiffs' third amended complaint, and discovery commenced.

- *Claims Processing Matter*. In December 2007, the Company received a document subpoena from the Office of Inspector General (“OIG”) within the U.S. Department of Health and Human Services, requesting information relating to the processing of Medicaid and certain other government agency claims on behalf of its clients (which allegedly resulted in underpayments from our pharmacy benefit management clients to the applicable government agencies) on one of the Company’s adjudication platforms. In September 2014, the Company settled the OIG’s claims, as well as related claims by the Department of Justice and private plaintiffs, without any admission of liability. The Company concluded its discussions with the OIG concerning other claim processing issues and resolved those additional matters on December 22, 2016 for the payment of an immaterial amount.
- *FTC and Multi-State Investigation*. In March 2010, the Company learned that various State Attorneys General offices and certain other government agencies were conducting a multi-state investigation of certain of the Company’s business practices similar to those being investigated at that time by the U.S. Federal Trade Commission (“FTC”). Twenty-eight states, the District of Columbia and the County of Los Angeles are known to be participating in this investigation. The prior FTC investigation, which commenced in August 2009, was officially concluded in May 2012 when the consent order entered into between the FTC and the Company became final. The Company has cooperated with the multi-state investigation.
- *United States ex rel. Jack Chin v. Walgreen Company et al.* (U.S. District Court for the Central District of California). In March 2010, the Company received a subpoena from the OIG requesting information about programs under which the Company has offered customers remuneration conditioned upon the transfer of prescriptions for drugs or medications to the Company’s pharmacies in the form of gift cards, cash, non-prescription merchandise or discounts or coupons for non-prescription merchandise. In October 2016, the U.S. District Court for the Central District of California unsealed a *qui tam* complaint, filed in April 2009 against CVS Pharmacy and other retail pharmacies, alleging that the Company violated the federal False Claims Act, and the false claims acts of several states, by offering such programs. The federal government has declined intervention in the case.
- *United States ex rel. James Banigan and Richard Templin v. Organon USA Inc. et al.* (U.S. District Court for the District of Massachusetts). On October 29, 2010, the court unsealed a *qui tam* complaint, which had been under seal since 2007, against Organon, Omnicare, Inc. and PharMerica Corporation. The suit was brought by two former employees of Organon, as relators on behalf of the federal government and several state and local governments. The action alleges civil violations of the federal False Claims Act based on allegations that Organon and its affiliates paid Omnicare and several other long-term care pharmacies rebates, post-purchase discounts and other forms of remuneration in return for purchasing pharmaceuticals from Organon and taking steps to increase the purchase of Organon’s drugs in violation of the Anti-Kickback Statute. The U.S. Department of Justice declined to intervene in this action. The Company has tentatively agreed with the Department of Justice to resolve this matter for \$23 million plus interest. These financial terms are contingent on approval by authorized officials at the Department of Justice, negotiation of terms of a settlement agreement, approval and releases from the OIG, the National Association of Medicaid Fraud Control Units, and the Department of Justice. While the Company believes that a final settlement will be reached, there can be no assurance that any final settlement agreement will be reached or as to the final terms of such settlement.
- *United States ex rel. Anthony R. Spay v. CVS Caremark Corporation et al.* (U.S. District Court for the Eastern District of Pennsylvania). In January 2012, the court unsealed a first amended *qui tam* complaint filed in August 2011 by an individual relator, Anthony Spay, who is described in the complaint as having once been employed by a firm providing pharmacy prescription benefit audit and recovery services. The complaint seeks monetary damages and alleges that Caremark’s processing of Medicare claims on behalf of one of its clients violated the federal False Claims Act. The United States declined to intervene in the lawsuit. In September 2015, the Court granted Caremark’s motion for summary judgment in its entirety, and entered judgment in favor of Caremark and against Spay. In October 2015, Spay filed a notice of appeal in the United States Court of Appeals for the Third Circuit; that court heard oral arguments on the appeal in November 2016.

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## Notes to Consolidated Financial Statements

- *State of Texas ex rel. Myron Winkelman and Stephani Martinson et al. v. CVS Health Corporation* (Travis County District Court). In February 2012, the Attorney General of the State of Texas issued Civil Investigative Demands and has issued a series of subsequent requests for documents and information in connection with its investigation concerning the Health Savings Pass program and other pricing practices with respect to claims for reimbursement from the Texas Medicaid program. In January 2017, the court unsealed a first amended petition. The amended petition alleges the Company violated the Texas Medicaid Fraud Prevention Act by submitting false claims for reimbursement to Texas Medicaid by, among other things, failing to use the price available to members of the CVS Health Savings Pass program as the usual and customary price. The amended petition was unsealed following the Company's filing of *CVS Pharmacy, Inc. v. Charles Smith et al.* (Travis County District Court), a declaratory judgment action against the State of Texas in December 2016 seeking a declaration that the prices charged to members of the Health Savings Pass program do not constitute usual and customary prices under the Medicaid regulation.
- *California ReadyFill Subpoena*. In November 2012, the Company received a subpoena for documents from the OIG requesting information concerning automatic refill programs used by pharmacies to refill prescriptions for customers. The subpoena was issued in connection with an investigation conducted out of the U.S. Attorney's Office for the Central District of California. The Company produced documents and data.
- *Pure Services Subpoena*. In 2013, Omnicare received a subpoena seeking information regarding Omnicare's May 2008 acquisition of Pure Service Pharmacy. In 2016, Omnicare reached an agreement regarding financial terms to resolve, for \$1.5 million plus interest, the subpoena regarding the acquisition of Pure Service Pharmacy. These financial terms are contingent on approval by authorized officials at the Department of Justice, negotiation of terms of a settlement agreement, approval and releases from the OIG, the National Association of Medicaid Fraud Control Units, and the Department of Justice. While the Company believes that a final settlement will be reached, there can be no assurance that any final settlement agreement will be reached or as to the final terms of such settlement.
- *Auto Label Subpoena*. In 2014, Omnicare received a subpoena seeking information regarding Omnicare's Auto Label Verification system. In 2016, Omnicare reached an agreement regarding financial terms to resolve, for \$8 million plus interest, the subpoena regarding Omnicare's Auto Label Verification system. These financial terms are contingent on approval by authorized officials at the Department of Justice, negotiation of terms of a settlement agreement, approval and releases from the OIG, the National Association of Medicaid Fraud Control Units, and the Department of Justice. While the Company believes that a final settlement will be reached, there can be no assurance that any final settlement agreement will be reached or as to the final terms of such settlement.
- *Subpoena Concerning PBM Administrative Fees*. In March 2014, the Company received a subpoena from the United States Attorney's Office for the District of Rhode Island, requesting documents and information concerning bona fide service fees and rebates received from pharmaceutical manufacturers in connection with certain drugs utilized under Part D of the Medicare Program, as well as the reporting of those fees and rebates to Part D plan sponsors. The Company has been cooperating with the government and providing documents and information in response to the subpoena.
- *ReadyFill Subpoena (Minnesota)*. In May 2015, the Company received a subpoena from the OIG requesting information and documents concerning the Company's automatic refill programs, adherence outreach programs, and pharmacy customer incentives, particularly in connection with claims for reimbursement made to the Minnesota Medicaid program. The Company has been cooperating with the investigation and providing information in response to the subpoena.



- *Corcoran et al. v. CVS Health Corporation* (U.S. District Court for the Northern District of California) and *Podgorny et al. v. CVS Health Corporation* (U.S. District Court for the Northern District of Illinois). These putative class actions were filed against the Company in July and September 2015. The cases were consolidated in United States District Court in the Northern District of California. Plaintiffs seek damages and injunctive relief on behalf of a class of consumers who purchased certain prescription drugs under the consumer protection statutes and common laws of certain states. Several third-party payors filed similar putative class actions on behalf of payors captioned *Sheet Metal Workers Local No. 20 Welfare and Benefit Fund v. CVS Health Corp.* (U.S. District Court for the District of Rhode Island) and *Plumbers Welfare Fund, Local 130 v. CVS Health Corporation* (U.S. District Court for the District of Rhode Island) in February and August 2016. In all of these cases the plaintiffs allege the Company overcharged for certain prescription drugs by not submitting as the pharmacy's usual and customary price the price available to members of the CVS Health Savings Pass program. The Company is defending these actions.
- *Omnicare DEA Subpoena*. In September 2015, Omnicare was served with an administrative subpoena by the U.S. Drug Enforcement Agency ("DEA"). The subpoena seeks documents related to controlled substance policies, procedures, and practices at eight pharmacy locations from May 2012 to the present. The Company has been cooperating and providing documents in response to this administrative subpoena.
- *Omnicare Cycle Fill CID*. In October 2015, Omnicare received a Civil Investigative Demand from the United States Attorney's Office for the Southern District of New York requesting information and documents concerning Omnicare's cycle fill process for assisted living facilities. The Company has been cooperating with the government and providing documents and information in response to the Civil Investigative Demand.
- *PBM Pricing CID*. In October 2015, the Company received from the U.S. Department of Justice a Civil Investigative Demand requesting documents and information in connection with a False Claims Act investigation concerning allegations that the Company submitted, or caused to be submitted, to the Medicare Part D program prescription drug event data that misrepresented true prices paid by the Company's PBM to pharmacies for drugs dispensed to Part D beneficiaries with prescription benefits administered by the Company's PBM. The Company has been cooperating with the government and providing documents and information in response to the Civil Investigative Demand.
- *United States ex rel. Sally Schimelpfenig and John Segura v. Dr. Reddy's Laboratories Limited and Dr. Reddy's Laboratories, Inc.* (U.S. District Court for the Eastern District of Pennsylvania). In November 2015, the court unsealed a second amended *qui tam* complaint filed in September 2015. The U.S. Department of Justice declined to intervene in this action. The relators allege that the Company, Walgreens, Wal-Mart, and Dr. Reddy's Laboratories violated the federal and various state False Claims Acts by dispensing prescriptions in unit dose packaging supplied by Dr. Reddy's that was not compliant with the Consumer Product Safety Improvement Act and the Poison Preventive Packaging Act and thereby allegedly rendering the drugs misbranded under the Food, Drug & Cosmetic Act. The Company's motion to dismiss remains pending.
- *Barchock et al. v. CVS Health Corporation et al.* (U.S. District Court for the District of Rhode Island). In February 2016, an ERISA class action lawsuit was filed against the Company, the Benefit Plans Committee of the Company, and Galliard Capital Management, Inc., by Mary Barchock, Thomas Wasecko, and Stacy Weller, purportedly on behalf of the 401(k) Plan and the Employee Stock Ownership Plan of the Company (the "Plan"), and participants in the Plan. The complaint alleges that the defendants breached fiduciary duties owed to the plaintiffs and the Plan by investing too much of the Plan's Stable Value Fund in short-term money market funds and cash management accounts. The Company has moved to dismiss the plaintiffs' amended complaint.
- *State of California ex rel. Matthew Omlansky v. CVS Caremark Corporation* (Superior Court of the State of California, County of Sacramento). In April 2016, the court unsealed a first amended *qui tam* complaint filed in July 2013. The government has declined intervention in this case. The relator alleges that the Company submitted false claims for payment to California Medicaid in connection with reimbursement for drugs available through the Health Savings Pass program as well as certain other generic drugs. The Company's motion to dismiss the complaint was denied.

## Notes to Consolidated Financial Statements

- *DEA Matters*. In October 2016, the Company reached an agreement in principle with the U.S. Attorney's Office for the Eastern District of California to resolve alleged violations of the Controlled Substances Act ("CSA") for \$5 million. The settlement is contingent on the negotiation of terms of a settlement agreement. The Company is also undergoing several audits by the DEA Administrator and is in discussions with the DEA and the U.S. Attorney's Office in several locations concerning allegations that the Company has violated certain requirements of the CSA.
- *State of Mississippi v. CVS Health Corporation et al.* (Chancery Court of Desoto County, Mississippi, Third Judicial District). In July 2016, the Company was served with a complaint filed on behalf of the State of Mississippi alleging that CVS retail pharmacies in Mississippi submitted false claims for reimbursement to Mississippi Medicaid by not submitting as the pharmacy's usual and customary price the price available to members of the CVS Health Savings Pass program. The Company has responded to the complaint, filed a counterclaim, and moved to transfer the case to circuit court.

The Company is also a party to other legal proceedings, government investigations, inquiries and audits, and has received and is cooperating with subpoenas or similar process from various governmental agencies requesting information, all arising in the normal course of its business, none of which is expected to be material to the Company. The Company can give no assurance, however, that its business, financial condition and results of operations will not be materially adversely affected, or that the Company will not be required to materially change its business practices, based on: (i) future enactment of new health care or other laws or regulations; (ii) the interpretation or application of existing laws or regulations as they may relate to the Company's business, the pharmacy services, specialty pharmacy, retail pharmacy, long-term care pharmacy or retail clinic industries or to the health care industry generally; (iii) pending or future federal or state governmental investigations of the Company's business or the pharmacy services, specialty pharmacy, retail pharmacy, long-term care pharmacy or retail clinic industry or of the health care industry generally; (iv) pending or future government enforcement actions against the Company; (v) adverse developments in any pending *qui tam* lawsuit against the Company, whether sealed or unsealed, or in any future *qui tam* lawsuit that may be filed against the Company; or (vi) adverse developments in pending or future legal proceedings against the Company or affecting the pharmacy services, specialty pharmacy, retail pharmacy, long-term care pharmacy or retail clinic industry or the health care industry generally.

### 12 | Segment Reporting

The Company currently has three reportable segments: Pharmacy Services, Retail/LTC and Corporate. The Retail/LTC Segment includes the operating results of the Company's Retail Pharmacy and LTC/RxCrossroads operating segments as the operations and economics characteristics are similar. The Company's segments maintain separate financial information for which operating results are evaluated on a regular basis by the Company's chief operating decision maker in deciding how to allocate resources and in assessing performance.

The Company evaluates its Pharmacy Services and Retail/LTC segments' performance based on net revenue, gross profit and operating profit before the effect of nonrecurring charges and gains and certain intersegment activities. The Company evaluates the performance of its Corporate Segment based on operating expenses before the effect of nonrecurring charges and gains and certain intersegment activities. The chief operating decision maker does not use total assets by segment to make decisions regarding resources, therefore the total asset disclosure by segment has not been included. See Note 1 "Significant Accounting Policies" for a description of the Pharmacy Services, Retail/LTC and Corporate segments and related significant accounting policies.

In 2016, approximately 11.2% of the Company's consolidated net revenues were from Aetna, a Pharmacy Services Segment client. In 2015 and 2014, no single customer accounted for 10% or more of the Company's consolidated net revenues. More than 99% of the Company's consolidated net revenues are earned and long-lived assets are located in the United States.

The following table is a reconciliation of the Company's business segments to the consolidated financial statements:

IN MILLIONS	Pharmacy Services Segment <sup>(1)(2)</sup>	Retail/LTC Segment <sup>(2)</sup>	Corporate Segment	Intersegment Eliminations <sup>(2)</sup>	Consolidated Totals
<b>2016:</b>					
Net revenues	<b>\$ 119,963</b>	<b>\$ 81,100</b>	<b>\$ —</b>	<b>\$ (23,537)</b>	<b>\$ 177,526</b>
Gross profit <sup>(3)</sup>	<b>5,901</b>	<b>23,738</b>	<b>—</b>	<b>(782)</b>	<b>28,857</b>
Operating profit <sup>(4)(5)(6)</sup>	<b>4,672</b>	<b>7,281</b>	<b>(894)</b>	<b>(721)</b>	<b>10,338</b>
Depreciation and amortization	<b>714</b>	<b>1,642</b>	<b>119</b>	<b>—</b>	<b>2,475</b>
Additions to property and equipment	<b>295</b>	<b>1,732</b>	<b>252</b>	<b>—</b>	<b>2,279</b>
<b>2015:</b>					
Net revenues	100,363	72,007	—	(19,080)	153,290
Gross profit	5,227	21,992	—	(691)	26,528
Operating profit <sup>(5)(6)</sup>	3,989	7,130	(1,037)	(628)	9,454
Depreciation and amortization	654	1,336	102	—	2,092
Additions to property and equipment	359	1,883	125	—	2,367
<b>2014:</b>					
Net revenues	88,440	67,798	—	(16,871)	139,367
Gross profit	4,771	21,277	—	(681)	25,367
Operating profit	3,514	6,762	(796)	(681)	8,799
Depreciation and amortization	630	1,205	96	—	1,931
Additions to property and equipment	308	1,745	83	—	2,136

(1) Net revenues of the Pharmacy Services Segment include approximately \$10.5 billion, \$8.9 billion and \$8.1 billion of Retail Co-Payments for 2016, 2015 and 2014, respectively. See Note 1 "Significant Accounting Policies" to the consolidated financial statements for additional information about Retail Co-Payments.

(2) Intersegment eliminations relate to intersegment revenue generating activities that occur between the Pharmacy Services Segment and the Retail/LTC Segment. These occur in the following ways: when members of Pharmacy Services Segment clients ("members") fill prescriptions at the Company's retail pharmacies to purchase covered products, when members enrolled in programs such as Maintenance Choice<sup>®</sup> elect to pick up maintenance prescriptions at one of the Company's retail pharmacies instead of receiving them through the mail, or when members have prescriptions filled at the Company's long-term care pharmacies. When these occur, both the Pharmacy Services and Retail/LTC segments record the revenues, gross profit and operating profit on a standalone basis.

(3) The Retail/LTC Segment gross profit for the year ended December 31, 2016 includes \$46 million of acquisition-related integration costs. The integration costs are related to the acquisitions of Omnicare and the pharmacies and clinics of Target.

(4) The Pharmacy Services Segment operating profit for the year ended December 31, 2016 includes the reversal of an accrual of \$88 million in connection with a legal settlement.

(5) The Retail/LTC Segment operating profit for the three months and year ended December 31, 2016 includes a \$34 million asset impairment charge in connection with planned store closures in 2017 related to the Company's enterprise streamlining initiative. The Retail/LTC Segment operating profit for the 2016 and 2015 include \$281 million and \$64 million, respectively, of acquisition-related integration costs. The integration costs are related to the acquisitions of Omnicare and the pharmacies and clinics of Target.

(6) The Corporate Segment operating loss for the year ended December 31, 2016 includes \$10 million of integration costs. For the year ended December 31, 2015, the Corporate Segment operating loss includes \$156 million of acquisition-related transaction and integration costs and a \$90 million charge related to a legacy lawsuit challenging the 1999 legal settlement by MedPartners of various securities class actions and a related derivative claim.

## Notes to Consolidated Financial Statements

### 13 | Earnings Per Share

The following is a reconciliation of basic and diluted earnings per share from continuing operations for the respective years:

IN MILLIONS, EXCEPT PER SHARE AMOUNTS	2016	2015	2014
Numerator for earnings per share calculation:			
Income from continuing operations	\$ 5,320	\$ 5,230	\$ 4,645
Income allocated to participating securities	(27)	(26)	(19)
Net income attributable to noncontrolling interest	(2)	(2)	—
Income from continuing operations attributable to CVS Health	\$ 5,291	\$ 5,202	\$ 4,626
Denominator for earnings per share calculation:			
Weighted average shares, basic	1,073	1,118	1,161
Effect of dilutive securities	6	8	8
Weighted average shares, diluted	1,079	1,126	1,169
Earnings per share from continuing operations:			
Basic	\$ 4.93	\$ 4.65	\$ 3.98
Diluted	\$ 4.91	\$ 4.62	\$ 3.96

### 14 | Quarterly Financial Information (Unaudited)

IN MILLIONS, EXCEPT PER SHARE AMOUNTS	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
<b>2016:</b>					
Net revenues	\$ 43,215	\$ 43,725	\$ 44,615	\$ 45,971	\$177,526
Gross profit	6,744	7,015	7,492	7,606	28,857
Operating profit	2,176	2,350	2,817	2,995	10,338
Income from continuing operations	1,147	924	1,542	1,707	5,320
Income (loss) from discontinued operations, net of tax	—	—	(1)	—	(1)
Net income attributable to CVS Health	1,146	924	1,540	1,707	5,317
Basic earnings per share:					
Income from continuing operations attributable to CVS Health	\$ 1.04	\$ 0.86	\$ 1.44	\$ 1.60	\$ 4.93
Income (loss) from discontinued operations attributable to CVS Health	\$ —	\$ —	\$ —	\$ —	\$ —
Net income attributable to CVS Health	\$ 1.04	\$ 0.86	\$ 1.44	\$ 1.60	\$ 4.93
Diluted earnings per share:					
Income from continuing operations attributable to CVS Health	\$ 1.04	\$ 0.86	\$ 1.43	\$ 1.59	\$ 4.91
Income (loss) from discontinued operations attributable to CVS Health	\$ —	\$ —	\$ —	\$ —	\$ —
Net income attributable to CVS Health	\$ 1.04	\$ 0.86	\$ 1.43	\$ 1.59	\$ 4.90
Dividends per share	\$ 0.425	\$ 0.425	\$ 0.425	\$ 0.425	\$ 1.70
Stock price: (New York Stock Exchange)					
High	\$ 104.05	\$ 106.10	\$ 98.06	\$ 88.80	\$ 106.10
Low	\$ 89.65	\$ 93.21	\$ 88.99	\$ 73.53	\$ 73.53

IN MILLIONS, EXCEPT PER SHARE AMOUNTS	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
<b>2015:</b>					
Net revenues	\$ 36,332	\$ 37,169	\$ 38,644	\$ 41,145	\$ 153,290
Gross profit	6,164	6,402	6,661	7,301	26,528
Operating profit	2,132	2,262	2,331	2,729	9,454
Income from continuing operations	1,221	1,272	1,237	1,500	5,230
Income (loss) from discontinued operations, net of tax	—	—	10	(1)	9
Net income attributable to CVS Health	1,221	1,272	1,246	1,498	5,237
Basic earnings per share:					
Income from continuing operations attributable to CVS Health	\$ 1.08	\$ 1.13	\$ 1.10	\$ 1.35	\$ 4.65
Income (loss) from discontinued operations attributable to CVS Health	\$ —	\$ —	\$ 0.01	\$ —	\$ 0.01
Net income attributable to CVS Health	\$ 1.08	\$ 1.13	\$ 1.11	\$ 1.35	\$ 4.66
Diluted earnings per share:					
Income from continuing operations attributable to CVS Health	\$ 1.07	\$ 1.12	\$ 1.10	\$ 1.34	\$ 4.62
Income (loss) from discontinued operations attributable to CVS Health	\$ —	\$ —	\$ 0.01	\$ —	\$ 0.01
Net income attributable to CVS Health	\$ 1.07	\$ 1.12	\$ 1.11	\$ 1.34	\$ 4.63
Dividends per share	\$ 0.35	\$ 0.35	\$ 0.35	\$ 0.35	\$ 1.40
Stock price: (New York Stock Exchange)					
High	\$ 104.56	\$ 106.47	\$ 113.45	\$ 105.29	\$ 113.45
Low	\$ 94.16	\$ 98.74	\$ 95.12	\$ 91.56	\$ 91.56

## Five-Year Financial Summary

IN MILLIONS, EXCEPT PER SHARE AMOUNTS	2016	2015	2014	2013	2012
<b>Statement of operations data:</b>					
Net revenues	<b>\$ 177,526</b>	\$ 153,290	\$ 139,367	\$ 126,761	\$ 123,120
Gross profit	<b>28,857</b>	26,528	25,367	23,783	22,488
Operating expenses	<b>18,519</b>	17,074	16,568	15,746	15,278
Operating profit	<b>10,338</b>	9,454	8,799	8,037	7,210
Interest expense, net	<b>1,058</b>	838	600	509	557
Loss on early extinguishment of debt	<b>643</b>	—	521	—	348
Income tax provision <sup>(1)</sup>	<b>3,317</b>	3,386	3,033	2,928	2,436
Income from continuing operations	<b>5,320</b>	5,230	4,645	4,600	3,869
Income (loss) from discontinued operations, net of tax	<b>(1)</b>	9	(1)	(8)	(7)
Net income	<b>5,319</b>	5,239	4,644	4,592	3,862
Net (income) loss attributable to noncontrolling interest	<b>(2)</b>	(2)	—	—	2
Net income attributable to CVS Health	<b>\$ 5,317</b>	\$ 5,237	\$ 4,644	\$ 4,592	\$ 3,864
<b>Per share data:</b>					
<b>Basic earnings per share:</b>					
Income from continuing operations attributable to CVS Health	<b>\$ 4.93</b>	\$ 4.65	\$ 3.98	\$ 3.78	\$ 3.05
Income (loss) from discontinued operations attributable to CVS Health	<b>\$ —</b>	\$ 0.01	\$ —	\$ (0.01)	\$ (0.01)
Net income attributable to CVS Health	<b>\$ 4.93</b>	\$ 4.66	\$ 3.98	\$ 3.77	\$ 3.04
<b>Diluted earnings per share:</b>					
Income from continuing operations attributable to CVS Health	<b>\$ 4.91</b>	\$ 4.62	\$ 3.96	\$ 3.75	\$ 3.02
Income (loss) from discontinued operations attributable to CVS Health	<b>\$ —</b>	\$ 0.01	\$ —	\$ (0.01)	\$ (0.01)
Net income attributable to CVS Health	<b>\$ 4.90</b>	\$ 4.63	\$ 3.96	\$ 3.74	\$ 3.02
Cash dividends per share	<b>\$ 1.70</b>	\$ 1.40	\$ 1.10	\$ 0.90	\$ 0.65
<b>Balance sheet and other data:</b>					
Total assets <sup>(1)</sup>	<b>\$ 94,462</b>	\$ 92,437	\$ 73,202	\$ 70,550	\$ 65,474
Long-term debt	<b>\$ 25,615</b>	\$ 26,267	\$ 11,630	\$ 12,767	\$ 9,079
Total shareholders' equity	<b>\$ 36,834</b>	\$ 37,203	\$ 37,963	\$ 37,938	\$ 37,653
Number of stores (at end of year)	<b>9,750</b>	9,681	7,866	7,702	7,508

(1) As of January 1, 2016, the Company early adopted Accounting Standard Update No. 2015-17, Income Taxes (Topic 740) issued by the Financial Accounting Standards Board in November 2015. The effect of the retrospective adoption on the Company's historical consolidated balance sheets is a reduction in current assets and deferred income taxes of \$1.2 billion, \$985 million, \$902 million and \$693 million as of December 31, 2015, 2014, 2013 and 2012, respectively.



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## Report of Ernst & Young LLP, Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of CVS Health Corporation

We have audited the accompanying consolidated balance sheets of CVS Health Corporation as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2016. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of CVS Health Corporation at December 31, 2016 and 2015, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2016, 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), CVS Health Corporation's internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 9, 2017 expressed an unqualified opinion thereon.

*Ernst & Young LLP*

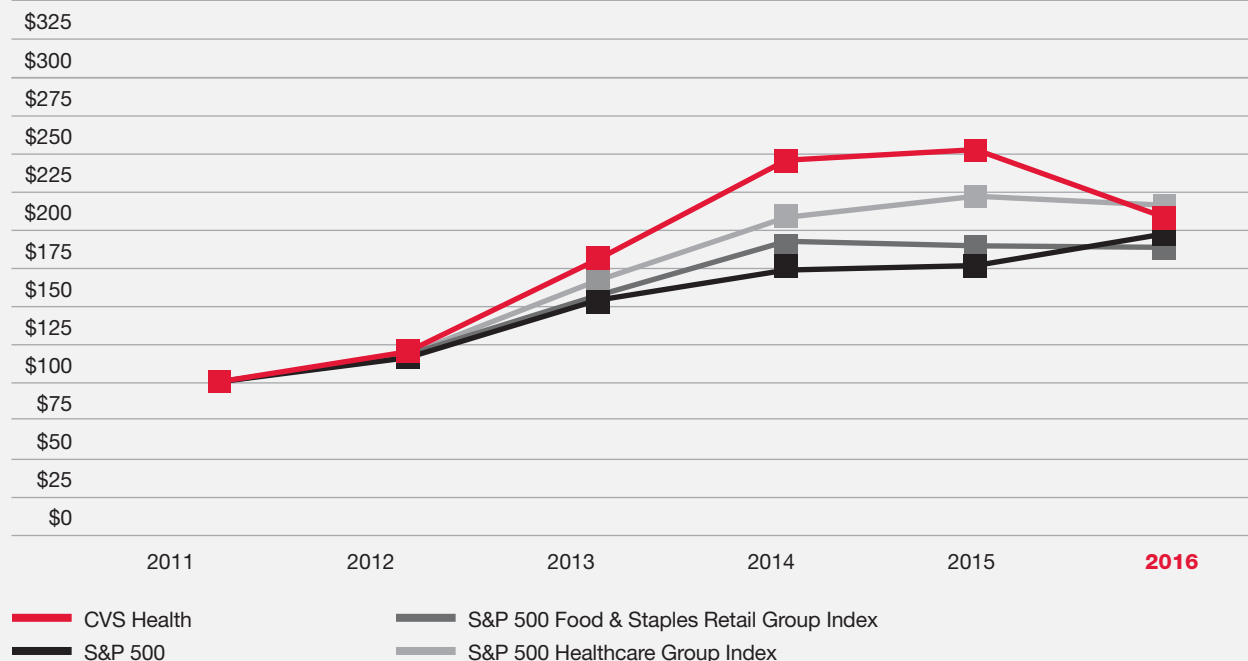
Boston, Massachusetts  
February 9, 2017

## Stock Performance Graph

The following graph shows changes over the past five-year period in the value of \$100 invested in: (1) our common stock; (2) S&P 500 Index; (3) S&P 500 Food and Staples Retailing Industry Group Index, which currently includes seven retail companies; (4) S&P 500 Healthcare Sector Group Index, which currently includes 56 health care companies.

### Relative Total Returns Since 2011 – Annual

DECEMBER 31, 2011 TO DECEMBER 31, 2016



	YEAR END						1 YR CAGR 2015-16	3 YR CAGR 2013-16	5 YR CAGR 2011-16
	2011	2012	2013	2014	2015	2016			
CVS Health	\$100	\$120	\$181	\$247	\$254	\$209	-17.8%	4.9%	15.9%
S&P 500 <sup>(1)</sup>	\$100	\$116	\$154	\$174	\$177	\$198	11.9%	8.8%	14.6%
S&P 500 Food & Staples Retail Group Index <sup>(2)</sup>	\$100	\$118	\$157	\$193	\$190	\$189	-0.8%	6.4%	13.6%
S&P 500 Healthcare <sup>(3)</sup>	\$100	\$118	\$167	\$209	\$223	\$217	-2.7%	9.2%	16.8%

Note: Analysis assumes reinvestment of dividends.

(1) Includes CVS Health.

(2) Includes seven companies: (COST, CVS, KR, SYY, WBA, WFM, WMT).

(3) Includes 56 companies.

The year-end values of each investment shown in the preceding graph are based on share price appreciation plus dividends, with the dividends reinvested as of the last business day of the month during which such dividends were ex-dividend. The calculations exclude trading commissions and taxes. Total stockholder returns from each investment, whether measured in dollars or percentages, can be calculated from the year-end investment values shown beneath the graph.

# Shareholder Information

## Officers

### Larry J. Merlo

President and Chief Executive Officer

### Lisa G. Bisaccia

Executive Vice President and  
Chief Human Resources Officer

### Eva C. Boratto

Executive Vice President – Controller  
and Chief Accounting Officer

### Troyen A. Brennan, M.D.

Executive Vice President and  
Chief Medical Officer

### David M. Denton

Executive Vice President and  
Chief Financial Officer

### Helena B. Foulkes

Executive Vice President and  
President – CVS Pharmacy

### Stephen J. Gold

Executive Vice President and  
Chief Information Officer

### J. David Joyner

Executive Vice President, Sales and  
Account Services – CVS Caremark

### Robert O. Kraft

Executive Vice President and  
President – Omnicare

### Thomas M. Moriarty

Executive Vice President, Chief Policy  
Officer and General Counsel

### Jonathan C. Roberts

Executive Vice President and  
Chief Operating Officer

### Andrew J. Sussman, M.D.

Executive Vice President, Clinical Services  
and Associate Chief Medical Officer

### Nancy R. Christal

Senior Vice President – Investor Relations

### Carol A. DeNale

Senior Vice President and Treasurer

### David A. Falkowski

Senior Vice President and  
Chief Compliance Officer

### John P. Kennedy

Senior Vice President and Chief Tax Officer

### Colleen M. McIntosh

Senior Vice President, Corporate Secretary  
and Assistant General Counsel

### Thomas S. Moffatt

Vice President, Assistant Secretary and  
Assistant General Counsel

## 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 31, 2016. After our 2016 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

### Richard M. Bracken <sup>(1) (2)</sup>

Former Chairman and Chief Executive Officer  
HCA Holdings, Inc.

### C. David Brown II <sup>(1) (3)</sup>

Chairman of the Firm  
Broad and Cassel

### Alecia A. DeCoudreaux <sup>(2) (4)</sup>

Former President  
Mills College

### Nancy-Ann M. DeParle <sup>(2) (4)</sup>

Partner  
Consonance Capital Partners, LLC

### David W. Dorman <sup>(1) (3)</sup>

Chairman of the Board  
CVS Health Corporation

### Anne M. Finucane <sup>(1) (3)</sup>

Vice Chairman  
Bank of America Corporation

### Larry J. Merlo

President and Chief Executive Officer  
CVS Health Corporation

### Jean-Pierre Millon <sup>(2) (4)</sup>

Former President and Chief Executive Officer  
PCS Health Services, Inc.

### Richard J. Swift <sup>(4)</sup>

Former Chairman, President and Chief  
Executive Officer  
Foster Wheeler Ltd.

### William C. Weldon <sup>(1) (3)</sup>

Former Chairman and Chief Executive Officer  
Johnson & Johnson

### Tony L. White <sup>(2) (3)</sup>

Former Chairman, President and  
Chief Executive Officer  
Applied Biosystems, Inc.

*(1) Member of the Nominating and  
Corporate Governance Committee*

*(2) Member of the Patient Safety and  
Clinical Quality Committee*

*(3) Member of the Management Planning  
and Development Committee*

*(4) Member of the Audit Committee*

## Shareholder Information

### Corporate Headquarters

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

### Annual Shareholders' Meeting

May 10, 2017  
CVS Health Corporate Headquarters

### Stock Market Listing

The 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:

Wells Fargo Shareowner Services  
P.O. Box 64874  
St. Paul, MN 55164-0874  
Toll-free: (877) CVS-PLAN (287-7526)  
International: +1 (651) 450-4064  
Email: stocktransfer@wellsfargo.com  
Website: www.shareowneronline.com

### Direct Stock Purchase/Dividend Reinvestment Program

Shareowner Services Plus Plan<sup>SM</sup> provides a  
convenient and economical way for you to  
purchase your first shares or additional shares  
of CVS Health common stock. The program is  
sponsored and administered by Wells Fargo  
Bank, N.A. For more information, including an  
enrollment form, please contact Wells Fargo  
Bank, N.A. 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  
Senior Vice President – Investor Relations  
CVS Health 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  
investors.cvshealth.com.



**WE ARE**

**A pharmacy innovation company**

**OUR STRATEGY**

**Reinventing pharmacy**

**OUR PURPOSE**

**Helping people on their path to better health**

**OUR VALUES**

- Innovation**
- Collaboration**
- Caring**
- Integrity**
- Accountability**



The CVS Health 2016 Annual Report achieved the following results by printing on paper containing 10 percent post-consumer recycled content. FSC® is not responsible for any calculations of results from choosing this paper.

Trees Saved	Water Saved	Energy Saved	Solid Waste Not Produced	Greenhouse Gases Not Produced	Hazardous Air Pollutants Not Produced
82 fully grown	38,287 gallons	31,000,000 MMBTUs	2,563 pounds	7,059 pounds	7 pounds