EXPRESS SCRIPTS INC
Form 10-Q
July 25, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2007.

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________ to _____________.

Commission File Number: 0-20199

EXPRESS SCRIPTS, INC.
(Exact name of registrant as specified in its charter)

Delaware	**43-1420563**
(State of Incorporation)	(I.R.S. employer identification no.)
One Express Way, St. Louis, MO	**63121**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (314) 996-0900

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

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

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

Common stock outstanding as of June 30, 2007:	257,851,000 Shares

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EXPRESS SCRIPTS, INC.

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PART I. FINANCIAL INFORMATION

Item 1. **Financial Statements**

EXPRESS SCRIPTS, INC.
Unaudited Consolidated Balance Sheet

(in millions, except share data)	**June 30, 2007**	**December 31, 2006**
Assets		
Current assets:		
Cash and cash equivalents	$ 111.2	$ 131.0
Receivables, net	1,303.9	1,334.4
Inventories	198.4	194.6
Deferred taxes	107.1	90.9
Prepaid expenses and other current assets	24.2	21.2
Total current assets	1,744.8	1,772.1
Property and equipment, net	198.5	201.4
Goodwill	2,688.0	2,686.0
Other intangible assets, net	360.5	378.4
Other assets	41.1	70.2
Total assets	$ 5,032.9	$ 5,108.1
Liabilities and Stockholders' Equity		
Current liabilities:		
Claims and rebates payable	$ 1,198.3	$ 1,275.7
Accounts payable	570.2	583.4
Accrued expenses	346.4	390.2
Current maturities of long-term debt	220.1	180.1
Total current liabilities	2,335.0	2,429.4
Long-term debt	1,700.3	1,270.4
Other liabilities	310.2	283.4
Total liabilities	4,345.5	3,983.2
Stockholders' Equity:		
Preferred stock, 5,000,000 shares authorized, $0.01 par value per share;		
and no shares issued and outstanding	-	-
Common stock, 1,300,000,000 shares authorized, $0.01 par value per share;		
shares issued: 318,867,000 and 159,442,000, respectively;		
shares outstanding: 257,851,000 and 135,650,000, respectively	3.2	1.6
Additional paid-in capital	538.1	495.3
Accumulated other comprehensive income	15.0	11.9
Retained earnings	2,303.5	2,017.3
	2,859.8	2,526.1
Common stock in treasury at cost, 61,016,000 and 23,792,000		
shares, respectively	(2,172.4)	(1,401.2)
Total stockholders' equity	687.4	1,124.9
Total liabilities and stockholders' equity	$ 5,032.9	$ 5,108.1

See accompanying Notes to Unaudited Consolidated Financial Statements

EXPRESS SCRIPTS, INC.
Unaudited Consolidated Statement of Operations

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions, except per share data)	**2007**	**2006**	**2007**	**2006**
Revenues [1]	$ 4,600.4	$ 4,421.1	$ 9,139.9	$ 8,801.1
Cost of revenues [1]	4,157.0	4,057.5	8,270.4	8,092.9
Gross profit	443.4	363.6	869.5	708.2
Selling, general and administrative	183.1	171.1	355.8	332.2
Operating income	260.3	192.5	513.7	376.0
Other (expense) income:				
Non-operating gains (charges), net	4.2	-	(18.8)	-
Undistributed loss from joint venture	(0.4)	(0.3)	(0.8)	(0.8)
Interest income	2.6	4.0	5.4	9.0
Interest expense	(25.6)	(23.7)	(47.8)	(44.2)
	(19.2)	(20.0)	(62.0)	(36.0)
Income before income taxes	241.1	172.5	451.7	340.0
Provision for income taxes	88.4	64.7	165.3	127.5
Net income	$ 152.7	$ 107.8	$ 286.4	$ 212.5
Basic earnings per share:	$ 0.58	$ 0.38	$ 1.07	$ 0.74
Weighted average number of common shares outstanding during the period - Basic EPS	263.6	282.4	267.6	287.6
Diluted earnings per share:	$ 0.57	$ 0.38	$ 1.06	$ 0.73
Weighted average number of common shares outstanding during the period - Diluted EPS	267.0	286.8	271.1	292.4

[1]*Excludes estimated retail pharmacy co-payments of $943.9 and $1,045.7 for the three months ended June 30, 2007 and 2006, respectively, and $1,932.1 and $2,266.5 the six months ended June 30, 2007 and 2006, respectively. These are amounts we instructed retail pharmacies to collect from members. We have no information regarding actual co-payments collected.*

See accompanying Notes to Unaudited Consolidated Financial Statements

EXPRESS SCRIPTS, INC.
Unaudited Consolidated Statement of Changes in Stockholders' Equity

	Number of Shares	Amount					
(in millions)	Common Stock	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2006	159.4	$ 1.6	$495.3	$ 11.9	$2,017.3	$(1,401.2)	$1,124.9
Comprehensive income:							
Net income	-	-	-	-	286.4	-	286.4
Other comprehensive income:							
Foreign currency translation adjustment	-	-	-	5.1	-	-	5.1
Realized gains on available-for-sale securities; net of taxes				(2.0)			(2.0)
Comprehensive income	-	-	-	3.1	286.4	-	289.5
Stock split in form of stock dividend	159.4	1.6	(1.6)	-	-	-	-
Treasury stock acquired	-	-	-	-	-	(826.7)	(826.7)
Changes in stockholders' equity related to employee stock plans	0.1	-	44.4	-	-	55.5	99.9
Cumulative effect of adoption of FIN 48	-	-	-	-	(0.2)	-	(0.2)
Balance at June 30, 2007	318.9	$ 3.2	$538.1	$ 15.0	$2,303.5	$(2,172.4)	$ 687.4

See accompanying Notes to Unaudited Consolidated Financial Statements

EXPRESS SCRIPTS, INC.
Unaudited Consolidated Statement of Cash Flows

	Six Months Ended June 30,	
(in millions)	**2007**	**2006**
Cash flows from operating activities:		
Net income	$ 286.4	$ 212.5
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	52.1	51.9
Non-cash adjustments to net income	23.5	13.4
Changes in operating assets and liabilities:		
Claims and rebates payable	(77.4)	(175.8)
Other net changes in operating assets and liabilities	(33.3)	91.8
Net cash provided by operating activities	251.3	193.8
Cash flows from investing activities:		
Purchases of property and equipment	(29.9)	(20.7)
Sale of marketable securities	34.2	-
Other	(0.6)	(0.1)
Net cash provided by (used in) investing activities	3.7	(20.8)
Cash flows from financing activities:		
Proceeds from long-term debt	600.0	-
Repayment of long-term debt	(80.1)	(80.1)
Repayment of revolving credit line, net	(50.0)	285.0
Tax benefit relating to employee stock compensation	39.3	27.5
Treasury stock acquired	(826.7)	(707.7)
Net proceeds from employee stock plans	42.1	19.7
Deferred financing fees	(1.3)	(0.3)
Net cash used in financing activities	(276.7)	(455.9)
Effect of foreign currency translation adjustment	1.9	0.9
Net decrease in cash and cash equivalents	(19.8)	(282.0)
Cash and cash equivalents at beginning of period	131.0	477.9
Cash and cash equivalents at end of period	$ 111.2	$ 195.9

See accompanying Notes to Unaudited Consolidated Financial Statements

EXPRESS SCRIPTS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Summary of significant accounting policies

Our significant accounting policies normally included in financial statements prepared in conformity with generally accepted accounting principles, have been omitted from this Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission. However, we believe the disclosures contained in this Form 10-Q are adequate to make the information presented not misleading when read in conjunction with the notes to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission on February 8, 2007. For a full description of our accounting policies, please refer to the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2006.

We believe the accompanying unaudited consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments except as otherwise disclosed) necessary to present fairly the Unaudited Consolidated Balance Sheet at June 30, 2007, the Unaudited Consolidated Statements of Operations for the three and six months ended June 30, 2007 and 2006, the Unaudited Consolidated Statement of Changes in Stockholders' Equity for the six months ended June 30, 2007, and the Unaudited Consolidated Statements of Cash Flows for the six months ended June 30, 2007 and 2006. Operating results for the three and six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

Note 2 – Non-operating gains (charges), net

On December 18, 2006, we announced a proposal to acquire all of the outstanding shares of Caremark Rx, Inc. ("Caremark") common stock. On March 16, 2007, Caremark shareholders approved a merger agreement with CVS Corporation ("CVS") and we subsequently withdrew our proposal to acquire Caremark. Legal and other professional fees (which do not include expenses incurred internally) of $27.4 million were expensed in the first quarter of 2007. Additionally in the first quarter, we received a $4.4 million special dividend CVS/Caremark Corporation ("CVS/ Caremark") paid on Caremark stock we owned prior to the CVS/Caremark merger. As of June 30, 2007, we have sold all of our shares of CVS/Caremark stock, resulting in a non-operating gain of approximately $4.2 million, which was recorded in the second quarter of 2007. We recognized net non-operating charges in the first six months of 2007 of $18.8 million.

Note 3 – Goodwill and other intangibles

The following is a summary of our goodwill and other intangible assets (amounts in millions).

	June 30, 2007		December 31, 2006	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Goodwill				
PBM (1)	$1,511.4	$ 107.3	$1,509.2	$ 107.1
SAAS(1)	1,283.9	-	1,283.9	-
	$2,795.3	$ 107.3	$2,793.1	$ 107.1
Other intangible assets				
PBM				
Customer contracts	$ 244.8	$ 91.5	$ 244.2	$ 85.3
Other	60.3	49.5	61.6	49.3
	305.1	141.0	305.8	134.6
SAAS				
Customer relationships	231.5	41.4	231.5	31.0
Other (2)	9.2	2.9	9.9	3.2
	240.7	44.3	241.4	34.2
Total other intangible assets	$ 545.8	$ 185.3	$ 547.2	$ 168.8

(1) We have two reportable segments: Pharmacy Benefit Management ("PBM") and Specialty and Ancillary Services ("SAAS").
(2) Changes in other intangible assets are a result of the write-off of fully-amortized contractual assets, consisting of non-compete agreements that are no longer in effect.

The aggregate amount of amortization expense of other intangible assets was $9.7 million and $10.4 million for the three months ended June 30, 2007 and 2006, respectively, and $19.5 million and $20.5 million for the six months ended June 30, 2007 and 2006, respectively. The future aggregate amount of amortization expense of other intangible assets is approximately $21.2 million for the remainder of 2007, $36.3 million for 2008, $35.3 million for 2009, $33.7 million for 2010, and $31.8 million for 2011. The weighted average amortization period of intangible assets subject to amortization is 16 years in total, and by major intangible class is 5 to 20 years for customer-related intangibles and four years for other intangible assets.

Note 4 – Common Stock

On May 23, 2007, we announced a two-for-one stock split for stockholders of record on June 8, 2007, effective June 22, 2007. The split was effected in the form of a dividend by issuance of one additional share of common stock for each share of common stock outstanding. The earnings per share and the weighted average number of shares outstanding for basic and diluted earnings per share for each period have been adjusted for the stock split.

Note 5 – Financing

We amended our existing credit facility in the second quarter to provide additional borrowings up to $800.0 million, of which $600.0 million was outstanding at the end of the second quarter ("Term-1 Loans"). The new Term-1 Loans have similar terms to our existing Term A loans with the following notable exceptions:

- Delayed draw feature (through December 31, 2007) allowing for interim borrowings up to $800.0 million.
- No scheduled payments, until the maturity of the loan.

As a result of this amendment, we added approximately $1.4 million of deferred financing fees in the second quarter of 2007.

The following represents the schedule of current maturities for our long-term debt as of June 30, 2007 (amounts in millions):

Year Ended December 31,	
2007	$ 100.0
2008	260.1
2009	420.0
2010	1,140.0
2011	0.1
Thereafter	0.2
	$ 1,920.4

Note 6 – Income Taxes

We adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation ("FIN") 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109," on January 1, 2007. As a result of the implementation of FIN 48, we recorded $23.5 million of unrecognized tax benefits within the consolidated balance sheet, with no net impact to the consolidated statement of operations. Of this amount, approximately $0.2 million was accounted for as a reduction to the January 1, 2007 balance of retained earnings, in accordance with adoption provisions of FIN 48. Included in our unrecognized tax benefits are $7.2 million of uncertain tax positions that would impact our effective tax rate if recognized. We do not expect any significant increases or decreases to our unrecognized tax benefits within 12 months of June 30, 2007.

Prior to our adoption of FIN 48, we only included interest expense on underpayments of income taxes in our income tax provision. We have accrued an aggregate $3.7 million of interest in our income tax provision. Interest was computed on the difference between the tax position recognized in accordance with FIN 48 and the amount previously taken or expected to be taken in our tax returns. Upon adoption of FIN 48, we have elected an accounting policy to also classify accrued penalties related to unrecognized tax benefits in our income tax provision. Previously, our policy was to classify penalties as an operating expense in arriving at pretax income.

Our U.S. federal income tax returns for tax years 2003 and beyond remain subject to examination by the Internal Revenue Service ("IRS"). The IRS commenced an examination of our consolidated 2003 and 2004 federal income tax returns in the second quarter of 2006 that is anticipated to be concluded by the end of 2007. Accordingly, we have agreed to extend our statute of limitations for the 2003 tax year from September 17, 2007 to March 31, 2008. The statute of limitations for the 2004 tax year will expire on September 15, 2008. Our state income tax returns for 2003 through 2005 remain subject to examination by various state authorities with the latest closing period on November 15, 2010. In addition, we have extended the statutes for certain state jurisdictions with respect to years prior to 2003 that will expire June 30, 2007, unless otherwise extended.

Note 7 – Earnings per share (reflecting the two-for-one stock split effective June 22, 2007)

Basic earnings per share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed in the same manner as basic earnings per share but adds the number of additional common shares that would have been outstanding for the period if the dilutive potential common shares had been issued. The following is the reconciliation between the number of weighted average shares used in the basic and diluted earnings per share calculation for all periods (amounts in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Weighted average number of common shares outstanding during the period – Basic EPS(1)	263.6	282.4	267.6	287.6
Dilutive common stock equivalents:				
Outstanding stock options, "stock-settled" stock appreciation rights ("SSRs"), restricted stock units, and executive deferred compensation units	3.4	4.4	3.5	4.8
Weighted average number of common shares outstanding during the period – Diluted EPS(1)	267.0	286.8	271.1	292.4

(1) Excludes SSRs of 0.2 million for the six months ended June 30, 2007. These were excluded because their effect was anti-dilutive.

The above shares are all calculated under the "treasury stock" method in accordance with Financial Accounting Standard ("FAS") 128, "Earnings per Share."

Note 8 – Stock-based compensation plans (reflecting the two-for-one stock split effective June 22, 2007)

Under our stock-based compensation plans, we have issued stock options, SSRs, restricted stock and performance share awards. Awards are typically settled using treasury shares. The maximum contractual term of stock options and SSRs granted under the 2000 Long Term Incentive Plan ("LTIP") is 10 years. Due to the nature of the awards, we use the same valuation methods and accounting treatments for SSRs and stock options. During the first six months of 2007, we granted 2,300,000 SSRs and 61,000 stock options with a weighted average fair market value of $12.81 per share. The SSRs and stock options have three-year graded vesting.

During the first six months of 2007, we granted to certain officers and employees approximately 292,000 restricted shares of common stock and performance shares with a weighted average fair market value of $40.75 per share. The restricted stock awards have three-year graded vesting, and the performance shares cliff vest at the end of the three years. The number of performance shares that ultimately vest is dependent upon achieving specific performance targets. Prior to vesting, these shares are subject to forfeiture to us without consideration upon termination of employment under certain circumstances. The total number of non-vested restricted stock and performance share awards was 541,000 at June 30, 2007 and 498,000 at December 31, 2006.

We recognized stock-based compensation expense of $8.2 million and $6.6 million in the three months ended June 30, 2007 and 2006, respectively, and $16.8 million and $14.1 million in the six months ended June 30, 2007 and 2006, respectively. Unamortized stock-based compensation as of June 30, 2007 was $34.4 million for stock options and SSRs, and $13.9 million for restricted stock and performance shares.

The fair value of options and SSRs granted is estimated on the date of grant using a Black-Scholes multiple option-pricing model with the following weighted average assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Expected life of option	3-5 years	3-5 years	3-5 years	3-5 years
Risk-free interest rate	4.8%	4.8%-5.3%	4.5%-5.2%	4.6%-5.3%
Expected volatility of stock	31%	34%	31%	34%
Expected dividend yield	None	None	None	None

Note 9 – Contingencies

We accrue self-insurance reserves based upon estimates of the aggregate liability of claim costs in excess of our insurance coverage. Reserves are estimated using certain actuarial assumptions followed in the insurance industry and our historical experience. The majority of these claims are legal claims and our liability estimate is primarily related to the cost to defend these claims. We do not accrue for settlements, judgments, monetary fines or penalties until such amounts are probable and estimable, in compliance with FAS 5, "Accounting for Contingencies." Under FAS 5, if the range of possible loss is broad, the liability accrual should be based on the lower end of the range.

While we believe that our services and business practices are in compliance with applicable laws, rules and regulations in all material respects, we cannot predict the outcome of these matters at this time. An unfavorable outcome in one or more of these matters could result in the imposition of judgments, monetary fines or penalties, or injunctive or administrative remedies. We can give no assurance that such judgments, fines and remedies, and future costs associated with legal matters, would not have a material adverse effect on our financial condition, our consolidated results of operations or our consolidated cash flows.

Note 10 – Segment reporting

We report segments on the basis of services offered and have determined we have two reportable segments: PBM and SAAS. Operating income is the measure used by our chief operating decision maker to assess the performance of each of our operating segments. The following table presents information about our reportable segments, including a reconciliation of operating income to income before income taxes, for the three and six months ended June 30, 2007 and 2006:

(in millions)	**PBM**	**SAAS**	**Total**
For the three months ended June 30, 2007			
Product revenue:			
Network revenues	$ 2,376.8	$ -	$ 2,376.8
Home delivery revenues	1,250.5	-	1,250.5
Other revenues	-	898.4	898.4
Service revenues	42.0	32.7	74.7
Total revenues	3,669.3	931.1	4,600.4
Depreciation and amortization expense	16.8	9.4	26.2
Operating income	249.8	10.5	260.3
Non-operating gains			4.2
Undistributed loss from joint venture			(0.4)
Interest income			2.6
Interest expense			(25.6)
Income before income taxes			241.1

Capital expenditures	17.4	3.8	21.2

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(in millions)	**PBM**	**SAAS**	**Total**
For the three months ended June 30, 2006			
Product revenue:			
Network revenues	$ 2,175.9	$ -	$ 2,175.9
Home delivery revenues	1,311.3	-	1,311.3
Other revenues	-	859.8	859.8
Service revenues	41.2	32.9	74.1
Total revenues	3,528.4	892.7	4,421.1
Depreciation and amortization expense	16.8	9.3	26.1
Operating income	170.0	22.5	192.5
Undistributed loss from joint venture			(0.3)
Interest income			4.0
Interest expense			(23.7)
Income before income taxes			172.5
Capital expenditures	8.3		