RITE AID CORP
Form 10-Q
January 08, 2019
Table of Contents

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 December 1, 2018

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 1-5742

RITE AID CORPORATION

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**23-1614034** (I.R.S. Employer Identification No.)
30 Hunter Lane, Camp Hill, Pennsylvania (Address of principal executive offices)	**17011** (Zip Code)

Registrant s telephone number, including area code: **(717) 761-2633.**

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report):

Not Applicable

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, and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of Large Accelerated Filer, Accelerated Filer, Smaller Reporting Company and Emerging Growth Company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer x	Accelerated Filer o	Non-Accelerated Filer o	Smaller reporting company o Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

The registrant had 1,066,879,495 shares of its $1.00 par value common stock outstanding as of December 20, 2018.

Table of Contents

RITE AID CORPORATION

TABLE OF CONTENTS

Table of Contents

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This report, as well as our other public filings or public statements, include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are often identified by terms and phrases such as anticipate, believe, intend, estimate, expect, continue, should, could, may, plan, project, predict, will and similar expressions and include refer and relate to our future prospects, developments and business strategies.

Factors that could cause actual results to differ materially from those expressed or implied in such forward-looking statements include, but are not limited to:

- our high level of indebtedness;
- our ability to make interest and principal payments on our debt and satisfy the other covenants contained in our credit facilities and other debt agreements;
- the ongoing impact of private and public third party payors continued reduction in prescription drug reimbursement rates and their efforts to limit access to payor networks, including through mail order;
- our ability to achieve the benefits of our efforts to reduce the costs of our generic and other drugs, and our ability to achieve and sustain drug pricing efficiencies;
- the impact of the loss of one or more major third party payor contracts;
- the inability to complete the sale of remaining distribution centers to Walgreens Boots Alliance, Inc. (WBA), due to the failure to satisfy the minimal remaining conditions applicable only to the distribution centers being transferred at such distribution center closing;
- the impact on our business, operating results and relationships with customers, suppliers, third party payors, and employees, resulting from our efforts over the past several years to consummate a significant transaction with WBA and Albertsons Companies, Inc. (Albertsons);

- the risk that we will not be able to meet our obligations under our Transition Services Agreement (TSA) with WBA, which could expose us to significant financial penalties;

- the risk that we cannot reduce our selling, general and administrative expenses enough to offset lost revenue from the TSA agreement as the amount of stores serviced under the agreement decreases;

- the risk that there may be changes to our strategy due to the terminated merger (the Merger) with Albertsons, or if the remaining distribution center closing of the Sale (as defined herein) do not close, which may include delaying or reducing capital or other expenditures, selling assets or other operations, closing underperforming stores, attempting to restructure or refinance our debt, seeking additional capital or incurring other costs associated with restructuring our business, any of which could have an impact on our stock price;

- the risk that we may need to take further impairment charges if our future results do not meet our expectations;

- our ability to refinance our indebtedness on terms favorable to us;

- our ability to improve the operating performance of our stores in accordance with our long term strategy;

- our ability to grow prescription count and realize front-end sales growth;

- our ability to hire and retain qualified personnel;

- decisions to close additional stores and distribution centers or undertake additional refinancing activities, which could result in charges to our operating statement;

- our ability to manage expenses and working capital;

Table of Contents

- continued consolidation of the drugstore and the pharmacy benefit management (PBM) industries;

- the risk that changes in federal or state laws or regulations, including the Health Care Education Affordability Reconciliation Act, the repeal of all or part of the Patient Protection and the Affordable Care Act (or Patient Care Act) and any regulations enacted thereunder may occur;

- the risk that provider and state contract changes may occur;

- risks related to compromises of our information or payment systems or unauthorized access to confidential or personal information of our associates or customers;

- our ability to maintain our current pharmacy services business and obtain new pharmacy services business, including maintaining renewals of expiring contracts, avoiding contract termination rights that may permit certain of our clients to terminate their contracts prior to their expiration and early price renegotiations prior to contract expirations;

- the continued impact of gross margin pressure in the PBM industry due to increased market competition and client demand for lower prices while providing enhanced service offerings;

- our ability to maintain our current Medicare Part D business and obtain new Medicare Part D business, as a result of the annual Medicare Part D competitive bidding process;

- the expiration or termination of our Medicare or Medicaid managed care contracts by federal or state governments;

- risks related to other business effects, including the effects of industry, market, economic, political or regulatory conditions, future exchange or interest rates or credit ratings, changes in tax laws, regulations, rates and policies or competitive development including aggressive promotional activity from our competitors;

- the risk that we could experience deterioration in our current Star rating with the Centers of Medicare and Medicaid Services (CMS) or incur CMS penalties and/or sanctions;

- the nature, cost and outcome of pending and future litigation and other legal proceedings or governmental investigations, including any such proceedings related to the Merger or Sale and instituted against us and others;

- the potential reputational risk to our business during the period in which WBA is operating the Acquired Stores (as defined below) under the Rite Aid banner;

- the inability to fully realize the benefits of our tax attributes;

- our ability to maintain the listing of our common stock on the New York Stock Exchange (the NYSE), and the resulting impact of either a delisting or remedies taken to prevent a delisting would have on our results of operations and financial condition; and

- other risks and uncertainties described from time to time in our filings with the Securities and Exchange Commission (the SEC).

We undertake no obligation to update or revise the forward-looking statements included in this report, whether as a result of new information, future events or otherwise, after the date of this report. Our actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. Factors that could cause or contribute to such differences are discussed in the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations included herein and in our Annual Report on Form 10-K for the fiscal year ended March 3, 2018 (the Fiscal 2018 10-K), which we filed with the SEC on April 26, 2018, our Quarterly Report on Form 10-Q for the thirteen weeks ended June 2, 2018 (the First Quarter 2019 10-Q) which we filed on July 6, 2018, and our Quarterly Report on Form 10-Q for the thirteen weeks ended September 1, 2018 (the Second Quarter 2019 10-Q) which we filed on October 4, 2018, as well as in the Risk Factors section of the Fiscal 2018 10-K. These documents are available on the SEC s website at *www.sec.gov*.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

RITE AID CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

(unaudited)

	December 1, 2018		March 3, 2018	
ASSETS				
Current assets:				
Cash and cash equivalents	$	410,043	$	447,334
Accounts receivable, net		1,717,830		1,869,100
Inventories, net of LIFO reserve of $600,401 and $581,090		1,894,274		1,799,539
Prepaid expenses and other current assets		176,439		181,181
Current assets held for sale		131,892		438,137
Total current assets		4,330,478		4,735,291
Property, plant and equipment, net		1,335,740		1,431,246
Goodwill		1,108,135		1,421,120
Other intangibles, net		462,362		590,443
Deferred tax assets		635,416		594,019
Other assets		210,827		217,208
Total assets	$	8,082,958	$	8,989,327
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Current maturities of long-term debt and lease financing obligations	$	16,066	$	20,761
Accounts payable		1,707,242		1,651,363
Accrued salaries, wages and other current liabilities		997,017		1,231,736
Current liabilities held for sale				560,205
Total current liabilities		2,720,325		3,464,065
Long-term debt, less current maturities		3,394,466		3,340,099
Lease financing obligations, less current maturities		26,200		30,775
Other noncurrent liabilities		488,553		553,378
Total liabilities		6,629,544		7,388,317
Commitments and contingencies				
Stockholders equity:				
Common stock, par value $1 per share; 1,500,000 shares authorized; shares issued and outstanding 1,066,902 and 1,067,318		1,066,902		1,067,318
Additional paid-in capital		4,860,219		4,850,712

Accumulated deficit		(4,440,250)		(4,282,471)
Accumulated other comprehensive loss		(33,457)		(34,549)
Total stockholders equity		1,453,414		1,601,010
Total liabilities and stockholders equity	$	8,082,958	$	8,989,327

See accompanying notes to condensed consolidated financial statements.

Table of Contents

RITE AID CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(unaudited)

	Thirteen Week Period Ended	
	December 1, 2018	December 2, 2017
Revenues	$ 5,450,060	$ 5,353,170
Costs and expenses:		
Cost of revenues	4,267,972	4,166,447
Selling, general and administrative expenses	1,142,555	1,166,514
Lease termination and impairment charges	2,628	3,939
Interest expense	56,008	50,308
(Gain) loss on sale of assets, net	(382)	205
	5,468,781	5,387,413
Loss from continuing operations before income taxes	(18,721)	(34,243)
Income tax benefit	(1,471)	(16,061)
Net loss from continuing operations	(17,250)	(18,182)
Net income from discontinued operations, net of tax	12,740	99,213
Net (loss) income	$ (4,510)	$ 81,031
Computation of (loss) income attributable to common stockholders:		
Loss from continuing operations attributable to common stockholders basic and diluted	$ (17,250)	$ (18,182)
Income from discontinued operations attributable to common stockholders basic and diluted	12,740	99,213
(Loss) income attributable to common stockholders basic and diluted	$ (4,510)	$ 81,031
Basic and diluted (loss) income per share:		
Continuing operations	$ (0.02)	$ (0.02)
Discontinued operations	$ 0.02	$ 0.10
Net basic and diluted (loss) income per share	$ (0.00)	$ 0.08

See accompanying notes to condensed consolidated financial statements.

Table of Contents

RITE AID CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(In thousands)

(unaudited)

	Thirteen Week Period Ended	
	December 1, 2018	**December 2, 2017**
Net (loss) income	$ (4,510)	$ 81,031
Other comprehensive income:		
Defined benefit pension plans:		
Amortization of prior service cost, net transition obligation and net actuarial losses included in net periodic pension cost, net of $144 and $342 tax expense	364	514
Total other comprehensive income	364	514
Comprehensive (loss) income	$ (4,146)	$ 81,545

See accompanying notes to condensed consolidated financial statements.

Table of Contents

RITE AID CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(unaudited)

	Thirty-Nine Week Period Ended	
	December 1, 2018	December 2, 2017
Revenues	$ 16,259,912	$ 16,134,704
Costs and expenses:		
Cost of revenues	12,747,924	12,624,365
Selling, general and administrative expenses	3,449,173	3,469,298
Lease termination and impairment charges	52,096	11,090
Goodwill and intangible asset impairment charges	375,190	
Interest expense	175,033	152,165
Loss on debt retirements, net	554	
Walgreens Boots Alliance merger termination fee		(325,000)
Gain on sale of assets, net	(11,206)	(20,623)
	16,788,764	15,911,295
(Loss) income from continuing operations before income taxes	(528,852)	223,409
Income tax (benefit) expense	(117,527)	89,268
Net (loss) income from continuing operations	(411,325)	134,141
Net income from discontinued operations, net of tax	262,091	42,257
Net (loss) income	$ (149,234)	$ 176,398
Computation of (loss) income attributable to common stockholders:		
(Loss) income from continuing operations attributable to common stockholders basic and diluted	$ (411,325)	$ 134,141
Income from discontinued operations attributable to common stockholders basic and diluted	262,091	42,257
(Loss) income attributable to common stockholders basic and diluted	$ (149,234)	$ 176,398
Basic and diluted (loss) income per share:		
Continuing operations	$ (0.39)	$ 0.13
Discontinued operations	$ 0.25	$ 0.04
Net basic and diluted (loss) income per share	$ (0.14)	$ 0.17

See accompanying notes to condensed consolidated financial statements.

Table of Contents

RITE AID CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(In thousands)

(unaudited)

	Thirty-Nine Week Period Ended	
	December 1, 2018	December 2, 2017
Net (loss) income	$ (149,234)	$ 176,398
Other comprehensive income:		
Defined benefit pension plans:		
Amortization of prior service cost, net transition obligation and net actuarial losses included in net periodic pension cost, net of $432 and $1,026 tax expense	1,092	1,543
Total other comprehensive income	1,092	1,543
Comprehensive (loss) income	$ (148,142)	$ 177,941

See accompanying notes to condensed consolidated financial statements.

Table of Contents

RITE AID CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Thirty-Nine Week Period Ended	
	December 1, 2018	December 2, 2017
Operating activities:		
Net (loss) income	$ (149,234)	$ 176,398
Net income from discontinued operations, net of tax	262,091	42,257
Net (loss) income from continuing operations	$ (411,325)	$ 134,141
Adjustments to reconcile to net cash provided by operating activities of continuing operations:		
Depreciation and amortization	270,957	292,448
Lease termination and impairment charges	52,096	11,090
Goodwill and intangible asset impairment charges	375,190	
LIFO charge	19,311	20,393
Gain on sale of assets, net	(11,206)	(20,623)
Stock-based compensation expense	11,563	22,550
Loss on debt retirements, net	554	
Changes in deferred taxes	(126,102)	98,597
Changes in operating assets and liabilities:		
Accounts receivable	(5,437)	(19,865)
Inventories	(78,489)	(84,731)
Accounts payable	181,497	118,941
Other assets	(12,304)	(30,049)
Other liabilities	(216,086)	(118,442)
Net cash provided by operating activities of continuing operations	50,219	424,450
Investing activities:		
Payments for property, plant and equipment	(139,218)	(140,816)
Intangible assets acquired	(31,573)	(20,201)
Proceeds from insured loss		3,627
Proceeds from dispositions of assets and investments	15,801	19,254
Proceeds from sale-leaseback transactions	2,587	
Net cash used in investing activities of continuing operations	(152,403)	(138,136)
Financing activities:		
Net proceeds from (payments to) revolver	1,245,000	(264,080)
Principal payments on long-term debt	(437,597)	(7,292)
Change in zero balance cash accounts	(15,964)	27,594
Net proceeds from issuance of common stock	2,294	4,416
Payments for taxes related to net share settlement of equity awards	(2,419)	(4,103)
Financing fees paid for early debt redemption	(13)	
Net cash provided by (used in) financing activities of continuing operations	791,301	(243,465)
Cash flows from discontinued operations:		
Operating activities of discontinued operations	(47,268)	(62,294)

Investing activities of discontinued operations		664,653		189,175
Financing activities of discontinued operations		(1,343,793)		(245,340)
Net cash used in discontinued operations		(726,408)		(118,459)
Decrease in cash and cash equivalents		(37,291)		(75,610)
Cash and cash equivalents, beginning of period		447,334		245,410
Cash and cash equivalents, end of period	$	410,043	$	169,800

See accompanying notes to condensed consolidated financial statements.

Table of Contents

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Thirteen and Thirty-Nine Week Periods Ended December 1, 2018 and December 2, 2017

(Dollars and share information in thousands, except per share amounts)

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X and therefore do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete annual financial statements. The accompanying financial information reflects all adjustments which are of a recurring nature and, in the opinion of management, are necessary for a fair presentation of the results for the interim periods. The results of operations for the thirteen and thirty-nine week periods ended December 1, 2018 are not necessarily indicative of the results to be expected for the full year. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Rite Aid Corporation (Rite Aid) and Subsidiaries (together with Rite Aid, the Company) Fiscal 2018 10-K.

The discussion and presentation of the operating and financial results of our business segments have been impacted by the following event.

Pursuant to the terms and subject to the conditions set forth in the Amended and Restated Asset Purchase Agreement (the Amended and Restated Asset Purchase Agreement), dated as of September 18, 2017, by and among Rite Aid, WBA and Walgreen Co., an Illinois corporation and wholly owned direct subsidiary of WBA (Buyer), Buyer agreed to purchase from Rite Aid 1,932 stores (the Acquired Stores), three distribution centers, related inventory and other specified assets and liabilities related thereto for a purchase price of approximately $4,375,000, on a cash free, debt free basis (the Asset Sale or the Sale). As of December 1, 2018, the Company has sold all 1,932 Acquired Stores, one (1) distribution center, and related assets to WBA in exchange for proceeds of $4,217,937, which were used to repay outstanding debt. Based on its magnitude and because the Company has exited certain markets, the Sale represents a significant strategic shift that has a material effect on the Company s operations and financial results. Accordingly, the Company has applied discontinued operations treatment for the Asset Sale as required by Accounting Standards Codification 210-05 Discontinued Operations (ASC 205-20). In accordance with ASC 205-20, the Company reclassified the assets and liabilities to be sold, including the 1,932 Acquired Stores, three (3) distribution centers, related inventory and other specified assets and liabilities related thereto (collectively the Assets to be Sold or Disposal Group) to assets and liabilities held for sale on its consolidated balance sheets as of the periods ended December 1, 2018 and March 3, 2018, and reclassified the financial results of the Disposal Group in its consolidated statements of operations and consolidated statements of cash flows for all periods presented. Additionally, corporate support activities related to the Disposal Group were not reclassified to discontinued operations. Please see additional information as provided in Note 3 Asset Sale to WBA.

Recently Adopted 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 No. 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 No. 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 No. 2016-10, Identifying Performance Obligations and Licensing, which amends the guidance in those areas in the new revenue recognition standard. These ASUs, collectively the new revenue standard , are effective for annual reporting periods (including interim reporting periods within those periods) beginning January 1, 2018.

The Company adopted the new revenue standard as of March 4, 2018 using the modified retrospective method and applying the new standard to all contracts with customers. Therefore, the comparative financial information has not been restated and continues to be reported under the accounting standards in effect for those periods. In connection with the adoption of the new revenue standard, the Company identified one difference in its Retail Pharmacy segment related to the timing of revenue recognition for third party prescription revenues, which was historically recognized at the time the prescription was filled. Upon adoption of ASU No. 2014-09, this revenue is recognized at the time the customer takes possession of the merchandise. In connection with its March 4, 2018 adoption of the new revenue standard on a modified retrospective basis, the Company recorded a reduction to accounts receivable of $57,897, a reduction to deferred tax assets of $1,772, an increase to inventory of $51,121, and a corresponding increase to accumulated deficit of $8,548 within its Retail Pharmacy segment.

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Thirteen and Thirty-Nine Week Periods Ended December 1, 2018 and December 2, 2017

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In addition, the Company identified revenues under one specific rebate administration program under which the Company s Pharmacy Services segment was determined to be the principal and historically recognized revenues and cost of revenues on a gross basis of approximately $123,500 during fiscal 2018. Upon adoption of the new revenue standard, the Company is now recording revenue from this program on a net basis.

The following is a discussion of the Company s revenue recognition policies by segment under the new revenue recognition accounting standard:

Revenue Recognition

Retail Pharmacy Segment

For front end sales, the Retail Pharmacy segment recognizes revenues upon the transfer of control of the goods to the customer. The Company satisfies its performance obligation at the point of sale for front end transactions. The Retail Pharmacy segment front end revenue is measured based on the amount of fixed consideration that we expect to receive, net of an allowance for estimated future returns. Return activity is immaterial to revenues and results of operations in all periods presented.

For pharmacy sales, the Retail Pharmacy segment recognizes revenue upon the transfer of control of the goods to the customer. The Company satisfies its performance obligation, upon pickup by the customer, which is when the customer takes title to the product. Each prescription claim is its own arrangement with the customer and is a performance obligation, separate and distinct from other prescription claims. The Company s revenue is measured based on the amount of fixed consideration that we expect to receive, reduced by refunds owed to the third party payor for pricing guarantees and performance against defined value-based service and performance metrics. The inputs to these estimates are not highly subjective or volatile. The effect of adjustments between estimated and actual amounts have not been material to the Company s results of operations or financial position. Prescriptions are generally not returnable.

The Retail Pharmacy segment offers a chain-wide loyalty card program titled wellness +. Individual customers are able to become members of the wellness + program. Members participating in the wellness + loyalty card program earn points on a calendar year basis for eligible front end merchandise purchases and qualifying prescription purchases. One point is awarded for each dollar spent towards front end merchandise and 25 points are awarded for each qualifying prescription.

Members reach specific wellness + tiers based on the points accumulated during the calendar year, which entitles such customers to certain future discounts and other benefits upon reaching that tier. For example, any customer that reaches 1,000 points in a calendar year achieves the Gold tier, enabling him or her to receive a 20% discount on qualifying purchases of front end merchandise for the remaining portion of the calendar year and also the next calendar year. There is also a similar Silver level with a lower threshold and benefit level.

Points earned pursuant to the wellness+ program represent a performance obligation and the Company allocates revenue between the merchandise purchased and the wellness + points based on the relative stand-alone selling price of each performance obligation. The relative value of the wellness + points is initially deferred as a contract liability (included in other current and noncurrent liabilities). As customers redeem the points to receive discounted front end merchandise or when the points expire, the Retail Pharmacy segment recognizes an allocable portion of the deferred contract liability into revenue. The Retail Pharmacy segment had accrued contract liabilities of $60,560 as of December 1, 2018, of which $55,907 is included in other current liabilities and $4,653 is included in noncurrent liabilities. The Retail Pharmacy segment had accrued contract liabilities of $63,851 as of March 3, 2018, of which $50,036 is included in other current liabilities and $13,815 is included in noncurrent liabilities.

The wellness + program also allows a customer to earn Bonus Cash based on qualifying purchases. Wellness + Rewards members have the opportunity to redeem their accumulated Bonus Cash on a future purchase with a 60 day expiration window.

For a majority of the Bonus Cash issuances, funding is provided by our vendors through contractual arrangements. This funding is treated as a contract liability and remains a contract liability until (i) wellness + Rewards members redeem their Bonus Cash, or (ii) wellness + Rewards members allow the Bonus Cash to expire. Upon redemption or expiration, the Retail Pharmacy segment recognizes an allocable portion of the accrued contract liability into revenue. For Bonus Cash issuances that are not vendor funded, the contract liability is recorded at the time of issuance through a reduction to revenues, and not recognized until the Bonus Cash is redeemed or expires.

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Thirteen and Thirty-Nine Week Periods Ended December 1, 2018 and December 2, 2017

(Dollars and share information in thousands, except per share amounts)

(unaudited)

Pharmacy Services Segment

The Pharmacy Services segment sells prescription drugs indirectly through its retail pharmacy network and directly through its mail service dispensing pharmacy. The Pharmacy Services segment recognizes revenue from prescription drugs sold by (i) its mail service dispensing pharmacy and (ii) under retail pharmacy network contracts where it is the principal at the contract prices negotiated with its clients, primarily employers, insurance companies, unions, government employee groups, health plans, Managed Medicaid plans, Medicare plans, and other sponsors of health benefit plans, and individuals throughout the United States. Revenues include: (i) the portion of the price the client pays directly to the Pharmacy Services segment, net of any volume-related or other discounts paid back to the client (see Drug Discounts below), (ii) the price paid to the Pharmacy Services segment by client plan members for mail order prescriptions (Mail Co-Payments), (iii) client plan member copayments made directly to the retail pharmacy network, and (iv) administrative fees. Revenue is recognized when the Pharmacy Services segment meets its performance obligations relative to each transaction type. The following revenue recognition policies have been established for the Pharmacy Services segment:

- 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. At this point the Company has performed all of its performance obligations.

- Revenues generated from prescription drugs sold by the Pharmacy Services segment s mail service dispensing pharmacy are recognized when the prescription is shipped. At the time of shipment, the Pharmacy Services segment has performed all of its performance obligations under its client contracts, as control of and title to the product has passed to the client plan members. The Pharmacy Services segment does not experience a significant level of returns or reshipments.

- Revenues generated from administrative fees based on membership or claims volume are recognized monthly based on the terms within the individual contracts, either a monthly member based fee, or a claims volume based fee.

In the majority of its contracts, the Pharmacy Services segment is the principal because its client contracts give clients the right to obtain access to its pharmacy contracts under which the Pharmacy Services segment directs its pharmacy network to provide the services (drug dispensing, consultation, etc.) and goods (prescription drugs) to the clients members at its negotiated pricing. The Pharmacy Services segment s obligations under its client contracts are separate and distinct from its obligations to the third party pharmacies included in its retail pharmacy network contracts. Pursuant to these contracts, the Pharmacy Services segment is contractually required to pay the third party pharmacies in its retail pharmacy network for products sold after payment is received from its clients. The Pharmacy Services segment has control over these transactions until the prescription is transferred to the member and, thus, that it is acting as a principal. As such, the Pharmacy Services segment records the total prescription price contracted with clients in revenues.

Amounts paid to pharmacies and amounts charged to clients are exclusive of the applicable co-payment under Pharmacy Services segment contracts. Retail pharmacy co-payments, which we instruct retail pharmacies to collect from members, are included in our revenues and our cost of revenues.

For contracts under which the Pharmacy Services segment acts as an agent or does not control the prescription drugs prior to transfer to the client, no revenue is recognized.

Drug Discounts The Pharmacy Services segment deducts from its revenues that are generated from prescription drugs sold by third party pharmacies any rebates, inclusive of discounts and fees, earned by its clients based on utilization levels and other factors as negotiated with the prescription drug manufacturers or suppliers. Rebates are paid to clients in accordance with the terms of client contracts.

Medicare Part D The Pharmacy Services segment, through its EIC subsidiary, participates in the federal government s Medicare Part D program as a Prescription Drug Plan (PDP). Please refer to Note 8, Medicare Part D.

Table of Contents

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Thirteen and Thirty-Nine Week Periods Ended December 1, 2018 and December 2, 2017

(Dollars and share information in thousands, except per share amounts)

(unaudited)

Disaggregation of Revenue

The following tables disaggregate the Company s revenue by major source in each segment for the thirteen and thirty-nine week periods ended December 1, 2018:

In thousands	For the thirteen week period ended December 1, 2018	For the thirty-nine week period ended December 1, 2018
Retail Pharmacy segment:		
Pharmacy sales	$ 2,664,200	$ 7,803,395
Front end sales	1,276,621	3,873,830
Other revenue	35,898	108,771
Total Retail Pharmacy segment	$ 3,976,719	$ 11,785,996
Pharmacy Services segment	1,525,837	4,630,410
Intersegment elimination	(52,496)	(156,494)
Total revenue	$ 5,450,060	$ 16,259,912

Impact of New Revenue Recognition Standard on Financial Statement Line Items

The Company adopted the new revenue standard using the modified retrospective method. The cumulative effect of applying the new standard to all contracts was recorded as an adjustment to accumulated deficit as of the adoption date. As a result of applying the modified retrospective method to adopt the new revenue standard, the following adjustments were made to accounts on the condensed consolidated balance sheet as of March 4, 2018:

In thousands	Impact of Change in Accounting Policy As Reported March 3, 2018	Adjustments	Adjusted March 4, 2018
Condensed Consolidated Balance Sheet:			
Accounts receivable, net	$ 1,869,100	$ (57,897)	$ 1,811,203
Inventories, net	1,799,539	51,121	1,850,660
Deferred tax assets	594,019	(1,772)	592,247
Total assets	8,989,327	(8,548)	8,980,779
Accumulated deficit	(4,282,471)	(8,548)	(4,291,019)
Total shareholders equity	1,601,010	(8,548)	1,592,462

Reclassification of the Statements of Cash Flows presentation

During the thirty-nine week period ended December 1, 2018, the Company expanded its disclosure on its Statements of Cash Flows to include changes in other assets separate from changes in other liabilities, which had historically been combined. Prior period amounts have been reclassified to conform to the current period presentation.

Recently Issued Accounting Pronouncements Not Yet Adopted

In August 2018, the FASB issued ASU 2018-14, *Compensation - Retirement benefits (Topic 715-20)*. This ASU amends ASC 715 to add, remove and clarify disclosure requirements related to defined benefit pension and other postretirement plans. The ASU eliminates the requirement to disclose the amounts in accumulated other comprehensive income expected to be recognized as part of net periodic benefit cost over the next year. The ASU also removes the disclosure requirements for the effects of a one-percentage-point change on the assumed health care costs and the effect of this change in rates on service cost, interest cost and the benefit obligation for postretirement health care benefits. This ASU is effective for fiscal years ending after December 15, 2020 and must be applied on a retrospective basis. The Company is evaluating the effect of adopting this new accounting guidance, but does not expect adoption will have a material impact on the Company s financial position.

In February 2016, the FASB issued ASU No. 2016-02, *Leases, (Topic 842)* (ASU-2016-02 or the Lease Standard), which is intended to improve financial reporting around leasing transactions. The ASU affects all companies and other organizations that engage in lease transactions (both lessee and lessor) of lease assets such as real estate and equipment. This ASU will require organizations that lease assets referred to as lessees to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. ASU No. 2016-02 is effective for fiscal years and interim periods within those years beginning January 1, 2019.

Table of Contents

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Thirteen and Thirty-Nine Week Periods Ended December 1, 2018 and December 2, 2017

(Dollars and share information in thousands, except per share amounts)

(unaudited)

During July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842)*: Targeted Improvements. Among other things, ASU 2018-11 provides administrative relief by allowing entities to implement the Lease Standard on a modified retrospective basis, similar to the method used by the Company to adopt the revenue standard. Effectively, the modified retrospective basis permits the Company to adopt the Lease Standard through a cumulative effect adjustment to its opening balance sheet for the first quarter of fiscal 2020, with the cumulative effect accounted for as a component of retained earnings, and report under the new Lease Standard on a post adoption basis. The Company expects to adopt this standard on a modified retrospective basis. The Company is currently evaluating the impact that the Lease Standard implementation will have on its balance sheet, results of operations and cash flows. At this time, the Company does not anticipate a material impact on its consolidated results of operations and cash flows, however, the Lease Standard is anticipated to have a material impact on the Company s total assets and liabilities due to the recording of the required right of use asset and corresponding liability for all lease obligations that are currently classified as operating leases.

In August 2018, the FASB issued ASU No. 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40)*, which is intended to provide entities with additional guidance to determine which software implementation costs to capitalize and which costs to expense. The ASU will allow entities to capitalize costs for implementation activities during the application development stage. ASU No. 2018-15 is effective for fiscal years and interim periods within those years beginning after December 15, 2019 (fiscal 2020). Early adoption of ASU 2018-15 is permitted. The Company is in the process of assessing the impact of the adoption of ASU 2018-15, but does not expect adoption will have a material impact on the Company s financial position, results of operations and cash flows.

2. Termination of the Merger Agreement with Albertsons Companies, Inc.

On February 18, 2018, Rite Aid entered into an Agreement and Plan of Merger (the Merger Agreement) with Albertsons, Ranch Acquisition II LLC, a Delaware limited liability company and a wholly-owned direct subsidiary of Albertsons (Merger Sub II) and Ranch Acquisition Corp., a Delaware corporation and a wholly-owned direct subsidiary of Merger Sub II (Merger Sub and, together with Merger Sub II, the Merger Subs). On August 8, 2018, Rite Aid, Albertsons and Merger Subs entered into a Termination Agreement (the Merger Termination Agreement) under which the parties mutually agreed to terminate the Merger Agreement. Subject to limited customary exceptions, the Merger Termination Agreement mutually releases the parties from any claims of liability to one another relating to the contemplated Merger. Under the terms of the Merger Agreement, neither Rite Aid nor Albertsons is responsible for any payments to the other party as a result of the termination of the Merger Agreement and Rite Aid is no longer subject to the interim operating covenants and restrictions contained in the Merger Agreement.

3. Asset Sale to WBA

On September 18, 2017, the Company entered into the Amended and Restated Asset Purchase Agreement with WBA and Buyer, which amended and restated in its entirety the previously disclosed Asset Purchase Agreement (the Original APA), dated as of June 28, 2017, by and among the Company, WBA and Buyer. Pursuant to the terms and subject to the conditions set forth in the Amended and Restated Asset Purchase Agreement, Buyer agreed to purchase from the Company 1,932 Acquired Stores, three (3) distribution centers, related inventory and other specified assets and liabilities related thereto for a purchase price of $4,375,000, on a cash-free, debt-free basis in the Sale.

The Company announced on September 19, 2017 that the waiting period under the HSR Act, expired with respect to the Sale. The Company completed the store transfer process in March of 2018, which resulted in the transfer of all 1,932 stores and related assets to WBA, and the received of cash proceeds of $4,156,686.

On September 13, 2018, the Company completed the sale of one of its distribution centers and related assets to WBA for proceeds of $61,251. The impact of the sale of the distribution center and related assets resulted in a pre-tax gain of $14,151, which has been included in the results of operations and cash flows of discontinued operations during the thirteen week period ended December 1, 2018. The transfer of the remaining two distribution centers and related assets remains subject to minimal customary closing conditions applicable only to the distribution centers being transferred at such distribution center closings, as specified in the Amended and Restated Asset Purchase Agreement.

The parties to the Amended and Restated Asset Purchase Agreement have each made customary representations and warranties. The Company has agreed to various covenants and agreements, including, among others, the Company s agreement to conduct its business at the distribution centers being sold to WBA in the ordinary course during the period between the execution of the Amended and Restated Asset Purchase Agreement and the distribution center closing. The Company has also agreed to provide transition services to Buyer for up to three (3) years after the initial closing of the Sale. Under the terms of the TSA, the Company provides various services on behalf of WBA, including but not limited to the purchase and distribution of inventory and virtually all selling, general and administrative activities. In connection with these services, the Company purchases the related inventory and incurs cash payments for the selling, general and administrative activities, which, the Company bills on a cash neutral basis to WBA in

Table of Contents

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Thirteen and Thirty-Nine Week Periods Ended December 1, 2018 and December 2, 2017

(Dollars and share information in thousands, except per share amounts)

(unaudited)

accordance with terms as outlined in the TSA. Total billings for these items during the thirteen and thirty-nine week periods ended December 1, 2018 were $1,587,824 and $5,464,383, respectively, of which $327,869 is included in Accounts receivable, net. The Company charged WBA TSA fees of $17,900 and $64,848 during the thirteen and thirty-nine week periods ended December 1, 2018, respectively, which are reflected as a reduction to selling, general and administrative expenses. During the thirteen and thirty-nine week periods ended December 2, 2017, the amount charged to WBA for TSA fees was nominal.

Under the terms of the Amended and Restated Asset Purchase Agreement, the Company has the option to purchase pharmaceutical drugs through an affiliate of WBA under terms, including cost, that are substantially equivalent to Walgreen s for a period of ten (10) years, subject to certain terms and conditions. The Company has until May of 2019 to exercise this option. On December 19, 2018, the Company and McKesson Corporation (NYSE:MCK) (McKesson) entered into a binding letter of intent that will continue the Company s pharmaceutical sourcing and distribution partnership for an additional ten (10) years. Under the terms, McKesson will continue providing the Company with sourcing and direct-to-store delivery for brand and generic pharmaceutical products through March 2029.

Based on its magnitude and because the Company exited certain markets, the Sale represented a significant strategic shift that has a material effect on the Company s operations and financial results. Accordingly, the Company has applied discontinued operations treatment for the Sale as required by Accounting Standards Codification 210-05 *Discontinued Operations* (ASC 205-20). In accordance with ASC 205-20, the Company reclassified the Disposal Group to assets and liabilities held for sale on its consolidated balance sheets as of the periods ended December 1, 2018 and March 3, 2018, and reclassified the financial results of the Disposal Group in its consolidated statements of operations and consolidated statements of cash flows for all periods presented. The Company also revised its discussion and presentation of operating and financial results to be reflective of its continuing operations as required by ASC 205-20.

The carrying amount of the Assets to be Sold, which were included in the Retail Pharmacy segment, have been reclassified from their historical balance sheet presentation to current assets and liabilities held for sale as follows:

	December 1, 2018	March 3, 2018

Inventories	$	82,545	$	264,286
Property and equipment		49,347		158,433
Goodwill(a)				4,629
Intangible assets				10,789
Current assets held for sale	$	131,892	$	438,137
Current maturities of long-term lease financing obligations	$		$	270
Accrued salaries, wages and other current liabilities				6,146
Long-term debt, less current maturities(b)				549,549
Lease financing obligations, less current maturities				838
Other noncurrent liabilities				3,402
Current liabilities held for sale	$		$	560,205

(a) The Company had $76,124 of goodwill in its Retail Pharmacy segment resulting from the acquisition of Health Dialog and RediClinic, which is accounted for as Retail Pharmacy segment enterprise goodwill. The Company has allocated a portion of its Retail Pharmacy segment enterprise goodwill to the discontinued operation.

(b) In connection with the Sale, the Company had estimated that the Sale would generate excess cash proceeds of approximately $4,027,400 which would be used to repay outstanding indebtedness. During the thirty-nine week period ended December 1, 2018, the Company has a use of cash for financing purposes of $1,343,793 in its discontinued operations and, based on refinements to its calculations, reduced its estimate of excess cash proceeds by approximately $24,500 and reclassified that amount to assets held and used. Consequently, the Company has classified $0 and $549,549 of estimated cash proceeds to be used for debt repayment to liabilities held for sale as of December 1, 2018 and March 3, 2018, respectively. For the thirty-nine week period ended December 1, 2018, the Company repaid outstanding indebtedness of $1,343,793 with Sale proceeds. For the fifty-two week period ended March 3, 2018, the Company repaid outstanding indebtedness of $3,135,000 with the proceeds from the Sale.

Table of Contents

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Thirteen and Thirty-Nine Week Periods Ended December 1, 2018 and December 2, 2017

(Dollars and share information in thousands, except per share amounts)

(unaudited)

The operating results of the discontinued operations that are reflected on the unaudited condensed consolidated statements of operations within net income (loss) from discontinued operations are as follows:

	Thirteen Week Period Ended		Thirty-Nine Week Period Ended	
	December 1, 2018	December 2, 2017	December 1, 2018	December 2, 2017
Revenues	$ 6,727	$ 2,386,710	$ 34,843	$ 7,130,653
Costs and expenses:				
Cost of revenues(a)	126	1,752,664	17,389	5,274,187
Selling, general and administrative expenses(a)	3,855	572,810	20,300	1,765,620
Lease termination and impairment charges		11		74
Loss on debt retirements, net			22,645	
Interest expense (b)		59,456	4,615	178,797
Gain on assets sold to Walgreens Boots Alliance	(14,077)	(157,010)	(374,619)	(157,010)
Loss (gain) on sale of assets, net	3	(589)	14	23
	(10,093)	2,227,342	(309,656)	7,061,691
Income from discontinued operations before income taxes	16,820	159,368	344,499	68,962
Income tax expense	4,080	60,155	82,408	26,705
Net income from discontinued operations, net of tax	$ 12,740	$ 99,213	$ 262,091	$ 42,257

(a) Cost of revenues and selling, general and administrative expenses for the discontinued operations excludes corporate overhead. These charges are reflected in continuing operations.

(b) In accordance with ASC 205-20, the operating results for the thirteen and thirty-nine week periods ended December 1, 2018 and December 2, 2017, respectively, for the discontinued operations include interest expense relating to outstanding indebtedness repaid with the estimated excess proceeds from the Sale.

The operating results reflected above do not fully represent the Disposal Group s historical operating results, as the results reported within net income from discontinued operations only include expenses that are directly attributable to the Disposal Group.

4. Income (Loss) Per Share

Basic income (loss) per share is computed by dividing income available to common stockholders by the weighted average number of shares of common stock outstanding for the period. Diluted income (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the income of the Company subject to anti-dilution limitations.

	Thirteen Week Period Ended		Thirty-Nine Week Period Ended	
	December 1, 2018	**December 2, 2017**	**December 1, 2018**	**December 2, 2017**
Basic and diluted (loss) income per share:				
Numerator:				
Net (loss) income from continuing operations	$ (17,250)	$ (18,182)	$ (411,325)	$ 134,141
Net income from discontinued operations, net of tax	12,740	99,213	262,091	42,257
(Loss) income attributable to common stockholders basic and diluted	$ (4,510)	$ 81,031	$ (149,234)	$ 176,398
Denominator:				
Basic weighted average shares	1,058,395	1,048,502	1,056,488	1,048,342
Outstanding options and restricted shares, net		7,367		18,948
Diluted weighted-average shares	1,058,395	1,055,869	1,056,488	1,067,290
Basic and diluted (loss) income per share:				
Continuing operations	$ (0.02)	$ (0.02)	$ (0.39)	$ 0.13
Discontinued operations	0.02	0.10	0.25	0.04
Net basic and diluted (loss) income per share	$ (0.00)	$ 0.08	$ (0.14)	$ 0.17

Table of Contents

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Thirteen and Thirty-Nine Week Periods Ended December 1, 2018 and December 2, 2017

(Dollars and share information in thousands, except per share amounts)

(unaudited)

Due to their antidilutive effect, 21,692 and 9,861 potential common shares related to stock options have been excluded from the computation of diluted income per share for the thirteen week periods ended December 1, 2018 and December 2, 2017, respectively. Due to their antidilutive effect, 21,692 and 5,195 potential common shares related to stock options have been excluded from the computation of diluted income per share for the thirty-nine week periods ended December 1, 2018 and December 2, 2017, respectively. Also, excluded from the computation of diluted income per share for the thirteen and thirty-nine week periods ended December 1, 2018 and December 2, 2017 are restricted shares of 6,745 and 0, respectively, which are included in shares outstanding.

5. Lease Termination and Impairment Charges

Lease termination and impairment charges consist of amounts as follows:

	Thirteen Week Period Ended	Thirty-Nine Week Period Ended