CAREMARK RX INC
Form 10-Q
November 08, 2002

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2002

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: 1-14200

CAREMARK RX, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**63-1151076**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3000 Galleria Tower, Suite 1000
Birmingham, Alabama 35244
(Address and zip code of principal executive offices)

(205) 733-8996
(Registrant's telephone number, including area code)

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 ý No o.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ý No o.

As of October 31, 2002, the registrant had 262,095,611 shares (including 6,402,665 shares held in trust to be utilized in employee benefit plans) of common stock, par value $.001 per share, issued and outstanding.

FORWARD LOOKING STATEMENTS AND FACTORS THAT MAY AFFECT FUTURE RESULTS

In passing the Private Securities Litigation Reform Act of 1995 (the "Reform Act"), 15 U.S.C.A. Sections 77z-2 and 78u-5 (Supp. 1996), Congress encouraged public companies to make "forward-looking statements" by creating a safe harbor to protect companies from securities law liability in connection with forward-looking statements. Caremark Rx, Inc. ("Caremark Rx") intends to qualify both its written and oral forward-looking statements for protection under the Reform Act and any other similar safe harbor provisions. Unless the context indicates otherwise, the words "Company," "we," "our," and "us," whenever used in this Quarterly Report on Form 10-Q, refer collectively to Caremark Rx and its wholly-owned subsidiaries.

"Forward-looking statements" are defined by the Reform Act. Generally, forward-looking statements include expressed expectations of future events and the assumptions on which the expressed expectations are based. All forward-looking statements are inherently uncertain as they are based on various expectations and assumptions concerning future events, and they are subject to numerous known and unknown risks and uncertainties which could cause actual events or results to differ materially from those projected. Due to those risks and uncertainties, the investment community is urged not to place undue reliance on our written or oral forward-looking statements. We undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results over time.

Forward-looking statements are contained in this document. Moreover, through our senior management, we may from time to time make forward-looking statements about matters described herein or about other matters concerning us.

There are several factors which could adversely affect our operations and financial results, including, but not limited to, the following:

> Risks relating to our ability to successfully terminate leases and other contractual agreements related to our discontinued operations and the outcome of various litigation surrounding the closure or sale of our Physician Practice Management ("PPM") business; risks relating to identification of, and competition for, growth and expansion opportunities; risks relating to declining reimbursement levels for products distributed; risks relating to exposure to liabilities in excess of our insurance; risks relating to compliance with, or changes in, government regulation, including pharmacy licensing requirements and healthcare reform legislation; risks relating to adverse developments in any investigation related to the pharmaceutical industry that may be conducted by governmental authorities; risks relating to adverse resolution of existing or future lawsuits; risks relating to costs of modification of our information systems to comply with privacy and electronic interchange standards mandated by the Health Insurance Portability and Accountability Act of 1996 ("HIPAA") and risks relating to our liquidity and capital requirements.

More detailed discussions of certain of these risk factors can be found in our Annual Report on Form 10-K for the year ended December 31, 2001, under the captions: "Business Government Regulation," "Legal Proceedings" and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

CAREMARK RX, INC. AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

INDEX

CAREMARK RX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)

	September 30, 2002	December 31, 2001
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 249,943	$ 159,066
Accounts receivable, less allowances for doubtful accounts of $23,746 in 2002 and $18,865 in 2001	490,784	324,086
Inventories	165,307	146,362
Prepaid expenses and other current assets	6,701	10,375
Current assets of discontinued operations	2,737	7,565
Total current assets	915,472	647,454
Property and equipment, net of accumulated depreciation of $140,380 in 2002 and $118,814 in 2001	128,993	119,511
Intangible assets, net of accumulated amortization of $15,354 in 2002 and $12,401 in 2001	69,564	26,018
Other non-current assets	74,594	77,714
Non-current assets of discontinued operations	2,728	2,974

	September 30, 2002	December 31, 2001
Total assets	$ 1,191,351	$ 873,671
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 548,652	$ 444,301
Other accrued expenses and liabilities	227,255	204,534
Income taxes payable	3,451	3,033
Current portion of long-term debt	2,500	2,500
Current liabilities of discontinued operations	19,065	24,489
Total current liabilities	800,923	678,857
Long-term debt, net of current portion	696,250	695,625
Other long-term liabilities	50,931	70,916
Long-term liabilities of discontinued operations		740
Total liabilities	1,548,104	1,446,138
Commitments and contingencies		
Convertible Preferred Securities	200,000	200,000
Stockholders' deficit:		
Common stock, $.001 par value per share; 400,000 shares authorized; issued 235,325 shares in 2002 and 232,652 shares in 2001	235	233
Additional paid-in capital	1,401,989	1,395,246
Treasury stock 655 shares	(9,239)	
Shares held in trust 6,412 in 2002 and 6,472 in 2001	(103,360)	(104,581)
Accumulated deficit	(1,846,378)	(2,063,365)
Total stockholders' deficit	(556,753)	(772,467)
Total liabilities and stockholders' deficit	$ 1,191,351	$ 873,671

The accompanying Notes to Condensed Consolidated Financial Statements
are an integral part of these balance sheets.

CAREMARK RX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	**2001**	**2002**	**2001**

	Three Months Ended September 30,		Nine Months Ended September 30,	
Net revenue	$ 1,713,392	$ 1,380,458	$ 4,953,975	$ 4,127,788
Operating expenses:				
Cost of revenues	1,564,214	1,271,387	4,543,125	3,810,174
Selling, general and administrative expenses	41,087	35,032	119,004	106,058
Depreciation and amortization	7,819	6,640	21,822	19,785
Interest expense, net	11,627	14,330	35,443	51,233
Income before provision for income taxes	88,645	53,069	234,581	140,538
Provision for income taxes	6,649	3,980	17,594	10,540
Net income	81,996	49,089	216,987	129,998
Preferred security dividends	3,304	3,304	9,913	9,913
Net income to common stockholders	$ 78,692	$ 45,785	$ 207,074	$ 120,085
Average number of common shares outstanding basic	228,529	225,411	227,829	224,302
Average number of common shares outstanding diluted	263,876	263,147	264,576	262,067
Net income per common share basic	$ 0.34	$ 0.20	$ 0.91	$ 0.54
Net income per common share diluted	$ 0.31	$ 0.19	$ 0.82	$ 0.50

The accompanying Notes to Condensed Consolidated Financial Statements
are an integral part of these statements.

CAREMARK RX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Nine Months Ended September 30,	
	2002	**2001**
Cash flows from continuing operations:		
Net income	$ 216,987	$ 129,998
Adjustments to reconcile net income to net cash provided by continuing operations:		
Depreciation and amortization	21,822	19,785
Non-cash interest expense	2,498	2,817
Changes in operating assets and liabilities, net of effects of acquisitions and disposals of businesses	66,659	61,235

	Nine Months Ended September 30,	
Net cash provided by continuing operations	307,966	213,835
Cash flows from investing activities:		
Capital expenditures, net	(30,951)	(26,821)
Acquisitions of businesses, net of cash acquired	(49,581)	
Net cash used in investing activities	(80,532)	(26,821)
Cash flows from financing activities:		
Proceeds from issuance of equity securities, net	17,155	13,478
Purchase of treasury stock	(9,239)	
Net proceeds (repayments) under credit facility	625	(36,472)
Long-term debt issuance costs	(1,270)	(5,110)
Net proceeds (repayments) under trade receivables sales facility	(99,200)	14,499
Dividend payments on Convertible Preferred Securities	(10,500)	(6,892)
Net cash used in financing activities	(102,429)	(20,497)
Cash used in discontinued operations	(34,128)	(38,678)
Cash paid for special charges		(884)
Net increase in cash and cash equivalents	90,877	126,955
Cash and cash equivalents beginning of period	159,066	2,352
Cash and cash equivalents end of period	$ 249,943	$ 129,307

The accompanying Notes to Condensed Consolidated Financial Statements
are an integral part of these statements.

CAREMARK RX, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2002
(Unaudited)

Note 1. ***Business and Basis of Presentation***

Caremark Rx, Inc., a Delaware corporation, is one of the largest pharmaceutical services companies in the United States. Caremark Rx's operations are conducted primarily through its wholly-owned, indirect subsidiary, Caremark Inc. ("Caremark"). The Company's customers are primarily sponsors of health benefit plans (employers, insurance companies, unions, government employee groups, managed care organizations) and individuals located throughout the United States.

The unaudited condensed consolidated financial statements include the accounts of Caremark Rx and its wholly-owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial reporting and in accordance with Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring items) necessary for a fair presentation of results for the interim periods presented. The results of operations for any interim period are not necessarily indicative of results to be expected for a full year. The unaudited condensed consolidated balance sheet of the Company at December 31, 2001, has been derived from audited financial statements but does not include all disclosures required by GAAP. These financial statements and footnote disclosures should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended December 31, 2001, which appear in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 20, 2002.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from those estimates and assumptions.

Note 2. ***Revenue Recognition***

The Company generates its net revenue primarily from dispensing prescription drugs, either directly through its mail service pharmacies or indirectly through its network of third-party retail pharmacies. The Company recognizes revenues from prescription drugs dispensed by its mail service pharmacies, and under retail network contracts where it is the principal, on a gross basis at the prescription prices (ingredient cost plus dispensing fee) negotiated with the Company's customers. Net revenue includes: (i) the portion of this amount paid directly to the Company by the customer, net of any volume-related or other sales discounts, (ii) the portion of this amount paid to either the Company ("Mail Copayments") or a third-party pharmacy in its retail network ("Retail Copayments") by individual participants in customers' benefit plans and (iii) administrative fees. Our net revenue for the three months and the nine months ended September 30, 2002, includes Retail Copayments of $225.2 million and $665.5 million, respectively, which were made directly by customers to the pharmacies in our independent retail network. These amounts totaled $178.8 million and $557.7 million for the three months and the nine months ended September 30, 2001, respectively.

SEC Staff Accounting Bulletin No. 101 ("SAB 101") provides general criteria for the timing aspect of revenue recognition, including consideration of whether: (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) collectibility is reasonably assured. The Company has established the following revenue recognition policies in accordance with SAB 101:

- Revenues generated from dispensing prescription drugs from the Company's mail service pharmacies are recognized when each prescription is shipped. At the time of shipment, the Company has performed substantially all of its obligations under its customer contracts and also does not experience a significant level of reshipments; and

- Revenues generated from sales of prescription drugs by pharmacies in the Company's third-party retail network and associated administrative fees are recognized when each claim is adjudicated using the Company's on-line claims processing system at the point-of-sale.

The Company has determined that its: (i) responsibilities to adjudicate claims properly in accordance with specific terms contained in individual customer contracts; (ii) separation of obligations under customer contracts from its responsibilities to pharmacies under its retail network contracts, and (iii) interaction with pharmacists, physicians and benefit plan participants during the dispensing process, among other indicators, qualify it as a principal under the indicators set forth in Emerging Issues Task Force Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent" ("EITF 99-19") in the significant majority of its retail network transactions. The Company's responsibilities under its customer contracts include, among others, validating eligibility and coverage levels, communicating the prescription price and the copayment due the retail pharmacy, identifying possible adverse drug interactions for the pharmacist to address with the physician prior to dispensing, suggesting medically appropriate generic alternatives where applicable, and approving the prescription for dispensing. Although we do not have credit risk with respect to Retail Copayments, we believe that all of the above indicators of gross treatment are present. The Company has an immaterial amount of retail claims volume under contracts not meeting the criteria for reporting revenue gross as a principal under EITF 99-19; therefore revenues recorded for these retail claims consist of only the administrative fee charged to the customer.

The Company also generates revenue from other sources which total less than 2% of total net revenue. These sources of revenue consist primarily of the following along with their accompanying revenue recognition policies:

Disease Management. This source of revenue relates to providing education and monitoring programs to participants for certain chronic diseases. Revenue is recognized on a per capita basis (i.e., per participant per month) as services are performed.

Health Benefit Management. This source of revenue primarily results from our ability to recommend changes to the participant's drug therapy. If the recommended change is approved by the prescribing physician and results in savings, we record our portion of the savings (as contractually determined with each customer) as revenue during the period in which the services are performed.

Data Access. This source of revenue results from the sale of participant-blinded pharmaceutical claim data. Revenue is recognized when contractual obligations have been performed.

The Company's cost of revenues includes the cost of pharmaceuticals dispensed, either directly through the Company's mail service pharmacies or indirectly through its network of third-party retail

pharmacies, and the operating costs of the Company's mail service pharmacies, customer service operations and related information technology support, excluding depreciation and/or amortization. The cost of pharmaceuticals dispensed component of cost of revenues consists of: (i) the cost of products purchased from manufacturers or distributors and shipped to participants in customers' benefit plans from the Company's mail service pharmacies, net of any associated volume-related or other purchase discounts and (ii) the cost of products distributed through the Company's third-party retail network under contracts where it is the principal, net of any associated volume-related or other purchase discounts, and including Retail Copayments.

Note 3. ***Acquisition of Choice Source Therapeutics***

On April 30, 2002, the Company acquired all of the outstanding capital stock of seven corporations under common control and collectively doing business as Choice Source Therapeutics ("Choice Source") for aggregate consideration of approximately $49.3 million, including acquisition-related expenses and a working capital settlement of $593,000 paid in the third quarter of 2002. Choice Source distributes pharmaceutical products, primarily those used for the treatment of hemophilia, to customers located in the U.S. The Company funded the acquisition of Choice Source from cash on hand.

The Company recorded the acquisition of Choice Source using the purchase method of accounting as required by Statement of Financial Accounting Standards No. 141, "Business Combinations." The Company recorded approximately $4.1 million of net working capital, $2.0 million of identifiable intangible assets and $43.2 million of goodwill in the initial purchase price allocation for Choice Source. The identifiable intangible assets of Choice Source consist entirely of certain licenses with indefinite estimated useful lives and are, therefore, not subject to amortization. The Company's unaudited condensed consolidated financial statements include the results of operations of Choice Source beginning May 1, 2002.

Note 4. ***Income Taxes***

At December 31, 2001, the Company had a cumulative net operating loss carryforward ("NOL") of approximately $2.0 billion available to reduce future amounts of taxable income, including taxable income generated in 2002. If not utilized to offset future taxable income, this NOL will expire on various dates through 2020, with approximately two-thirds of the total NOL amount expiring from 2018 to 2020. In addition to this NOL, the Company had approximately $90 million of future additional income tax deductions related to its discontinued operations at December 31, 2001. The Company also has a federal alternative minimum tax credit carry forward of approximately $17 million, which may be used to offset its ordinary federal corporate income taxes in the future.

GAAP requires the Company to record a valuation allowance against the deferred tax asset associated with this NOL if it is more likely than not that the deferred tax asset will not be utilized to offset future taxes. Due to many factors, including the uncertainties associated with projecting future income, the size of the NOL carryforward in relation to our history of unprofitable operations and continuing uncertainties surrounding our discontinued operations, the Company has recorded a valuation allowance for the full amount of its net deferred tax asset.

Significant variations exist in the customary relationship between income tax expense and pretax income because the Company has utilized its NOL to offset its taxable federal income and certain

taxable state income. Consequently, the Company has provided for income taxes at a rate of 7.5%, which represents its aggregate effective state and federal tax rate.

Note 5. ***Trade Receivables Sales Facility***

The Company has arranged to sell an undivided percentage ownership interest in certain of its accounts receivable pursuant to a $150 million revolving period trade receivables sales facility with General Electric Capital Corporation ("GECC") as funding agent and The Chase Manhattan Bank ("Chase") as group agent (collectively referred to as the "conduit"). GECC's $125 million commitment under this facility expires in January 2006, and Chase's $25 million commitment expires in February 2003. At December 31, 2001, the conduit had purchased an interest in approximately $99.2 million of the trade accounts receivable owned by MP Receivables Company, a wholly-owned, indirect subsidiary of the Company which is included in the accompanying unaudited condensed consolidated financial statements. MP Receivables' retained interest in these accounts receivable, excluding the $20 million restricted capital amount described below, was approximately $183 million at December 31, 2001.

During the nine months ended September 30, 2002, the Company repaid the conduit $99.2 million so that the conduit's interest in the Company's accounts receivable was reduced to zero. The Company retains full availability of amounts committed under the trade receivables sales facility.

The Company is required by the terms of the trade receivables sales facility to maintain $20 million of net assets in MP Receivables. To reflect the impact of this requirement, the Company has classified $20 million of MP Receivables' retained interest in the trade accounts receivable subject to the facility as "Other non-current assets" rather than "Accounts receivable" in the accompanying condensed consolidated balance sheets. Additionally, this facility is structured so that the accounts receivable underlying the undivided percentage ownership interest sold to the conduit are segregated from the remainder of the Company's assets. The collections on these receivables must be used to satisfy the conduit's interest therein before they are available to be used by the Company to satisfy its other obligations.

The Company accounts for its trade receivables sales facility under Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a Replacement of FASB Statement No. 125" ("FAS 140"). Under FAS 140, certain criteria must be met for a particular transaction or series of transactions to receive "sale treatment" (whereby the assets sold are removed from the balance sheet) rather than being treated as a loan with a pledge of an asset as collateral. These criteria are primarily that: (i) the transferred assets have been isolated from the transferor, meaning that they have been put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (ii) each transferee has the right to pledge or exchange the assets it received, and no condition both constrains the transferee from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor and (iii) the transferor does not maintain effective control over the transferred assets through either: (a) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity or (b) the ability to unilaterally cause the holder to return specific assets. The Company's trade receivables sales facility is structured so that the transactions occurring thereunder meet these criteria.

Note 6. ***Long-term Debt***

The Company's long-term debt at September 30, 2002, and December 31, 2001, consisted of the following (in thousands):

	September 30, 2002	December 31, 2001
Credit facility:		
Term loan facility (4.06% at September 30, 2002)	$ 248,750	$ 248,125

	September 30, 2002	December 31, 2001
Revolving facility		
	248,750	248,125
7.375% senior notes due 2006	450,000	450,000
	698,750	698,125
Less: amounts due within one year	(2,500)	(2,500)
	$ 696,250	$ 695,625

The Company has a credit facility with Bank of America, N.A. as administrative agent. The credit facility is guaranteed by the Company's material subsidiaries, including Caremark, and the Company and its material subsidiaries have granted a lien on substantially all of their respective current and future personal property and pledged the capital stock of Caremark International Inc., the parent company of Caremark, as security for amounts outstanding.

The credit facility consists of: (i) a $250 million term loan facility maturing on March 15, 2006 and (ii) a $300 million revolving credit facility maturing on March 15, 2005. At September 30, 2002, the Company had approximately $276 million available for borrowing under the revolving facility, exclusive of approximately $24 million reserved under letters of credit.

Borrowings under the credit facility currently bear interest at variable rates based on the London Inter-bank Offered Rate ("LIBOR"), plus varying margins. At the Company's option, or upon certain defaults or other events, borrowings under the credit facility may instead bear interest based on the prime rate plus varying margins.

The credit facility contains covenants that, among other things, restrict the Company's ability to incur additional indebtedness or guarantee obligations, engage in mergers or consolidations, dispose of assets, make investments or acquisitions, loans or advances, engage in certain transactions with affiliates, conduct certain corporate activities, create liens, make capital expenditures, prepay or modify the terms of other indebtedness, pay dividends and other distributions or change the nature of its business. In addition, the Company is required to comply with specified financial covenants, including a maximum leverage ratio, a minimum fixed charge coverage ratio and a minimum interest expense coverage ratio. The credit facility includes various customary and other events of default, including cross default provisions and defaults for any material judgment or change in control. The Company was in compliance with all debt covenants at September 30, 2002.

On April 11, 2002, the Company amended and restated its credit facility to revise certain features included therein. Significant changes made under this amendment and restatement were as follows:

With respect to the term loan facility, the interest rate was decreased by 0.75%;

The mandatory prepayment covenants for excess cash flows and equity issuances were removed, and the mandatory prepayment covenant for asset sale and indebtedness proceeds was reduced to 75% from 100%;

Certain exceptions to the limitations on amounts available for acquisitions of/investments in businesses, capital expenditures, dividends and stock buybacks and permitted liens were increased; and

The capital stock of Choice Source was pledged as security for amounts outstanding upon consummation of the Choice Source acquisition.

The removal of the mandatory prepayment covenant for excess cash flows resulted in a revision to scheduled term loan facility principal payments from amounts previously reported in the Company's 2001 Form 10-K. The revised term loan facility principal payment schedule is as follows (in thousands):

Remainder of 2002	$	625
2003		2,500
2004		2,500
2005		2,500
2006		240,625
	$	248,750

Note 7. ***Redeemable Preferred Stock***

In September 1999, the Company, through its wholly-owned subsidiary Caremark Rx Capital Trust I (the "Trust"), privately placed 4.0 million shares ($200.0 million aggregate face value) of 7% shared preference redeemable securities ("Convertible Preferred Securities"). The sole assets of the Trust, which has no business operations apart from administration of the Convertible Preferred Securities, are the 7% convertible subordinated debentures of the Company, maturing October 1, 2029, with principal amount of $206.2 million (the "Trust Debentures"). The Trust is the sole holder of the Trust Debentures.

Each Convertible Preferred Security may be converted, at the option of the holder, into shares of the Company's common stock at the rate of 6.7125 shares of common stock for each Convertible Preferred Security (equivalent to a conversion price of $7.4488 per share of common stock). The conversion of all Convertible Preferred Securities would result in the Company's issuance of approximately 26.9 million shares of common stock.

On October 15, 2002, the Company redeemed all of the Convertible Preferred Securities. See Note 11, "Subsequent Event."

10

Note 8. ***Earnings Per Common Share***

The following tables reconcile income (numerator) and shares (denominator) used in the Company's computations of net income per common share (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	**2001**	**2002**	**2001**
Numerator				
Net income	$ 81,996	$ 49,089	$ 216,987	$ 129,998
Less preferred security dividends	(3,304)	(3,304)	(9,913)	(9,913)
Basic numerator	78,692	45,785	207,074	120,085
Add preferred security dividends	3,304	3,304	9,913	9,913
Diluted numerator	$ 81,996	$ 49,089	$ 216,987	$ 129,998
Denominator				
Average number of common shares outstanding (basic denominator)	228,529	225,411	227,829	224,302
Common stock equivalents:				
Stock options	8,497	10,886	9,897	10,915
Convertible Preferred Securities	26,850	26,850	26,850	26,850
Average number of common shares outstanding (diluted denominator)	263,876	263,147	264,576	262,067

	Three Months Ended September 30,		Nine Months Ended September 30,	
Net income per common share basic	$ 0.34	$ 0.20	$ 0.91	$ 0.54
Net income per common share diluted	$ 0.31	$ 0.19	$ 0.82	$ 0.50

Options to purchase approximately 2.9 million shares of the Company's common stock at $17.33 to $26.19 per share were outstanding at and during the nine months ended September 30, 2002, but were excluded from the Company's computation of average number of common shares outstanding diluted because the options' exercise prices were greater than the average market price of the common shares underlying such options during the period.

Note 9. ***Discontinued Operations and Related Contingencies***

Overview. On November 11, 1998, the Company announced that Caremark, which operates the Company's pharmacy benefit management ("PBM") business, would become its core operating unit. The Company also announced its intent to divest its physician practice management and contract services businesses. As a result, in 1998 the Company restated its prior period financial statements to reflect these businesses, as well as the international operations sold during 1998, as discontinued operations.

Remaining Obligations. The net liabilities of discontinued operations ($13.6 million at September 30, 2002) represent the remaining net direct obligations of the Company's discontinued subsidiaries. The Company has also accrued $43.3 million of estimated remaining discontinued operations exit costs, which are included in "Other accrued expenses and liabilities" in the

accompanying unaudited condensed consolidated balance sheet at September 30, 2002. The Company expects to pay the majority of these obligations by the end of 2003. These amounts are estimates, and actual amounts could differ from those recorded.

The Company retained numerous operating leases, primarily for administrative and office space, related to its discontinued operations. As of September 30, 2002, the cumulative gross rents related to such leases were approximately $78.9 million, with sublease arrangements of approximately $22.4 million in place. The Company has estimated the costs to terminate or sublease these facilities and has included the net amount in its accrual for remaining discontinued operations exit costs.

Pursuant to the Provider Self-Disclosure Protocol of the Office of Inspector General ("OIG"), the Company has conducted a voluntary investigation of the practices of an affiliate which is included in the Company's discontinued operations and was known as Home Health Agency of Greater Miami, doing business as AmCare ("AmCare"). The investigation uncovered several potentially inappropriate practices by certain managers at AmCare, some of which may have resulted in overpayments from federal programs for AmCare's home health services. The Company has since terminated these managers, ceased AmCare's operations, and reported the matter to the OIG. While the resolution of this matter is as yet unknown, it is likely that the government will determine that overpayments were made which require repayment by the Company. The Company's estimate of the repayment due is included in the Company's accrual for discontinued operations exit costs referred to above.

Contingencies. The Company and/or one or more of its subsidiaries, affiliates or managed physician practices is a party to certain claims and proceedings related to its discontinued operations. The eventual outcome of these claims and proceedings could differ from the amounts accrued at September 30, 2002, and, if different, could result in the Company's recording additional losses on the disposal of its discontinued operations. Additionally, the Company has assigned to various parties approximately $99.5 million of lease obligations related to its discontinued operations. The Company and/or one or more of its subsidiaries or affiliates remain named as guarantor or obligor on these lease obligations.

Note 10. ***Contingencies***

The Company is party to certain legal actions arising in the ordinary course of business. The Company is named as a defendant in various legal actions arising from its continuing operations and its discontinued PPM operations, including employment disputes, contract disputes, personal injury claims and professional liability claims. Management does not view any of these actions as likely to result in an uninsured award that would have a material adverse effect on the operating results and financial condition of the Company.

On May 9, 2002 and May 10, 2002, Caremark received administrative subpoenas duces tecum issued by the U.S. Attorney's Office in Boston, Massachusetts. Following Caremark's receipt of the subpoenas, the U.S. Attorney's Office informed Caremark's counsel that the two subpoenas were related and that Caremark was not presently a target of the investigation. The subpoenas appeared to focus primarily on Caremark's business relationship with TAP Pharmaceuticals, including TAP's drugs Lupron and Prevacid. Caremark believes it is in compliance, in all material respects, with all laws and regulations applicable to its business practices and has cooperated with the subpoenas. Caremark cannot predict the purpose or outcome of the investigation at this time.

On April 2, 2002, the Company was served with a purported private class action lawsuit which was filed in the United States District Court, Central District of California. On August 29, 2002, this case was ordered transferred to the United State District Court, Northern District of Alabama. The Company was subsequently served on May 29, 2002 with a virtually identical lawsuit, containing the same types of allegations, which was also filed in the United States District Court, Central District of California. A motion to transfer this case is pending. These lawsuits, which are similar to pending litigation recently filed against other pharmacy benefit management companies, allege that we act as a fiduciary as that term is defined in the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and that we have breached certain purported fiduciary duties under ERISA. The lawsuits seek unspecified monetary damages and injunctive relief. We believe that we have meritorious defenses to these lawsuits and intend to vigorously defend these claims.

In 1993, approximately 3,900 independent and retail chain pharmacies filed a group of antitrust lawsuits and a class action lawsuit against brand name pharmaceutical manufacturers, wholesalers and PBM companies. Caremark was named as a defendant in a number of these lawsuits in 1994, but was not named in the class action. The complaints that named Caremark, which were transferred to the United States District Court for the Northern District of Illinois for pretrial proceedings, charged that certain defendant PBM companies, including Caremark, were favored buyers who knowingly induced or received discriminatory prices from pharmaceutical manufacturers in violation of the Robinson-Patman Act. Each complaint sought unspecified treble damages, declaratory and equitable relief and attorney's fees and expenses. The claims against Caremark were stayed in 1995 and have remained stayed. Numerous settlements among the parties other than Caremark have been reached. It is expected that the proceedings on the remaining class action claims and other claims not involving Caremark will move forward to trial and likely will precede the trial of any Robinson-Patman Act claims against Caremark.

Although the Company believes that it has meritorious defenses to the claims of liability or for damages in the actions that have been made against it, there can be no assurance that pending lawsuits will not have a disruptive effect upon the operations of the business, that the defense of the lawsuits will not consume the time and attention of the Company's senior management, or that the resolution of the lawsuits will not have a material adverse effect on the operating results and financial condition of the Company. The Company intends to vigorously defend each of its pending lawsuits. The Company believes that these lawsuits will not have a material adverse effect on the operating results and financial condition of the Company.

Note 11. ***Subsequent Event***

On September 13, 2002, the Company announced its intention to redeem its Convertible Preferred Securities. This redemption, which is more fully described in the Company's current report on Form 8-K which was filed with the Securities and Exchange Commission on September 16, 2002, was completed on October 15, 2002, and resulted in the Company's issuance of approximately 26,850,000 shares of its common stock in exchange for all 4 million outstanding shares of Convertible Preferred Securities. The shares issued upon redemption have been included as common stock equivalents in the Company's computations of net income per common share diluted for all periods presented; therefore, this redemption has no impact to earnings per common share diluted.

CAREMARK RX, INC. AND SUBSIDIARIES

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

September 30, 2002

The purpose of the following management's discussion and analysis of financial condition and results of operations ("MD&A") is to help facilitate an understanding of the significant factors influencing our historical operating results, financial condition and cash flows and also to convey management's expectations of the potential impact of known trends, events or uncertainties that may materially impact future results. This MD&A contains "forward-looking statements" as described on page i of this Quarterly Report on Form 10-Q.

Our MD&A should be read in conjunction with our unaudited condensed consolidated financial statements and notes thereto contained in this Quarterly Report on Form 10-Q. Additionally, the reader is also encouraged to refer to our audited consolidated financial statements and notes thereto and MD&A, including our critical accounting policies, for the year ended December 31, 2001, which appear in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on February 20, 2002.

Overview

We are one of the largest pharmaceutical services companies in the United States. Our services assist employers, insurance companies, unions, government employee groups, managed care organizations and other sponsors of health benefit plans and individuals throughout the United States in delivering prescription drugs in a cost-effective manner.

Our pharmaceutical services are generally referred to as pharmacy benefit management, or "PBM," services and involve the design and administration of programs aimed at reducing the costs and improving the safety, effectiveness and convenience of prescription drug use. We dispense prescription drugs on behalf of our customers through our three large, automated mail service pharmacies and our 21 smaller regional mail service pharmacies as well as through a nationwide network composed of over 55,000 independent retail pharmacies. We are currently in the process of opening a fourth automated mail service pharmacy in Phoenix, Arizona. The Phoenix pharmacy commenced limited operations in the fourth quarter of 2002, and we expect it to become fully operational in the second quarter of 2003.

We generate our net revenue primarily from dispensing prescription drugs, either directly through our mail service pharmacies or indirectly through our network of third-party retail pharmacies. See Note 2, "Revenue Recognition" to our unaudited condensed consolidated financial statements contained in this Quarterly Report on Form 10-Q for additional information concerning our revenue recognition policies.

Factors That May Affect Future Results

Our future operating results and financial condition are dependent on our ability to market our services profitably, successfully increase market share and manage expense growth relative to revenue growth. Our future operating results and financial condition may be affected by a number of additional factors, including: (i) our ability to successfully terminate leases and other contractual agreements related to our discontinued operations and the outcome of various litigation surrounding the closure or sale of our PPM business; (ii) identification of, and competition for, growth and expansion opportunities; (iii) declining reimbursement levels for products distributed; (iv) exposure to liabilities in excess of our insurance; (v) compliance with, or changes in, government regulation, including pharmacy licensing requirements and healthcare reform legislation; (vi) adverse developments in any investigation

related to the pharmaceutical industry that may be conducted by governmental authorities; (vii) adverse resolution of existing or future lawsuits; (viii) costs of modifications of our information systems to comply with HIPAA privacy and electronic interchange standards and (ix) liquidity and capital requirements. Changes in one or more of these factors could have a material adverse effect on our future operating results and financial condition.

There are various legal matters which, if adversely determined, could have a material adverse effect on our operating results and financial condition. See Note 10, "Contingencies" to our unaudited condensed consolidated financial statements contained in this Quarterly Report on Form 10-Q.

Results of Operations

The following tables set forth selected unaudited information about our results of continuing operations for each of the three-month and the nine-month periods ended September 30, 2002 and 2001. Unless otherwise noted, the discussion of factors influencing significant changes in individual line items following these tables refers to both the three-month and nine-month periods:

Three Months Ended
September 30,

	2002	2001	Increase/(Decrease)	
	(Dollars in thousands, except per share amounts)			
Net revenue	$ 1,713,392	$ 1,380,458	$ 332,934	24.1%
Operating expenses:				
Cost of revenues	1,564,214	1,271,387	292,827	23.0%
Selling, general and administrative expenses	41,087	35,032	6,055	17.3%
Depreciation and amortization	7,819	6,640	1,179	17.8%
Interest expense, net	11,627	14,330	(2,703)	-18.9%
Income before provision for income taxes	88,645	53,069	35,576	67.0%
Provision for income taxes	6,649	3,980	2,669	67.1%
Net income	$ 81,996	$ 49,089	$ 32,907	67.0%
Net income per common share diluted	$ 0.31	$ 0.19	$ 0.12	63.2%
Operating income (1)	$ 100,272	$ 67,399	$ 32,873	48.8%
Operating margin	5.85%	4.88%		
EBITDA (2)	$ 108,091	$ 74,039	$ 34,052	46.0%
EBITDA margin	6.31%	5.36%		
Net cash provided by (used in):				
Continuing operations	$ 121,031	$ 80,134	$ 40,897	51.0%
Investing activities	$ (17,612)	$ (6,108)	$ (11,504)	-188.3%
Financing activities	$ (10,867)	$ 847	$ (11,714)	N/C
Discontinued operations and special charges	$ (13,148)	$ (6,297)	$ (6,851)	-108.8%
Pharmacy claims processed (millions):				
Mail	5.1	4.6	0.5	10.7%
Retail	17.6	15.3	2.3	15.1%
	22.7	19.9	2.8	14.1%
Retail-adjusted pharmacy claims (3)	32.6	28.8	3.8	12.9%
Revenue per retail-adjusted pharmacy claim (3)	$ 52.60	$ 47.87	$ 4.73	9.9%

15

Nine Months Ended September 30,

	Nine Months Ended September 30, 2002	Nine Months Ended September 30, 2001	Increase/(Decrease)	
	(Dollars in thousands, except per share amounts)			
Net revenue	$ 4,953,975	$ 4,127,788	$ 826,187	20.0%
Operating expenses:				
Cost of revenues	4,543,125	3,810,174	732,951	19.2%
Selling, general and administrative expenses	119,004	106,058	12,946	12.2%
Depreciation and amortization	21,822	19,785	2,037	10.3%
Interest expense, net	35,443	51,233	(15,790)	-30.8%
Income before provision for income taxes	234,581	140,538	94,043	66.9%
Provision for income taxes	17,594	10,540	7,054	66.9%
Net income	$ 216,987	$ 129,998	$ 86,989	66.9%
Net income per common share diluted	$ 0.82	$ 0.50	$ 0.32	64.0%
Operating Income (1)	$ 270,024	$ 191,771	$ 78,253	40.8%
Operating Margin	5.45%	4.65%		
EBITDA (2)	$ 291,846	$ 211,556	$ 80,290	38.0%
EBITDA margin	5.89%	5.13%		
Net cash provided by (used in):				
Continuing operations	$ 307,966	$ 213,835	$ 94,131	44.0%
Investing activities	$ (80,532)	$ (26,821)	$ (53,711)	-200.3%
Financing activities	$ (102,429)	$ (20,497)	$ (81,932)	-399.7%
Discontinued operations and special charges	$ (34,128)	$ (39,562)	$ 5,434	13.7%
Pharmacy claims processed (millions):				
Mail	14.8	13.5	1.3	9.7%
Retail	52.6	47.3	5.3	11.2%
	67.4	60.8	6.6	10.9%
Retail-adjusted pharmacy claims (3)	96.3	87.1	9.2	10.5%
Revenue per retail-adjusted pharmacy claim (3)	$ 51.46	$ 47.37	$ 4.09	8.6%

(1)

We define Operating Income as net revenue less cost of revenue; selling, general and administrative expenses and depreciation and amortization. Our presentation of Operating Income is subject to the same limitations as our presentation of EBITDA as described at (2) below.

(2) EBITDA consists of earnings before interest income/expense, taxes, depreciation and amortization. EBITDA does not represent funds available for our discretionary use and is not intended to represent or to be used as a substitute for net income or cash flow from operations data as measured under United States generally accepted accounting principles. The items excluded from EBITDA are significant components of our statement of income, and must be considered in performing a comprehensive assessment of our overall financial performance. EBITDA, and the associated year-to-year trends, should not be considered in isolation. We believe that EBITDA is a supplemental measurement tool used by analysts and investors to help evaluate overall operating performance, and the ability to incur and service debt and make capital expenditures. Our calculation of EBITDA may not be consistent with calculations of EBITDA used by other companies.

(3) The retail-adjusted pharmacy claims statistic presents mail claims on a retail-equivalent basis through normalizing the total claims volume statistic for the difference between average days' supply for mail claims and retail claims. Average days' supply for mail claims is approximately three times that of retail claims; therefore, retail-adjusted pharmacy claims approximate the product of three times the mail claims volume plus the total retail claims volume. Retail-adjusted pharmacy claims provide a standard measure of overall claims volume and are used by management to evaluate our total operating performance on a per-claim basis.

Results of operations for the periods ended September 30, 2002 compared to the same periods in 2001

Net Revenue. The growth in net revenue in the 2002 periods was due primarily to an increase in the volume of retail-adjusted pharmacy claims processed (12.9% quarter-to-date and 10.5% year-to-date), which was driven by new customer contracts serviced, offset by losses of existing customers (referred to as "net new business"). The growth in net revenue and retail-adjusted pharmacy claims for the quarter ended September 30, 2002, was significantly positively influenced by the addition of the State of Illinois customer contract on July 1, 2002.

Additionally, drug cost inflation and changes in the mix of products distributed, offset by increased availability and utilization of generic equivalent drugs, resulted in a net increase (9.9% quarter-to-date and 8.6% year-to-date) in revenue per retail-adjusted pharmacy claim. Our mail generic dispensing rate, which represents the percentage of mail prescriptions filled with generic equivalent drugs, rose to 34.5% and 32.9% for the quarter and nine months ended September 30, 2002, from 30.9% and 30.8% for the same periods in 2001, respectively.

The growth in net revenue in the 2002 periods was also influenced by: (i) retention and growth of existing customers and (ii) the acquisition of Choice Source, which generated approximately $9.9 million and $17 million of net revenue for the quarter and nine months ended September 30, 2002, respectively.

Our net revenue for the quarter and the nine months ended September 30, 2002, includes Retail Copayments of $225.2 million and $665.5 million, respectively, which were made directly by customers to the pharmacies in our independent retail network. These amounts totaled $178.8 million and $557.7 million for the quarter and nine months ended September 30, 2001, respectively.

The impact of the expiration of patents covering several branded drugs significantly impacted the 2002 periods. These patent expirations had the effect of lowering our growth in net revenue by approximately 3.1% for the quarter-to-date period and 2.2% for the year-to-date period as prescriptions began to be filled with generic equivalent drugs instead of the formerly-patented drugs; however, our gross margins and overall profitability were favorably impacted due to the associated lower cost of the generic equivalent drugs.

According to independent data provided by IMS Health, the patents on branded drugs with total sales of over $20 billion in 2001 are expected to expire by the end of 2004. The impact of the expirations of certain of these patents is reflected in our results of operations as discussed above through September 30, 2002. We believe that our revenue growth will continue to be negatively impacted by these patent expirations; however, based on our experience to date, we believe that our gross margins and overall profitability should be favorably impacted as generic equivalent drugs supplant the formerly patented drugs.

Cost of Revenues. Cost of revenues increased on an absolute basis due to increases in net new business coupled with the other factors cited above for the increase in net revenue. Cost of revenues decreased as a percentage of revenues, reflecting primarily the impact of: (i) a shift in the mix of products sold toward those with higher margins, including generic drugs and those used for treatment of certain chronic conditions like hemophilia, multiple sclerosis and hepatitis C and (ii) leveraging our cost of service (i.e. pharmacy operating costs, customer service operations, etc.) over a larger revenue base.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased on an absolute basis in the 2002 periods to support the overall growth in our business and includes increases due to the Choice Source acquisition; however, selling, general and administrative expenses decreased as a percentage of net revenue in both periods. This decrease as a percentage of net revenue reflects our continued focus on leveraging our existing infrastructure to grow our business.

Depreciation and Amortization. Depreciation and amortization increased in the 2002 periods due primarily to the timing of capital expenditures being placed in service, offset by a reduction in amortization expense associated with the November 2001 restructuring of our contract with Oxford Health Plans. In 2002, we implemented the provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" concerning discontinuance of amortization of previously acquired goodwill; however, the implementation of this standard had no material impact on our amortization expense.

Interest Expense, Net. The decrease in net interest expense in the 2002 periods resulted primarily from a reduction in both interest rates applicable to and amounts due under our credit facility and our trade receivables sales facility, both of which are subject to variable interest rates coupled with increased interest income generated by cash on hand.

Provision for Income Taxes. Our effective combined federal and state tax rate was 7.5% for all periods presented. This effective rate is significantly below the statutorily enacted corporate income tax rates applicable to our taxable income for each period and is the result of: (i) the tax NOL carryforwards discussed below and (ii) state tax planning strategies which will allow us to utilize our consolidated state tax NOLs in certain states.

Historical Liquidity and Capital Resources

General. We broadly define liquidity as our ability to generate sufficient operating cash flow to meet our obligations and commitments. In addition, liquidity includes the ability to obtain appropriate financing to meet our business objectives. Therefore, liquidity cannot be considered separately from capital resources that consist of current or potentially available funds for use in achieving business objectives and meeting debt service commitments.

The following tables set forth selected unaudited information concerning our liquidity and capital resources and changes therein at and for the nine months ended September 30, 2002 (in millions):

Net cash provided by (used in):	
Continuing operations	$ 307.9
Investing activities	(80.5)
Financing activities	(102.4)
Discontinued operations	(34.2)
Net increase in cash and cash equivalents for the nine months ended September 30, 2002	90.8
Cash and cash equivalents December 31, 2001	159.1
Cash and cash equivalents September 30, 2002	$ 249.9
Net working capital (deficiency) (1):	
December 31, 2001	$ (31.4)
September 30, 2002	$ 114.6

	September 30, 2002	December 31, 2001
Long-term debt:		
Fixed-rate debt	$ 450.0	$ 450.0

	September 30, 2002	December 31, 2001
Variable-rate debt	$ 248.8	$ 248.1
Availability under revolving credit facility	$ 276.0	$ 288.0

(1) Working capital equals total current assets minus total current liabilities

Cash Flows from Continuing Operations. Our performance relative to net cash provided by continuing operations for the nine months ended September 30, 2002, resulted from factors discussed above related to income from continuing operations coupled with focused management of working capital.

Cash Flows from Investing Activities. Cash flows from investing activities for the nine months ended September 30, 2002, consist of $30.9 million of capital expenditures and $49.6 million of cash outflows associated with the Choice Source acquisition.

Cash Flows from Financing Activities. During the nine months ended September 30, 2002, we received net proceeds of $17.2 million from issuance of our common stock under employee benefit plans including exercises of non-qualified stock options. These proceeds were offset primarily by payments of $99.2 million under our trade receivables sales facility, preferred security dividends of $10.5 million, and purchases of our common stock on the open market of $9.2 million.

Cash Flows from Discontinued Operations. In addition to the amounts paid through September 30, 2002, to service liabilities which arose from our discontinued PPM operations, we have accrued approximately $56.9 million of remaining net liabilities related to our discontinued operations. We expect to pay approximately $25 million of this accrued amount during the remainder of 2002 with the majority of the remaining amount being paid in 2003. These amounts are estimates, and actual amounts could differ from those recorded.

Working Capital. We have historically operated with negative working capital due to: (i) the sale of interests in our accounts receivable under our trade receivables sales facility and (ii) the inclusion of net current liabilities related to our discontinued operations in the computation of working capital. The increase in working capital from December 31, 2001 to September 30, 2002, is due primarily to our operating cash flow performance during the period offset by amounts paid to acquire Choice Source and capital expenditures.

Credit Facility. We have a $550 million credit facility with Bank of America, N.A. as administrative agent which was put in place on March 15, 2001 and amended and restated on April 11, 2002. This credit facility consists of a $300 million revolving credit facility maturing in March 2005 and a $250 million term loan facility maturing in March 2006.

At September 30, 2002, borrowings under the credit facility bore interest at variable rates based on the London Inter-bank Offered Rate ("LIBOR"), plus varying margins and consisted of outstanding term loans of $248.8 million. At September 30, 2002, we had approximately $276 million available for borrowing under the revolving credit facility, exclusive of approximately $24 million reserved under letters of credit.

The credit facility is guaranteed by our material subsidiaries and secured by certain liens and pledges, contains prepayment provisions with respect to certain cash proceeds and contains restrictive covenants. The security interests, guarantees and covenants applicable to the credit facility are described in further detail in Note 6, "Long-term Debt" to our unaudited condensed consolidated financial statements contained in this Quarterly Report on Form 10-Q.

Senior Notes. Our senior notes are in an aggregate principal amount of $450 million and bear interest at 7.375% annually, with all principal amounts due in October 2006. The indenture for the senior notes contains, among other things, restrictions on subsidiary indebtedness, sale and leaseback transactions, consolidations, mergers and sales of assets. The senior notes are not guaranteed by any subsidiary. The indenture for the senior notes also contains restrictions on indebtedness secured by liens. To comply with this covenant, we have secured the senior notes on an equal and ratable basis with the credit facility.

Trade Receivables Sales Facility. We have arranged to sell an undivided percentage ownership interest in certain of our accounts receivable pursuant to a $150 million revolving period trade receivables sales facility which is described in further detail in Note 5, "Trade Receivable Sales Facility" to the unaudited condensed consolidated financial statements contained in this Quarterly Report on Form 10-Q.

During the nine months ended September 30, 2002, the Company repaid the conduit $99.2 million so that the conduit's interest in the Company's accounts receivable was reduced to zero. The Company retains full availability of amounts committed under the trade receivables sales facility.

Outlook

Liquidity and Capital Resources Overview. Currently, our liquidity needs arise primarily from: (i) funding discontinued operations (including the funding of any retained liabilities); (ii) commitments related to financing obtained through the issuance of long-term debt; (iii) working capital requirements (iv) capital expenditures and (v) the periodic repurchase of our common stock pursuant to our stock repurchase program discussed further below. Additionally, subject to certain restrictions in the credit facility, we have acquired businesses, and may continue to acquire additional businesses in the future, and could fund any such acquisition using cash on hand, availability under our trade receivables sales facility or our revolving credit facility, or a combination thereof. We believe that our cash flows from operations and amounts available under our trade receivables sales facility and our revolving credit facility are sufficient to meet our liquidity needs.

On July 1, 2002, we announced that we had adopted a plan to repurchase up to $150 million of our common stock on the open market. These repurchases will occur at times and in amounts permitted under our credit facility. We repurchased 694,100 shares for an aggregate amount of approximately $9.6 million under this plan through October 31, 2002.

Changes in Accounts Receivable Sales. Our operating cash flow performance for the nine months ended September 30, 2002, was sufficient to enable us to reduce the conduit's net investment in our accounts receivable to zero from the $99.2 million net investment held by the conduit at December 31, 2001. This change had the effect of increasing the carrying amount of accounts receivable on our balance sheet as well as certain common accounts receivable-based ratios like days sales outstanding. Our results of operations were not impacted by this change.

Planned Capital Expenditures. We expect total capital expenditures for 2002 to be approximately $55 million. Additionally, we continue to evaluate the scope of modifications of our information systems needed to comply with applicable HIPAA rules. We expect that HIPAA requirements will result in additional capital expenditures over the level required for maintenance and growth of our operations through 2003, which is the scheduled deadline for HIPAA compliance. We do not expect costs associated with HIPAA to materially impact our financial condition, results of operations or cash flows.

Elimination of Preferred Security Dividends. On October 15, 2002, we redeemed our Convertible Preferred Securities. This redemption will result in the elimination of the associated $3.5 million quarterly ($14 million annual) dividend payment beginning with the payment which would have been due January 1, 2003.

Discontinued Operations. Future cash needed to fund the remaining net liabilities of discontinued operations and estimated exit costs, which was estimated to be approximately $56.9 million, in aggregate, at September 30, 2002, will be funded by cash flows from continuing operations and by borrowings under the revolving credit facility or sales of interests in our accounts receivable under the trade receivables sales facility. We believe that these sources will be sufficient to fund these payments, which we expect to total approximately $25 million over the remainder of 2002, with the majority of the remaining amount expected to be paid in 2003. See Note 9, "Discontinued Operations and Related

Contingencies" to the unaudited condensed consolidated financial statements contained in this Quarterly Report on Form 10-Q.

Deferred Income Taxes. We had NOL carryforwards of approximately $2.0 billion as of December 31, 2001. If not utilized to offset future taxable income, these NOL carryforwards will expire on various dates through 2020. In addition to these NOL carryforwards, we had approximately $90 million of future additional income tax deductions as of December 31, 2001, related to our discontinued operations. We also have a federal alternative minimum tax credit carryforward of approximately $17 million, which may be used to offset our ordinary federal corporate income taxes in the future.

Under Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," we are required to record a valuation allowance against the deferred tax asset for the future tax benefits of tax loss and tax credit carryforwards, as well as for other temporary differences, if it is more likely than not that we will not be able to utilize the deferred tax asset to offset future taxes.

Management believes that, based upon all available historical information and after considering appropriate tax planning strategies in light of the uncertainty of forecasting future taxable income, it is more likely than not that the deferred tax assets will not be realized. Accordingly, we have recorded a valuation allowance for the amount of the deferred tax assets in excess of the deferred tax liabilities. However, the ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible and NOLs can be carried forward.

Management continues to review the likelihood of realizing the benefit of our deferred tax assets in light of our recent levels of profitability coupled with continued resolution of uncertainties surrounding our discontinued operations, and it is possible that an adjustment to the deferred tax asset valuation allowance may be made in future periods. If management were to determine that such an adjustment was necessary, we would adjust the valuation allowance to reflect the estimated net realizable value of the deferred tax asset at that time. This amount may continue to be significantly below the gross amount of the deferred tax asset. We would then provide for income taxes at a rate equal to the effective enacted federal and state tax rates applicable to our income, which would approximate 40% under current tax rates, rather than the 7.5% rate currently being used. Subsequent revisions to the estimated net realizable value of the deferred tax asset could cause our provision for income taxes to vary significantly from period to period, although our cash tax payments would remain unaffected until the benefit of the NOL is utilized.

Recent Accounting Pronouncements

In July 2001, the FASB issued Statements of Financial Accounting Standards No. 141, "Business Combinations" ("FAS 141") and No. 142, "Goodwill and Other Intangible Assets" ("FAS 142"). Business combinations initiated after June 30, 2001, must be accounted for under the provisions of these two statements. We must also apply these provisions to previously recorded business combinations as of January 1, 2002. The principal provisions of FAS 141 and FAS 142 are as follows:

All business combinations initiated after June 30, 2001, will be accounted for using the "purchase" method, under which the identifiable assets and liabilities of the acquired business are recorded at their respective fair market values with the residual amount being recorded as goodwill. The "pooling-of-interests" method, under which the financial statements of the acquirer and the acquiree were combined as if the two businesses had always been one, will no longer be used.

Goodwill and identifiable intangible assets will no longer be amortized over a maximum period of forty years. Goodwill will not be amortized but will instead be tested for impairment annually or upon the occurrence of certain "triggering events." Identifiable intangible assets will be amortized over their

expected useful lives; those with indefinite expected useful lives will not be amortized but will be tested for impairment using a similar methodology to that used for goodwill. Identifiable intangible assets which are amortizable will be tested for impairment under FAS 144 (as defined).

Additionally, the FASB issued Statements of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ("FAS 143") and No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("FAS 144") during 2001. FAS 143 relates to obligations which generally are incurred in connection with the ownership of real property. We currently lease the substantial majority of our real property and, therefore, do not believe that the provisions of FAS 143 apply to our current operations.

FAS 144 superseded Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for the disposal of a segment of a business. FAS 144 also amended Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to eliminate the exception to consolidation for a subsidiary for which control is likely to be temporary.

We adopted FAS 141, FAS 142, FAS 143 and FAS 144 on January 1, 2002, and the adoption of these standards had no material impact on our financial condition, results of operations or cash flows.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk from changes in interest rates related to debt outstanding under our credit facility and for the discount on revolving sales of accounts receivable under our trade receivables sales facility. Our earnings and the fair value of our fixed-rate debt are subject to change as a result of movements in market interest rates. At September 30, 2002, we had $248.8 million of obligations which were subject to variable rates of interest. A hypothetical increase in interest rates of 1% from the rate at September 30, 2002, would result in an increase in annual interest expense of $2.5 million, presuming that obligations subject to variable interest rates remained constant. The impact of such a change on the carrying value of long-term debt would not be significant. These amounts are determined based on only the impact of the hypothetical interest rates on our outstanding obligations and do not consider the effects, if any, of the potential changes in the overall level of economic activity that could exist in such an environment.

CONTROLS AND PROCEDURES

Within 90 days prior to the filing date of this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-14(c) and 15d-14(c) of the Exchange Act. Based on that evaluation, our CEO and CFO have concluded that our disclosure controls and procedures are effective. There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the evaluation.

PART II OTHER INFORMATION

Item 1. ***Legal Proceedings***

The Company is party to certain legal proceedings as described in Note 10, "Contingencies" to its unaudited condensed consolidated financial statements appearing elsewhere in this Quarterly Report on Form 10-Q and hereby incorporated herein by reference.

Item 5. ***Other Information***

The Securities and Exchange Commission has announced that it will routinely review prior filings and issue comment letters to each of the Fortune 500 companies. Caremark Rx, Inc. received its comment letter, covering the 2001 Form 10-K and the March 31, 2002 Form 10-Q, in the second quarter of 2002. The comments focused on expanded or supplemental disclosures, and the Company believes that none of the comments would require it to restate its consolidated financial position, results of operations or cash flows. The Company prepared and filed a response to the SEC in which management indicated that it would include certain additional disclosures in its second quarter Form 10-Q and in future applicable filings.

On September 27, 2002, the SEC sent a second letter to the Company after concluding its review of management's response. This second letter narrowed the scope of the SEC's original comments and continued to focus on expanded or supplemental disclosures in certain areas. The Company prepared and filed a response to this second letter on November 1, 2002, and has included additional disclosures in this third quarter Form 10-Q. These matters are subject to interpretation and the SEC has not concluded its review of the Company's responses to the second letter.

Item 6. ***Exhibits and Reports on Form 8-K***

(a) *Exhibits.*

Exhibit No.	
10.1	First Amendment and Waiver dated August 26, 2002 to the First Amended and Restated Credit Agreement dated April 11, 2002 among the Company; the Initial Lender Parties named therein; J.P. Morgan Securities Inc.; Wachovia Bank, National Association; Bank of America Securities LLC and Bank of America, N.A.
99.1	Certification by Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.2	Certification by Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b)

Reports on Form 8-K. The Company filed the following current reports on Form 8-K during the quarter ended September 30, 2002:

Date Filed	Item Reported
September 16, 2002	Item 5. *Other Events:* The Company reported its intent to redeem, on October 15, 2002, all of its outstanding 7% convertible subordinated debentures due 2029 and its 7% shared preference redeemable preferred securities.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CAREMARK RX, INC.

By: /s/ HOWARD A. MCLURE

Howard A. McLure
Executive Vice President and
Chief Financial Officer

Date: November 8, 2002

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, E. Mac Crawford, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Caremark Rx, Inc.;

2.

Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3.

Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4.

The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a)

designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b)

evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c)

presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5.

The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a)

all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b)

any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6.

The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 8, 2002

/s/ E. MAC CRAWFORD

E. Mac Crawford
Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Howard A. McLure, certify that:

1.

I have reviewed this quarterly report on Form 10-Q of Caremark Rx, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 8, 2002

/s/ HOWARD A. MCLURE

Howard A. McLure
Chief Financial Officer