

EXPRESS SCRIPTS INC
Form 10-K
February 25, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2008, OR
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____.

Commission File Number: 0-20199

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

Delaware
(State or other jurisdiction of incorporation or organization)

43-1420563
(I.R.S. Employer Identification No.)

One Express Way, St. Louis, MO
(Address of principal executive offices)

63121
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Class	Name of each exchange on which registered
Common Stock \$0.01 par value	Nasdaq Global Select Market
Preferred Share Purchase Rights	

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ___ No

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

No ___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation of S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. []

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer []

Non-accelerated filer []

Smaller reporting company []

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ___ No

The aggregate market value of Registrant's voting stock held by non-affiliates as of June 30, 2008, was \$15,264,424,000 based on 243,374,000 such shares held on such date by non-affiliates and the average sale price for the Common Stock on such date of \$62.72 as reported on the Nasdaq Global Select Market. Solely for purposes of this computation, the Registrant has assumed that all directors and executive officers of the Registrant are affiliates of the Registrant. The Registrant has no non-voting common equity.

Common stock outstanding as of January 31, 2009:

247,676,000 Shares

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates by reference portions of the definitive proxy statement for the Registrant's 2009 Annual Meeting of Stockholders, which is expected to be filed with the Securities and Exchange Commission not later than 120 days after the registrant's fiscal year ended December 31, 2008.

1

Information included in or incorporated by reference in this Annual Report on Form 10-K, other filings with the Securities and Exchange Commission (the “SEC”) and our press releases or other public statements, contain or may contain forward looking statements. Please refer to a discussion of our forward looking statements and associated risks in “Item 1—Business—Forward Looking Statements and Associated Risks” and “Item 1A—Risk Factors” in this Annual Report on Form 10-K.

PART I

THE COMPANY

Item 1 — Business

Industry Overview

Prescription drugs play a significant role in healthcare and today constitute the first line of treatment for many medical conditions. As pharmaceutical research opens the potential for even more effective drugs, demand can be expected to increase. For millions of people, prescription drugs equate to the hope of improved health and quality of life. At the same time, prescription drug costs are shaping one of the most persistent challenges to health care financing. Even as pharmaceutical development opens new paths to better healthcare, we confront the possibility that high costs may limit access to these therapies.

Employer total medical costs continue to outpace the rate of overall inflation. Prescription drug costs accounted for approximately 10.3% of United States health care expenditures in 2008 and are expected to increase to about 12.1% in 2017 according to the Centers for Medicare & Medicaid (“CMS”) estimates. In response to cost pressures being exerted on health benefit providers such as managed care organizations, health insurers, employers and unions, we develop innovative strategies designed to keep medications affordable. As evidence of these strategies, our annual per member drug spending increased by only 2.7% in 2008, compared to the 5.5% increase in 2007.

Plan sponsors who are more aggressive in taking advantage of our effective tools to manage drug spend have seen actual reduction in their prescription drug trend while preserving healthcare outcomes. Greater use of generic drugs and lower-cost brand drugs reduced spending to levels never seen before for commercially insured consumers and their employers. Our leading generic penetration rate of 66.1% for 2008 was 2.4% above the national rate of 63.7% (based on estimates for the twelve month period through September 2008), resulting in lower drug spending for both members and plan sponsors

We help health benefit providers address access and affordability concerns resulting from rising drug costs while helping to improve healthcare outcomes. We manage the cost of the drug benefit by performing the following functions:

- evaluating drugs for price, value and efficacy in order to assist clients in selecting a cost-effective formulary;
 - leveraging purchasing volume to deliver discounts to health benefit providers;
 - promoting the use of generics and low-cost brands; and
- offering cost-effective home delivery pharmacy and specialty services which result in drug-cost savings for plan sponsors and co-payment savings for members.

We work with clients, manufacturers, pharmacists and physicians to increase efficiency in the drug distribution chain, to manage costs in the pharmacy benefit, and to improve members’ health outcomes and satisfaction.

Pharmacy benefit management (“PBM”) companies combine retail pharmacy claims processing, formulary management and home delivery pharmacy services to create an integrated product offering to manage the prescription drug benefit for payors. Some PBMs now provide specialty services to provide treatments for diseases that rely upon high-cost injectible, infused, oral or inhaled drugs which provide a more effective solution than many retail pharmacies. PBMs also have broadened their service offerings to include compliance programs, outcomes research, drug therapy management programs, sophisticated data analysis and other distribution services.

Company Overview

We are one of the largest PBMs in North America and we provide a full range of services to our clients, which include HMOs, health insurers, third-party administrators, employers, union-sponsored benefit plans, workers' compensation plans and government health programs.

Our PBM services include:

- retail network pharmacy management
 - retail drug card programs
 - home delivery pharmacy services
 - benefit design consultation
 - drug utilization review
- drug formulary management programs
- compliance and therapy management programs for our clients

Services from our Specialty and Ancillary Services ("SAAS") segment, which consists of the Specialty operations of CuraScript, Inc. ("CuraScript") and our Specialty Distribution Services ("SDS") and Phoenix Marketing Group LLC ("PMG") lines of business, include:

• delivery of injectible biopharmaceutical products to patients' homes, physician offices, and certain associated patient care services

- distribution of pharmaceuticals and medical supplies to providers and clinics
- bio-pharma services including reimbursement and customized logistics solutions
- distribution of pharmaceuticals to low-income patients through pharmaceutical manufacturer-sponsored and company-sponsored generic patient assistance programs
- distribution of pharmaceuticals requiring special handling or packaging including infertility pharmaceuticals
- distribution of sample units to physicians and verification of practitioner licensure

Our revenues are generated primarily from the delivery of prescription drugs through our contracted network of retail pharmacies, home delivery pharmacy services and SAAS services. Revenues from the delivery of prescription drugs to our members represented 98.7% of revenues in 2008 and 98.6% in both 2007 and 2006. Revenues from services, such as the fees associated with the administration of retail pharmacy networks contracted by certain clients, market research programs, medication counseling services, certain specialty distribution services, and sample fulfillment and sample accountability services, comprised the remainder of our revenues.

Prescription drugs are dispensed to members of the health plans we serve primarily through networks of retail pharmacies that are under non-exclusive contracts with us and through the three home delivery fulfillment pharmacies and eight specialty drug pharmacies we operated as of December 31, 2008. More than 60,000 retail pharmacies, which represent more than 95% of all United States retail pharmacies, participate in one or more of our networks. The top ten retail pharmacy chains represent approximately 60% of the total number of stores in our largest network.

We were incorporated in Missouri in September 1986, and were reincorporated in Delaware in March 1992. Our principal executive offices are located at One Express Way, Saint Louis, Missouri, 63121. Our telephone number is (314) 996-0900 and our web site is www.express-scripts.com.

Products and Services

Pharmacy Benefit Management Services

Overview. Our PBM services involve the management of outpatient prescription drug use to foster high quality, cost-effective pharmaceutical care. We offer our PBM services to our clients in the United States and Canada. Our PBM services include:

- retail network pharmacy management
 - retail drug card programs
 - home delivery pharmacy services
 - benefit design consultation
 - drug utilization review
- drug formulary management programs
- compliance and therapy management programs for our clients

We consult with our clients to assist them in selecting plan design features that balance the client's requirements for cost control with member convenience. For example, some clients receive a smaller discount on pricing in the retail pharmacy network or home delivery pharmacy in exchange for receiving all or a larger share of the pharmaceutical manufacturer rebates. Other clients receive a greater discount on pricing at the retail pharmacy network or home delivery pharmacy in exchange for a smaller share of the pharmaceutical manufacturer rebates.

During 2008, 82.9% of our revenues were derived by our PBM operations, compared to 83.4% and 84.1% during 2007 and 2006, respectively. The number of retail pharmacy network claims processed and the number of home delivery pharmacy claims remained relatively constant from 2007 to 2008. This is primarily due to the expected client attrition of discount card programs and other low margin clients and decreased utilization due to the current economic environment, roughly offsetting the addition of new clients.

Retail Pharmacy Network Administration. We contract with retail pharmacies to provide prescription drugs to members of the pharmacy benefit plans we manage. In the United States, we negotiate with pharmacies to discount the price at which they will provide drugs to members. We manage national and regional networks in the United States that are responsive to client preferences related to cost containment, convenience of access for members, and network performance. We also manage networks of pharmacies that are customized for or under direct contract with specific clients. In addition, we have contracted Medicare Part D provider networks to comply with CMS access requirements for the Medicare Part D Prescription Drug Program.

All retail pharmacies in our pharmacy networks communicate with us online and in real-time to process prescription drug claims. When a member of a plan presents his or her identification card at a network pharmacy, the network pharmacist sends the specified member and prescription information in an industry-standard format through our systems, which will process the claim and send a response back to the pharmacy. The electronic processing of the claim includes, among other things, the following:

- confirming the member's eligibility for benefits under the applicable health benefit plan and the conditions to or limitations of coverage
- performing a concurrent drug utilization review and alerting the pharmacist to possible drug interactions and reactions or other indications of inappropriate prescription drug usage
 - updating the member's prescription drug claim record
- if the claim is accepted, confirming to the pharmacy that it will receive payment for the drug dispensed according to its provider agreement with us
- informing the pharmacy of the co-payment amount to be collected from the member based upon the client's plan design and the remaining payable amount due to the pharmacy from the plan

Patient Services. As of December 31, 2008, we operated three home delivery pharmacies to dispense prescription drugs located in Maryland Heights, Missouri; Bensalem, Pennsylvania; and Tempe, Arizona. In addition to the order processing that occurs at these home delivery pharmacies, we also operate five non-dispensing order processing facilities in Troy, New York; Harrisburg, Pennsylvania; Bensalem, Pennsylvania; Albuquerque, New Mexico; and Tempe, Arizona. In addition, we operated eight contact centers located in Bloomington, Minnesota; Farmington Hills, Michigan; Harrisburg, Pennsylvania; St. Mary's, Georgia; Tempe, Arizona; Orlando, Florida; St. Louis, Missouri; and Pueblo, Colorado. Our pharmacies provide patients with convenient access to maintenance medications and enable us to manage our clients' drug costs through operating efficiencies and economies of scale. Through our home delivery pharmacies, we are directly involved with the prescriber and patient and, as a result, we believe we are generally able to achieve a higher level of generic substitutions and therapeutic interventions than can be achieved through the retail pharmacy networks.

Patient Care Contact Centers. Although we contract with health plans, the ultimate recipients of many of our services are the members of these health plans. We believe client satisfaction is dependent upon patient satisfaction. Domestic patients can call us toll-free, 24 hours a day, 7 days a week, to obtain information about their prescription drug plan from our trained patient care advocates and pharmacists.

Benefit Plan Design and Consultation. We offer consultation and financial modeling to assist our clients in selecting benefit plan designs that meet their needs for member satisfaction and cost control. The most common benefit design options we offer to our clients are:

- financial incentives and reimbursement limitations on the drugs covered by the plan, including drug formularies, tiered co-payments, deductibles or annual benefit maximums
 - generic drug utilization incentives
- incentives or requirements to use only certain network pharmacies or to order certain maintenance drugs (e.g. therapies for diabetes, high blood pressure, etc.) only for home delivery
 - reimbursement limitations on the amount of a drug which can be obtained in a specific period
- utilization management programs such as step therapy and prior authorization, that focus the use of medications according to clinically developed algorithms
- behavior-centric programs that drive adoption of generics, better therapy adherence and greater use of home delivery

The client's choice of benefit design is entered into our electronic claims processing system, which applies the plan design parameters as claims are submitted and enables our clients and us to monitor the financial performance of the plan.

Formulary Development, Compliance and Therapy Management. Formularies are lists of drugs to which benefit design is applied under the applicable plan. We have many years of formulary development expertise and maintain an extensive clinical pharmacy department.

Our foremost consideration in the formulary development process is the clinical appropriateness of the particular drugs. In developing formularies, we first perform a rigorous assessment of the available evidence regarding the drug's safety and clinical effectiveness. No new drug is added to the formulary until it is approved by our National Pharmacy & Therapeutics Committee ("P&T Committee") – a panel composed of nineteen independent physicians and pharmacists in active clinical practice, representing a variety of specialties and practice settings, typically with major academic affiliations. We fully comply with the P&T Committee's clinical recommendations. In making its clinical recommendation, the P&T Committee has no knowledge of information regarding the discount or rebate arrangement we might negotiate with the manufacturer. This is designed to ensure the clinical recommendation is not affected by our financial arrangements. After the clinical recommendation is made, the drugs are evaluated on an economic basis to determine optimal cost-effectiveness.

We administer a number of different formularies for our clients. The use of formulary drugs is encouraged through various benefit design features. Historically, many clients selected a plan design that included an open formulary in which all drugs were covered by the plan. Today, a majority of our clients select formularies which are designed to be used with various financial or other incentives, such as three-tier co-payments, that drive the selection of formulary drugs over their non-formulary alternatives. Some clients select closed formularies, in which benefits are available only for drugs listed on the formulary. In 2008, about 77% of all claims fell into three-tier or closed categories compared to 76% for 2007 and 75% for 2006. Use of formulary drugs can be encouraged in the following ways:

- through plan design features, such as tiered co-payments, which require the member to pay a higher amount for a non-formulary drug
- by employing a behavior-centric approach to understand and communicate with members
- by educating members and physicians with respect to benefit design implications
 - by promoting the use of lower cost generic alternatives
- by implementing utilization management programs such as step therapy and prior authorization, that focus the use of medications according to clinically developed algorithms

We also provide formulary compliance services to our clients. For example, if a doctor has prescribed a drug that is not on a client's formulary, we notify the pharmacist through our claims processing system. The pharmacist may then contact the doctor to attempt to obtain the doctor's consent to change the prescription to the appropriate formulary product. The doctor has the final decision-making authority in prescribing the medication.

We also offer innovative clinically based intervention programs to assist and manage patient quality of life, client drug trend, and physician communication/education. These programs encompass comprehensive point of service and retrospective drug utilization review, physician profiling, academic detailing, prior authorization, disease care management, and clinical guideline dissemination to physicians.

Behavior Centric Approach (Consumerology). During 2008, we established the Center for Cost-Effective Consumerism to provide insight into how consumers make decisions about healthcare. We have learned financial incentives alone are not sufficiently effective to motivate necessary change. The key is an advanced understanding of human behavior that treats members as individuals.

We are employing principles of behavioral economics to develop new approaches that drive adoption of generics, better therapy adherence and greater use of home delivery. These new programs have been well received by our plan sponsor clients. We are conducting pilots to test these principles, and using the insights acquired to further improve how members use their pharmacy benefit, stay compliant with their medications and save money for themselves and their plan sponsors.

Information Reporting and Analysis Programs. Through the use of sophisticated information and reporting systems we are better able to manage the prescription drug benefit. We analyze prescription drug data to identify cost trends and budget for expected drug costs, assess the financial impact of plan design changes and assist clients in identifying costly utilization patterns through an online prescription drug decision support tool.

We offer education programs to members in managing clinical outcomes and the total health care costs associated with certain conditions such as asthma, diabetes and cardiovascular disease. These programs are based on the premise that better informed patient and physician behavior can positively influence medical outcomes and reduce overall medical costs. We identify patients who may benefit from these programs through claims data analysis or self-enrollment.

We offer a tiered approach to member education and wellness, ranging from information provided through our internet site, to educational mailings, to our intensive one-on-one registered nurse or pharmacist counseling. The programs include providing patient profiles directly to their physicians, as well as measurements of the clinical,

personal and economic outcomes of the programs.

Rebate Programs. We develop, manage and administer rebate programs that allow pharmaceutical manufactures to provide rebates and administrative fees based on utilization of their products by members of our clients' benefit plans. The rebate portion that the client receives varies in accordance with each client contract.

Our rebates are determined based on the characteristics of the formulary design selected by the client and their pharmacy benefit structure. The amount of rebates generated by these types of programs is a function of the particular product dispensed and the level of utilization that occurs. Manufacturers participating in our rebate programs pay us administrative fees in connection with the services and systems we provide through the rebate program.

6

Electronic Claims Processing System. Our electronic claims processing system enables us to implement sophisticated intervention programs to assist in managing prescription drug utilization. The system can alert the pharmacist to generic substitution and therapeutic intervention opportunities as well as formulary compliance issues, or administer prior authorization and step-therapy protocol programs at the time a claim is submitted for processing. Our claims processing system also creates a database of drug utilization information that can be accessed both at the time the prescription is dispensed and also on a retrospective basis to analyze utilization trends and prescribing patterns for more intensive management of the drug benefit.

Consumer Health and Drug Information. We maintain a public website, www.DrugDigest.org, dedicated to helping consumers make informed decisions about using drugs. Much of the information on [DrugDigest.org](http://www.DrugDigest.org) is written by pharmacists – primarily doctors of pharmacy who are also affiliated with academic institutions. We continually work to expand the interactive tools available on [DrugDigest.org](http://www.DrugDigest.org) which provide consumers an opportunity to take an even more active role in maintaining their own health. The information on [DrugDigest.org](http://www.DrugDigest.org) includes:

- a drug interaction checker
- a drug side effect comparison tool
- tools to check for less expensive generic and alternative drugs
- audible drug name pronunciations
- comparisons of different drugs used to treat the same health condition
- information on health conditions and their treatments
- instructional videos showing administration of specific drug dosage forms
- monographs on drugs and dietary supplements
- photographs of pills and capsules
- interactive care pathways and health risk assessments

Many features of [DrugDigest.org](http://www.DrugDigest.org) are available in the limited-access member website at www.express-scripts.com. The member website gives our clients' members access to personalized current and, in many cases, previous drug histories. Members can use the interactive tools from [DrugDigest.org](http://www.DrugDigest.org) to check for drug interactions and find possible side effects for all of the drugs they take.

To facilitate communications between members and physicians, health condition information from [DrugDigest.org](http://www.DrugDigest.org) has been compiled into "For Your Physician Visit" which is available on the member website. Using it, members complete and print appropriate checklists on conditions such as diabetes and depression. Discussing the completed checklists gives both the member and the physician a better understanding of the member's true health status. Information on [DrugDigest.org](http://www.DrugDigest.org) does not constitute part of this document.

SAAS Services

Overview. Our SAAS segment includes the Specialty operations of CuraScript, and our SDS and PMG lines of business. Through our SAAS segment we provide specialty services, including delivery of injectible drugs to patient homes, physician offices and certain associated patient care services; distribution of pharmaceuticals and medical supplies to providers and clinics; and bio-pharma services including reimbursement and customized logistics solutions. The SAAS segment also includes distribution of specialty pharmaceuticals requiring special handling or packaging; distribution of pharmaceuticals to low-income patients through manufacturer-sponsored branded and company-sponsored generic patient assistance programs; and distribution of sample units to physicians and verification of practitioner licensure. During 2008, 17.1% of our revenues were derived from SAAS services, compared to 16.6% and 15.9% during 2007 and 2006, respectively.

Collectively under the CuraScript name, we now operate four integrated brands that service the patient through multiple paths: Payors, Providers, and Pharma. CuraScriptSP operates specialty pharmacies in eight states with

primary operations located in Orlando, Florida. These locations provide patient care and direct specialty home delivery to our patients. CuraScriptSD provides specialty distribution of pharmaceuticals and medical supplies direct to providers and clinics and operates a Group Purchasing Organization (“GPO”) for many of our clients. We currently operate CuraScriptSD, a specialty distribution center located in Grove City, OH. FreedomFP provides fertility services to both providers and patients and is located in Byfield, MA. Finally, HealthBridge provides Bio-Pharma services including reimbursement and customized logistics solutions. We believe in total, the collective CuraScript brands position us solidly within the Specialty market.

7

Discontinued Operations. On June 30, 2008, we completed the sale of CuraScript Infusion Pharmacy, Inc. (“IP”), our infusion pharmacy line of business, for \$27.5 million and recorded a pre-tax gain of approximately \$7.4 million. The gain is included in net loss from discontinued operations, net of tax in the consolidated statement of income for the year ended December 31, 2008. IP was identified as available for sale during the fourth quarter of 2007 as we considered it non-core to our future operations. IP had previously been reported in our SAAS segment.

In connection with the classification of IP as a discontinued operation, we recorded a charge of \$34.0 million in the fourth quarter of 2007, the majority of which reflects the IP goodwill and intangible asset impairment losses and the subsequent write-down of IP assets to fair market value (see—“Critical Accounting Policies—Asset Impairment”).

On April 4, 2008, we completed the sale of Custom Medical Products, Inc. (“CMP”) and recorded a pre-tax loss of approximately \$1.3 million which is included in net loss from discontinued operations, net of tax in the consolidated statement of income for the year ended December 31, 2008. CMP had previously been reported in our SAAS segment.

Payor Services. We offer health plan providers and their members customized disease-specific treatment programs which cover both pharmacy and medical benefits. In addition to helping payors design a customized plan, we assist with eligibility review, prior authorization coordination, monitoring and reporting of patient therapy adherence as well as electronic claims processing and billing. Our monitoring and reporting of patient therapy includes clinical tracking, plan-specific reports, and provider treatment and dispensing patterns. We are able to provide a clinical and financial picture of plan members with chronic illnesses which measures pharmacy expenses and patients’ treatment progress.

Physician Services. Through our CuraScriptSD business unit we provide distribution services primarily to office and clinic-based physicians treating chronic disease patients who regularly order high-dollar-value pharmaceuticals. We are able to provide to these physicians competitive pricing on pharmaceuticals and medical supplies.

Biotech Services. In the PhRMA 2008 Report on Medicines in Development, there were more than 600 biotech drugs in clinical trials or under review by the United States Food and Drug Administration at the end of 2008. For new biopharmaceuticals being launched, we can provide biotech manufacturers product distribution management services. We design strategies tailored to each product’s needs with a focus on identifying opportunities to educate the marketplace regarding drug effectiveness, proper utilization and payor acceptance.

Other Services. We also provide a range of centralized supply chain services which can include sampling programs, patient assistance programs, and clinical trial assistance as well as specialized shipping and storage and customized dosing.

We are a leader in sample accountability, database management and practitioner verification services for the pharmaceutical industry, operating the nation’s largest prescription drug sample fulfillment business.

We provide specialty distribution services, consisting of the distribution of, and creation of a database of information for, products requiring special handling or packaging, products targeted to a specific physician or patient population, and products distributed to low-income patients. Our services include eligibility, fulfillment, inventory, insurance verification/authorization and payment. We also administer sample card programs for certain manufacturers where the ingredient costs of pharmaceuticals dispensed from retail pharmacies are included in revenues, as well as costs of revenues. These services are provided from our Maryland Heights, Missouri facility.

Segment Information

We report segments on the basis of services offered and have determined we have two reportable segments: PBM and SAAS. Our domestic and Canadian PBM operating segments have similar characteristics and as such have been aggregated into a single PBM reporting segment. Our SAAS segment includes the Specialty operations of CuraScript, and our SDS and PMG lines of business. Information regarding our segments appears in Note 14 of the notes to our consolidated financial statements and is incorporated by reference herein.

Suppliers

We maintain an inventory of brand name and generic pharmaceuticals in our home delivery pharmacies and biopharmaceutical products in our specialty pharmacies and distribution centers to meet the needs of our patients whether they are being treated for rare or chronic diseases. If a drug is not in our inventory, we can generally obtain it from a supplier within one business day. We purchase pharmaceuticals either directly from manufacturers or through authorized wholesalers. Currently, approximately 98% of our branded pharmaceutical purchases by our home delivery pharmacies and approximately 75% of our purchases by our SAAS segment are through one wholesaler. Generic pharmaceuticals are generally purchased directly from manufacturers.

Clients

We are a provider of PBM services to several market segments. Our clients include HMOs, health insurers, third-party administrators, employers, union-sponsored benefit plans, workers' compensation plans and government health programs. We provide Specialty services to customers who also include HMOs, health insurers, third-party administrators, employers, union-sponsored benefit plans, government health programs, office-based oncologists, renal dialysis clinics, ambulatory surgery centers, primary care physicians, retina specialists, and others.

Our top five clients collectively represented 18.2%, 18.1%, and 19.6% of revenues during 2008, 2007 and 2006 respectively. None of our clients accounted for 10% or more of our consolidated revenues in fiscal years 2008, 2007 or 2006.

Medicare Prescription Drug Coverage

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "MMA") created the federal Voluntary Prescription Drug Benefit Program under "Part D" of the Social Security Act. Since January 1, 2006, eligible Medicare beneficiaries have been able to obtain prescription drug coverage under Part D by enrolling in a prescription drug plan ("PDP") or a "Medicare Advantage" plan that offers prescription drug coverage (an "MA-PD"). In addition, the MMA created an opportunity for employers offering eligible prescription drug coverage for their Medicare-eligible members to receive a subsidy payment by enrolling in the Retiree Drug Subsidy ("RDS") program. To claim the subsidy, the beneficiaries that an employer claims cannot be enrolled in a PDP or MA-PD.

Our services support clients who have elected to become a PDP or an MA-PD. In addition, we support the needs of employers who enroll in the RDS program. We provide PBM services to these clients as well as Part D functions that include managing member out of pocket costs, creation of Explanation of Benefits of the prescription data event, medication therapy management services, and various reporting required by CMS.

In 2006, we were approved by CMS to function as a Part D PDP plan sponsor, offering prescription drug coverage to Employer Group Waiver Plans, through our wholly owned subsidiary, Express Scripts Insurance Company. Beginning January 1, 2007, our PDP offered prescription drug coverage nationally and in Puerto Rico. In 2008, the requirement changed no longer requiring us to offer a plan to the individual market. Therefore beginning in 2008, we only offer an Employer Group Waiver Plan. The Express Scripts Insurance Company is licensed by the

Arizona Department of Insurance as a Disability Insurer which meets the CMS requirements of a risk-bearing entity regulated under state insurance laws or similar statutes.

9

Acquisitions and Joint Ventures

On July 22, 2008, we completed the acquisition of the Pharmacy Services Division of MSC - Medical Services Company (“MSC”), a privately held PBM, for a purchase price of \$251.0 million, which includes a purchase price adjustment for working capital and transaction costs. MSC is a leader in providing PBM services to clients providing workers’ compensation benefits. The transaction was accounted for under the provisions of Financial Accounting Standards (“FAS”) 141, “Business Combinations.” The purchase price was funded through internally generated cash and temporary borrowings under our revolving credit facility. This acquisition is reported as part of our PBM segment and did not have a material effect on our consolidated financial statements (See Note 3).

We are one of the founders of RxHub, an electronic exchange enabling physicians who use electronic prescribing technology to link to pharmacies, PBM companies, and health plans. On July 1, 2008, the merger of RxHub and SureScripts was announced. The new organization will enable physicians to securely access health information when caring for their patients through a fast and efficient health exchange. We have retained one-sixth ownership in the merged company. Due to the decreased ownership percentage, the investment is being recorded using the cost method, under which dividends are the basis of recognition of earnings from an investment. This change did not have a material effect on our consolidated financial statements.

On October 10, 2007, we purchased Connect Your Care, LLC (“CYC”), a leading provider of consumer directed healthcare technology solutions to the employer, health plan and financial services markets. The purchase price was funded through internally generated cash. The purchase agreement includes an earnout provision, payable after three years based on the performance of the business. This acquisition is reported as part of our PBM segment, and did not have a material effect on our consolidated financial statements.

We regularly review potential acquisitions and affiliation opportunities. We believe available cash resources, bank financing or the issuance of additional common stock or other securities could be used to finance future acquisitions or affiliations. There can be no assurance we will make new acquisitions or establish new affiliations in 2009 or thereafter. (see “Liquidity and Capital Resources – Acquisitions and Related Transactions”).

Company Operations

General. As of December 31, 2008, our PBM segment operated three dispensing home delivery pharmacies, five non-dispensing order processing centers, and eight patient contact centers out of leased and owned facilities; and our SAAS segment operated eight specialty drug pharmacies. Electronic pharmacy claims processing takes place at facilities owned by Electronic Data Systems Corp. (“EDS”). At our Canadian facilities, we have sales and marketing, client services, pharmacy help desk, clinical, network contracting and management, and certain management information systems capabilities.

Sales and Marketing. In the United States, our sales managers and directors market and sell PBM services, supported by a team of client-service representatives, clinical pharmacy managers, and benefit analysis consultants. This team works with clients to make prescription drug use safer and more affordable. A dedicated sales staff cross-markets SAAS services to our PBM clients. In addition, sales personnel dedicated to our SAAS segment use direct marketing to generate new customers and solidify existing customer relationships. In Canada, marketing and sales efforts are conducted by our staff based in Mississauga, Ontario and Montreal, Quebec.

Network Contracting and Management. Our Network Contracting and Management group is responsible for contracting and administering our pharmacy networks. To participate in our retail pharmacy networks, pharmacies must meet certain qualifications, including the requirement that all applicable, credentialing state and/or licensing requirements are being maintained. Pharmacies can contact our pharmacy help desk toll-free, 24 hours a day, 7 days a week, for information and assistance in filling prescriptions for our clients’ members. In addition, our Network

Contracting and Management group audits pharmacies in the retail pharmacy networks to determine compliance with the terms of their contracts.

10

Clinical Support. Our staff of highly-trained pharmacists and physicians provides clinical support for our PBM services. These health care professionals are responsible for a wide range of activities including tracking the drug pipeline; identifying emerging medication-related safety issues and notifying physicians, clients, and patients (if appropriate); providing drug information services; formulary management; development of utilization management, safety (concurrent and retrospective drug utilization review), and other clinical interventions that identify and/or contact physicians, pharmacists, or patients.