CVS CORP
Form 10-Q
November 09, 2001

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

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

For the Quarterly Period Ended September 29, 2001

Commission File Number 001-01011

CVS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	05-0494040
(State of Incorporation)	(I.R.S. Employer Identification Number)

One CVS Drive, Woonsocket, Rhode Island 02895

(Address of principal executive offices)

Telephone: (401) 765-1500

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ____

Common Stock, $0.01 par value, issued and outstanding at November 6, 2001:

390,784,079 shares

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Part I Item 1

CVS Corporation
Consolidated Condensed Statements of Operations
(Unaudited)

In millions, except per share amounts	13 Weeks Ended September 29, 2001	September 30, 2000	Septe
Net sales	$5,410.8	$4,916.4	$
Cost of goods sold, buying and warehousing costs	4,039.0	3,619.0	
Gross margin	1,371.8	1,297.4	
Selling, general and administrative expenses	1,070.9	937.7	
Depreciation and amortization	80.7	75.0	
Total operating expenses	1,151.6	1,012.7	
Operating profit	220.2	284.7	
Interest expense, net	16.1	20.1	
Earnings before income tax provision	204.1	264.6	
Income tax provision	80.4	105.9	
Net earnings	123.7	158.7	
Preference dividends, net of income tax benefit	3.7	3.8	
Net earnings available to common shareholders	$ 120.0	$ 154.9	$

Basic earnings per common share:			
Net earnings	$ 0.31	$ 0.40	$
Weighted average basic common shares outstanding	391.5	391.0	
Diluted earnings per common share:			
Net earnings	$ 0.30	$ 0.39	$
Weighted average diluted common shares outstanding	406.0	407.5	
Dividends declared per common share	$ 0.0575	$ 0.0575	$

See accompanying notes to consolidated condensed financial statements.

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Part I Item 1

CVS Corporation
Consolidated Condensed Balance Sheets

In millions, except share and per share amounts	(Unaudit September 2 20
Assets:	
Cash and cash equivalents	$ 406
Accounts receivable, net	956
Inventories	4,068
Deferred income taxes	132
Other current assets	100
Total current assets	5,664
Property and equipment, net	1,952
Goodwill, net	850
Other assets	477
Total assets	$8,945
Liabilities:	
Accounts payable	$1,550
Accrued expenses	1,074
Short-term borrowings	603
Current portion of long-term debt	21
Total current liabilities	3,250
Long-term debt	836
Deferred income taxes	28
Other long-term liabilities	118
Shareholders' equity:	
Preference stock, series one ESOP convertible, par value $1.00: authorized 50,000,000 shares; issued and outstanding	

4,917,000 shares at September 29, 2001 and 5,006,000 shares at December 30, 2000	262
Common stock, par value $0.01: authorized 1,000,000,000 shares; issued 408,404,000 shares at September 29, 2001 and 407,395,000 shares at December 30, 2000	4
Treasury stock, at cost: 17,629,000 shares at September 29, 2001 and 15,073,000 shares at December 30, 2000	(510
Guaranteed ESOP obligation	(240
Capital surplus	1,537
Retained earnings	3,660
Total shareholders' equity	4,713
Total liabilities and shareholders' equity	$8,945

See accompanying notes to consolidated condensed financial statements.

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Part I Item 1

CVS Corporation
Consolidated Condensed Statements of Cash Flows
(Unaudited)

In millions	39 We September 29, 2001
Cash flows from operating activities:	
Net earnings	$ 543.5
Adjustments required to reconcile net earnings to net cash provided by operating activities:	
Depreciation and amortization	239.5
Deferred income taxes and other noncash items	11.5
Change in operating assets and liabilities, providing/(requiring) cash, net of effects from acquisitions:	
Accounts receivable, net	(132.0
Inventories	(510.5
Other current assets	(7.8
Other assets	(2.7
Accounts payable	199.2
Accrued expenses	58.9
Other long-term liabilities	2.0
Net cash provided by operating activities	401.6
Cash flows from investing activities:	
Additions to property and equipment	(473.0
Proceeds from sale-leaseback transactions	94.0
Acquisitions (net of cash acquired) and investments	(123.2
Proceeds from sale or disposal of assets	11.6
Net cash used in investing activities	(490.6
Cash flow from financing activities:	

Additions to (reductions in) long-term debt	296.2
Proceeds from exercise of stock options	45.1
Additions to short-term borrowings	13.8
Purchase of treasury shares	(129.0
Dividends paid	(67.8
Net cash provided by financing activities	158.3
Net increase (decrease) in cash and cash equivalents	69.3
Cash and cash equivalents at beginning of period	337.3
Cash and cash equivalents at end of period	$ 406.6

See accompanying notes to consolidated condensed financial statements.

CVS Corporation
Notes to Consolidated Condensed Financial Statements
(Unaudited)

Note 1

The accompanying consolidated condensed financial statements of CVS Corporation ("CVS" or the "Company") have been prepared without audit, in accordance with the rules and regulations of the Securities and Exchange Commission. In accordance with such rules and regulations, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted, although the Company believes that the disclosures included herein are adequate to make the information presented not misleading. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2000.

In the opinion of management, the accompanying consolidated condensed financial statements include all adjustments (consisting only of normal recurring adjustments) which are necessary to present a fair statement of the Company's results of operations for the interim periods presented. Because of the influence of various factors on the Company's operations, including certain holidays and other seasonal influences, net earnings for any interim period may not be comparable to the same interim period in previous years or necessarily indicative of earnings for the full fiscal year.

Certain reclassifications have been made to the consolidated condensed financial statements of prior periods to conform to the current period presentation.

Note 2

The Company currently operates four business segments: Retail Pharmacy, Pharmacy Benefit Management ("PBM"), Specialty Pharmacy and Internet Pharmacy. The Company's business segments are operating units that offer different products and services, and require distinct technology and marketing strategies.

The Retail Pharmacy segment, which includes 4,086 retail drugstores located in 24 states and the District of Columbia, operates under the CVS/pharmacy name. The Retail Pharmacy segment is the Company's only reportable segment.

The PBM segment provides a full range of prescription benefit management services to managed care providers and other organizations. These services include plan design and administration, formulary management, mail order

pharmacy services, claims processing and generic substitution. The PBM segment operates under the PharmaCare Management Services name.

The Specialty Pharmacy segment, which includes mail order facilities and 49 retail pharmacies located in 20 states and the District of Columbia, operates under the CVS ProCare name. The Specialty Pharmacy segment focuses on supporting individuals that require complex and expensive drug therapies.

The Internet Pharmacy segment, which includes a mail order facility and a complete online retail pharmacy, operates under the CVS.com name.

The Company evaluates segment performance based on operating profit before intersegment profits.

CVS Corporation
Notes to Consolidated Condensed Financial Statements
(Unaudited)

Following is a reconciliation of the Company's business segments to the consolidated condensed financial statements for the thirteen and thirty-nine weeks ended September 29, 2001 and September 30, 2000 and total assets as of September 29, 2001 and December 30, 2000:

In millions	Retail Pharmacy Segment	All Other Segments	Consolidated Totals
13 weeks ended:			
September 29, 2001:			
Net sales	$ 5,188.7	$222.1	$ 5,410.8
Operating profit	215.9	4.3	220.2
September 30, 2000:			
Net sales	$ 4,764.6	$151.8	$ 4,916.4
Operating profit	284.1	0.6	284.7
39 weeks ended:			
September 29, 2001:			
Net sales	$15,633.2	$657.7	$16,290.9
Operating profit	934.7	8.9	943.6
September 30, 2000:			
Net sales	$14,157.0	$441.7	$14,598.7
Operating profit	947.9	5.6	953.5
Total assets:			
September 29, 2001	$ 8,418.2	$527.3	$ 8,945.5
December 30, 2000	7,498.8	450.7	7,949.5

Note 3

Following are the components of net interest expense for the thirteen and thirty-nine week periods listed below:

	13 Weeks Ended		39
	September 29,	September 30,	September 29,

In millions	2001	2000	2001
Interest expense	$17.0	$21.3	$50.1
Interest income	(0.9)	(1.2)	(3.2
Interest expense, net	$16.1	$20.1	$46.9

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Part I Item 1

CVS Corporation
Notes to Consolidated Condensed Financial Statements
(Unaudited)

Note 4

Basic earnings per common share is computed by dividing: (i) net earnings, after deducting the after-tax dividends on the ESOP preference stock, by (ii) the weighted average number of common shares outstanding during the period (the "Basic Shares").

When computing diluted earnings per common share, the Company assumes that the ESOP preference stock is converted into common stock and all dilutive stock options are exercised. After the assumed ESOP preference stock conversion, the ESOP Trust would hold common stock rather than ESOP preference stock and would receive common stock dividends (currently $0.23 per share) rather than ESOP preference stock dividends (currently $3.90 per share). Since the ESOP Trust uses the dividends it receives to service its debt, the Company would have to increase its contribution to the ESOP Trust to compensate it for the lower dividends. This additional contribution would reduce the Company's net earnings, which in turn, would reduce the amounts that would have to be accrued under the Company's incentive compensation plans. Diluted earnings per common share is computed by dividing: (i) net earnings, after accounting for the difference between the dividends on the ESOP preference stock and common stock and after making adjustments for the incentive compensation plans by (ii) Basic Shares plus the additional shares that would be issued assuming that all dilutive stock options are exercised and the ESOP preference stock is converted into common stock.

Following is a reconciliation of basic and diluted earnings per common share for the thirteen and thirty-nine week periods listed below:

	13 weeks ended	
In millions, except per share amounts	September 29, 2001	September 30, 2000
Numerator for earnings per common share calculation:		
Net earnings	$123.7	$158.7
Preference dividends, net of income tax benefit	(3.7)	(3.8)
Net earnings available to common shareholders, basic	$120.0	$154.9
Net earnings	$123.7	$158.7
Effect of dilutive securities:		
Dilutive earnings adjustments	(1.9)	(0.1)
Net earnings available to common shareholders, diluted	$121.8	$158.6

Denominator for earnings per common share calculation:		
Weighted average common shares, basic	391.5	391.0
Effect of dilutive securities:		
ESOP preference stock	10.7	10.8
Stock options	3.8	5.7
Weighted average common shares, diluted	406.0	407.5
Basic earnings per common share	$ 0.31	$ 0.40
Diluted earnings per common share	$ 0.30	$ 0.39

Part I Independent Auditors' Review Report

The Board of Directors and Shareholders of
CVS Corporation:

We have reviewed the consolidated condensed balance sheet of CVS Corporation as of September 29, 2001, and the related consolidated condensed statements of operations for the thirteen and thirty-nine week periods ended September 29, 2001 and September 30, 2000, and cash flows for the thirty-nine week periods then ended. These consolidated condensed financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the consolidated condensed financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of CVS Corporation as of December 30, 2000 and the related consolidated statements of operations, shareholders' equity, and cash flows for the fifty-two week period then ended (not presented herein); and in our report dated February 1, 2001 we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated condensed balance sheet as of December 30, 2000, is fairly presented, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

KPMG LLP

Providence, Rhode Island
October 29, 2001

Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

The following discussion explains the material changes in our results of operations for the thirteen and thirty-nine weeks ended September 29, 2001 and September 30, 2000 and the significant developments affecting our financial condition since December 30, 2000. We strongly recommend that you read our audited consolidated financial statements and footnotes and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the fiscal year ended December 30, 2000.

The following discussion contains forward-looking statements which are subject to risks and uncertainties which could cause actual results to differ materially. Please read the "Cautionary Statement Concerning Forward-Looking Statements" section below.

Results of Operations

Third Quarter (Thirteen Weeks Ended September 29, 2001 versus September 30, 2000)

Net sales for the third quarter of 2001 increased $494.4 million (or 10.1%) to $5.4 billion, compared to $4.9 billion in the third quarter of 2000. Same store sales, consisting of sales from stores that have been open for more than one year, rose 7.6%. Pharmacy same store sales increased 11.8%, while front-end same store sales increased 0.3%.

As you review our sales performance, we believe you should consider the following important information:

- Our pharmacy sales growth has benefited from our ability to attract and retain managed care customers and favorable industry trends. These trends include an aging American population; many "baby boomers" are now in their fifties and are consuming a greater number of prescription drugs. The increased use of pharmaceuticals as the first line of defense for healthcare and the introduction of a number of successful new prescription drugs has also contributed to the growing demand for pharmacy services. However, the introduction of new prescription drugs has had less of an impact on sales in fiscal 2001, compared to recent years, due to the lack of significant "blockbuster" drug introductions during 2001.

- Sales also benefited from our active relocation program that seeks to move our existing shopping center stores to larger, more convenient, freestanding locations. Historically, we have achieved significant improvements in customer count and net sales when we do this. The resulting increase in net sales has typically been driven by an increase in front store sales, which normally have a higher gross margin. We believe that our relocation program offers a significant opportunity for future growth, as only 41% of our existing stores were freestanding as of September 29, 2001. Our current long-term goal is to have 70-80% of our stores located in freestanding sites. We cannot, however, guarantee that future store relocations will deliver the same results as those historically achieved.

- Sales were negatively impacted by operational problems combined with the weakening economy and increasingly competitive environment. We believe the operational issues, which included: a pharmacist shortage resulting in reduced pharmacy hours and closed pharmacy departments; out-of-stock

merchandise and increased customer wait times; combined with the weakening economy and an increasingly competitive environment, ultimately resulted in lower customer counts and lost sales during the third quarter. To address these issues, we intensified our pharmacist recruiting and retention efforts. These efforts significantly improved staffing levels and reduced turnover in our stores. We also continued our customer reactivation program, which involves direct mailings and targeted incentives to former CVS customers. Further, we increased our promotional activity in response to the increasingly competitive environment.

- Sales were also negatively impacted during the third quarter by fewer prescription file buys versus last year and our declining to participate in certain third party insurance plans, which did not meet our minimum profitability standards.

- In the event that the negative trends described above continue and/or our sales initiatives do not perform as planned, we may not be able to meet our sales and net earnings targets.

Gross margin for the third quarter of 2001 increased $74.4 million (or 5.7%) to $1.4 billion, compared to $1.3 billion in the third quarter of 2000. Gross margin as a percentage of net sales for the third quarter of 2001 was 25.4%, compared to 26.4% of net sales in the third quarter of 2000.

Why has our gross margin rate been declining?

- Pharmacy sales are growing at a faster pace than front store sales. On average, our gross margin on pharmacy sales is lower than our gross margin on front store sales. Pharmacy sales were 67% of total sales in the third quarter of 2001, compared to 63% in the third quarter of 2000.

- Sales to customers covered by third party insurance programs have continued to increase and, thus, have become a larger part of our total pharmacy business. On average, our gross margin on third party pharmacy sales is lower than our gross margin on cash pharmacy sales. Third party prescription sales were 91% of pharmacy sales in the third quarter of 2001, compared to 89% in the third quarter of 2000.

- Also contributing to the decline was an increase in markdowns associated with our increased promotional activity and elevated shrink expense. We expect these trends to continue in the fourth quarter of 2001.

Total operating expenses for the third quarter of 2001 were 21.3% of net sales compared to 20.6% of net sales in the third quarter of 2000. During the third quarter of 2000, we recognized a $19.2 million pre-tax ($11.5 million after-tax) nonrecurring gain in total operating expenses representing partial payment of our share of the settlement proceeds from a class action lawsuit. If you exclude the effect of this nonrecurring gain, comparable total operating expenses for the third quarter of 2001 were 21.3% of net sales compared to 21.0% of net sales in the third quarter of 2000.

As you review our comparable total operating expenses, we believe you should consider the following important information:

- Historically, our sales performance has allowed net sales to grow at a faster pace than total operating expenses.

- During the third quarter of 2001, we incurred higher store pharmacy payroll and benefits expense as a percentage of net sales to address the shortage of pharmacists discussed above. We also incurred higher advertising expenses as we continued our customer reactivation program aimed at attracting lost customers and in response to the increasingly competitive environment.

Operating profit for the third quarter of 2001 decreased $64.5 million (or 22.7%) to $220.2 million, compared to $284.7 million in the third quarter of 2000. If you exclude the effect of the nonrecurring gain we recognized during the third quarter of 2000, our comparable operating profit decreased $45.3 million (or 17.1%) to $220.2 million compared to $265.5 million in the third quarter of 2000. Comparable operating profit as a percentage of net sales was 4.1% in the third quarter of 2001, compared to 5.4% in the third quarter of 2000.

Interest expense, net for the third quarter of 2001 was $16.1 million, compared to $20.1 million in the third quarter of 2000. Our interest expense totaled $17.0 million in the third quarter of 2001, compared to $21.3 million in the third quarter of 2000. Interest income was $0.9 million in the third quarter of 2001 versus $1.2 million in the third quarter of 2000. Interest expense decreased due to a combination of lower average interest rates and lower average borrowing levels during the third quarter of 2001.

Income tax provision ~ Our effective income tax rate was 39.4% for the third quarter of 2001, compared to 40.0% for the third quarter of 2000. The decrease in our effective income tax rate was primarily due to lower state income taxes and a decrease in the amount of goodwill amortization that is not deductible for income tax purposes.

Net earnings for the third quarter of 2001 decreased $35.0 million (or 22.1%) to $123.7 million, or $0.30 per diluted share, compared to $158.7 million, or $0.39 per diluted share, in the third quarter of 2000. If you exclude the effect of the nonrecurring gain we recognized in the third quarter of 2000, our comparable net earnings decreased $23.5 million (or 16.0%) to $123.7 million, or $0.30 per diluted share, compared to $147.2 million, or $0.36 per diluted share in the third quarter of 2000.

Nine Months (Thirty-nine Weeks Ended September 29, 2001 versus September 30, 2000)

Net sales for the first nine months of 2001 increased $1.7 billion (or 11.6%) to $16.3 billion, compared to $14.6 billion in the first nine months of 2000. Same store sales, consisting of sales from stores that have been open for more than one year, rose 9.0%. Pharmacy same store sales increased 14.1%, while front-end same store sales increased 0.4%. Pharmacy sales were 67% of total sales in the first nine months of 2001, compared to 62% in the first nine months of 2000. Third party prescription sales were 91% of pharmacy sales during the first nine months of 2001, compared to 89% in the first nine months of 2000. See "Third Quarter" above for further information about the factors that affected our net sales.

Gross margin for the first nine months of 2001 increased $350.5 million (or 8.9%) to $4.3 billion, compared to $3.9 billion in the first nine months of 2000. Gross margin as a percentage of net sales for the first nine months of 2001 was 26.3%, compared to 26.9% of net sales in the first nine months of 2000. See "Third Quarter" above for further information about the factors that affected our gross margin as a percentage of net sales.

Total operating expenses for the first nine months of 2001 were 20.5% of net sales, compared to 20.4% of net sales in the first nine months of 2000. If you exclude the effect of the nonrecurring gain we recognized in the third quarter of 2000, comparable total operating expenses were 20.5% of net sales in the first nine months of 2001 compared to 20.5% of net sales in the first nine months of 2000. During the first nine months of 2001, we received $46.8 million of settlement proceeds from lawsuits alleging antitrust law violations by certain manufacturers of brand name prescription drugs. We elected to contribute the entire $46.8 million in settlement proceeds to the CVS Charitable Trust, Inc. to fund future charitable giving. As a result, the net effect of these two nonrecurring items had no impact on our net earnings for the first nine months of 2001. See "Third Quarter" above for further information about the factors that affected our total operating expenses.

Operating profit for the first nine months of 2001 decreased $9.9 million (or 1.0%) to $943.6 million, compared to $953.5 million in the first nine months of 2000. If you exclude the effect of the nonrecurring gain we recognized in the third quarter of 2000, our comparable operating profit increased $9.3 million (or 1.0%) to $943.6 million compared to $934.3 million in the first nine months of 2000. Comparable operating profit as a percentage of net sales was 5.8% in the first nine months of 2001, compared to 6.4% in the first nine months of 2000.

Interest expense, net for the first nine months of 2001 was $46.9 million, compared to $59.2 million in the first nine months of 2000. Our interest expense totaled $50.1 million in the first nine months of 2001, compared to $62.4 million in the first nine months of 2000. Interest income was $3.2 million in the first nine months of both 2001 and 2000. Interest expense decreased due to a combination of lower average interest rates and lower average borrowing levels during the first nine months of 2001.

Income tax provision ~ Our effective income tax rate was 39.4% for the first nine months of 2001, compared to 40.0% for the first nine months of 2000. The decrease in our effective income tax rate was primarily due to lower state income taxes and a decrease in the amount of goodwill amortization that is not deductible for income tax purposes.

Net earnings for the first nine months of 2001 increased $7.0 million (or 1.3%) to $543.5 million, or $1.32 per diluted share, compared to $536.5 million, or $1.32 per diluted share, in the first nine months of 2000. If you exclude the effect of the nonrecurring gain we recognized in the third quarter of 2000, our comparable net earnings increased $18.5 million (or 3.5%) to $543.5 million, or $1.32 per diluted share, compared to $525.0 million, or $1.29 per diluted share in the first nine months of 2000.

Liquidity and Capital Resources

Liquidity ~ Our primary sources of liquidity are cash provided by operations, commercial paper and long-term borrowings. We may also elect to use other financing sources in the future to support our continued growth.

Our commercial paper program is supported by a $650 million, five-year unsecured revolving credit facility which expires on May 30, 2006 and a $650 million, 364-day unsecured revolving credit facility, which expires on May 30, 2002. As of September 29, 2001, we had $603.4 million of commercial paper outstanding at a weighted average interest rate of 2.9%.

Our credit facilities and unsecured senior notes contain customary restrictive financial and operating covenants. We do not believe that the restrictions contained in these covenants materially affect our financial or operating flexibility.

We believe that our cash on hand and cash provided by operations, together with our ability to obtain additional short-term and long-term financing, will be sufficient to cover our working capital needs, capital expenditures and debt service requirements for at least the next twelve months.

On March 6, 2000, the Board of Directors approved a common stock repurchase program, which allows the Company to acquire up to $1 billion of its common stock, in part, to fund employee benefit plans. During the third quarter of 2001, the Company repurchased 3.4 million shares of common stock at an aggregate cost of $129.0 million. From the inception of the program through September 29, 2001, the Company repurchased 8.1 million shares of common stock at an aggregate cost of $292.2 million.

Net Cash Used in Operations ~ Net cash provided by operations increased $99.4 million to $401.6 million in the first nine months of 2001 compared to $302.2 million in the first nine months of 2000. The improvement in net cash provided by operations was primarily the result of improved working capital management.

Capital Expenditures ~ Our additions to property and equipment totaled $473.0 million during the first nine months of 2001, compared to $496.6 million during the first nine months of 2000. During the third quarter, we opened 29 new stores, relocated 34 stores and closed 24 stores. Year-to-date, we opened 59 new stores, relocated 82 and closed 57. During the remainder of fiscal 2001, we plan to open approximately 100 new or relocated stores. As of September 29, 2001, we operated 4,135 retail and specialty pharmacy stores in 32 states and the District of Columbia, compared to 4,106 stores as of September 30, 2000.

Management's Discussion and Analysis of Financial Condition and Results of Operations

We finance a portion of our new store development program through sale-leaseback transactions. During the third quarter of 2001, we completed a sale-leaseback transaction involving five of our distribution centers. The distribution centers were sold at fair market value resulting in net proceeds of $94.0 million. The gain on the transaction was deferred and is being amortized over the life of the new operating lease.

Recent Developments

Restructuring and Asset Impairment Charge

As part of a comprehensive business review designed to streamline operations and enhance operating efficiencies, the Company announced on October 30, 2001, its intention to implement an Action Plan during the fourth quarter of 2001 that primarily includes the following:

- Closing approximately 200 stores as part of a store consolidation program;
- Closing one of its ten distribution facilities;
- Closing one of ProCare's two mail order facilities; and
- Staff reductions related to the above closings and other streamlining initiatives.

While the above Action Plan is not yet finalized, the Company expects to record a pre-tax restructuring and asset impairment charge of approximately $350 million, or $0.56 per diluted share, during the fourth quarter of 2001, in

accordance with, Emerging Issues Task Force Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)," Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and Staff Accounting Bulletin No. 100, "Restructuring and Impairment Charges."

The Company also announced it would integrate its specialty pharmacy business segment, ProCare, and its PBM segment, PharmaCare.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board issued two new pronouncements; Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141, which is effective for acquisitions initiated after June 30, 2001, prohibits the use of the pooling-of-interest method for business combinations and establishes the accounting and financial reporting requirements for business combinations accounted for by the purchase method. SFAS No. 142, addresses financial accounting and reporting for acquired goodwill and other intangible assets. Among other things, SFAS No. 142 requires that goodwill no longer be amortized, but instead be tested for impairment in accordance with the provisions of SFAS No. 142. Amortization expense related to goodwill was $33.7 million in 2000 and is $24.4 million for the first nine months of 2001. Except for goodwill and intangible assets acquired after June 30, 2001, which are subject immediately to the provisions of SFAS No. 142, this statement is effective for fiscal years beginning after December 15, 2001.

Also in June 2001, SFAS No. 143, "Accounting for Asset Retirement Obligations" was issued. This statement requires companies to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and to capitalize the associated asset retirement costs as part of the carrying amount of the long-lived asset. The provisions of SFAS No. 143 are effective for fiscal years beginning after June 15, 2002.

In August 2001, SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" was issued. Although this statement, which supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of", retains many of the recognition and measurement provision of SFAS No. 121, it significantly changes the criteria for classifying an asset as held-for-sale. The provisions of SFAS No. 144 are effective for fiscal years beginning after December 15, 2001.

We are currently in the process of determining the impact these pronouncements will have on our consolidated financial statements.

Cautionary Statement Concerning Forward-Looking Statements

Certain statements in this Form 10-Q (as well as in our other public filings, web site, press releases and oral statements made by Company management and/or representatives), constitute forward-looking statements, which are subject to risks and uncertainties. Forward-looking statements include information concerning:

- our future results of operations, including sales and earnings per common share growth;

- our ability to continue to reduce selling, general and administrative

expenses as a percentage of net sales;

- our belief concerning the growth and profitability of CVS ProCare and the benefits associated with the integration of CVS ProCare and PharmaCare;

- our belief concerning the growth and profitability of CVS.com;

- our belief concerning our ability to continue to increase our free cash flow;

- our belief that we will have sufficient cash flows to support our future working capital needs, capital expenditures and debt service requirements;

- our belief that we can continue to reduce inventory levels and improve inventory turnover;

- our planned store development program, including store openings, number of freestanding locations, new markets and capital expenditures;

- our ability to continue to fund our new store development through sale-leaseback transaction on terms satisfactory to the Company; and

- our belief that we can continue to improve operating performance by relocating existing in-line stores to freestanding locations.

In addition, statements that include the words "believes", "expects", "anticipates", "intends", "estimates" or similar expressions are forward-looking statements. For all of these statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

You should understand that the following important factors, in addition to those discussed elsewhere in this report and in the documents which are incorporated by reference (and in our other public filings, press releases and oral statements made by Company management and/or representatives), could cause actual results to differ materially from those expressed in the forward-looking statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations

What Factors Could Affect the Outcome of Our Forward-Looking Statements?

Industry and Market Factors

- changes in economic conditions generally or in the markets served by CVS;

- future federal and/or state regulatory and legislative actions affecting CVS and/or the chain drugstore industry;

- consumer preferences and spending patterns;

- competition from other drugstore chains, from alternative distribution channels such as supermarkets, membership clubs, mail order companies and internet companies (e-commerce) and from other third party plans;

- the continued introduction of successful new prescription drugs;

- the continued efforts of health maintenance organizations, managed care organizations, pharmacy benefit management companies, governmental agencies and other third party payers to reduce prescription drug costs; and

- changes in accounting policies and practices, including taxation

requirements.

Operating Factors

- our ability to continue to implement new information systems and technologies;
- our ability to successfully attract customers through our customer reactivation program;
- our ability to obtain the benefits expected from the Action Plan;
- our ability to continue to secure suitable new store locations at favorable lease terms;
- our ability to continue to purchase inventory on favorable terms;
- adverse determinations with respect to litigation or other claims;
- our ability to attract, hire and retain suitable pharmacists and management personnel;
- our ability to establish effective advertising, marketing and promotional programs (including pricing strategies) in the different geographic markets in which we operate; and
- the creditworthiness of the purchasers of former businesses whose store leases are guaranteed by CVS.

Part I Item 3

Quantitative and Qualitative Disclosures About Market Risk

The Company has not entered into any transactions using derivative financial instruments or derivative commodity instruments and believes that its exposure to market risk associated with other financial instruments, principally interest rate risk inherent in its debt portfolio, is not material.

Part II Item 1

Legal Proceedings

As of November 9, 2001, six actions have been filed in the United States District Court for the District of Massachusetts asserting claims under the federal securities laws on behalf of a purported class of the Company's shareholders. The actions are styled Turberg v. CVS Corp., et al., No. 01-CV-11464; Shapiro v. CVS Corp., et al., No. 01-CV-11490; Taylor v. CVS Corp., et al., No. 01-CV-11507; Knisley v. CVS Corp., et al., No. 01-CV-11613; Fink v. CVS Corp., et al., No. 01-CV-11637; and Potash v. CVS Corp., et al., No. 01-CV-11732. The complaints in the actions, which are substantially identical, allege that several public statements by the Company between February and May 2001 failed to disclose that, as later reported by the Company in a June 27, 2001 press release, the Company's earnings per share for the second quarter and for the full year would be lower than previously anticipated. According to the complaints, following the June 27, 2001 announcement, the price of the Company's common stock fell from $44.10 to $36.51 per share. Plaintiffs assert claims against the Company and Thomas M. Ryan, the Chairman of the Board of Directors,

President and Chief Executive Officer of the Company, for alleged securities fraud under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The actions are in their earliest stages. The Company and Mr. Ryan believe that the claims asserted in the actions are without merit and intend to defend against them vigorously.

Exhibits and Reports on Form 8-K

Exhibits:

3.1 Amended and Restated Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 to CVS Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 1996).

3.1A Certificate of Amendment to the Amended and Restated Certificate of Incorporation, effective May 13, 1998 (incorporated by reference to Exhibit 4.1A to Registrant's Registration Statement No. 333-52055 on Form S-3/A dated May 18, 1998).

3.2 By-laws of the Registrant, as amended and restated (incorporated by reference to Exhibit 3.2 to CVS Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 1998).

15.1 Letter re: Unaudited Interim Financial Information.

Reports on Form 8-K:

There were no Reports on Form 8-K filed during the third quarter of 2001.

Signatures:

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

CVS Corporation
(Registrant)

/s/ David B. Rickard

David B. Rickard
Executive Vice President, Chief Financial Officer
and Chief Administrative Officer
November 9, 2001