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PRESENTATION

Operator

Good afternoon, and welcome to McKesson's Corporation fiscal 2007 fourth quarter conference call. (OPERATOR INSTRUCTIONS) Today's conference is being recorded. If you have any objections, you may disconnect at this time. I would now like to introduce Mr. Larry Kurtz, Vice President, Investor Relations, please go ahead, sir.

Larry Kurtz - ***McKesson Corporation - VP, IR***

Thank you, Ed. Good afternoon, and welcome to the McKesson fiscal 2007 fourth quarter conference call for the financial community. With me today are John Hammergren, McKesson's Chairman and CEO; and Jeff Campbell, our CFO. John will provide a business update with highlights of the year, and we'll then introduce Jeff who will review the financial results for the quarter and year. After Jeff's comments, we'll open the call for your questions. We plan to end the call promptly after one hour at 6:00 p.m. Eastern Time.

Before we begin, I caution listeners that during the course of this call we'll make forward-looking statements within the meaning of the Federal Securities laws that involve risks and uncertainties regarding the operations and future results of McKesson. In addition to the Company's periodic, current, and annual reports filed with the Securities and Exchange Commission, please refer to the text of our press release for a discussion of the risks associated with such forward-looking statements. Thanks. Here is John Hammergren.

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Thanks, Larry. Thanks, everyone, for joining us on our call today. McKesson had a great fourth quarter capping off another excellent financial performance. For the full year, we had revenue growth of 7%, with earnings per diluted share of $2.89 from continuing operations, excluding adjustments to the securities litigation reserves, an increase of 17% from the prior year and well above both our original and revised outlook. We are executing very well across the Company. We are seeing the benefits of our strategy to deliver products, services, and solutions that are helping our customers make healthcare safer, more efficient, and higher quality. Our financial performance, operating excellence, and strategic capital deployment provide great momentum for fiscal 2008 where we expect to deliver earnings of $3.15 to $3.30 per diluted share.

In fiscal 2007, we had a very good performance a across all three segments of the Company, pharmaceutical solutions operating margin expanded 8 basis points to 1.53%, a strong performance considering we had $95 million in positive anti-trust settlements a year ago compared to $10 million this year. Medical surgical solutions grew revenues 16% for the year while completing a seamless transition out of the acute care medical surgical business.

Provider technologies revenues grew 24% and operating profit increased 11% even as we continued to make significant investments in product development, sales force expansion, and acquisitions to expand our offering and strengthen our position in emerging markets. These strong performances across the segments produce cash flow from operations of more than $1.5 billion which was significantly above our expectation of $1 billion. We continue to execute a balanced capital deployment strategy designed to create additional shareholder value.

During fiscal 2007, we spent $306 million for capital expenditures and capitalized software to drive the growth of existing businesses. We repurchased $1 billion in shares. We paid $72 million in dividends, and we made $1.9 billion in acquisitions that have the potential to accelerate future growth and stockholder value creation. We financed our January purchase of Per-Se with $800 million in cash, and $1 billion in new debt bringing our debt-to-capital ratio to 24%, closer to our long term target of 30 to 40%.

We ended the year with $2 billion in cash, given our strong balance sheet, expectations for growth and solid cash flow, we were in a great position to continue our flexible opportunistic strategy for further shareholder value creation. During the fourth quarter, McKesson repurchased $247 million of stock completing our previous purchase program. I'm pleased that our most recent meeting, the Board of Directors authorized an additional $1 billion worth of share repurchase to put into a new program. All in all, we had a terrific year, and we are excited about the opportunities in the coming year.

Turning to our segment results, in pharmaceutical solutions, the team is executing very well on every facet of the business. We are being disciplined with contract renewals, we have been successful providing more higher margin products and services to our customers, and we are performing well on our agreements with branded pharmaceutical manufacturers. We continue to be focused on improving the quality and efficiency of our operations to leverage our growth.

Our goal is to grow at the rate of market growth adjusted for our mix of business. For the year, our U.S. Healthcare direct store deliveries, revenue growth was 11% when you adjust for the loss of the low margin business we terminated at the beginning of the year. Our strong growth reflects the growth of our customers, partially driven by Part D drug coverage for seniors, the effect of which is now being anniversaried. Warehouse sales for the year grew at 8% in line with market growth.

Since the transition to a more predictable compensation from branded pharmaceutical manufacturers, we have focused our sales force on the need to maintain sale margin during contract renewals. During fiscal 2007 our sale margin remained stable and was actually up a couple of basis points. We renewed longstanding relationships with several of our largest customers including Wal-Mart, Target and Aetna and expanded our relationships with CVS and Broadlane the Hospital GPO. We're also seen as a leader in the quality of service which is a powerful compliment to our one McKesson approach for comprehensive supply chain, information, and automation solutions for hospitals. Customer feedback and survey results show that McKesson ranks first in terms of overall hospital customer satisfaction with our pharmaceutical distribution service.

We knew that fiscal 2007 represented a great opportunity for the team to grow our generics business, with a significant number of major branded pharmaceuticals scheduled to lose patent protection. The use of cost efficient generics is a huge focus of payers and employers. As a result the branded to generic conversion cycle is now extremely rapid. On average more than 90% of the branded volume is replaced by the generic within several months. We have a terrific team managing our generics business. To maximize our generics opportunity in fiscal 2007 the team put together a plan that included an expanded customer base for our proprietary generics programs, a new information system that could better track buying compliance among customers, and a new telemarketing capability, marketed into our customer base. The planning has paid off.

The generics conversions of Zocor and Zoloft early in the year went very well. According to IMS, Zocor is the first case where the conversion to a generic led to an increase in overall units of the molecule dispensed. Further enhancing the market opportunity. We also benefited from the brief introduction of a generic form of Plavix. But even beyond these noteworthy examples, the overall market for generics grew quite strongly during the past year. We executed well on our opportunities and as a result, sales growth for our one stop generics program for retail pharmacy increased 40% for the quarter and 51% for the year. We believe we have the industry leading generics program.

We expect fiscal 2008 will represent another year of strong growth in sales and profit from generic drugs, with a similar volume of branded pharmaceuticals scheduled to lose patent protection. In terms of our fiscal year, the timing is different compared to last year whereas there were a number of major generic drug launches in the first two quarters of fiscal 2007, such as the generic forms of Zocor, Zoloft and Plavix, the current expectation is that the majority of generic drug launches in fiscal 2008 will occur late in the year.

We also have a terrific team that manages our agreements to deliver value to branded pharmaceutical manufacturers which drives our compensation. In fiscal 2007 we optimized our opportunities through great operating performance under our agreements. I'm pleased with the strength of our relationships at branded manufacturers and the stability this has produced for our pharmaceutical distribution business.

Turning to medical surgical solutions, while operating profit was relatively flat for fiscal 2007, we made significant market progress positioning this business for future growth. Revenues were up 16% during a year of transition. In September, we sold our acute care business that provides medical surgical supplies to hospitals. Many of these hospitals are also customers of our U.S. Pharmaceutical distribution business, or of our provider technology business. It was crucial that the transition be handled very well and that we maintain our positive brand reputation within this sector of the market. We completed the transition of our acute care business ahead of schedule. Most important, the handoff was seamless and the feedback from customers has been very positive.

Finally, provider technology solidified its leadership position for comprehensive information solutions in our traditional core hospital customer base. Demand remains strong, especially for our market leading medical imaging solutions. We continue to benefit from an improved pace of implementations and pull revenue from our software backlog. Our medical imaging revenues grew almost 50% for the year, and we completed 168 radiology installations, a 30% increase from the prior year. We replaced 26 competitor systems while no competitor replaced any of our systems. We expanded our sales reach beyond the hospital market through a partnership with Toshiba for the small hospital and imaging center market and now we're seeing an increased demand for our cardiology imaging products. Horizon cardiology Hemo is now being added to the Toshiba partnership.

Our medical imaging solutions received two number one rankings in the 2006 Top 20 year-end best-in-KLAS report, one in the community health information category for Horizon Medical Imaging, and another in the cardiology reporting and documentation category, for Horizon Cardiology. With our tremendous growth over the past four years we are now poised to take a market leading position in the medical imaging market. Not surprisingly our medical imaging group is a recipient of the frost and Sullivan market penetration leadership award for our U.S. PACS industry, the second consecutive year , reflecting our growth in market share.

Our automation technologies are a key differentiator for us in the hospital market. McKesson remains the leader in medication safety with the only fully integrated solution spanning information systems, automated drug dispensing and bedside error prevention and since 2003 our customer base for automation products has grown 70%. McKessons's robot RX is installed in 325 hospitals in the United States and Canada where it dispenses half a billion doses annually error free. Our horizon admin RX bedside scanning technology monitors more than 95 million drug administrations annually preventing more than 325,000 errors every week.

During fiscal 2007 we made four strategic acquisitions to expand our positions in emerging markets for physician office information solutions, consumer directed healthcare, and healthcare connectivity. The largest of these acquisitions is Per-Se technologies which had six product and service offerings, five of which were overlapping with existing McKesson businesses, building our scale and building our product offering. We have been moving quickly to integrate the Per-Se assets into McKesson and create a combined product and service offering for our customers. We integrated the Per-Se pharmacy software systems business into our existing business of pharmaceutical solutions giving us products that address information systems needs from small independent pharmacies to large chains. Through the combination of McKesson, Per-Se, and Practice Partner, we now reach 120,000 physicians with solutions that address the needs of every practice in the country regardless of size, specialty, or geographic location. With our expanded product line and customer base, we already are aggressively promoting McKesson's complete solution for physicians including software, supplies, connectivity, and revenue cycle outsourcing. We see great growth potential for us in this space.

We've combined the connectivity and claims processing assets at McKesson and Per-Se into a new business that we have branded Relay Health. Relay Health expands on McKesson's previous physician patient communications business with a focus on helping to decrease administrative costs and improved care by connecting physicians and other providers, pharmacies, payers, and of course consumers. This is a very powerful collection of assets that we believe can become a strong differentiator as consumerism and healthcare grows. We see an increasing demand for online healthcare transactions of all kinds, from real time eligibility checking, to looking up lab results online, to formulary compliance. Meeting this demand with our offering expands our growth potential.

Turning to international, we continue to make great progress in Europe. In the United Kingdom we have more than 50% of the NHS operating with a new payroll and Human Resources information systems from McKesson. In France, we achieved go lives for all nine SSA Ministry of Defense Army Hospitals which run the complete McKesson solution. We now have a presence in the largest of 262 of 1,000 French public hospitals and over the past five years our revenues in France have increased nearly fourfold.

As you saw in our press release beginning next quarter we will report our results in two segments. McKesson Distribution Solutions which includes what was previously reported as pharmaceutical solutions and medical surgical solutions with the exception of our payor business, which will now be reported together with provider technologies in the second segment, McKesson Technology Solutions. This change reflects our decision to more closely align our payor business with the strategy we are pursuing in provider technologies and Relay Health, to create value by promoting connectivity, economic alignment, and transparency of information between payors and providers. We have a very large install base of payer software customers and continue to introduce new products to maintain our market leadership position. We believe that aligning the two solution sets produces a powerful value proposition unique to McKesson.

In summary McKesson performed very well in fiscal 2007 and based on the demonstrated value of our product and service offering, our operating progress and strategic investments, we enter fiscal 2008 well positioned for growth in both existing and emerging markets for healthcare services and healthcare information technology. We are the largest pharmaceutical distributor in the United States and Canada and own 49% of the leading pharmaceutical distributor in Mexico. We're the largest distributor of generics in North America at a time when the consumption of these drugs is growing due to their great value and we are well positioned in the attractive alternate site medical surgical market. Software and automation solutions that can improve efficiency and quality of healthcare have tremendous value for our customers. We continue to see strong demand from our solutions for our large install base of hospital and payor customers. We have a unique offerings for the emerging sectors of the market and are using our technology to connect all participants across the healthcare spectrum.

A strong balance sheet and solid operating cash flow provide resources to further the creation of additional shareholder value. Every day, McKesson and its people are making healthcare safer and more efficient. At the same time, we are creating value for our customers, employees, and shareholders. It's a terrific combination and a great place to be. With that, I'll turn the call over to Jeff, and I look forward to addressing your questions when he finishes. Jeff?

Jeff Campbell - ***McKesson Corporation - EVP, CFO***

Well, thank you, John, and good afternoon, everyone. As you just heard, this was another excellent quarter. We're extremely pleased with our overall results for both the quarter and the year. In Fiscal 2007, we continued to execute well operationally, while deploying capital for additional opportunities across the company. The continued strength of our balance sheet combined with expected strong cash flow from our businesses should allow for further shareholder value creation in fiscal 2008.

In my remarks today, I will cover both the fourth quarter and full year results. As you know, we provide our guidance on an annual basis due to both the seasonality and the quarter to quarter volatility that is inherent to some of our businesses. In this context, an annual look at our financial results, can provide more meaningful insight into some of the key trends.

Now, let me begin by reviewing the consolidated income statement. As always, I will provide more specifics when I discuss each segment in more detail. We had revenue growth in the quarter of 6%, $24.2 billion and 7% for the year to $93 billion. Our overall revenue growth is driven by the 6% annual growth in pharmaceutical solutions, given that this segment accounts for 95% of our total revenues. We were, however, pleased to see much higher revenue growth rates in our other two segments with 16% for medical surgical and 24% for provider technologies, including two months of Per-Se results. Obviously, this kind of revenue growth can drive greater bottom line impacts for the Company given our higher margins in these segments.

Overall gross profits of $1.3 billion in the quarter and $4.3 billion for the year were up 20% to 15% respectively. We were able to increase overall gross margins across all three segments for the year, a great sign of strong performance with our customers. Moving below the gross profit line, our operating expenses, excluding any securities litigation charges or credits were up 25% to $883 million for the quarter, and increased 18% for the full year to $3.1 billion. Now, this fiscal year departed from our usual expectation of getting operating expense leverage due to a number of unusual items. These included in particular the added operational expenses and integration costs associated with several acquisitions including two months of Per-Se, higher compensation expenses, including $44 million in expenses associated with the implementation of FAS 123R, and higher restructuring and other costs associated with several divestitures and rightsizings.

Continuing my walk down the P&L, operating income was up 9% to 368 million for the quarter and up 12% to $1.3 billion on a full year basis. Moving below operating income, our interest expense of $31 million in the quarter and $99 million in the year was up 24%, 5% respectively. Both were higher due to the $1 billion in debt we added to finance the acquisition of Per-Se. Other income was down 38% for the quarter and 5% for the year, due to lower interest income. Once again, due to the $1.8 billion acquisition of Per-Se, which was also partially funded with about $800 million of cash.

Moving to taxes. Our fourth quarter provision for income taxes reflects a reduction in the Company's full year effective tax rate from 34% to 33%, and favorable adjustments to income tax expense totaling $4 million. As a reminder, our full year income tax expense includes an $83 million credit to reverse previously recorded securities litigation tax reserves.

Excluding securities litigation charges or credits, diluted EPS from continuing operations was $0.85 in the quarter and $0.69 in the prior year. Our full year diluted EPS from continuing operations excluding securities litigation charges was $289 this year versus $2.46 the prior year, a 17% increase. Clearly, a great result that we are pleased with.

To wrap up our consolidated results in the quarter, our diluted EPS calculation was based on 304 million weighted average diluted shares outstanding compared to 314 million in the prior year. For the full year, our diluted EPS calculation was based on 305 million weighted average diluted shares outstanding compared to 316 million in the prior year. The number of shares used in this calculation declined primarily due to the cumulative impact of our share repurchases, including $247 million of stock repurchase in the quarter, which brought our total share repurchase for the fiscal year to $1 billion.

Let's now move on to our three segments, pharmaceutical solutions revenues were up 5% to $23 billion for the fourth quarter and up 6% to $88.7 million for the year. Our Canadian business grew revenues at 13% for the quarter and the year. I would note that this years fourth quarter and therefore the year included five additional sales days. There was also a negative 2% currency impact for the quarter and a benefit of 5% for the year.

Our overall sales mix for the quarter was 29% institutional, 24% retail chain, 13% independent, 34% warehouse, and that break down a year ago was 32% institutional, 22% retail chains, 13% independent, and 33% warehouse. Gross profit for this segment was up sharply for both the quarter and the full year due to a continued relatively stable sell margin, great performance under our agreements with branded manufacturers including some impact from branded price inflation and a strong increase in generic sales, particularly in our proprietary one stop program that John talked about.

To better understand the trends for gross profit year-over-year, we need to consider two items--LIFO and our positive anti-trust settlement. Bear with me on lots of numbers here. In fiscal year 2007, our LIFO credit was $26 million in the fourth quarter and $64 million for the full year. in Fiscal 2006 LIFO the credit was $12 million in the fourth quarter and $32 million for the full year. So for the quarter and the year, we had increased LIFO credits of $14 million and $32 million. We also had significant changes in our positive anti- trust settlements. In the fourth quarter of fiscal year 2007, we had no settlement and $10 million for the full year. The comparable numbers for last fiscal year were $7 million for the fourth quarter and $95 million for the year. While adjusting for these two items makes gross profit growth only marginally different in the fourth quarter, it moves the full year gross profit growth to 14%, a strong indicator of our momentum in this segment.

Our pharmaceutical solutions operating expenses were up 15% for the quarter to $395 million and up 9% for the year to $1.4 billion. We always have some quarterly volatility in our expenses, but higher year-over-year operating expenses are primarily due to higher legal expenses, restructuring charges primarily related to the sale of our retail automation business, higher compensation expenses, some of which is related to FAS 123R. Operating profit for the quarter and the year was up 16% and 12% respectively. Operating margin for the quarter was 177 basis points compared to 161 basis points in the prior year, bringing our fiscal year margin to 153 basis points. Excluding the favorable anti-trust settlements and LIFO from both years, however, our operating margin for the year was up 15 basis points. These results reflect great execution by our Pharmaceutical Solutions team.

Turning to medical surgical solutions, we are pleased to have successfully transitioned our acute care business to Owens and Minor. Medical surgical solutions revenues of $575 million in the quarter and $2.4 billion in the year were up 13% and 16% respectively, both of which reflect above market growth across the business. The acquisition of Sterling Medical in April 2006 and an additional week of sales in fiscal 2007 compared to a year ago. For the full year, we had operating profit of $81 million slightly lower than a year ago and operating margin of 3.43%.

Turning to provider technologies, let me remind everyone on the call that we closed the acquisition of Per-Se Technologies on January 26, 2007, and hence the fourth quarter and full year results that I'll be discussing here today will include approximately two months of Per-Se results. As John mentioned, Per-Se had six businesses, five of which overlap with existing McKesson businesses. We have moved quickly to integrate Per-Se and in many cases have combined Per-Se assets with McKesson assets and other acquisitions to operate them on a unified basis. Because of this we believe that the most meaningful way to view the results of Per-Se and the other components of our provider technology segment is on a combined basis. I will note that on a consolidated basis, we estimate the impact of Per-Se in the quarter be about $0.02 dilutive primarily to the increased interest expense and lower interest income. Also for those of you who model this, across McKesson, we will have $60 million of annual amortization of intangibles resulting from the acquisition of Per-Se.

Now, let me discuss the provider technologies financials. We achieved another strong performance, 39% revenue growth for the quarter to $597 million. Software and software systems revenue were up 7% in the quarter to $111 million. Services revenue where the majority of Per-Se revenues were booked, was up 52% to $435 million in the quarter. For the year, total revenues were up 24% to $1.9 billion with software and software systems revenue up 16%, to $374 million, services revenue up 28% to $1.4 billion. Our software deferral rate was 78% in the fourth quarter compared to 85% in the prior year. Let me remind you that in the prior year fourth quarter, we signed one of our largest contracts ever with Triad, such a very large contract tend to have higher deferral rates.

Gross profit increased 25% for the year providing a gross margin of 47% about 50 basis points above the prior year. Provider technologies operating expenses increased 45% in the quarter to $237 million, and increased 27% for the full year to $749 million. Higher expenses were primarily due to the impact of Per-Se and three other acquisitions, new product development investments and sales force expansion, and $16 million in equity based compensation expense for the year. For the quarter MPT capitalized 20% of their R&D expenditures compared to 24% a year ago and for the year, capitalized 21% compared to 24% a year ago. Total gross R&D spending for the full year was $270 million up 25% for the prior year.

For the full year our operating profit was up 11% to $159 million and our operating margin was 8.35%. Operating profit grew 6%. However, the fourth quarter included $5 million in pre-tax restructuring expense, primarily for the transition of staff at Legacy sites in the UK, $4 million of Per-Se costs for the write-off of in process R&D and an asset impairment, and $7 million in equity based compensation allocated to this segment for FAS 123R. Adjusting for these items our fourth quarter operating profit was up 40%.

Leaving our segment performance now turning briefly to the balance sheet and cash flow statements. On the working capital side, our receivables were up 5% from the prior year to $6.6 billion and our day sales outstanding was down 1 day at 21 days. Compared to a year ago, our inventories increased 14% to $8.2 billion and our payables were up 9% to$10.9 billion. Our day sales in inventory of 32 days and day sales in payables of 43 days were up three days and two days respectively from a year ago. Given the magnitude of our inventory and payables these metrics can fluctuate materially on any given day but we are generally pleased with our working capital trend. Our strong operating performance resulted in great operating cash flows of $1.5 billion. We ended the year with $2 billion of cash on our balance sheet down from $2.1 billion last year and gross debt-to-capital ratio of 24%. Capital spending was $126 million for the year, lower than the $166 we spent in the prior year, when we opened two new pharmaceutical distribution centers in our network. Capitalized software expenditures were $180 million for the year up from the 160 million we spent last year, driven by both internal investment and software held for sale. We once again enter our new fiscal year with an extremely strong balance sheet and as a result at its most recent meeting of the Board of Directors authorized an additional $1 billion share repurchase program.

Before I comment on our fiscal 2008 guidance I'd like to briefly discuss our new segment reporting realignment and its impact on our fiscal 2008 financial results. We believe that this realignment makes great business sense due to the common strategies and customer needs between the business units being combined. We will provide historical statements reflecting the two segments later this quarter. Let me highlight a couple of points now. Combining our medical surgical business in the newly created distribution solution segment, while moving our payer business to the newly created technology solutions segment would have had almost no impact on the distribution solutions segment revenue growth or operating margin in fiscal 2007. Literally only a basis point here and there. On the other hand, our payer business contribution to technology solutions operating margins would have been more significant by 80 basis points in fiscal 2007.

Now to our guidance, $3.15 to $3.30 per diluted share. I point you to our Press release today where you will find a detailed list of key assumptions underlying this guidance. I want to take just a few more minutes here, however, highlighting some a few of the major ones. The guidance includes equity based compensation expense expected to be between $0.19 and $0.21 per diluted share in fiscal 2008, compared to $0.13 in 2007 due to the multi-year ramp up of expense we are experiencing as we previously discussed. This expense will be allocated to segments according to employee participation, and will have a more significant impact on technologies solutions segment operating profits. On a more general note, while we don't provide quarterly guidance, we expect the fourth quarter will be especially strong compared to the first three quarters for several reasons.

First, while another year of strong growth and sales in profit from generic pharmaceuticals is expected, whereas there were a number of major generic drug launches the first two quarters of fiscal 2007, current expectation is that the majority of generic drug launches in fiscal 2008 will occur late in the fiscal year. Second, LIFO credits are also expected to be booked mostly in the latter half of the year, so we will have substantially less than in FY '07 as we only have a remaining pharmaceutical LIFO reserve of $18 million. Third, the structure of our agreements with branded manufacturers will continue to produce some seasonality in EPS quarter to quarter and our guidance assumes that brand price inflation in fiscal 2008 will remain approximately the same as in fiscal 2007. Last, we also have always had some seasonality in our technology Solutions segment due to the seasonality in software sales. All of these items together will likely produce an EPS pattern for FY '08 heavily weighted towards the last quarter.

Moving to taxes, the guidance assumes a tax rate range of 34 to 35%, up from 33% this year, so I caution you that this may vary from quarter to quarter. Guidance range also assumes continued share repurchases to offset stock option exercises over time. diluted shares used in the calculation of earnings per share are expected to average 302 million for the year The guidance range includes all restructurings we may undertake across the Company, but our guidance does not include any potential securities litigation reserve adjustments nor are we including the impact from any new acquisitions, divestitures or any material restructurings or integration related actions. Overall, we feel great about our financial results and gotten off to a great start in fiscal 2008. Thank you, and with that, I'll turn the call over to the operator for your questions.

QUESTION AND ANSWER

Operator

Thank you, sir. (OPERATOR INSTRUCTIONS) First question comes from Tom Gallucci from Merrill Lynch. Your line is open, sir.

Tom Gallucci - ***Merrill Lynch - Analyst***

Thank you, good evening. Jeff, you got cut off a little bit on my line when you were going over, I guess Per-Se extra expenses and restructuring items and some write-off I guess related to Per-Se R&D. Would you mind repeating those just as clarification?

Jeff Campbell - ***McKesson Corporation - EVP, CFO***

Yes, I'm sorry, Tom. I guess we're having some technical challenges. Am I clear now?

Tom Gallucci - ***Merrill Lynch - Analyst***

Right now, yes.

Jeff Campbell - ***McKesson Corporation - EVP, CFO***

Okay. I think what you're referring to is when I was talking about the fourth quarter results for our MPT segment, I pointed out that there are a number of unusual items in those fourth quarter MPT results including $5 million in a pre-tax restructuring expense which was primarily for the transition of staff at Legacy NHS sites in the UK, $4 million of Per-Se cost which was the write-off of in process R&D and an asset impairment and then I just reminded people we also had $7 million in equity based compensation allocated to that segment under FAS 123R.

Tom Gallucci - ***Merrill Lynch - Analyst***

Okay, great. And then if you could, maybe discuss a little bit more on the sale side, pricing environment? I think in your comments you said relatively stable. We've got more questions around that of late. I know you renewed some very big customers during the year so if you could just expand on what you are seeing there, that would be helpful.

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

This is John, Tom. We for 175 years have dealt with sort of the competitive environments that we're in and we see the market continue to be competitive but frankly pretty stable. We actually saw our sale margins increase slightly year-over-year, and we're pleased with the renewals that we accomplished and we're pleased with the ability to continue to add value to our customer relationships. As I talked about a couple of years ago, we had a very strenuous effort to go out and retrain our salesforce on really how to sell and how to represent the value and how to deliver value for our customers on an ongoing basis and how to build lifetime relationships and I would say that that focus is paying off.

Tom Gallucci - ***Merrill Lynch - Analyst***

On the sale margin statement that it was actually up year-over-year, is that adjusted for any sort of a mix or is that just pure cell margin apples-to-apples?

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Well, there's always mix in all of our ratios and so that clearly has some mix in it, but I would say if anything, our mix is always working a little bit against us because our largest segment is probably less profitable than our slower growing smaller segments, and so we're always battling against growing our warehouse business or growing our large chain business which is frankly a drag on those ratios.

Tom Gallucci - ***Merrill Lynch - Analyst***

Okay, thank you.

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Yes.

Operator

Next question comes from Ricky Goldwasser from UBS. Your line is open, ma'am.

Ricky Goldwasser - ***UBS - Analyst***

Yes, good evening. Just a question on the strong growth that you are showing in retail generic, I think it was 40% in the quarter and 51% year-over-year. What are your expectations, what are you factoring in for fiscal year '08 and off the 51% growth that we seen in the year, what's a function off the strong product introductions that we've seen versus your just capturing share and also you talked a little bit about Health Mart and how the program, the franchise program has grown significantly since last year. Does the growth that you are seeing, did it have an impact on your drug distribution margin already in fiscal year '07 or is it going to be more kind of fiscal year '08 impact given that you have the established base? Thank you.

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Well, thank you for the question. I'll take a stab at it and clearly Jeff can jump in here. We have been focused heavily on building our generics program now for some time and believe that we've done not only a great job of building relationships with the right manufacturers and structuring contracts with those manufacturers that reflect the value that we deliver. We've done a great job I think of pulling through generic volume in our existing customer base. We have been heavily involved in basically creating value propositions for our customers, both the small independents as well as the larger customers to selective generics from us and that dual prong strategy of both working the supply side as well as the demand side of the equation for generics has paid off, as to our growth year-over-year, I think by anyone's measure we have grown faster than the market has in generics. Clearly when the market is a positive environment for us, we want to take advantage of it but I think the true testament to our success is our ability to capture growth that goes beyond just pure market growth and that's around the penetration of our customers, and that's been a big priority for us.

You mentioned Health Mart. Our Health Mart franchise has expanded rapidly and we're well over 1,000 stores starting at less than 300 or so when we began the process of revitalizing Health Mart and that pays big dividends in the margin structure and the value prop that we deliver both to the customer as well as back to the Company. We frankly are able to improve our margins while we're improving our customers operations and it's a win-win for both of us. As to our objectives for '08, I don't want to get into specifics around generics but I will tell you that our expectations would be for us to continue to grow generics faster than the overall generic growth itself, and clearly generics are growing faster than the overall pharmaceutical segment so we expect it to be another positive year for us.

Ricky Goldwasser - ***UBS - Analyst***

Okay, and then just lastly, just a quick question on Med Surg and the margin growing forward. The margins you reported was below what we were modeling potentially because some of the one-timers and restructuring, but how should we model margins for that segment going forward and when will you give us more information for the two separate segments?

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Well, as we said in the past, our focus has been on really stabilizing our alternate site position in the marketplace and frankly, our focus this year was getting the acute care transition down and making sure we had momentum in the rest of our remaining business so we were probably were not as heavily focused on-(Inaudible) that exist. Having said that though, clearly the organization is focused on taking advantage of the ever growing footprint we have in alternate site. The pull through of our private label products, the pull through of pharmaceuticals, the pull through of equipment into that customer base, and we talked in the past about that business producing a 4 to 6% kind of operating margin rate and we expect that will still be our target.

Jeff Campbell - ***McKesson Corporation - EVP, CFO***

And Ricky, in answer to your last question, we would expect to do a public filing some time in the next month or two, well before we get to the end of June quarter that will provide the historical segment data, restated to reflect the new segment definitions.

Ricky Goldwasser - ***UBS - Analyst***

Thank you.

Operator

Next question comes from Lisa Gill from JPMorgan. Your line is open.

Lisa Gill - ***JPMorgan - Analyst***

Great thanks very much and good afternoon. I was wondering if you could talk, Jeff, around the share repurchases. Are they included in the guidance that you've given, this $1 billion, first off and then secondly, when we think about the margins and the drug distribution business, if we are starting to see stabilized margins on the sell side I'm just wondering what the your expectations are around margin improvement. I think in the past you talked about something like mid to high single digit growth for those margins; is that correct?

Jeff Campbell - ***McKesson Corporation - EVP, CFO***

Well, we'll take those one at a time. On the share repurchase side, Lisa, what we have done in the guidance we've provided is that we have based it on a diluted shares calculation of 302 million for the year. Now, our expectation in terms of the pace at which we buy back shares, it will depend a little bit on market conditions. It will depend upon how our option exercises proceed over time, but to the extent that the combination of those things produces a result different than the 302, it would cause the EPS guidance to change a little bit, but that's the way we have thought about share repurchase in the guidance. On the margin side, I think, and John can chime in, what we have consistently said is when you look at the '06 to '07 experience we have what we consider a pretty extraordinary result when you put it on a like-for-like basis with the life taking LIFO out and the positive anti-trust settlements, you add 15 basis points of improvement from '06 to '07. We would not expect that kind of improvement every year but our goal in this business is to find a way to pull those margins up a little bit every single year.

Lisa Gill - ***JPMorgan - Analyst***

So that mid to high single digit I think is what you talked about in the past, Jeff, is that correct?

Jeff Campbell - ***McKesson Corporation - EVP, CFO***

Well, we try not to be that specific. That's an aggressive number I'd say.

Lisa Gill - ***JPMorgan - Analyst***

Okay.

Operator

Next question comes from George Hill from Leerink Swann. Your line is open.

George Hill - ***Leerink Swann - Analyst***

Hi, thanks for taking the question, guys. John, maybe you could just revisit these numbers. Did you say that imaging revenue grew 50% in the quarter or in the year?

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

In the year.

George Hill - ***Leerink Swann - Analyst***

Okay, and then installations were also up 30% for the year.

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Yes.

George Hill - ***Leerink Swann - Analyst***

Then if the software sales growth in the quarter was a little bit lower than we were looking for, if we kind of strip out imaging and we strip out Per-Se, was software growth negative in the quarter?

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Well, we still had software growth. I think the way we think about the software business and I've talked about this in the past, I think several years ago, we first started to experience this when we actually had a software business recovering. It was really an issue of quarterly timing and the ability to recognize revenue through implementations, so when I look at software for our segment, I think about it for the entire year, and the fact that we had a 16% increase in software revenues year on year, I think is a pretty solid result, and I would expect that business to continue to perform very well, and any one quarter we can experience kind of lumps in the business either positive or negative that may make it look something outside of the norm, but I think we are very pleased with the way we're positioned in that business and like I said I think the full year was very solid and I've been out doing some business recently with some customers and I have to tell you that I think our salesforce and our customers are as excited about our offering as I've ever seen them so I'm really very optimistic about the next fiscal year and technology and I think the Per-Se acquisition and the creation of Relay Health our connection business and the coming together of our payer software businesses with our provider software businesses will allow us to provide a more complete solution for our customers going in both directions but it will improve the efficiency and quality of the care we're trying to deliver.

George Hill - ***Leerink Swann - Analyst***

Thanks and quickly, Jeff, when you guys begin to restate, are you going to give us the same level of disclosure in the provider technology segment you give us now or continue to break out software services and hardware?

Jeff Campbell - ***McKesson Corporation - EVP, CFO***

Yes, we will certainly continue to have a break out of the revenue by the most relevant components.

George Hill - ***Leerink Swann - Analyst***

Okay, thank you.

Operator

Next question comes from Ross Muken from Deutsche Bank. Your line is open.

Ross Muken - ***Deutsche Bank - Analyst***

Hi, guys. I just want to dig into two things actually that George just brought up. On the provider business, can you talk a bit about what you're seeing in sort of the clinical and admin markets, both relative to your existing customer base and now as I guess this year you move a bit outside your traditional base in terms of new deal wins?

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Well, we are very pleased with the progress we're making with the clinical product line and as evidence of our continuing momentum in that segment, the clinical product line is really taking off and I think it is industry leading. We're now in the heavy implementation phase, which obviously allows us to begin to recognize revenue. We are also heavily developing products now for the physician marketplace which we think frankly could be as large as the hospital market, and it's heavily, or I should say it's not heavily penetrated so we're very optimistic on that front as well, and I think the ability like I said to participate in the transactions in healthcare, this moving to and from of both financial transactions as well as clinical transactions provides a whole other leg to the stool, so I feel like we're very well positioned and the market continues to be robust.

Ross Muken - ***Deutsche Bank - Analyst***

And is there any possibility you can give a little more color about some of the growth you saw in the physician market in the quarter? You pointed it out historically as being very strong the last few quarters. Has that momentum continued for you?

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Yes. I'd say the momentum in the physician market continues, albeit on a smaller scale than the rest of our provider business. Frankly, most of the healthcare IT opportunity and physicians is going to be in the smaller physician practices, which the industry is only now getting around to, so we're pretty well poised I think for that, and it allows us to take the installed base of legacy applications from Per-Se, our supply solutions medical supply product lines and our software businesses as well as our transaction business into that space and as you may recall, Per-Se was the largest provider of revenue cycle outsourcing for physician offices so yet another offering that we can bring to the physician market.

Ross Muken - ***Deutsche Bank - Analyst***

Great. Thanks, guys.

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Welcome.

Operator

Next question comes from Larry Marsh from Lehman Brothers. Your line is open, sir.

Larry Marsh - ***Lehman Brothers - Analyst***

Thanks. Good afternoon, everyone. Clarification from Jeff, I have a question for John. Jeff, are you giving us any sense of the revenue contribution from Per-Se in the quarter divided up by software, hardware, and services? I know you talked about it being in for two months, but are you being more specific?

Jeff Campbell - ***McKesson Corporation - EVP, CFO***

Well, the short answer, Larry, is no.

Larry Marsh - ***Lehman Brothers - Analyst***

Okay.

Jeff Campbell - ***McKesson Corporation - EVP, CFO***

Because we have moved really quickly and I think the management teams involved have done a great job of very quickly putting these businesses together which means you've got in some cases products on one side or the other that might have overlapped, that you're sunsetting, so I don't think you get as meaningful a number if you try to or that meaningful a number if you focus on just the legacy portions of MPT or Per-Se. All that said, if you just go look at the historical run rate of Per-Se, before we bought them, it's fair to say that the revenues were in the $100 million range for the two month period.

Larry Marsh - ***Lehman Brothers - Analyst***

Okay, and how much fell into the payer segment? You said it was sort of a small piece of obviously drug, but are you breaking out how much of that was reallocated?

Jeff Campbell - ***McKesson Corporation - EVP, CFO***

We're not. The reality is for modeling purposes most of it ends up in what has historically been our MPT segment.

Larry Marsh - ***Lehman Brothers - Analyst***

Okay, second question then just so I'm clear around clarification, restructuring of five and then the 4 million of in process R&D, I think you mentioned your fiscal '08 guidance includes some incremental restructurings. Are you referring to the things you might continue to do in Per-Se and giving a ballpark of how much that might be?

Jeff Campbell - ***McKesson Corporation - EVP, CFO***

Yes. That's a good question, Larry. What we're trying to do in the language in the press release around this was say look, there's certain small what I'd consider fairly small restructurings that are already on our horizon, most of which have to do with Per-Se. In total they are probably $0.01 or $0.02 and that's included within our guidance range. The caveat we're giving you is if we do a new acquisition or something really new and material that we haven't decided on yet comes up, it's not necessarily in the range but the stuff we know about today, all of which is pretty modest in size, will be covered within that range.

Larry Marsh - ***Lehman Brothers - Analyst***

Okay. Second, I guess major question which is sort of capital deployment, obviously the $1 billion is good, and look at your balance sheet you're still in an under levered position, John, you've talked about this sort of stair step or blended or portfolio approach in the market and it still strikes me the $1 billion is conservative. How do we think about your use of capital here in the next year?

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Well, I think we will continue to take advantage of the opportunity to deploy capital in an intelligent way to create shareholder value. We have done this as a sort of a portfolio approach as we've talked about and I think that will continue, Larry. Having said that though, we are making progress towards our target debt levels. We're up 24% which is I think a nice positive step in the right direction, and we continue to use all of the vehicles at our disposal that I think an intelligent way to get it done.

Larry Marsh - ***Lehman Brothers - Analyst***

Okay. Very good and just final clarification, is there going to be any change in reporting structure with now Med Surg up into the full distribution business or is that still going to be run separately by Brian coming up through- (Inaudible).

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

It continues to be run by Brian reporting to Paul. The pharmaceutical segment reported to Paul as well so there's no change there. We have a great management team in our payer segment that is led by Emad Risk and Emad you guys have met, reports to Paul today, and will be reporting to Pam in this new structure. Below Emad, not much change in the organization today but over time we'll look for opportunities to continue to leverage the assets of both of those great companies, our provider business and our payer business, and then I mentioned also sort of the third leg in that business called Relay Health which is the transaction machine that sits between the payer installed software and the provider installed software, so having all of those businesses clustered in the same organization with Pam will allow us I think to make a streamline decision around product development and deployment and to obviously trade products that nobody else can create. If you actually took a matrix of all of our competitors in every one of these segments, you won't find very many names across transactions, payers, and provider software businesses.

Larry Marsh - ***Lehman Brothers - Analyst***

Very good. Thank you.

Operator

Next question comes from Eric Coldwell from Robert W. Baird. Your line is open.

Eric Coldwell - ***Robert W. Baird - Analyst***

Thanks. Actually most of my questions have been asked but I again apologize. We missed a lot of the management prepared remarks. So was there any clarity on exactly where the expenses were in the medical surgical solutions group, obviously, our model could have had some errors in it but your operating margin was I think less than half of what we targeted. What were the incremental expenses in Med Surg this quarter?

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Well, I can't really speak to your target. We've been saying 4 to 6% all along in our public comments around the segment and the segment fell slightly below 4% this year, this quarter, but frankly is a rounding error in the Corporation and we were focused primarily on making sure that we were growing the alternate site business and that we were transitioning the acute care business in the proper way and if it costs us a couple of extra million dollars here and there in the transition, it was more important for us to get those other two things right from a go forward perspective. So, was the margin a little disappointing to us in Med Surg this quarter? Yes. Was it a big deal to us? Not really because our focus was in a couple of other areas.

Eric Coldwell - ***Robert W. Baird - Analyst***

John, I would, in all deference it was a fantastic quarter. We're very pleased with these results but the margin was less than 2% which is less than half of the low end of your prior range. It was more like 12 or $13 million, not a couple of million of operating expense. Could you just give any clarity on what that might have been ?

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Well, Eric, we continue to feel good and certainly have a plan for the next year to get into that range. There's a variety of both what I would call very small accounting items and as John said, frankly, some places where we made a very conscience decision so spend some more money to make the transition go smoothly, and I'm not sure there's anymore to the story really than that, John, unless you want to add anything.

Eric Coldwell - ***Robert W. Baird - Analyst***

No, and I apologize. I was talking about the full year, not about the quarters. You're right.

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

The number in the quarter was a little disappointing from that perspective, but like I said, I think there's a bunch of noise in the number and including expenses were running above the rates that we think they need to run at that we weren't going to take out until that last customer was transitioned and I want to emphasize here that these are ongoing customer relationships for us. These big hospital customers were our best, one McKesson sites, obviously we didn't have that much share so we had to have a big relationship to get the Med Surg business and there were large MPT sites and there were large pharmaceutical distribution sites and we hope to retain the business on the rest of the remaining McKesson assets after we make the transition. So the ability to really put our heads down and focus on service during a transition was a key priority and that's what we were focused on.

Eric Coldwell - ***Robert W. Baird - Analyst***

And Jeff if I could just clarify, you mentioned the 60 million in amortization of merger related intangibles on the Per-Se deal. Any tax issues there or would that translate into about $0.13 of non-cash expense that will be baked into the guidance here?

Jeff Campbell - ***McKesson Corporation - EVP, CFO***

No, I think you've got it just right.

Eric Coldwell - ***Robert W. Baird - Analyst***

Okay, great. Good job, guys. Thank you.

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Thanks.

Operator

Next question comes from Bob Willoughby with, Banc of America Securities. Your line is open.

Bob Willoughby - ***Banc of America Securities - Analyst***

You have to stop taking these questions alphabetically I think. Can you give us, John, Anything qualitative on how Per-Se did operationally in the Pharmacy arena? It's an immensely profitable business. Have you been able to expand on that or kind of a claims growth number, any luck with the enterprise RX solution at all?

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Yes, I think starting at the high level of the Per-Se acquisition, overall, as Jeff mentioned we've done a great job of rapid integration of that asset and it was broken into most of the buckets owned by Pam Pure and her team and then the pharmaceutical, pharmacy systems business managed by Paul Julian and his team. Those transitions have all gone very well and I would say in particular, the pharmacy switch business that you're talking about the transaction business continues to be a very high performing asset for us and we're very pleased with the quality of the team that we brought over. We have had a great retention of the Per-Se operating executives, and the Corporate executives that are no longer with us did a great job of transitioning their responsibilities to our McKesson corporate executives so across-the-board from Phil's team on down I couldn't be more delighted with the early on performance.

Bob Willoughby - ***Banc of America Securities - Analyst***

Any luck with any major chain stepping up and committing to the enterprise RX solution or still way off in the future?

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Well, I wouldn't say it's way off in the future, but I would say the enterprise RX software product as well as our mail order software products probably continue to need some additional investment as we get them ready to rollout on a big time big scale way, and in typical McKesson fashion, we want to make sure things are ready for primetime as they are rolled out so there are some things there that Paul and his team are doing to make sure we've got the proper resources to support these products as they're sold and to get them implemented in the right way but I'm optimistic with those platforms and as I'm sure you're aware, Bob, we are now the major provider of pharmacy software, both chain and independent and mail in the country.

Bob Willoughby - ***Banc of America Securities - Analyst***

That's great. Thank you.

John Hammergren - ***McKesson Corporation - Chairman, President, CEO***

Thank you.

Operator

Next question will come from Andy Speller from A.G. Edwards. Your line is open.

Andy Speller *- A.G. Edwards - Analyst*

Thanks. All my questions have been asked and answered but I just want to clarify on the tax in the quarter, you said you took the full year tax rate down to 33. Is that right? And then there was a $4 million benefit from something? Can you clarify what that was, please?

Jeff Campbell *- McKesson Corporation - EVP, CFO*

Yes, that's a good question, Andy. So the effective rate for the year we pulled down to 33% in this fourth quarter which of course means there's a catch up effect, as you adjust for the prior three quarters which we had been booking at 34%. In addition, we had a one-time what we would call a discrete item which was a $4 million positive settlement. Now, as we look forward to next year in the guidance we've given you a range from 34 to 35% which is really driven by the confluence of our ever changing tax position and the implementation of FIN 48 which will hit us starting in the June quarter.

Andy Speller *- A.G. Edwards - Analyst*

Thanks and just one follow-up if I could with regard to the LIFO. I'm just wondering how you were able to book such a large credit, given what you reported with generics for the year, a comment about that?

Jeff Campbell *- McKesson Corporation - EVP, CFO*

Well, remember the way to think about that LIFO charge, it's driven by the confluence of branded prices which tend to be going up over time and generic driven price deflation. So when generic price deflation is particularly strong, which it was in fiscal '07, that is actually what drives you into that larger credit position.

Andy Speller *- A.G. Edwards - Analyst*

Okay. Thanks. I thought it was reverse but okay.

John Hammergren *- McKesson Corporation - Chairman, President, CEO*

Well, thank you for that last question, Andy. I think we've completed all the questions for today. I want to thank all of you for your time and attention this morning. I apologize also for the communications problems with one of our microphones here I think. We'll get it cleared up. If you have additional questions on the content please contact Larry. We're certainly excited about McKesson's position in this growing and dynamic market. We think we are in the right markets at the right time and we have the right offerings. I couldn't be more pleased with our tremendous results in fiscal 2007 and momentum we take into fiscal 2008 and I look forward to reporting our results to you as the year progresses. So thank you again for your time and for the great questions. Larry?

Larry Kurtz *- McKesson Corporation - VP, IR*

Thanks, John. Just to wrap up here, on our upcoming activities with the financial community, on June 13, we will present at the Goldman Sachs Healthcare Conference in Dana Point, on June 21s, we will host our annual Investor Day in New York City, starting around 8:30 or 9:00 and we will send out an e-mail on that shortly with the details. We are planning to host another event for the financial community at our annual Trade Show for Independent Pharmacy so a chance to catch up on some of that pharmacy software and generics programs that have been doing so well. That will be July 8, in Boston and that's not a typo, it is a Sunday afternoon. I apologize about that but if you can make it, there's a reception that night. We hope so. And we plan to release our first quarter results for fiscal 2008 in late July. So thanks until we see you at one of those events. Goodbye, and take care.

Operator

At this time, that would conclude today's conference. You may disconnect. Thank you for your attendance.