RITE AID CORP
Form 10-Q
October 04, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended August 27, 2016

OR

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

For the transition period from to

Commission File Number: 1-5742

RITE AID CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

Not Applicable

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The registrant had 1,052,134,264 shares of its $1.00 par value common stock outstanding as of September 22, 2016.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

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

- our high level of indebtedness;
- our ability to make interest and principal payments on our debt and satisfy the other covenants contained in our credit facilities and other debt agreements;
- the continued impact of private and public third party payors reduction in prescription drug reimbursement rates and their ongoing efforts to limit access to payor networks, including mail order;
- our ability to achieve the benefits of our efforts to reduce the costs of our generic and other drugs, and our ability to achieve drug pricing efficiencies;
- the inability to complete the proposed acquisition (the Merger) of us by Walgreens Boots Alliance, Inc., a Delaware corporation (WBA), due to the failure to satisfy the remaining conditions to the completion of the Merger, including receipt of required regulatory approvals;
- the continuing effect of the pending Merger on our business relationships (including, without limitation, customers and suppliers), operating results and business generally;
- our ability to continue to improve the operating performance of our stores in accordance with our long term strategy;

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

- our ability to hire and retain qualified personnel;

- competitive pricing pressures, including aggressive promotional activity from our competitors;

- decisions to close additional stores and distribution centers or undertake additional refinancing activities (subject to the limitations in the Merger Agreement), which could result in charges to our operating statement;

- our ability to manage expenses and working capital;

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

- changes in state or federal legislation or regulations, and the continued impact from the ongoing implementation of the Patient Protection and Affordable Care Act as well as other healthcare reform;

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

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

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

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

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- the expiration or termination of our Medicare or Medicaid managed care contracts by federal or state governments and related tax matters;
- the risk that the Merger Agreement may be terminated in certain limited circumstances that require us to pay WBA a termination fee of $325 million;
- risks that the proposed Merger disrupts our current plans and operations or affects our ability to retain or recruit key employees;
- the amount of the costs, fees, expenses and charges related to the Merger Agreement or the Merger;
- risks related to the Merger diverting management s or employees attention from ongoing business operations;
- risks associated with the financing of the Merger transaction;
- the risk that our stock price may decline significantly if the Merger is not completed;
- risks related to obtaining the requisite consents to the Merger, including, without limitation, the timing (including possible delays) and expiration or termination of the applicable waiting periods under the HSR Act and other applicable antitrust laws, and the risk that such consents might not be received;
- the risk that the Merger may not be completed in a timely manner, if at all;
- risks related to other business effects, including the effects of industry, market, economic, political or regulatory conditions, future exchange or interest rates or credit ratings, changes in tax laws, regulations, rates and policies or competitive development;

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

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

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

We undertake no obligation to update or revise the forward-looking statements included in this report, whether as a result of new information, future events or otherwise, after the date of this report. Our actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. Factors that could cause or contribute to such differences are discussed in the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations included herein and in our Annual Report on Form 10-K for the fiscal year ended February 27, 2016 (the Fiscal 2016 10-K), and our Quarterly Report on Form 10-Q for the thirteen weeks ended May 28, 2016 (the First Quarter 2017 10-Q) which we filed on July 5, 2016, as well as in the Risk Factors section of the Fiscal 2016 10-K, which we filed with the SEC on April 25, 2016. These documents are available on the SEC s website at *www.sec.gov*.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

RITE AID CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

(unaudited)

	August 27, 2016	February 27, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 136,093	$ 124,471
Accounts receivable, net	1,828,641	1,601,008
Inventories, net of LIFO reserve of $1,033,907 and $1,006,396	2,827,018	2,697,104
Prepaid expenses and other current assets	146,764	128,144
Total current assets	4,938,516	4,550,727
Property, plant and equipment, net	2,281,392	2,255,398
Goodwill	1,715,479	1,713,475
Other intangibles, net	921,348	1,004,379
Deferred tax assets	1,538,604	1,539,141
Other assets	215,630	213,890
Total assets	$ 11,610,969	$ 11,277,010
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current maturities of long-term debt and lease financing obligations	$ 24,399	$ 26,848
Accounts payable	1,695,840	1,542,797
Accrued salaries, wages and other current liabilities	1,331,707	1,427,250
Total current liabilities	3,051,946	2,996,895
Long-term debt, less current maturities	7,173,656	6,914,393
Lease financing obligations, less current maturities	46,641	52,895
Other noncurrent liabilities	722,057	731,399
Total liabilities	10,994,300	10,695,582
Commitments and contingencies		
Stockholders equity:		
Common stock, par value $1 per share; 1,500,000 shares authorized; shares issued and outstanding 1,052,125 and 1,047,754	1,052,125	1,047,754
Additional paid-in capital	4,841,988	4,822,665

Accumulated deficit		(5,231,025)		(5,241,210)
Accumulated other comprehensive loss		(46,419)		(47,781)
Total stockholders equity		616,669		581,428
Total liabilities and stockholders equity	$	11,610,969	$	11,277,010

See accompanying notes to condensed consolidated financial statements.

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RITE AID CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(unaudited)

	Thirteen Week Period Ended	
	August 27, 2016	August 29, 2015
Revenues	$ 8,029,806	$ 7,664,776
Costs and expenses:		
Cost of revenues	6,113,063	5,742,485
Selling, general and administrative expenses	1,778,247	1,725,826
Lease termination and impairment charges	7,233	9,637
Interest expense	105,388	115,410
Loss on debt retirements, net		33,205
Loss on sale of assets, net	174	281
	8,004,105	7,626,844
Income before income taxes	25,701	37,932
Income tax expense	10,928	16,463
Net income	$ 14,773	$ 21,469
Computation of income attributable to common stockholders:		
Income attributable to common stockholders basic and diluted	$ 14,773	$ 21,469
Basic and diluted income per share	$ 0.01	$ 0.02

See accompanying notes to condensed consolidated financial statements.

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RITE AID CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(unaudited)

	Thirteen Week Period Ended			
	August 27, 2016		August 29, 2015	
Net income	$	14,773	$	21,469
Other comprehensive income:				
Defined benefit pension plans:				
Amortization of prior service cost, net transition obligation and net actuarial losses included in net periodic pension cost, net of $451 and $398 tax expense		681		598
Total other comprehensive income		681		598
Comprehensive income	$	15,454	$	22,067

See accompanying notes to condensed consolidated financial statements.

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RITE AID CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(unaudited)

	Twenty-Six Week Period Ended	
	August 27, 2016	August 29, 2015
Revenues	$ 16,213,987	$ 14,312,337
Costs and expenses:		
Cost of revenues	12,402,944	10,530,516
Selling, general and administrative expenses	3,571,494	3,425,411
Lease termination and impairment charges	13,014	14,659
Interest expense	210,501	239,017
Loss on debt retirements, net		33,205
Loss on sale of assets, net	1,230	320
	16,199,183	14,243,128
Income before income taxes	14,804	69,209
Income tax expense	4,619	28,904
Net income	$ 10,185	$ 40,305
Computation of income attributable to common stockholders:		
Income attributable to common stockholders basic and diluted	$ 10,185	$ 40,305
Basic and diluted income per share	$ 0.01	$ 0.04

See accompanying notes to condensed consolidated financial statements.

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RITE AID CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(unaudited)

	Twenty-Six Week Period Ended	
	August 27, 2016	August 29, 2015
Net income	$ 10,185	$ 40,305
Other comprehensive income:		
Defined benefit pension plans:		
Amortization of prior service cost, net transition obligation and net actuarial losses included in net periodic pension cost, net of $902 and $796 tax expense	1,362	1,195
Total other comprehensive income	1,362	1,195
Comprehensive income	$ 11,547	$ 41,500

See accompanying notes to condensed consolidated financial statements.

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RITE AID CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Twenty-Six Week Period Ended	
	August 27, 2016	August 29, 2015
Operating activities:		
Net income	$ 10,185	$ 40,305
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation and amortization	280,839	237,348
Lease termination and impairment charges	13,014	14,659
LIFO charge	27,511	11,973
Loss on sale of assets, net	1,230	320
Stock-based compensation expense	23,696	16,201
Loss on debt retirements, net		33,205
Changes in deferred taxes	1,998	1,574
Excess tax benefit on stock options and restricted stock	(3,248)	(20,869)
Changes in operating assets and liabilities:		
Accounts receivable	(227,255)	8,119
Inventories	(157,471)	(24,469)
Accounts payable	150,339	31,909
Other assets and liabilities, net	(107,972)	(8,703)
Net cash provided by operating activities	12,866	341,572
Investing activities:		
Payments for property, plant and equipment	(225,718)	(271,683)
Intangible assets acquired	(28,869)	(43,462)
Acquisition of businesses, net of cash acquired		(1,779,571)
Proceeds from dispositions of assets and investments	6,833	6,081
Net cash used in investing activities	(247,754)	(2,088,635)
Financing activities:		
Proceeds from issuance of long-term debt		1,800,000
Net proceeds from revolver	250,000	728,000
Principal payments on long-term debt	(11,230)	(661,217)
Change in zero balance cash accounts	534	(51,309)
Net proceeds from issuance of common stock	3,958	8,105
Financing fees paid for early debt redemption		(26,003)
Excess tax benefit on stock options and restricted stock	3,248	20,869
Deferred financing costs paid		(34,634)
Net cash provided by financing activities	246,510	1,783,811
Increase in cash and cash equivalents	11,622	36,748
Cash and cash equivalents, beginning of period	124,471	115,899
Cash and cash equivalents, end of period	$ 136,093	$ 152,647
Supplementary cash flow data:		

Cash paid for interest (net of capitalized amounts of $101 and $87, respectively)	$	199,966	$	170,053
Cash payments of income taxes, net of refunds	$	5,628	$	3,154
Equipment financed under capital leases	$	2,860	$	1,271
Equipment received for noncash consideration	$	746	$	2,011
Stock consideration issued in connection with business acquisitions	$		$	240,907
Conversion of the 8.5% convertible notes to common stock	$		$	64,089
Gross borrowings from revolver	$	1,937,000	$	2,904,000
Gross payments to revolver	$	1,687,000	$	2,176,000

See accompanying notes to condensed consolidated financial statements.

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Thirteen and Twenty-Six Week Periods Ended August 27, 2016 and August 29, 2015

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

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X and therefore do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete annual financial statements. The accompanying financial information reflects all adjustments which are of a recurring nature and, in the opinion of management, are necessary for a fair presentation of the results for the interim periods. The results of operations for the thirteen and twenty-six week periods ended August 27, 2016 are not necessarily indicative of the results to be expected for the full year. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Rite Aid Corporation (Rite Aid) and Subsidiaries (together with Rite Aid, the Company) Fiscal 2016 10-K.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers.* This ASU supersedes the revenue recognition requirements in Accounting Standards Codification 605 Revenue Recognition and most industry-specific guidance throughout the Codification. The standard requires that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This ASU is effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. The Company is in the process of assessing the impact of the adoption of ASU 2014-09 on its financial position, results of operations and cash flows.

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

In March 2016, the FASB issued ASU No. 2016-09, *Compensation Stock Compensation, (Topic 718): Improvements to Employee Share-Based Payment Accounting*, which is intended to simplify aspects of the accounting for share-based payment transactions. The ASU simplifies the accounting of stock compensation, including income tax implications, the balance sheet classification of awards as either equity or liabilities, and the cash flow classification of employee share based payment transactions. ASU No. 2016-09 is effective for fiscal years and interim periods within those years beginning December 15, 2016. Early adoption of all the amendments for ASU 2016-09 is permitted. Amendments requiring recognition of excess tax benefits and tax deficiencies in the income statement must be applied prospectively. Amendments related to the presentation of excess tax benefits on the statement of cash flows may be applied either prospectively or retrospectively based on the Company s election. Amendments related to the statement of cash flows presentation of employee taxes paid when an employer withholds shares must be applied retrospectively. The Company is in process of assessing the impact of the adoption of ASU No. 2016-09 on its financial position, results of operations and cash flows.

2. Acquisition

On June 24, 2015, the Company completed its acquisition of TPG VI Envision BL, LLC and Envision Topco Holdings, LLC (EnvisionRx), pursuant to the terms of an agreement (Agreement) dated February 10, 2015 (the Acquisition). EnvisionRx, which was a portfolio company of TPG Capital L.P. prior to its acquisition by the Company, is a full-service pharmacy services provider. EnvisionRx provides both transparent and traditional pharmacy benefit manager (PBM) service options through its EnvisionRx and MedTrak PBMs, respectively. EnvisionRx also offers fully integrated mail-order and specialty pharmacy services

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through Orchard Pharmaceutical Services; access to the nation s largest cash pay infertility discount drug program via Design Rx; an innovative claims adjudication software platform in Laker Software; and a national Medicare Part D prescription drug plan through Envision Insurance Company s (EIC) EnvisionRx Plus Silver product for the low income auto-assign market and its Clear Choice product for the chooser market. EnvisionRx is headquartered in Twinsburg, Ohio and operates as a 100 percent owned subsidiary of the Company.

Pursuant to the terms of the Agreement, as consideration for the Acquisition, the Company paid $1,882,211 in cash and issued 27,754 shares of Rite Aid common stock. The Company financed the cash portion of the Acquisition with borrowings under its Amended and Restated Senior Secured Revolving Credit Facility, and the net proceeds from the April 2, 2015 issuance of $1,800,000 aggregate principal amount of 6.125% senior notes due 2023 (the 6.125% Notes). The consideration associated with the common stock was $240,907 based on a stock price of $8.68 per share, representing the closing price of the Company s common stock on the closing date of the Acquisition.

The Company s condensed consolidated financial statements for the thirteen and twenty-six week periods ended August 27, 2016 includes EnvisionRx results of operations. The Company s condensed consolidated financial statements for the thirteen and twenty-six week periods ended August 29, 2015 include EnvisionRx results of operations from the Acquisition date of June 24, 2015 through August 29, 2015 (please see Note 13 Segment Reporting for the Pharmacy Services segment results included within the condensed consolidated financial statements for the thirteen and twenty-six week periods ended August 27, 2016 and August 29, 2015, which reflects the results of EnvisionRx). The Company s condensed consolidated financial statements reflect the final purchase accounting adjustments in accordance with ASC 805 Business Combinations , whereby the purchase price was allocated to the assets acquired and liabilities assumed based upon their estimated fair values on the Acquisition date.

The following allocation of the purchase price is final:

Final purchase price		
Cash consideration	$	1,882,211
Stock consideration		240,907
Total	$	2,123,118
Final purchase price allocation		
Cash and cash equivalents	$	103,834
Accounts receivable		892,678
Inventories		7,276
Prepaid expenses and other current assets		13,386
Total current assets		1,017,174
Property and equipment		13,196
Intangible assets(1)		646,600
Goodwill		1,639,355
Other assets		7,219
Total assets acquired		3,323,544
Accounts payable		491,672
Reinsurance funds held		381,225
Other current liabilities(2)		215,770
Total current liabilities		1,088,667
Other long term liabilities(3)		111,759
Total liabilities assumed		1,200,426
Net assets acquired	$	2,123,118

(1) Intangible assets are recorded at estimated fair value, as determined by management based on available information which includes a final valuation prepared by an independent third party. The fair values assigned to identifiable intangible assets were determined through the use of the income approach, specifically the relief from royalty and the multi-period excess earnings methods. The major assumptions used in arriving at the estimated identifiable intangible asset values included management s estimates of future cash flows, discounted at an appropriate rate of return which are based on the weighted average cost of capital for both the Company and other market participants, projected customer attrition rates, as well as applicable royalty rates for comparable assets. The useful lives for intangible assets were determined based upon the remaining useful economic lives of the intangible assets that are expected to contribute directly or indirectly to future cash flows. The estimated fair value of intangible assets and related useful lives as included in the final purchase price allocation include:

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		Estimated Fair Value	Estimated Useful Life (In Years)
Customer relationships	$	465,000	17
CMS license		57,500	25
Claims adjudication and other developed software		59,000	7
Trademarks		20,100	10
Backlog		11,500	3
Trademarks		33,500	Indefinite
Total	$	646,600	

(2) Other current liabilities includes $116,057 due to TPG under the terms of the Agreement, representing the amounts due to EnvisionRx from CMS, less corresponding amounts due to various reinsurance providers under certain reinsurance programs, for CMS activities that relate to the year ended December 31, 2014. This liability was satisfied with a payment to TPG on November 5, 2015.

(3) Primarily relates to deferred tax liabilities.

The above goodwill represents future economic benefits expected to be recognized from the Company s expansion into the pharmacy services market, as well as expected future synergies and operating efficiencies from combining operations with EnvisionRx. Goodwill resulting from the Acquisition of $1,639,355 has been allocated to the Pharmacy Services segment of which $1,368,657 is deductible for tax purposes.

During the thirteen and twenty-six week periods ended August 27, 2016, $6 of costs related to the Acquisition were expensed by the Company as incurred. During the thirteen and twenty-six weeks periods ended August 29, 2015, acquisition costs of $9,613 and $27,072, respectively, were expensed as incurred. The following unaudited pro forma combined financial data gives effect to the Acquisition as if it had occurred as of March 1, 2014.

These unaudited pro forma combined results have been prepared by combining the historical results of the Company and historical results of EnvisionRx. The unaudited pro forma condensed combined financial data for all periods presented were adjusted to give effect to pro forma events that 1) are directly attributable to the aforementioned transaction, 2) factually supportable, and 3) expected to have a continuing impact on the consolidated results of operations. Specifically, these adjustments reflect:

- Incremental interest expense relating to the $1,800,000 6.125% Notes issued on April 2, 2015, the net proceeds of which were used to finance the cash portion of the Acquisition.

- Incremental amortization resulting from increased fair value of the identifiable intangible assets as noted in the final purchase price allocation.

- Removal of costs incurred in connection with the Acquisition by both the Company and EnvisionRx, including bridge loan commitment fees of $15,375.

- Removal of interest expense incurred by EnvisionRx as the underlying debt was repaid upon the acquisition date.

- Removal of debt extinguishment charges incurred by EnvisionRx.

- Inclusion of the 27,754 shares of Rite Aid common stock issued to fund the stock portion of the purchase price in the basic and diluted share calculation.

The unaudited pro forma combined information is not necessarily indicative of what the combined company s results actually would have been had the Acquisition been completed as of the beginning of the periods as indicated. In addition, the unaudited pro forma combined information does not purport to project the future results of the combined company.

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	Thirteen week Periods Ended		Twenty-Six week Periods Ended	
	August 27, 2016 Pro forma	August 29, 2015 Pro forma	August 27, 2016 Pro forma	August 29, 2015 Pro forma
Net revenues as reported	$ 8,029,806	$ 7,664,776	$ 16,213,987	$ 14,312,337
EnvisionRx revenue, prior to the acquisition		364,159		1,735,635
Less pre-acquisition intercompany revenue		(23,777)		(104,731)
Pro forma combined revenues	$ 8,029,806	$ 8,005,158	$ 16,213,987	$ 15,943,241
Net income as reported	$ 14,773	$ 21,469	$ 10,185	$ 40,305
EnvisionRx net income (loss) before income taxes, prior to the acquisition		(56,544)		(45,307)
Incremental interest expense on the 6.125% Notes issued on April 2, 2015				(11,097)
Incremental amortization resulting from fair value adjustments of the identifiable intangible assets		(3,778)		(16,509)
Transaction costs incurred by both the Company and EnvisionRx		36,754		55,864
Debt extinguishment charges incurred by EnvisionRx		31,601		31,601
Income tax expense relating to pro forma adjustments		(3,294)		(5,966)
Pro forma net income	$ 14,773	$ 26,208	$ 10,185	$ 48,891
Basic income per share	$ 0.01	$ 0.03	$ 0.01	$ 0.05
Diluted income per share	$ 0.01	$ 0.02	$ 0.01	$ 0.05

The unaudited pro forma condensed combined financial information for the thirteen and twenty-six week periods ended August 27, 2016 is identical to the actual results reported by the Company because EnvisionRx results were included in the consolidated operations of the Company for the entire period.

3. Pending Merger

On October 27, 2015, Rite Aid entered into an Agreement and Plan of Merger (the Merger Agreement) with WBA, and Victoria Merger Sub, Inc., a Delaware corporation and a wholly owned direct subsidiary of WBA (Victoria Merger Sub). Pursuant to the terms and subject to the conditions set forth in the Merger Agreement, Victoria Merger Sub will merge with and into Rite Aid (the Merger), with Rite Aid surviving the Merger as a 100 percent owned direct subsidiary of WBA. On February 4, 2016, the proposal to adopt the Merger Agreement was approved by approximately 97% of the votes cast at the special meeting, which represented approximately 72% of the Company s total outstanding shares of common stock entitled to vote as of the record date of the special meeting. A quorum of 74% of the Company s total outstanding shares of common stock as of the record date voted at the special meeting. Completion of the Merger is subject to various closing conditions, including but not limited to (i) the expiration or earlier termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, (ii) the absence of any law or order prohibiting the Merger, and (iii) the absence of a material adverse effect on Rite Aid, as defined in the Merger Agreement. Under the terms of the Merger Agreement, at the effective time of the Merger, each share of Rite Aid s common stock, par value $1.00 per share, issued and outstanding immediately prior to the effective time (other than shares owned by (i) WBA, Victoria Merger Sub or Rite Aid (which will be cancelled), (ii) stockholders who have properly exercised and perfected appraisal rights under Delaware law, or (iii) any direct or indirect 100 percent owned subsidiary of Rite Aid or WBA (which will be converted into shares of common stock of the surviving corporation)) will be converted into the right to receive $9.00 per share in cash, without interest.

Rite Aid and WBA and Victoria Merger Sub have each made customary representations, warranties and covenants in the Merger Agreement, including, among other things, that (i) Rite Aid and its subsidiaries will continue to conduct our business in the ordinary course consistent with past practice between the execution of the Merger Agreement and the closing of the Merger and (ii) Rite Aid will not solicit proposals relating to alternative transactions to the Merger or engage in discussions or negotiations with respect thereto, subject to certain exceptions. Additionally, the Merger Agreement limits the Company s ability to incur indebtedness for borrowed money and issue additional capital stock, among other things. The Company continues to believe that the transaction will close in the second half of calendar year 2016.

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4. Income Per Share

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

	Thirteen Week Period Ended				Twenty-Six Week Period Ended			
		August 27, 2016		August 29, 2015		August 27, 2016		August 29, 2015
Numerator for income per share:								
Income attributable to common stockholders basic and diluted	$	14,773	$	21,469	$	10,185	$	40,305
Denominator:								
Basic weighted average shares		1,044,198		1,029,793		1,043,317		1,008,242
Outstanding options and restricted shares, net		17,251		19,341		17,210		18,959
Diluted weighted average shares		1,061,449		1,049,134		1,060,527		1,027,201
Basic and diluted income per share	$	0.01	$	0.02	$	0.01	$	0.04

Due to their antidilutive effect, 3,351 and 2,893 potential common shares related to stock options have been excluded from the computation of diluted income per share as of August 27, 2016 and August 29, 2015, respectively.

During the May 2015, $64,089 of the Company s 8.5% convertible notes due 2015 were converted into 24,762 shares of common stock, pursuant to their terms.

5**. Lease Termination and Impairment Charges**

Lease termination and impairment charges consist of amounts as follows:

	Thirteen Week Period Ended				Twenty-Six Week Period Ended			
		August 27, 2016		August 29, 2015		August 27, 2016		August 29, 2015
Impairment charges	$	78	$	5	$	697	$	278
Lease termination charges		7,155		9,632		12,317		14,381
	$	7,233	$	9,637	$	13,014	$	14,659

Impairment Charges

These amounts include the write-down of long-lived assets at locations that were assessed for impairment because of management s intention to relocate or close the location or because of changes in circumstances that indicated the carrying value of an asset may not be recoverable.

Lease Termination Charges

As part of the Company s ongoing business activities, the Company assesses stores and distribution centers for potential closure or relocation. Decisions to close or relocate stores or distribution centers in future periods would result in lease termination charges, lease exit costs and inventory liquidation charges, as well as impairment of assets at these locations. The following table reflects the closed store and distribution center charges that relate to new closures, changes in assumptions and interest accretion:

	Thirteen Week Period Ended		Twenty-Six Week Period Ended	
	August 27, 2016	August 29, 2015	August 27, 2016	August 29, 2015
Balance beginning of period	$ 198,990	$ 230,803	$ 208,421	$ 241,047
Provision for present value of noncancellable lease payments of closed stores	2,530	4,426	3,152	5,972
Changes in assumptions about future sublease income, terminations and changes in interest rates	1,096	1,005	1,907	434
Interest accretion	3,618	4,217	7,396	8,520
Cash payments, net of sublease income	(15,526)	(16,784)	(30,168)	(32,306)
Balance end of period	$ 190,708	$ 223,667	$ 190,708	$ 223,667

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6. Fair Value Measurements

The Company utilizes the three-level valuation hierarchy for the recognition and disclosure of fair value measurements. The categorization of assets and liabilities within this hierarchy is based upon the lowest level of input that is significant to the measurement of fair value. The three levels of the hierarchy consist of the following:

- Level 1 Inputs to the valuation methodology are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

- Level 2 Inputs to the valuation methodology are quoted prices for similar assets and liabilities in active markets, quoted prices in markets that are not active or inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the instrument.

- Level 3 Inputs to the valuation methodology are unobservable inputs based upon management s best estimate of inputs market participants could use in pricing the asset or liability at the measurement date, including assumptions about risk.

Non-Financial Assets Measured on a Non-Recurring Basis

Long-lived non-financial assets are measured at fair value on a nonrecurring basis for purposes of calculating impairment using Level 2 and Level 3 inputs as defined in the fair value hierarchy. The fair value of long-lived assets using Level 2 inputs is determined by evaluating the current economic conditions in the geographic area for similar use assets. The fair value of long-lived assets using Level 3 inputs is determined by estimating the amount and timing of net future cash flows (which are unobservable inputs) and discounting them using a risk-adjusted rate of interest (which is Level 1). The Company estimates future cash flows based on its experience and knowledge of the market in which the store is located. Significant increases or decreases in actual cash flows may result in valuation changes. During the twenty-six week period ended August 27, 2016, long-lived assets from continuing operations with a carrying value of $2,577, primarily store assets, were written down to their fair value of $1,880, resulting in an impairment charge of $697 of which $78 relates to the thirteen week period ended August 27, 2016. During the twenty-six week period ended August 29, 2015, long-lived assets from continuing operations with a carrying value of $2,193, primarily store assets, were written down to their fair value of $1,915, resulting in an impairment charge of $278 of which $5 relates to the thirteen-week period ended August 29, 2015. If our actual future cash flows differ from our projections materially, certain stores that are either not impaired or partially impaired in the current period may be further impaired in future periods.

The following table presents fair values for those assets measured at fair value on a non-recurring basis at August 27, 2016 and August 29, 2015:

Fair Value Measurement Using

	Level 1	Level 2	Level 3	Total as of August 27, 2016
Long-lived assets held for use	$	$	$ 857	$ 857
Long-lived assets held for sale	$	$ 1,023	$	$ 1,023
Total	$	$ 1,023	$ 857	$ 1,880

	Level 1	Level 2	Level 3	Total as of August 29, 2015
Long-lived assets held for use	$	$	$ 1,726	$ 1,726
Long-lived assets held for sale	$	$	$ 189	$ 189
Total	$	$	$ 1,915	$ 1,915

As of August 27, 2016 and August 29, 2015, the Company did not have any financial assets measured on a recurring basis.

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Other Financial Instruments

Financial instruments other than long-term indebtedness include cash and cash equivalents, accounts receivable and accounts payable. These instruments are recorded at book value, which we believe approximate their fair values due to their short term nature. In addition, the Company has $6,201 of investments, carried at amortized cost as these investments are being held to maturity, which are included as a component of prepaid expenses and other current assets as of August 27, 2016. The Company believes the carrying value of these investments approximates their fair value.

The fair value for LIBOR-based borrowings under the Company s senior secured credit facility and first and second lien term loans are estimated based on the quoted market price of the financial instrument which is considered Level 1 of the fair value hierarchy. The fair values of substantially all of the Company s other long-term indebtedness are estimated based on quoted market prices of the financial instruments which are considered Level 1 of the fair value hierarchy. The carrying amount and estimated fair value of the Company s total long-term indebtedness was $7,173,746 and $7,584,402, respectively, as of August 27, 2016. There were no outstanding derivative financial instruments as of August 27, 2016 and February 27, 2016.

7. Income Taxes

The Company recorded an income tax expense of $10,928 and $16,463 for the thirteen week periods ended August 27, 2016 and August 29, 2015, respectively, and an income tax expense of $4,619 and $28,904 for the twenty-six week periods ended August 27, 2016 and August 29, 2015, respectively. The income tax expense for the thirteen weeks ended August 27, 2016 and August 29, 2015 was based on an estimated effective tax rate of 42.5% and 43.4%, respectively. The income tax expense for the twenty-six week periods ended August 27, 2016 and August 29, 2015 was based on an estimated effective tax rate of 31.2% and 41.8%, respectively. The lower effective income tax expense rate for the twenty-six week period ended August 27, 2016 is the result of a discrete income tax benefit recorded for the lapse of a statute of limitations on an uncertain tax position which lowered the Company s effective income tax expense rate by 8.9%.

The Company recognizes tax liabilities in accordance with the guidance for uncertain tax positions and management adjusts these liabilities with changes in judgment as a result of the evaluation of new information not previously available. Due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from the current estimate of the tax liabilities.

While it is expected that the amount of unrecognized tax benefits will change in the next twelve months, the Company does not expect the change to have a significant impact on the results of operations or the financial position of the Company.

The Company regularly evaluates valuation allowances established for deferred tax assets for which future realization is uncertain. Management will continue to monitor all available evidence related to the net deferred tax assets that may change the most recent assessment, including events that have occurred or are anticipated to occur. The Company continues to maintain a valuation allowance against net deferred tax assets of $211,919 and $212,023, which relates primarily to state deferred tax assets at August 27, 2016 and February 27, 2016, respectively.

8. Medicare Part D

The Company offers Medicare Part D benefits through EIC, which has contracted with CMS to be a Prescription Drug Plan (PDP) and, pursuant to the Medicare Prescription Drug, Improvement and Modernization Act of 2003, must be a risk-bearing entity regulated under state insurance laws or similar statutes.

EIC is a licensed domestic insurance company under the applicable laws and regulations. Pursuant to these laws and regulations, EIC must file quarterly and annual reports with the National Association of Insurance Commissioners (NAIC) and certain state regulators, must maintain certain minimum amounts of capital and surplus under formulas established by certain states and must, in certain circumstances, request and receive the approval of certain state regulators before making dividend payments or other capital distributions to the Company. The Company does not believe these limitations on dividends and distributions materially impact its financial position. EIC is subject to minimum capital and surplus requirements in certain states. The minimum amount of capital and surplus required to satisfy regulatory requirements in these states is $26,618 as of June 30, 2016. EIC was in excess of the minimum required amounts in these states as of August 27, 2016.

The Company has recorded estimates of various assets and liabilities arising from its participation in the Medicare Part D program based on information in its claims management and enrollment systems. Significant estimates arising from its participation in this program include: (i) estimates of low-income cost subsidies, reinsurance amounts, and coverage gap discount amounts ultimately payable to CMS based on a detailed claims reconciliation that will occur in the following year; (ii) an estimate of amounts receivable from CMS under a risk-sharing feature of the Medicare Part D program design, referred to as the risk corridor and (iii) estimates for

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claims that have been reported and are in the process of being paid or contested and for our estimate of claims that have been incurred but have not yet been reported.

As of August 27, 2016, accounts receivable, net included $379,533 due from CMS and accrued salaries, wages and other current liabilities included $179,765 of EIC liabilities under certain reinsurance contracts. As of February 27, 2016, accounts receivable, net included $275,032 due from CMS and accrued salaries, wages and other current liabilities included $166,238 of EIC liabilities under certain reinsurance contracts. EIC limits its exposure to loss and recovers a portion of benefits paid by utilizing quota-share reinsurance with a commercial reinsurance company.

9. Goodwill and Other Intangible Assets

Goodwill and indefinitely-lived assets, such as certain trademarks acquired in connection with acquisition transactions, are not amortized, but are instead evaluated for impairment on an annual basis at the end of the fiscal year, or more frequently if events or circumstances indicate that impairment may be more likely. During the thirteen and twenty-six week periods ended August 27, 2016 and the fifty-two week period ended February 27, 2016, no impairment charges have been taken against the Company s goodwill or indefinitely-lived intangible assets. Below is a summary of the changes in the carrying amount of goodwill for the twenty-six week period ended August 27, 2016:

		August 27, 2016	
	Retail Pharmacy	**Pharmacy Services**	**Total**
Balance, February 27, 2016	$ 76,124	$ 1,637,351	$ 1,713,475
Acquisition (see Note 2. Acquisition)			
Change in goodwill resulting from changes to the final purchase price allocation		2,004	2,004
Balance, August 27, 2016	$ 76,124	$ 1,639,355	$ 1,715,479

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The Company s intangible assets are finite-lived and amortized over their useful lives. Following is a summary of the Company s finite-lived and indefinitely-lived intangible assets as of August 27, 2016 and February 27, 2016.

	August 27, 2016				February 27, 2016			
	Gross Carrying Amount	Accumulated Amortization	Net	Remaining Weighted Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net	Remaining Weighted Average Amortization Period
Favorable leases and other	$ 667,119	$ (522,417)	$ 144,702	7 years	$ 665,197	$ (507,776)	$ 157,421	8 years
Prescription files	1,564,559	(1,338,015)	226,544	3 years	1,541,518	(1,285,633)	255,885	3 years
Customer relationships(a)	465,000	(77,085)	387,915	16 years	465,000	(44,203)	420,797	17 years
CMS license	57,500	(2,722)	54,778	24 years	57,500	(1,572)	55,928	25 years
Claims adjudication and other developed software	59,197	(9,973)	49,224	6 years	59,000	(5,760)	53,240	7 years
Trademarks	20,100	(2,379)	17,721	9 years	20,100	(1,373)	18,727	10 years
Backlog	11,500	(4,536)	6,964	2 years	11,500	(2,619)	8,881	3 years
Total finite	$ 2,844,975	$ (1,957,127)	887,848		$ 2,819,815	$ (1,848,936)	970,879	
Trademarks	33,500		33,500	Indefinite	33,500		33,500	Indefinite
Total	$ 2,878,475	$ (1,957,127)	$ 921,348		$ 2,853,315	$ (1,848,936)	$ 1,004,379	

(a) Amortized on an accelerated basis which is determined based on the remaining useful economic lives of the customer relationships that are expected to contribute directly or indirectly to future cash flows.

Also included in other non-current liabilities as of August 27, 2016 and February 27, 2016 are unfavorable lease intangibles with a net carrying amount of $43,746 and $46,947, respectively. These intangible liabilities are amortized over their remaining lease terms at the time of acquisition.

Amortization expense for these intangible assets and liabilities was $55,409 and $110,912 for the thirteen and twenty-six week periods ended August 27, 2016, respectively. Amortization expense for these intangible assets and liabilities was $48,609 and $80,550 for the thirteen and twenty-six week periods ended August 29, 2015, respectively. The anticipated annual amortization expense for these intangible assets and liabilities is 2017 $216,319; 2018 $174,705; 2019 $137,295; 2020 $107,707 and 2021 $74,994.

10. Indebtedness and Credit Agreements

Following is a summary of indebtedness and lease financing obligations at August 27, 2016 and February 27, 2016:

	August 27, 2016	February 27, 2016

Secured Debt:		
Senior secured revolving credit facility due January 2020 ($2,350,000 and $2,100,000 face value less unamortized debt issuance costs of $29,495 and $33,903)	$ 2,320,505	$ 2,066,097
Tranche 1 Term Loan (second lien) due August 2020 ($470,000 face value less unamortized debt issuance costs of $4,802 and $5,414)	465,198	464,586
Tranche 2 Term Loan (second lien) due June 2021 ($500,000 face value less unamortized debt issuance costs of $2,725 and $3,007)	497,275	496,993
Other secured	90	90
	3,283,068	3,027,766
Guaranteed Unsecured Debt:		
9.25% senior notes due March 2020 ($902,000 face value plus unamortized premium of $2,407 and $2,743 and less unamortized debt issuance costs of $8,878 and $10,180)	895,529	894,563
6.75% senior notes due June 2021 ($810,000 face value less unamortized debt issuance costs of $7,130 and $7,872)	802,870	802,128
6.125% senior notes due April 2023 ($1,800,000 face value less unamortized debt issuance costs of $28,205 and $30,343)	1,771,795	1,769,657
	3,470,194	3,466,348

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	August 27, 2016	February 27, 2016
Unguaranteed Unsecured Debt:		
7.7% notes due February 2027 ($295,000 face value less unamortized debt issuance costs of $1,711 and $1,794)	293,289	293,206
6.875% fixed-rate senior notes due December 2028 ($128,000 face value less unamortized debt issuance costs of $805 and $837)	127,195	127,163
	420,484	420,369
Lease financing obligations	70,950	79,653
Total debt	7,244,696	6,994,136
Current maturities of long-term debt and lease financing obligations	(24,399)	(26,848)
Long-term debt and lease financing obligations, less current maturities	$ 7,220,297	$ 6,967,288

Credit Facility

The Company s senior secured credit facility (Amended and Restated Senior Secured Credit Facility or revolver) has a borrowing capacity of $3,700,000 and matures in January 2020. Borrowings under the revolver bear interest at a rate per annum between (i) LIBOR plus 1.50% and LIBOR plus 2.00% with respect to Eurodollar borrowings and (ii) the alternate base rate plus 0.50% and the alternate base rate plus 1.00% with respect to ABR borrowings, in each case, based upon the average revolver availability (as defined in the Amended and Restated Senior Secured Credit Facility). The Company is required to pay fees between 0.250% and 0.375% per annum on the daily unused amount of the revolver, depending on the Average Revolver Availability (as defined in the Amended and Restated Senior Secured Credit Facility). Amounts drawn under the revolver become due and payable on January 13, 2020.

The Company s ability to borrow under the revolver is based upon a specified borrowing base consisting of accounts receivable, inventory and prescription files. At August 27, 2016, the Company had $2,350,000 of borrowings outstanding under the revolver and had letters of credit outstanding against the revolver of $67,787, which resulted in additional borrowing capacity of $1,282,213. The Merger Agreement contains a requirement that the Company s borrowings under the revolver not exceed $3,000,000 in the aggregate immediately prior to the closing of the Merger.

The Amended and Restated Senior Secured Credit Facility restricts the Company and the Subsidiary Guarantors (as defined herein) from accumulating cash on hand, and under certain circumstances, requires the funds in the Company s deposit accounts to be applied first to the repayment of outstanding revolving loans under the Amended and Restated Senior Secured Credit Facility and then to be held as collateral for the senior obligations.

The Amended and Restated Senior Secured Credit Facility allows the Company to have outstanding, at any time, up to $1,500,000 in secured second priority debt, split-priority term loan debt, unsecured debt and disqualified preferred stock in addition to borrowings under the Amended and Restated Senior Secured Credit Facility and existing indebtedness, provided that not in excess of $750,000 of such secured second priority debt, split-priority term loan debt, unsecured debt and disqualified preferred stock shall mature or require scheduled payments of principal prior to 90 days after the latest of (a) the fifth anniversary of the effectiveness of the Amended and Restated Senior Secured Credit Facility and (b) the latest maturity date of any Term Loan or Other Revolving Loan (each as defined in the Amended and Restated Senior Secured Credit Facility) (excluding bridge facilities allowing extensions on customary terms to at least the date that is 90 days after such date and, with respect to any escrow notes issued by Rite Aid, excluding any special mandatory redemption of the type described in clause (iii) of the definition of Escrow Notes in the Amended and Restated Senior Secured Credit Facility). Subject to the limitations described in clauses (a) and (b) of the immediately preceding sentence, the Amended and Restated Senior Secured Credit Facility additionally allows the Company to issue or incur an unlimited amount of unsecured debt and disqualified preferred stock so long as a Financial Covenant Effectiveness Period (as defined in the Amended and Restated Senior Secured Credit Facility) is not in effect; provided, however, that certain of the Company s other outstanding indebtedness limits the amount of unsecured debt that can be incurred if certain interest coverage levels are not met at the time of incurrence or other exemptions are not available. The Amended and Restated Senior Secured Credit Facility also contains certain restrictions on the amount of secured first priority debt the Company is able to incur. The Amended and Restated Senior Secured Credit Facility also allows for the voluntary repurchase of any debt or other convertible debt, so long as the Amended and Restated Senior Secured Credit Facility is not in default and the Company maintains availability under its revolving credit facility of more than $365,000.

The Amended and Restated Senior Secured Credit Facility has a financial covenant that requires the Company to maintain a minimum fixed charge coverage ratio of 1.00 to 1.00 (a) on any date on which availability under the revolving credit facility is less than $200,000 or (b) on the third consecutive business day on which availability under the revolving credit facility is less than $250,000 and, in each case, ending on and excluding the first day thereafter, if any, which is the 30th consecutive calendar day on which availability under the revolving credit facility is equal to or greater than $250,000. As of August 27, 2016, the availability was

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at a level that did not trigger this covenant. The Amended and Restated Senior Secured Credit Facility also contains covenants which place restrictions on the incurrence of debt, the payments of dividends, sale of assets, mergers and acquisitions and the granting of liens.

The Amended and Restated Senior Secured Credit Facility also provides for customary events of default.

The Company also has two second priority secured term loan facilities. The first includes a $470,000 second priority secured term loan (the Tranche 1 Term Loan). The Tranche 1 Term Loan matures on August 21, 2020 and currently bears interest at a rate per annum equal to LIBOR plus 4.75% with a LIBOR floor of 1.00%, if the Company chooses to make LIBOR borrowings, or at Citibank s base rate plus 3.75%. The second includes a $500,000 second priority secured term loan (the Tranche 2 Term Loan). The Tranche 2 Term Loan matures on June 21, 2021 and currently bears interest at a rate per annum equal to LIBOR plus 3.875% with a LIBOR floor of 1.00%, if the Company chooses to make LIBOR borrowings, or at Citibank s base rate plus 2.875%.

With the exception of EIC, substantially all of Rite Aid Corporation s 100 percent owned subsidiaries guarantee the obligations under the Amended and Restated Senior Secured Credit Facility, second priority secured term loan facilities, and unsecured guaranteed notes. The Amended and Restated Senior Secured Credit Facility and second priority secured term loan facilities are secured, on a senior or second priority basis, as applicable, by a lien on, among other things, accounts receivable, inventory and prescription files of the Subsidiary Guarantors. The subsidiary guarantees related to the Company s Amended and Restated Senior Secured Credit Facility and second priority secured term loan facilities and, on an unsecured basis, the unsecured guaranteed notes, are full and unconditional and joint and several, and there are no restrictions on the ability of the Company to obtain funds from its subsidiaries. The Company has no independent assets or operations. Additionally, prior to the Acquisition, the subsidiaries, including joint ventures, that did not guarantee the Amended and Restated Senior Secured Credit Facility, the credit facility, second priority secured term loan facilities and applicable notes, were minor. Accordingly, condensed consolidating financial information for the Company and subsidiaries is not presented for those periods. Subsequent to the Acquisition, other than EIC, the subsidiaries, including joint ventures, that do not guarantee the credit facility, second priority secured term loan facilities and applicable notes, are minor. As such, condensed consolidating financial information for the Company, its guaranteeing subsidiaries and non-guaranteeing subsidiaries is presented for those periods subsequent to the Acquisition. See Note 16 Guarantor and Non-Guarantor Condensed Consolidating Financial Information for additional disclosure.

Other Transactions

On April 2, 2015, the Company issued $1,800,000 aggregate principal amount of its 6.125% Notes, the net proceeds of which, along with other available cash and borrowings under its Amended and Restated Senior Secured Credit Facility, were used to finance the cash portion of the Acquisition. The Company s obligations under the notes are fully and unconditionally guaranteed, jointly and severally, on an unsubordinated basis, by all of its subsidiaries that guarantee the Company s obligations under the Amended and Restated Senior Secured Credit Facility, second priority secured term loan facilities, the 9.25% senior notes due 2020 (the 9.25% Notes) and the 6.75% senior notes due 2021 (the 6.75% Notes) (the Rite Aid Subsidiary Guarantors), including EnvisionRx and certain of its domestic subsidiaries other than, among others, EIC (the EnvisionRx Subsidiary Guarantors and, together with the Rite Aid Subsidiary Guarantors, the Subsidiary Guarantors). The guarantees are unsecured. The 6.125% Notes are unsecured, unsubordinated obligations of Rite Aid Corporation and rank equally in right of payment with all of its other unsecured, unsubordinated indebtedness.

During May 2015, $64,089 of the Company s 8.5% convertible notes due 2015 were converted into 24,762 shares of common stock, pursuant to their terms. The remaining $79 of the Company s 8.5% convertible notes due 2015 were repaid by the Company upon maturity.

On August 15, 2015, the Company completed the redemption of all of its outstanding $650,000 aggregate principal amount of its 8.00% Notes. In connection with the redemption, the Company recorded a loss on debt retirement, including call premium and unamortized debt issue costs, of $33,205 during the second quarter of fiscal 2016.

Maturities

The aggregate annual principal payments of long-term debt for the remainder of fiscal 2017 and thereafter are as follows: 2017 $90; 2018 $0; 2019 $0; 2020 $2,350,000; 2021 $1,372,000 and $3,533,000 thereafter.

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11. Stock Options and Stock Awards

The Company recognizes share-based compensation expense over the requisite service period of the award, net of an estimate for the impact of forfeitures. Operating results for the twenty-six week periods ended August 27, 2016 and August 29, 2015 include $23,696 and $16,201, respectively, of compensation costs related to the Company s stock-based compensation arrangements.

Beginning in fiscal 2015, the Company provided certain of its associates with performance based incentive plans under which the associates will receive a certain number of shares of the Company s common stock based on the Company meeting certain financial and performance goals. During the twenty-six week periods ended August 27, 2016 and August 29, 2015, the Company incurred $9,112 and $4,413 related to these performance based incentive plans, respectively, which is recorded as a component of stock-based compensation expense.

The total number and type of newly awarded grants and the related weighted average fair value for the twenty-six week periods ended August 27, 2016 and August 29, 2015 are as follows:

	August 27, 2016		August 29, 2015	
	Shares	**Weighted Average Fair Value**	**Shares**	**Weighted Average Fair Value**
Stock options granted		$ N/A	3,647	$ 4.45
Restricted stock awards granted	3,613	$ 7.73	2,177	$ 8.68
Total awards	3,613		5,824	

Typically, stock options granted vest, and are subsequently exercisable in equal annual installments over a four-year period for employees. Restricted stock awards typically vest in equal annual installments over a three-year period.

The Company calculates the fair value of stock options using the Black- Scholes-Merton option pricing model. The following assumptions were used in the Black-Scholes-Merton option pricing model:

	Twenty-Six Week Period Ended	
	August 27, 2016	**August 29, 2015**
Expected stock price volatility	N/A	56%
Expected dividend yield	N/A	0%
Risk-free interest rate	N/A	1.7%
Expected option life	N/A	5.5 years

As of August 27, 2016, the total unrecognized pre-tax compensation costs related to unvested stock options and restricted stock awards granted, net of estimated forfeitures and the weighted average period of cost amortization are as follows:

	August 27, 2016 Unvested stock options		August 27, 2016 Unvested restricted stock		August 27, 2016 Unvested performance shares	
Unrecognized pre-tax costs	$	17,016	$	42,851	$	34,076
Weighted average amortization period		2.3 years		2.3 years		1.9 years

12. Reclassifications from Accumulated Other Comprehensive Loss

The following table summarizes the components of accumulated other comprehensive loss and the changes in balances of each component of accumulated other comprehensive loss, net of tax as applicable, for the thirteen and twenty-six week periods ended August 27, 2016 and August 29, 2015:

	Thirteen Week Period Ended August 27, 2016		Thirteen Week Period Ended August 29, 2015		Twenty-Six Week Period Ended August 27, 2016		Twenty-Six Week Period Ended August 29, 2015	
	Defined benefit pension plans	Accumulated other comprehensive loss	Defined benefit pension plans	Accumulated other comprehensive loss	Defined benefit pension plans	Accumulated other comprehensive loss	Defined benefit pension plans	Accumulated other comprehensive loss
Accumulated other comprehensive loss								
Balance-beginning of period	$ (47,100)	$ (47,100)	$ (45,253)	$ (45,253)	$ (47,781)	$ (47,781)	$ (45,850)	$ (45,850)
Amounts reclassified from accumulated other comprehensive loss to net income, net of $451, $398, $902, and $796 tax expense	681	681	598	598	1,362	1,362	1,195	1,195
Balance-end of period	$ (46,419)	$ (46,419)	$ (44,655)	$ (44,655)	$ (46,419)	$ (46,419)	$ (44,655)	$ (44,655)

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The following table summarizes the effects on net income of significant amounts classified out of each component of accumulated other comprehensive loss for the thirteen and twenty-six week periods ended August 27, 2016 and August 29, 2015:

Thirteen Week Periods Ended August 27, 2016 and August 29, 2015			
	Amount reclassified from accumulated other comprehensive loss		
Details about accumulated other comprehensive loss components	**August 27, 2016**	**August 29, 2015**	**Affected line item in the condensed consolidated statements of operations**
Defined benefit pension plans			
Amortization of unrecognized prior service cost(a)	$	$ (18)	Selling, general and administrative expenses
Amortization of unrecognized net loss(a)	(1,132)	(978)	Selling, general and administrative expenses
	(1,132)	(996)	Total before income tax expense
	451	398	Income tax expense
	$ (681)	$ (598)	Net of income tax expense

Twenty-Six Week Periods Ended August 27, 2016 and August 29, 2015			
	Amount reclassified from accumulated other comprehensive loss		
Details about accumulated other comprehensive loss components	**August 27, 2016**	**August 29, 2015**	**Affected line item in the condensed consolidated statements of operations**
Defined benefit pension plans			
Amortization of unrecognized prior service cost(a)	$	$ (34)	Selling, general and administrative expenses
Amortization of unrecognized net loss(a)	(2,264)	(1,957)	Selling, general and administrative expenses
	(2,264)	(1,991)	Total before income tax expense
	902	796	Income tax expense
	$ (1,362)	$ (1,195)	Net of income tax expense

(a) See Note 13, Retirement Plans for additional details.

13. Retirement Plans

Net periodic pension expense recorded in the thirteen and twenty-six week periods ended August 27, 2016 and August 29, 2015, for the Company s defined benefit plans includes the following components:

	Defined Benefit Pension Plan	Nonqualified Executive Retirement Plans	Defined Benefit Pension Plan	Nonqualified Executive Retirement Plans
	Thirteen Week Period Ended		Twenty-Six Week Period Ended	

	August 27, 2016	August 29, 2015	August 27, 2016	August 29, 2015	August 27, 2016	August 29, 2015	August 27, 2016	August 29, 2015
Service cost	$ 292	$ 513	$	$	$ 584	$ 1,025	$	$
Interest cost	1,621	1,634	109	119	3,242	3,267	218	237
Expected return on plan assets	(1,142)	(1,593)			(2,284)	(3,186)		
Amortization of unrecognized prior service cost		18				34		
Amortization of unrecognized net loss	1,132	978			2,264	1,957		
Net pension expense	$ 1,903	$ 1,550	$ 109	$ 119	$ 3,806	$ 3,097	$ 218	$ 237

During the thirteen and twenty-six week periods ended August 27, 2016 the Company contributed $387 and $749, respectively, to the Nonqualified Executive Retirement Plans and $0 to the Defined Benefit Pension Plan. During the remainder of

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fiscal 2017, the Company expects to contribute $754 to the Nonqualified Executive Retirement Plans and $0 to the Defined Benefit Pension Plan.

14. Segment Reporting

Prior to June 24, 2015, the Company s operations were within one reportable segment. As a result of the completion of the Acquisition, the Company has realigned its internal management reporting to reflect two reportable segments, its retail drug stores (Retail Pharmacy), and its pharmacy services (Pharmacy Services) segments.

The Retail Pharmacy segment s primary business is the sale of prescription drugs and related consultation to its customers. Additionally, the Retail Pharmacy segment sells a full selection of health and beauty aids and personal care products, seasonal merchandise and a large private brand product line. The Pharmacy Services segment offers a full range of pharmacy benefit management services including plan design and administration, on both a transparent pass-through model and traditional model, formulary management and claims processing. Additionally, the Pharmacy Services segment offers specialty and mail order services, infertility treatment, and drug benefits to eligible beneficiaries under the federal government s Medicare Part D program.

The Parent Company s chief operating decision makers are its Parent Company Chief Executive Officer, Parent Company President and CEO Retail Pharmacy, CEO Pharmacy Services, Chief Financial Officer and its Senior Executive Vice Presidents (collectively the CODM). The CODM has ultimate responsibility for enterprise decisions. The CODM determines, in particular, resource allocation for, and monitors performance of, the consolidated enterprise, the Retail Pharmacy segment and the Pharmacy Services segment. The Retail Pharmacy and Pharmacy Services segment managers have responsibility for operating decisions, allocating resources and assessing performance within their respective segments. The CODM relies on internal management reporting that analyzes enterprise results on certain key performance indicators, namely, revenues, gross profit, and Adjusted EBITDA.

The following table is a reconciliation of the Company s business segments to the condensed consolidated financial statements for the thirteen and twenty-six week periods ended August 27, 2016 and August 29, 2015:

	Retail Pharmacy	Pharmacy Services	Intersegment Eliminations (1)	Consolidated
Thirteen Week Period Ended				
August 27, 2016:				
Revenues	$ 6,485,482	$ 1,634,876	$ (90,552)	$ 8,029,806
Gross Profit	1,819,349	97,394		1,916,743
Adjusted EBITDA(2)	262,643	50,010		312,653
August 29, 2015:				
Revenues	$ 6,647,243	$ 1,071,889	$ (54,356)	$ 7,664,776
Gross Profit	1,860,513	61,778		1,922,291
Adjusted EBITDA(2)	313,602	33,222		346,824
Twenty-Six Week Period Ended				
August 27, 2016:				
Revenues	$ 13,161,030	$ 3,237,235	$ (184,278)	$ 16,213,987
Gross Profit	3,624,716	186,327		3,811,043

Adjusted EBITDA(2)		507,470		91,185				598,655
August 29, 2015:								
Revenues	$	13,294,804	$	1,071,889	$	(54,356)	$	14,312,337
Gross Profit		3,720,043		61,778				3,781,821
Adjusted EBITDA(2)		612,865		33,222				646,087

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(1) Intersegment eliminations include intersegment revenues and corresponding cost of revenues that occur when Pharmacy Services segment customers use Retail Pharmacy segment stores to purchase covered products. When this occurs, both the Retail Pharmacy and Pharmacy Services segments record the revenue on a stand-alone basis.

(2) See Adjusted EBITDA, Adjusted Net Income, Adjusted Net Income per Diluted Share and Other Non-GAAP Measures in MD&A for additional details.

The following is a reconciliation of net income to Adjusted EBITDA for the thirteen and twenty-six week periods ended August 27, 2016 and August 29, 2015:

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	Thirteen Week Period Ended		Twenty-Six Week Period Ended	
	August 27, 2016	August 29, 2015	August 27, 2016	August 29, 2015
	(dollars in thousands)			
Net income	$ 14,773	$ 21,469	$ 10,185	$ 40,305
Interest expense	105,388	115,410	210,501	239,017
Income tax expense	10,928	16,463	4,619	28,904
Depreciation and amortization expense	142,051	127,699	280,839	237,348
LIFO charge	13,760	5,986	27,511	11,973
Lease termination and impairment charges	7,233	9,637	13,014	14,659
Loss on debt retirements, net		33,205		33,205
Other	18,520	16,955	51,986	40,676
Adjusted EBITDA	$ 312,653	$ 346,824	$ 598,655	$ 646,087

The following is balance sheet information for the Company s reportable segments:

	Retail Pharmacy	Pharmacy Services	Eliminations (2)	Consolidated
August 27, 2016:				
Total Assets	$ 8,703,457	$ 3,049,163	$ (141,651)	$ 11,610,969
Goodwill	76,124	1,639,355		1,715,479
Additions to property and equipment and intangible assets	248,477	6,110		254,587
February 27, 2016:				
Total Assets	$ 8,468,186	$ 2,948,548	$ (139,724)	$ 11,277,010
Goodwill	76,124	1,637,351		1,713,475
Additions to property and equipment and intangible assets	667,719	2,276		669,995

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(2) As of August 27, 2016 and February 27, 2016, intersegment eliminations include netting of the Pharmacy Services segment long-term deferred tax liability of $122,070 and $116,027, respectively, against the Retail Pharmacy segment long-term deferred tax asset for consolidation purposes in accordance with ASC 740, and intersegment accounts receivable of $19,581 and $23,697, respectively, that represents amounts owed from the Pharmacy Services segment to the Retail Pharmacy segment that are created when Pharmacy Services segment customers use Retail Pharmacy segment stores to purchase covered products.

15. Commitments and Contingencies

Legal Matters

The Company is a party to legal proceedings, investigations and claims in the ordinary course of its business, including the matters described below. The Company records accruals for outstanding legal matters when it believes it is probable that a loss will be incurred and the amount can be reasonably estimated. The Company evaluates, on a quarterly basis, developments in legal matters that could affect the amount of any accrual and developments that would make a loss contingency both probable and reasonably estimable. If a loss contingency is not both probable and estimable, the Company does not establish an accrued liability.

The Company s contingencies are subject to significant uncertainties, including, among other factors: (i) proceedings are in early stages; (ii) whether class or collective action status is sought and the likelihood of a class being certified; (iii) the outcome of pending appeals or motions; (iv) the extent of potential damages, fines or penalties, which are often unspecified or indeterminate; (v) the impact of discovery on the matter; (vi) whether novel or unsettled legal theories are at issue; (vii) there are significant factual issues to be resolved; and/or (viii) in the case of certain government agency investigations, whether a sealed qui tam lawsuit (whistleblower action) has been filed and whether the government agency makes a decision to intervene in the lawsuit following investigation.

As of August 27, 2016, the Company was aware of ten (10) putative class action lawsuits that were filed by purported Company stockholders, against the Company, its directors (the Individual Defendants, together with the Company, the Rite Aid Defendants), Walgreens Boots Alliance, Inc. (WBA) and Victoria Merger Sub Inc., (Victoria) challenging the transactions contemplated by the Merger agreement between the Company and WBA. Eight (8) of these actions were filed in the Court of Chancery of the State of Delaware (*Smukler v. Rite Aid Corp., et al.*, *Hirschler v. Standley, et al.*, *Catelli v. Rite Aid Corp., et al.*, *Orr v. Rite Aid Corp., et al.*, *DePietro v. Standley, et al.*, *Abadi v. Rite Aid Corp., et al.*, *Mortman v. Rite Aid Corp., et al.*). One (1) action

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was filed in Pennsylvania in the Court of Common Pleas of Cumberland County (*Wilson v. Rite Aid Corp., et al.*, *Sachs Investment Grp., et al. v. Standley, et al.*). The complaints in these nine (9) actions alleged primarily that the Company s directors breached their fiduciary duties by, among other things, agreeing to an allegedly unfair and inadequate price, agreeing to deal protection devices that allegedly prevented the directors from obtaining higher offers from other interested buyers for the Company and allegedly failing to protect against certain purported conflicts of interest in connection with the Merger. The Complaints further allege that the Company, WBA and/or Victoria aided and abetted these alleged breaches of fiduciary duty. The complaints sought, among other things, to enjoin the closing of the Merger as well as money damages and attorneys and experts fees.

On December 23, 2015, the eight (8) Delaware actions were consolidated in an action captioned *In re Rite Aid Corporation Stockholders Litigation,* Consol. C.A. No. 11663-CB (the Consolidated Action). In addition to the claims asserted in the nine (9) complaints discussed above, the operative pleading in the Consolidated Action also included allegations that the preliminary proxy statement contained material omissions, including with respect to the process that resulted in the Merger agreement and the fairness opinion rendered by the Company s banker. On December 28, 2015, the plaintiffs in the Consolidated Action filed a motion for expedited proceedings, which the Court orally denied at a hearing held on January 5, 2016. On March 11, 2016, the Court granted the plaintiffs notice and proposed order voluntarily dismissing the Consolidated Action as moot, while retaining jurisdiction solely for the purpose of adjudicating plaintiffs counsel s anticipated application for an award of attorneys fees and reimbursement of expenses. On April 15, 2016, the Company reached a settlement in principle related to this matter for an immaterial amount and on May 11, 2016, the Court entered a stipulated order regarding notice of payment thereof and final dismissal of this matter.

A tenth action was filed in the United States District Court for the Middle District of Pennsylvania (the Pennsylvania District Court), asserting a claim for violations of Section 14(a) of the Exchange Act and SEC Rule 14a-9 against all defendants and a claim for violations of Section 20(a) of the Exchange Act against the Individual Defendants and WBA (*Herring v. Rite Aid Corp., et al.*). The *Herring* complaint alleges, among other things, that Rite Aid and its Board of Directors disseminated an allegedly false and materially misleading proxy. The complaint sought to enjoin the shareholder vote on the proposed Merger, a declaration that the proxy was materially false and misleading in violation of federal securities laws, and an award of money damages and attorneys and experts fees. On January 14 and 16, 2016, respectively, the plaintiff in the Herring action filed a motion for preliminary injunction and a motion for expedited discovery. On January 21, 2016, the Rite Aid Defendants filed a motion to dismiss the Herring complaint. At a hearing held on January 25, 2016, the Pennsylvania District Court orally denied the plaintiff s motion for expedited discovery and subsequently denied the plaintiff s motion for preliminary injunction on January 28, 2016. On March 14, 2016, the Pennsylvania District Court appointed Jerry Herring, Don Michael Hussey and Joanna Pauli Hussey as lead plaintiffs for the putative class and approved their selection of Robbins Geller Rudman & Dowd LLP as lead counsel. On April 14, 2016, the Pennsylvania District Court granted the plaintiffs unopposed motion to stay the *Herring* action for all purposes pending consummation of the Merger.

The Company has been named in a collective and class action lawsuit, *Indergit v. Rite Aid Corporation et al.* pending in the United States District Court for the Southern District of New York, filed purportedly on behalf of current and former store managers working in the Company s stores at various locations around the country. The lawsuit alleges that the Company failed to pay overtime to store managers as required under the FLSA and under certain New York state statutes. The lawsuit also seeks other relief, including liquidated damages, attorneys fees, costs and injunctive relief arising out of state and federal claims for overtime pay. On April 2, 2010, the Court conditionally certified a nationwide collective group of individuals who worked for the Company as store managers since March 31, 2007. The Court ordered that Notice of the *Indergit* action be sent to the purported members of the collective group (approximately 7,000 current and former store managers) and approximately 1,550 joined the *Indergit* action. Discovery as to certification issues has been completed. On September 26, 2013, the Court granted Rule 23 class certification of the New York store manager claims as to liability only, but denied it as to damages, and denied the Company s motion for decertification of the nationwide collective action claims. The Company filed a motion seeking reconsideration of the Court s September 26, 2013 decision which motion was denied in June 2014. The Company subsequently filed a petition for an interlocutory appeal of the Court s September 26, 2013 ruling with the U. S. Court of Appeals for the Second Circuit which petition was denied in September 2014. Notice of the Rule 23 class certification as to liability only has been sent to approximately 1,750 current and former store managers in the state of New York. Discovery related to the merits of the claims is ongoing. At this time, the Company is not able to either predict the outcome of this lawsuit or estimate a potential range of loss with respect to the lawsuit. The Company s management believes, however, that this lawsuit is without merit and is vigorously defending this lawsuit.

The Company is currently a defendant in several lawsuits filed in state courts in California alleging violations of California wage and hour laws, rules and regulations pertaining primarily to failure to pay overtime, failure to pay for missed meals and rest periods, failure to reimburse business expenses and failure to provide employee seating (the California Cases). The lawsuits pertaining to failure to reimburse business expenses and provide employee seating purport to be class actions and seek substantial damages. The single-plaintiff and multi-plaintiff lawsuits regarding failure to pay overtime and failure to pay for missed meals and rest periods, in the aggregate, seek substantial damages. The Company has aggressively challenged the merits of the lawsuits and, where applicable, the allegations that the cases should be certified as class or representative actions.

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In the employee seating case (*Hall v. Rite Aid Corporation, San Diego County Superior Court*), the Court, in October 2011, granted the plaintiff s motion for class certification. The Company filed its motion for decertification, which motion was granted in November 2012. Plaintiff subsequently appealed the Court s order which appeal was granted in May 2014. The Company filed a petition for review of the appellate court s decision with the California Supreme Court, which petition was denied in August 2014. Proceedings in the *Hall* case were stayed pending a decision by the California Supreme Court in two similar cases. That decision was rendered on April 4, 2016. A status conference in the case is scheduled for November 18, 2016. With respect to the California Cases, the Company, at this time, is not able to predict either the outcome of these lawsuits or estimate a potential range of loss with respect to said lawsuits.

The Company was served with a Civil Investigative Demand Subpoena Duces Tecum dated August 26, 2011 by the United States Attorney s Office for the Eastern District of Michigan. The subpoena requests records regarding the relationship of Rite Aid s Rx Savings Program to the reporting of usual and customary charges to publicly funded health programs. In connection with the same investigation, the Company was served with a Civil Subpoena Duces Tecum dated February 22, 2013 by the State of Indiana Office of the Attorney General requesting additional information regarding both Rite Aid s Rx Savings Program and usual and customary charges. The Company has responded to both of the subpoenas. To enable the parties to discuss a possible resolution, the Medicaid Fraud Control Units of the several states, commonwealths and the District of Columbia and Rite Aid have entered into an agreement tolling the statute of limitations until October 7, 2015. The parties agreed to extend the tolling agreement until April 7, 2016. The parties anticipate exchanging pertinent claims data in the near future. At this stage of the proceedings, Rite Aid is unable to predict the outcome of any review by the government of such information and the outcome of the parties discussions of a possible resolution.

On April 26, 2012, the Company received an administrative subpoena from the U.S. Drug Enforcement Administration (DEA), Albany, New York District Office, requesting information regarding the Company s sale of products containing pseudoephedrine (PSE). In April 2012, it also received a communication from the U.S. Attorney s Office (USAO) for the Northern District of New York concerning an investigation of possible civil violations of the Combat Methamphetamine Epidemic Act of 2005 (CMEA). Additional subpoenas were issued in 2013, 2014, and 2015 seeking broader documentation regarding PSE sales and recordkeeping requirements. Assistant U.S. Attorneys from the Northern and Eastern Districts of New York and the Southern District of West Virginia are currently investigating, but no charges have been filed. Between September 2015 and August 2016, the Company received several grand jury subpoenas from the U.S. District Court for the Southern District of West Virginia seeking additional information in connection with the investigation of violations of the CMEA and/or the Controlled Substances Act (CSA). Violations of the CMEA or the CSA could result in the imposition of administrative, civil and/or criminal penalties against the Company. The Company is cooperating with the government and continues to provide information responsive to the subpoenas. The Company has entered into a tolling agreement with the USAOs in the Northern and Eastern Districts of New York and entered into a separate tolling agreement with the USAO in the Southern District of West Virginia. Discussions are underway to resolve these matters with those USAOs, but whether an agreement can be reached and on what terms is uncertain. While the Company s management cannot predict the outcome of these matters, it is possible that the Company s results of operations or cash flows could be materially affected by an unfavorable resolution. At this stage of the investigation, Rite Aid is unable to predict the outcome of the investigation.

In January 2013, the DEA, Los Angeles District Office, served an administrative subpoena on the Company seeking documents related to prescriptions by a certain prescriber. The USAO, Central District of California, also contacted the Company about a related investigation into allegations that Rite Aid pharmacies filled certain controlled substance prescriptions for a number of practitioners after their DEA registrations had expired or otherwise become invalid in violation of the federal Controlled Substances Act and DEA regulations. The Company responded to the administrative subpoena and subsequent informal requests for information from the USAO. The Company met with the USAO and DEA in January 2014 and is involved in ongoing discussions with the government regarding this matter. The Company has entered into a tolling agreement with the USAO. The Company recorded a legal accrual during the period ended March 1, 2014, which was revised during the period ending August 29, 2015. However, Rite Aid cannot predict at this time whether an agreement can be reached and the terms of any agreement.

The Company was served with a Civil Investigative Demand (CID) dated June 21, 2013 by the USAO for the Eastern District of California and the Attorney General s Office of the State of California (the AG). The CID requested records and responses to interrogatories regarding Rite Aid s Drug Utilization Review and prescription dispensing protocol and the dispensing of drugs designated Code 1 by the State of California. The

Company produced responsive documents and interrogatory responses to the USAO and AG. The Company produced documents in response to the CID and exchanged position letters with the USAO and AG concerning the merits of the government s claims. Discussions with the government are ongoing in an effort to resolve these issues, but whether an agreement can be reached and on what terms is uncertain.

Relator, Matthew Omlansky, filed a *qui tam* action, State of California ex rel. Matthew Omlansky v. Rite Aid Corporation, on behalf of the State of California against Rite Aid in the Superior Court of the State of California. In his Complaint, Relator alleges

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that Rite Aid violated the California False Claims Act by (i) failing to comply with California rules governing the Company s reporting of its usual and customary prices; (ii) failing to dispense the least expensive equivalent generic drug in certain circumstances, in violation of applicable regulations; and (iii) dispensing, and seeking reimbursement for, restricted brand name drugs without prior approval. Relator filed his Second Amended Complaint on April 19, 2016 and Rite Aid filed its demurrer on July 29, 2016. At this stage of the proceedings, Rite Aid is unable to predict the outcome of its demurrer and Relator s suit.

In addition to the above described matters, the Company is subject from time to time to various claims and lawsuits and governmental investigations arising in the ordinary course of business. While the Company s management cannot predict the outcome of any of the claims, the Company s management does not believe that the outcome of any of these legal matters will be material to the Company s consolidated financial position. It is possible, however, that the Company s results of operations or cash flows could be materially affected by an unfavorable resolution of pending litigation or contingencies.

16. Guarantor and Non-Guarantor Condensed Consolidating Financial Information

Rite Aid Corporation conducts the majority of its business through its subsidiaries. With the exception of EIC, substantially all of Rite Aid Corporation s 100 percent owned subsidiaries guarantee the obligations under the Amended and Restated Senior Secured Credit Facility, second priority secured term loan facilities, secured guaranteed notes and unsecured guaranteed notes (the Subsidiary Guarantors). Additionally, prior to the Acquisition, the subsidiaries, including joint ventures, that did not guarantee the Amended and Restated Senior Secured Credit Facility, second priority secured term loan facilities, secured guaranteed notes and unsecured guaranteed notes, were minor. Accordingly, condensed consolidating financial information for the Company and subsidiaries is not presented for those periods. Condensed consolidating financial information for the Company, its Subsidiary Guarantors and non-guarantor subsidiaries, is presented for periods subsequent to the Acquisition.

For the purposes of preparing the information below, Rite Aid Corporation uses the equity method to account for its investment in subsidiaries. The equity method has been used by Subsidiary Guarantors with respect to investments in the non-guarantor subsidiaries. The subsidiary guarantees related to the Company s Amended and Restated Senior Secured Credit Facility, second priority secured term loan facilities and secured guaranteed notes and, on an unsecured basis, the unsecured guaranteed notes, are full and unconditional and joint and several. Presented below is condensed consolidating financial information for Rite Aid Corporation, the Subsidiary Guarantors, and the non-guarantor subsidiaries at August 27, 2016, February 27, 2016, and for the thirteen and twenty-six week periods ended August 27, 2016 and August 29, 2015. Separate financial statements for Subsidiary Guarantors are not presented.

Rite Aid Corporation
Condensed Consolidating Balance Sheet
August 27, 2016
(unaudited)

	Rite Aid Corporation (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
ASSETS					
Current assets:					
Cash and cash equivalents	$	$ 102,801	$ 33,292	$	$ 136,093
Accounts receivable, net		1,447,099	381,542		1,828,641
Intercompany receivable		298,167		(298,167)(a)	
Inventories, net of LIFO reserve of $0, $1,033,907, $0, $0, and		2,827,018			2,827,018

$1,033,907					
Prepaid expenses and other current assets		137,346	9,418		146,764
Total current assets		4,812,431	424,252	(298,167)	4,938,516
Property, plant and equipment, net		2,281,392			2,281,392
Goodwill		1,715,479			1,715,479
Other intangibles, net		866,570	54,778		921,348
Deferred tax assets		1,538,604			1,538,604
Investment in subsidiaries	15,067,909	54,460		(15,122,369)(b)	
Intercompany receivable		7,211,877		(7,211,877)(a)	
Other assets		215,630			215,630

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Rite Aid Corporation
Condensed Consolidating Balance Sheet
August 27, 2016
(unaudited)

	Rite Aid Corporation (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Total assets	$ 15,067,909	$ 18,696,443	$ 479,030	$ (22,632,413)	$ 11,610,969
LIABILITIES AND STOCKHOLDERS EQUITY					
Current liabilities:					
Current maturities of long-term debt and lease financing obligations	$ 90	$ 24,309	$	$	$ 24,399
Accounts payable		1,694,122	1,718		1,695,840
Intercompany payable			298,167	(298,167)(a)	
Accrued salaries, wages and other current liabilities	65,617	1,157,106	108,984		1,331,707
Total current liabilities	65,707	2,875,537	408,869	(298,167)	3,051,946
Long-term debt, less current maturities	7,173,656				7,173,656
Lease financing obligations, less current maturities		46,641			46,641
Intercompany payable	7,211,877			(7,211,877)(a)	
Other noncurrent liabilities		706,356	15,701		722,057
Total liabilities	14,451,240	3,628,534	424,570	(7,510,044)	10,994,300
Commitments and contingencies					
Total stockholders equity	616,669	15,067,909	54,460	(15,122,369)(b)	616,669
Total liabilities and stockholders equity	$ 15,067,909	$ 18,696,443	$ 479,030	$ (22,632,413)	$ 11,610,969

(a) Elimination of intercompany accounts receivable and accounts payable amounts.

(b) Elimination of investments in consolidated subsidiaries.

Rite Aid Corporation
Condensed Consolidating Balance Sheet
February 27, 2016

	Rite Aid Corporation (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
ASSETS					