CARDINAL HEALTH INC
Form 10-Q
November 05, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

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

For the quarterly period ended September 30, 2014
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: 1-11373
Cardinal Health, Inc.
(Exact name of registrant as specified in its charter)

Ohio	31-0958666
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
7000 Cardinal Place, Dublin, Ohio	43017
(Address of principal executive offices)	(Zip Code)

(614) 757-5000
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 þ 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

The number of the registrant's common shares, without par value, outstanding as of October 31, 2014, was the following: 330,961,546.

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* Items not listed are inapplicable.

Item 1: Financial Statements
Condensed Consolidated Statements of Earnings (Unaudited)

	Three Months Ended September 30	
(in millions, except per common share amounts)	2014	2013
Revenue	$24,070	$24,523
Cost of products sold	22,729	23,259
Gross margin	1,341	1,264
Operating expenses:		
Distribution, selling, general and administrative expenses	775	732
Restructuring and employee severance	19	11
Amortization and other acquisition-related costs	53	49
Impairments and loss on disposal of assets	—	—
Litigation (recoveries)/charges, net	28	1
Operating earnings	466	471
Other income, net	(3)	(4)
Interest expense, net	34	33
Earnings before income taxes and discontinued operations	435	442
Provision for income taxes	169	102
Earnings from continuing operations	266	340
Loss from discontinued operations, net of tax	—	(1)
Net earnings	$266	$339
Basic earnings per common share:		
Continuing operations	$0.79	$1.00
Discontinued operations	—	—
Net basic earnings per common share	$0.79	$1.00
Diluted earnings per common share:		
Continuing operations	$0.78	$0.99
Discontinued operations	—	—
Net diluted earnings per common share	$0.78	$0.99
Weighted-average number of common shares outstanding:		
Basic	336	340
Diluted	340	344
Cash dividends declared per common share	$0.3425	$0.3025

See notes to condensed consolidated financial statements.

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

	Three Months Ended September 30	
(in millions)	2014	2013
Net earnings	$266	$339
Other comprehensive income/(loss):		
Net change in foreign currency translation adjustments	(24)	24
Net unrealized gain/(loss) on derivative instruments, net of tax	—	—
Total other comprehensive income/(loss), net of tax	(24)	24
Total comprehensive income	$242	$363

See notes to condensed consolidated financial statements.

Condensed Consolidated Balance Sheets

(in millions)	September 30, 2014 (Unaudited)	June 30, 2014
Assets		
Current assets:		
Cash and equivalents	$2,469	$2,865
Trade receivables, net	5,662	5,380
Inventories, net	8,069	8,266
Prepaid expenses and other	1,338	1,428
Total current assets	17,538	17,939
Property and equipment, net	1,434	1,459
Goodwill and other intangibles, net	5,923	5,870
Other assets	816	765
Total assets	$25,711	$26,033
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$11,995	$12,149
Current portion of long-term obligations and other short-term borrowings	843	801
Other accrued liabilities	2,058	2,165
Total current liabilities	14,896	15,115
Long-term obligations, less current portion	3,164	3,171
Deferred income taxes and other liabilities	1,395	1,346
Shareholders' equity:		
Preferred shares, without par value:		
Authorized—500 thousand shares, Issued—none	—	—
Common shares, without par value:		
Authorized—755 million shares, Issued—364 million shares at September 30, 2014 and June 30, 2014	2,948	2,980
Retained earnings	4,925	4,774
Common shares in treasury, at cost: 30 million shares and 27 million shares at September 30, 2014 and June 30, 2014, respectively	(1,663)	(1,423)
Accumulated other comprehensive income	46	70
Total shareholders' equity	6,256	6,401
Total liabilities and shareholders' equity	$25,711	$26,033

See notes to condensed consolidated financial statements.

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended September 30	
(in millions)	2014	2013
Cash flows from operating activities:		
Net earnings	$266	$339
Loss from discontinued operations, net of tax	—	1
Earnings from continuing operations	266	340
Adjustments to reconcile earnings from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	108	117
Gain on sale of other investments	(5)	—
Share-based compensation	25	24
Provision for bad debts	12	12
Change in operating assets and liabilities, net of effects from acquisitions:		
Decrease/(increase) in trade receivables	(291)	1,395
Decrease in inventories	199	1,098
Decrease in accounts payable	(157)	(1,852)
Other accrued liabilities and operating items, net	(96)	(183)
Net cash provided by operating activities	61	951
Cash flows from investing activities:		
Acquisition of subsidiaries, net of cash acquired	(61)	(25)
Additions to property and equipment	(36)	(26)
Purchase of available-for-sale securities and other investments	(75)	—
Proceeds from sale of available-for-sale securities and other investments	91	—
Net cash used in investing activities	(81)	(51)
Cash flows from financing activities:		
Net change in short-term borrowings	40	20
Net proceeds from issuance of common shares	25	75
Tax proceeds from share-based compensation	38	12
Dividends on common shares	(119)	(105)
Purchase of treasury shares	(360)	(50)
Net cash used in financing activities	(376)	(48)
Net increase/(decrease) in cash and equivalents	(396)	852
Cash and equivalents at beginning of period	2,865	1,901
Cash and equivalents at end of period	$2,469	$2,753

See notes to condensed consolidated financial statements.

1. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

Our condensed consolidated financial statements include the accounts of all majority-owned or controlled subsidiaries, and all significant intercompany transactions and amounts have been eliminated. To conform to the current year presentation, certain prior year amounts have been reclassified. References to "we," "our" and similar pronouns in this Quarterly Report on Form 10-Q for the quarter ended September 30, 2014 (this "Form 10-Q") refer to Cardinal Health, Inc. and its majority-owned or controlled subsidiaries unless the context requires otherwise. The results of businesses acquired or disposed of are included in the condensed consolidated financial statements from the effective date of the acquisition or up to the date of disposal, respectively.

Our condensed consolidated financial statements have been prepared in accordance with the U.S. Securities and Exchange Commission ("SEC") instructions to Quarterly Reports on Form 10-Q and include all of the information and disclosures required by accounting principles generally accepted in the United States ("GAAP") for interim financial reporting. The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect amounts reported in the condensed consolidated financial statements and accompanying notes. Actual amounts may differ from these estimated amounts. In addition, operating results presented for this fiscal 2015 interim period are not necessarily indicative of the results that may be expected for the full fiscal year ending June 30, 2015.

These condensed consolidated financial statements are unaudited and are presented pursuant to the rules and regulations of the SEC. Accordingly, the condensed consolidated financial statements included in this Form 10-Q should be read in conjunction with the audited consolidated financial statements and related notes contained in our Annual Report on Form 10-K for the fiscal year ended June 30, 2014 (the "2014 Form 10-K"). In our opinion, all adjustments necessary for a fair presentation of the condensed consolidated financial statements have been included. Except as disclosed elsewhere in this Form 10-Q, all such adjustments are of a normal and recurring nature.

Recent Financial Accounting Standards

In August 2014, the Financial Accounting Standards Board ("FASB") issued amended accounting guidance related to uncertainties about an entity’s ability to continue as a going concern. This guidance requires management to evaluate whether there is substantial doubt about a company’s ability to continue as a going concern. This amendment will be effective for us in the fourth quarter of fiscal 2017, with early adoption

permitted. We do not expect the adoption of this guidance to impact our financial statement disclosures.

In May 2014, the FASB issued amended accounting guidance related to revenue recognition. This guidance is based on the principle that revenue is recognized in an amount that reflects the consideration to which an entity expects to be entitled in exchange for the transfer of goods or services to customers. The guidance also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. This amendment will be effective for us in the first quarter of fiscal 2018. We are continuing to evaluate the options for adoption and the impact on our financial position and results of operations.

In July 2013, the FASB issued amended accounting guidance related to the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This guidance requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, unless certain conditions exists. We adopted this guidance in the first quarter of fiscal 2015. The adoption of this guidance did not impact our financial position or results of operations.

In March 2013, the FASB issued amended accounting guidance related to a parent company's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or group of assets within a foreign entity or of an investment in a foreign entity. The amended guidance requires the release of any cumulative translation adjustment into net income only upon complete or substantially complete liquidation of a controlling interest in a subsidiary or a group of assets within a foreign entity. Also, it requires the release of all or a pro rata portion of the cumulative translation adjustment to net income in the case of sale of an equity method investment that is a foreign entity. We adopted this amended guidance in the first quarter of fiscal 2015. The adoption of this guidance did not impact our financial position or results of operations.

2. Acquisitions

While we have completed acquisitions during the three months ended September 30, 2014, the pro forma results of operations and the results of operations for acquired businesses since the acquisition dates have not been separately disclosed because the effects were not significant compared to the consolidated financial statements, individually or in the aggregate.

AccessClosure

On May 9, 2014, we completed the acquisition of Access Closure, Inc. ("AccessClosure") for $320 million in an all-cash transaction. We funded the acquisition with cash on hand. The acquisition of AccessClosure, a manufacturer and distributor of extravascular closure devices, expands the Medical segment's portfolio of self-manufactured products. The assessment of fair value for AccessClosure is preliminary and is based on information that was available at the time the condensed consolidated financial statements were prepared.

3. Restructuring and Employee Severance

The following table summarizes restructuring and employee severance costs related to our restructuring activities:

	Three Months Ended September 30	
(in millions)	2014	2013
Employee-related costs (1)	$16	$4
Facility exit and other costs (2)	3	7
Total restructuring and employee severance	$19	$11

(1) Employee-related costs primarily consist of termination benefits provided to employees who have been involuntarily terminated and duplicate payroll costs during transition periods.

(2) Facility exit and other costs primarily consist of lease termination costs, accelerated depreciation, equipment relocation costs, project consulting fees and costs associated with restructuring our delivery of information technology infrastructure services.

The majority of restructuring costs incurred during the three months ended September 30, 2014 and 2013 related to restructuring activities within our Medical segment.

The following table summarizes activity related to liabilities associated with restructuring and employee severance:

(in millions)	Employee-Related Costs	Facility Exit and Other Costs	Total
Balance at June 30, 2014	$24	$—	$24
Additions	17	—	17
Payments and other adjustments	(11)	—	(11)
Balance at September 30, 2014	$30	$—	$30

4. Goodwill and Other Intangible Assets

Goodwill

The following table summarizes the changes in the carrying amount of goodwill, by segment and in total:

(in millions)	Pharmaceutical	Medical	Total
Balance at June 30, 2014	$2,158	$2,720	$4,878
Goodwill acquired, net of purchase price adjustments	6	50	56
Foreign currency translation adjustments and other	6	(5)	1
Balance at September 30, 2014	$2,170	$2,765	$4,935

Other Intangible Assets

Other intangible assets are amortized over periods ranging from one to twenty years. The following tables summarize other intangible assets by class at:

	September 30, 2014		
(in millions)	Gross Intangible	Accumulated Amortization	Net Intangible
Indefinite-life intangibles:			
Trademarks and other	$14	$—	$14
Total indefinite-life intangibles	14	—	14
Definite-life intangibles:			
Customer relationships	1,039	404	635

Trademarks, trade names and patents	221	74	147
Developed technology and other	296	104	192
Total definite-life intangibles	1,556	582	974
Total other intangible assets	$1,570	$582	$988

	June 30, 2014		
(in millions)	Gross Intangible	Accumulated Amortization	Net Intangible
Indefinite-life intangibles:			
Trademarks and other	$14	$—	$14
Total indefinite-life intangibles	14	—	14
Definite-life intangibles:			
Customer relationships	1,043	388	655
Trademarks, trade names and patents	213	69	144
Developed technology and other	258	79	179
Total definite-life intangibles	1,514	536	978
Total other intangible assets	$1,528	$536	$992

Total amortization of intangible assets was $45 million and $46 million for the three months ended September 30, 2014 and 2013, respectively. Estimated annual amortization of intangible assets for the remainder of fiscal 2015 through 2019 is as follows: $139 million, $174 million, $165 million, $123 million and $77 million.

5. Available-for-Sale Securities

We invest in marketable securities, which are classified as available-for-sale and are carried at fair value in the condensed consolidated balance sheets. We held the following investments in marketable securities at fair value at:

(in millions)	September 30, 2014	June 30, 2014
Current available-for-sale securities:		
Commercial paper	$15	$4
Treasury bills	3	85
International bonds	1	1
Corporate bonds	4	3
U.S. agency mortgage-backed securities	2	—
Total current available-for-sale securities	25	93
Long-term available-for-sale securities:		
Corporate bonds	10	5
U.S. agency bonds	43	2
U.S. agency mortgage-backed securities	13	—
Total long-term available-for-sale securities	66	7
Total available-for-sale securities	$91	$100

Gross unrealized gains and losses were immaterial at September 30, 2014. During the three months ended September 30, 2014, gross realized gains and losses were immaterial and we did not recognize any other-than-temporary impairments. At September 30, 2014 the weighted-average effective maturity of our current and long-term investments was approximately 5 months and 17 months, respectively.

6. Income Taxes

Generally, fluctuations in our provision for income taxes as a percentage of pretax earnings ("effective tax rate") are due to changes in international and U.S. state effective tax rates resulting from our business mix and discrete items.

During the three months ended September 30, 2014, the effective tax rate of 38.9 percent was unfavorably impacted by 2.6 percentage points ($11 million) due to the remeasurement of unrecognized tax benefits and 2.4 percentage points ($10 million) due to nondeductibility of litigation charges, partially offset by 3.3 percentage points ($14 million) due to adjusting deferred tax assets and related valuation allowances for the impact of Puerto Rico tax law changes enacted during the quarter.

During the three months ended September 30, 2013, the effective tax rate of 23.2 percent was impacted by net favorable discrete items of $61 million, which reduced the rate by 13.7 percentage points. The discrete items include the favorable impact of the settlement of federal and state tax controversies ($63 million).

We had $524 million and $510 million of unrecognized tax benefits at September 30, 2014 and June 30, 2014, respectively. The September 30, 2014 and June 30, 2014 balances include $331 million and $322 million, respectively, of unrecognized tax benefits that, if recognized, would have an impact on the effective tax rate. The remaining unrecognized tax benefits relate to tax positions for which ultimate deductibility is highly certain but for which there is uncertainty as to the timing of such deductibility. Recognition of these tax benefits would not affect our effective tax rate. We include the full amount of unrecognized tax benefits in deferred income taxes and other liabilities in the condensed consolidated balance sheets.

We recognize accrued interest and penalties related to unrecognized tax benefits in the provision for income taxes. At September 30, 2014 and June 30, 2014, we had $155 million and $143 million, respectively, accrued for the payment of interest and penalties. These balances are gross amounts before any tax benefits and are included in deferred income taxes and other liabilities in the condensed consolidated balance sheets.

It is reasonably possible that there could be a change in the amount of unrecognized tax benefits within the next 12 months due to activities of the U.S. Internal Revenue Service ("IRS") or other taxing authorities, including proposed assessments of additional tax, possible settlement of audit issues, reassessment of existing unrecognized tax benefits or the expiration of applicable statutes of limitations. We estimate that the range of the possible change in unrecognized tax benefits within the next 12 months is a decrease of approximately $45 million to an increase of approximately $20 million, exclusive of penalties and interest.

We file income tax returns in the U.S. federal jurisdiction, various U.S. state jurisdictions and various foreign jurisdictions. We are subject to audit by the IRS for fiscal years 2006 through the current fiscal year. We are generally subject to audit by taxing authorities in various U.S. state and foreign jurisdictions for fiscal years 2003 through the current fiscal year.

The IRS is currently conducting audits of fiscal years 2006 through 2010, and our transfer pricing arrangements continue to be under consideration as part of these audits. While the IRS has made and could make proposed adjustments to our transfer pricing arrangements or other matters, we are defending our reported tax positions, and have accounted for the unrecognized tax benefits associated with our tax positions.

We are a party to a tax matters agreement with CareFusion Corporation ("CareFusion"), under which CareFusion is obligated to indemnify us for certain tax exposures and transaction taxes prior to our fiscal 2010 spin-off of CareFusion. The indemnification receivable was $212 million and $210 million at September 30, 2014 and June 30, 2014, respectively, and is included in other assets in the condensed consolidated balance sheets.

7. Commitments, Contingent Liabilities and Litigation
Commitments
Joint Venture With CVS Health Corporation
In July 2014, we established Red Oak Sourcing, LLC ("Red Oak Sourcing"), a U.S.-based generic pharmaceutical sourcing entity with CVS Health Corporation ("CVS") with an initial term of 10 years. Both companies have contributed sourcing and supply chain expertise to the 50/50 joint venture and have committed to source generic pharmaceuticals through arrangements negotiated by it. Red Oak Sourcing negotiates generic pharmaceutical supply contracts on behalf of both companies, but does not own products or hold inventory on behalf of either company. We are required to pay 39 quarterly payments of $25.6 million to CVS commencing in October 2014 and, only if certain milestones are achieved, to pay additional predetermined amounts to CVS beginning in fiscal 2016. The fixed payments of $25.6 million will be expensed evenly commencing during the second quarter of fiscal 2015. No physical assets were contributed by either company to Red Oak Sourcing, and minimal funding has been provided to capitalize the entity.
Legal Proceedings
We become involved from time to time in disputes, litigation and regulatory matters incidental to our business, including governmental investigations and enforcement actions, personal injury claims, employment matters, commercial disputes, intellectual property matters, government contract compliance matters, disputes regarding environmental clean-up costs, claims in connection with acquisitions and divestitures and other matters arising out of the normal conduct of our business. We intend to vigorously defend ourselves in such matters.
We may be named from time to time in qui tam actions, which are initiated by private third parties purporting to act on behalf of federal or state governments that allege that false claims have been submitted or have been caused to be submitted for payment by the government. After a private party has filed a qui tam action, the government must investigate the private party's claim and determine whether to intervene in and take control over the litigation. These actions may remain under seal while the government makes this determination. If the government declines to intervene, the private party may nonetheless continue to pursue the litigation on behalf of the government.
In addition, we occasionally may suspect that products we manufacture, market or distribute do not meet product specifications, published standards or regulatory requirements. In such circumstances, we investigate and take appropriate corrective action. Such actions can lead to product recalls, costs to repair or replace affected products, temporary interruptions in product sales and action by regulators.
We accrue for contingencies related to disputes, litigation and regulatory matters if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Because these matters are inherently unpredictable and unfavorable developments or resolutions can occur, assessing contingencies is highly subjective and requires judgments about future events. We regularly review contingencies to determine whether our accruals and related disclosures are adequate. The amount of ultimate loss may differ from these estimates.
With respect to the matters described below, we are unable to estimate a range of reasonably possible loss for matters for which there is no accrual or additional loss for matters for which we already have recorded an accrual, since damages or fines have not been specified or the proceedings are at stages where significant uncertainty exists as to legal or factual issues and as to whether such matters will proceed to trial. We do not believe, based on currently available information, that the outcomes of these matters will have a material adverse effect on our financial position, results of operations or cash flows, though the outcome of one or more of these matters could be material to our results of operations for a particular period.
We recognize income from the favorable outcome of litigation when we receive the associated cash or assets.
We recognize estimated loss contingencies for litigation and regulatory matters and income from favorable resolution of litigation in litigation (recoveries)/charges, net in our condensed consolidated statements of earnings.
DEA Investigation and Related Matters

In February 2012, the U.S. Drug Enforcement Administration (the "DEA") issued an order to show cause and immediate suspension of our Lakeland, Florida distribution center's registration to distribute controlled substances, asserting that we failed to maintain required controls against the diversion of controlled substances. In May 2012, we entered into a settlement agreement with the DEA that resolved the administrative aspects of the DEA's action. The settlement agreement did not foreclose the possibility of the U.S. Department of Justice (the “DOJ”) seeking civil fines in Florida or elsewhere for the conduct covered by the settlement agreement. In that regard, we are continuing to provide information to and engage in discussions with several offices of the DOJ, including preliminary discussions regarding the feasibility of a settlement, and have accrued $27 million for this matter.

State of West Virginia vs. Cardinal Health, Inc.

In June 2012, the West Virginia Attorney General filed, and in January 2014 amended, complaints against 13 pharmaceutical wholesale distributors, including us, in the Circuit Court of Boone County, West Virginia alleging, among other things, that the distributors failed to maintain effective controls to guard against diversion of controlled substances in West Virginia, failed to report suspicious orders of controlled substances in accordance with the West Virginia Uniform Controlled Substances Act and were negligent in distributing controlled substances to pharmacies that serve individuals who abuse controlled substances. In addition to injunctive and other equitable relief, the complaints seek monetary damages and the creation of a court-supervised fund, to be financed by the defendants in these actions, for a medical monitoring program focused on prescription drug abuse.

Federal False Claims Investigation

As previously disclosed, the DOJ had requested information in connection with an investigation of possible violations of the federal False Claims Act with respect to our Medical segment's administration of a prime vendor agreement with the federal government. The investigation was prompted by a qui tam action filed under seal by a private third party. In September 2014, the DOJ declined to intervene in the qui tam action.

FTC Investigation

The Federal Trade Commission ("FTC") has been investigating supplier arrangements involving our Nuclear Pharmacy Services division primarily focused on the period between 2003 and 2008, and we have been providing information to and cooperating with the FTC on this matter. We believe that the FTC commissioners are now considering whether or not to take civil action against us.

8. Fair Value Measurements

The following tables present the fair values for those assets measured on a recurring basis at:

	September 30, 2014			
(in millions)	Level 1	Level 2	Level 3	Total
Cash equivalents (1)	$309	$—	$—	$309
Forward contracts (2)	—	5	—	5
Available-for-sale securities (3)	—	91	—	91
Other investments (4)	108	—	—	108
Total	$417	$96	$—	$513

	June 30, 2014			
(in millions)	Level 1	Level 2	Level 3	Total
Cash equivalents (1)	$740	$—	$—	$740
Forward contracts (2)	—	10	—	10
Available-for-sale securities (3)	—	100	—	100
Other investments (4)	106	—	—	106
Total	$846	$110	$—	$956

(1) Cash equivalents are comprised of highly liquid investments purchased with a maturity of three months or less. The carrying value of these cash equivalents approximates fair value due to their short-term maturities.

(2) The fair value of interest rate swaps, foreign currency contracts and commodity contracts is determined based on the present value of expected future cash flows considering the risks involved, including non-performance risk, and using discount rates appropriate for the respective maturities. Observable Level 2 inputs are used to determine the present value of expected future cash flows. The fair value of these derivative contracts, which are subject to master netting arrangements under certain circumstances, is presented on a gross basis in the condensed consolidated balance sheets.

(3) We invest in marketable securities, which are classified as available-for-sale and are carried at fair value in the condensed consolidated balance sheets. Observable Level 2 inputs such as quoted prices for similar securities, interest rate spreads, yield curves and credit risk are used to determine the fair value. See Note 5 for additional information regarding available-for-sale securities.

(4) The other investments balance includes investments in mutual funds, which are used to offset fluctuations in deferred compensation liabilities. These mutual funds primarily invest in the equity securities of companies with large market capitalization and high quality fixed income debt securities. The fair value of these investments is determined using quoted market prices.

9. Financial Instruments

We utilize derivative financial instruments to manage exposure to certain risks related to our ongoing operations. The primary risks managed through the use of derivative instruments include interest rate risk, currency exchange risk and commodity price risk. We do not use derivative instruments for trading or speculative purposes. While the majority of our derivative instruments are designated as hedging instruments, we also enter into derivative instruments that are designed to hedge a risk, but are not designated as hedging instruments. These derivative instruments are adjusted to current fair value through earnings at the end of each period. Our derivative and hedging programs are consistent with those described in the 2014 Form 10-K.

During the three months ended September 30, 2014, we entered into forward interest rate swaps with a total notional amount of $50 million to hedge probable, but not firmly committed, future transactions associated with our debt.

Fair Value of Financial Instruments

The carrying amounts of cash and equivalents, trade receivables, net, accounts payable and other accrued liabilities at September 30, 2014 and June 30, 2014 approximate fair value due to their short-term maturities.

The following table summarizes the estimated fair value of our long-term obligations and other short-term borrowings compared to the respective carrying amounts at:

(in millions)	September 30, 2014	June 30, 2014
Estimated fair value	$4,122	$4,115
Carrying amount	4,007	3,972

The estimated fair value of our long-term obligations and other short-term borrowings is estimated based on either the quoted market prices for the same or similar issues or other inputs derived from available market information, which represents a Level 2 measurement.

10. Shareholders' Equity

Share Repurchases

During the three months ended September 30, 2014, we repurchased 4.8 million common shares having an aggregate cost of $360 million. The average price paid per common share was $74.36.

During the three months ended September 30, 2013, we repurchased 1.0 million common shares having an aggregate cost of $50 million. The average price paid per common share was $51.65.

We funded the repurchases with available cash. The common shares repurchased are held in treasury to be used for general corporate purposes.

Accumulated Other Comprehensive Income

The following table summarizes the changes in the balance of accumulated other comprehensive income by component and in total:

(in millions)	Foreign Currency Translation Adjustments	Unrealized Gain on Derivatives, net of tax	Accumulated Other Comprehensive Income
Balance at June 30, 2014	$63	$7	$70
Other comprehensive loss, net of tax before reclassifications	(24)	—	(24)
Amounts reclassified to earnings	—	—	—
Total other comprehensive loss, net of tax	(24)	—	(24)
Balance at September 30, 2014	$39	$7	$46

Activity related to realized and unrealized gains and losses on available-for-sale securities as described in Note 5, was immaterial during the three months ended September 30, 2014.

11. Earnings Per Share

The following table reconciles the number of common shares used to compute basic and diluted earnings per share:

	Three Months Ended September 30	
(in millions)	2014	2013
Weighted-average common shares–basic	336	340
Effect of dilutive securities:		
Employee stock options, restricted share units and performance share units	4	4
Weighted-average common shares–diluted	340	344

For both the three months ended September 30, 2014 and 2013, there were one million potentially dilutive employee stock options, restricted share units and performance share units that

were antidilutive and therefore were not considered in the calculation of diluted earnings per share.

12. Segment Information

Our operations are principally managed on a products and services basis and are comprised of two operating segments, which are the same as our reportable segments: Pharmaceutical and Medical. The factors for determining the reportable segments include the manner in which management evaluates our performance combined with the nature of the individual business activities.

The following table presents revenue for each reportable segment and Corporate:

	Three Months Ended September 30	
(in millions)	2014	2013
Pharmaceutical (1)	$21,209	$21,813

Medical	2,852	2,711
Total segment revenue	24,061	24,524
Corporate (2)	9	(1)
Total revenue	$24,070	$24,523

(1) Our pharmaceutical distribution contract with Walgreen Co. expired on August 31, 2013.

(2) Corporate revenue consists of the elimination of inter-segment revenue and other revenue not allocated to the segments.

We evaluate segment performance based upon segment profit, among other measures. Segment profit is segment revenue, less segment cost of products sold, less segment SG&A expenses. Segment SG&A expenses include share-based compensation expense as well as allocated corporate expenses for shared functions, including corporate management, corporate finance, financial and customer care shared services, human resources, information technology and legal. Corporate expenses are allocated to the segments based upon headcount, level of benefit provided and other ratable allocation methodologies. Other income, net, interest expense, net and provision for income taxes are not allocated to the segments.

Restructuring and employee severance, amortization and other acquisition-related costs, impairments and loss on disposal of assets and litigation (recoveries)/charges, net are not allocated to the segments. In addition, certain investment and other spending are not allocated to the segments. Investment spending generally includes the first-year spend for certain projects that require incremental investments in the form of additional operating expenses. We encourage our segments and corporate functions to identify investment projects that will promote innovation and provide future returns. As approval decisions for such projects are dependent upon executive management, the expenses for such projects are often retained at Corporate. Investment spending within Corporate was $2 million and $3 million for the three months ended September 30, 2014 and 2013, respectively.

The following table presents segment profit by reportable segment and Corporate:

(in millions)	Three Months Ended September 30 2014	2013
Pharmaceutical	$451	$433
Medical	113	106
Total segment profit	564	539
Corporate	(98)	(68)
Total operating earnings	$466	$471

13. Share-Based Compensation

Share-Based Compensation Plans

We maintain stock incentive plans (collectively, the "Plans") for the benefit of certain of our officers, directors and employees.

The following table provides total share-based compensation expense by type of award:

(in millions)	Three Months Ended September 30 2014	2013
Restricted share unit expense	$16	$16
Employee stock option expense	5	5
Performance share unit expense	4	3
Total share-based compensation	$25	$24

The total tax benefit related to share-based compensation was $9 million for both the three months ended September 30, 2014 and 2013, respectively.

Stock Options

Employee stock options granted under the Plans generally vest in equal annual installments over three years and are exercisable for periods ranging from seven to ten years from the grant date. All stock options are exercisable at a price equal to the market value of the common shares underlying the option on the grant date.

The following table summarizes all stock option transactions under the Plans:

(in millions, except per share amounts)	Stock Options	Weighted-Average Exercise Price per Common Share
Outstanding at June 30, 2014	10	$39.16
Granted	1	71.52
Exercised	(2)	39.25
Canceled and forfeited	—	—
Outstanding at September 30, 2014	9	$44.16
Exercisable at September 30, 2014	6	$36.01

At September 30, 2014, the total pre-tax compensation cost, net of estimated forfeitures, related to nonvested stock options not yet recognized was $39 million, which is expected to be recognized over a weighted-average period of two years. The following table provides additional data related to stock option activity:

(in millions, except contractual lives)	September 30, 2014	June 30, 2014
Aggregate intrinsic value of outstanding options at period end	$282	$282
Aggregate intrinsic value of exercisable options at period end	$219	$185
Weighted-average remaining contractual life of outstanding options (in years)	6	6
Weighted-average remaining contractual life of exercisable options (in years)	5	4

Restricted Share Units
Restricted share units granted under the Plans generally vest in equal annual installments over three years. Restricted share units accrue cash dividend equivalents that are payable upon vesting of the awards.
The following table summarizes all transactions related to restricted share units under the Plans:

(in millions, except per share amounts)	Restricted Share Units	Weighted-Average Grant Date Fair Value per Share
Nonvested at June 30, 2014	3	$45.65
Granted	1	71.71
Vested	(1)	44.34
Canceled and forfeited	—	—
Nonvested at September 30, 2014	3	$56.48

At September 30, 2014, the total pre-tax compensation cost, net of estimated forfeitures, related to nonvested restricted share units not yet recognized was $128 million, which is expected to be recognized over a weighted-average period of two years.
Performance Share Units
Performance share units vest over a three-year performance period based on achievement of specific performance goals. Based on the extent to which the targets are achieved, vested shares may range from zero to 200 percent of the target award amount. Performance share units accrue cash dividend equivalents that are payable upon