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MCKESSON
Empowering Healthcare

To Our Stockholders:

Each year at this time, I share with you my perspective on how McKesson is performing as a company. This year, I will also explain several of the important ways your company is helping to transform a healthcare system that is in desperate need of our help — the ways we are altering the cost, quality, safety and efficiency of healthcare through McKesson's scale, clinical and process expertise, and technology. The dedication and efforts of our employees both to help McKesson reach its financial goals and, together with our customers, to change the future of healthcare for the better continues to fuel our success.

The positive momentum that began to build for McKesson in Fiscal 2005 continued throughout Fiscal 2006. The past year, we focused on executing our plans to continue to expand our now market-leading businesses in pharmaceutical distribution and healthcare information technology. For the full fiscal year, McKesson had revenues of $88.1 billion, up 10%, and net income of $751 million or $2.38 per diluted share. Full year net income from continuing operations, excluding net after-tax Securities Litigation charges of $30 million, was $767 million, or $2.44 cents per diluted share, up 12% from $2.18 for the prior year.

## McKesson and the Future of Healthcare

I'm proud of the financial results we are delivering, but equally proud of the role that McKesson plays in healthcare. We have a tremendous opportunity, and responsibility, to influence the healthcare experience for everyone. As patients, parents, caregivers, healthcare workers or investors, we are all aware of the tremendous challenges in healthcare and what is at stake for all of us. Despite the efforts of many in the system who try to compensate for what is missing or not working, almost every one of us has our own story that illustrates the shortcomings of our healthcare system. At the same time, we experience extraordinary healthcare advantages that we often take for granted. We have the best medicines available in the history of mankind. And because of McKesson's exacting quality standards, none of us has ever had to worry that our medicine might not be there, when and where we needed it, or that doctors might need a surgical supply they couldn't order. McKesson makes it happen, and we are leading the way to make providing, receiving and paying for healthcare simpler, safer, more connected, more efficient — and even more personal.

*Here are six key areas where McKesson plays a crucial role in transforming the cost and quality of healthcare:*

### 1 We are using McKesson's distribution system, scale, and supply chain excellence to help improve healthcare.

Every week, we deliver over $1 billion worth of medicines to every place where care is delivered; fully one-third of the medicines used each day in North America are delivered by McKesson. We also distribute more than 150,000 medical-surgical products. We do all of this with near-perfect accuracy.

## 2 We are becoming a key source of safety and error reduction.

Today McKesson systems automatically dispense more than 300 million doses of medicine a year, error-free, preventing 203,000 potentially harmful medication errors from occurring every week. We do this from the warehouse to the patient bedside. 200,000 doctors, 600 payors, and 25,000 retail pharmacies perform their daily clinical and administrative tasks using McKesson systems. More than 500,000 nurses rely on a McKesson solution to deliver safe care — that's about one out of every five nurses in the U.S.

## 3 We are actively pursuing a role in personal health management for patients.

Today, we are the leader in helping Medicaid patients manage their chronic diseases, such as asthma, diabetes, mental health and heart disease. Our Specialty Pharmaceutical business delivers expensive biotech therapies — and patient support — to patients and physicians in newer chronic care areas, like oncology. McKesson is providing tools, information and support such as in-home health monitoring devices, easy remote bill pay, virtual doctor patient consultations and scheduling, nurse triage, and more.

## 4 We are ensuring healthcare dollars are well spent.

Today we spend more on our imperfect healthcare system than any other nation on earth: $1.9 trillion a year. At McKesson, we are helping to improve the way healthcare dollars are spent by automating and streamlining manual processes, removing paper, improving supply chains and connections between providers and participants, and eliminating re-work and avoidable costs.

## 5 We are supporting efficient, productive clinicians.

From efficient, easy-to-use physician portals, to imaging tools for radiologists, to mobile nurse stations, and automation and software for pharmacists — and well beyond — we are helping improve the productivity and effectiveness of doctors, nurses and pharmacists. McKesson is a leader in clinical care guidelines, such as our InterQual software used by more than 3,500 health plans, hospitals, government agencies and others.

## 6 We are facilitating the next generation of healthcare, here and abroad.

We are exploring opportunities to selectively take our products and services abroad, participating in global trends, including generic drug sourcing, demand for healthcare IT and preventive care. Additionally, we are examining actively the future for groundbreaking next-generation therapies and approaches.

Today, McKesson and its employees are making the transformation of healthcare real. At the same time, we are creating significant value for our customers and shareholders.

## Business Segment Results

## Pharmaceutical Solutions

Pharmaceutical Solutions revenues increased 10% for the year, reflecting solid growth among core customers and also our mid-year acquisition of D&K Healthcare Resources (D&K). The new agreements we signed with pharmaceutical manufacturers became fully effective in Fiscal 2006, which smoothed the previous seasonality of operating profit in our largest segment, essentially pulling forward earnings into the first three quarters of the year and diminishing the historical fourth-quarter peak. We expect this trend will continue in coming years, though some seasonality will likely remain.

The other key component of our pharmaceutical distribution profit stream is our programs to acquire and sell generic drugs into our customer base. We believe that McKesson is now the world's largest buyer of generic drugs. With a projected $20 billion of branded drugs facing patent challenges and/or patent expirations in the United States in 2006, and $90 billion through 2011, the trend of increasing profit contribution from our domestic generics business should continue to have a positive impact on future segment margin rates and earnings.

In August 2005, we purchased D&K, a much smaller regional pharmaceutical distributor. Virtually all D&K customers were independent pharmacies or small retail drug chains, and with this acquisition we significantly expanded our market for higher-margin generic sales. Our integration team executed superbly on its plan to streamline operations and retain the D&K customer base. As a result of the work done by our team, the acquisition will meet its goal for accretion to earnings in Fiscal 2007.

On the operations side, in addition to the outstanding integration of the D&K acquisition, we continued to improve our quality of service and productivity. Studies by group purchasing organizations on relative service quality show McKesson to be the industry leader in terms of fill rates and invoice pricing integrity. Purdue Benchmark Research designated our Westlake ServiceFirst Call Center, which handles seven million calls annually, #1 in the industry. McKesson continues to pioneer supply chain safety technologies such as the development of RFID technologies to track product movement.

Our longstanding, market-leading Canadian pharmaceutical distribution operations continue to perform very well. We are also using our market position and operating infrastructure in Canada to drive sales of information technology, automation and payor products and services in this market. In Mexico, our expanded ownership of Nadro is enabling us to strengthen our understanding of that market and its opportunities, and to bring more of our expertise to bear in its operations. Our position as the #1 drug distributor in North America has never been stronger, and is an increasingly important asset in our relationships with multi-national customers and manufacturers.

The Pharmaceutical Solutions segment also includes our Payor business, which has great momentum. Our Disease Management business provides chronic care support and guidance to 1.5 million Americans through contracts with nine state Medicaid programs and one Medicare chronic care improvement program. During Fiscal 2006, McKesson renewed or extended four state programs, signed a new program with the state of Pennsylvania and implemented our Medicare program in the state of Mississippi with an outstanding 75% enrollment rate.

In summary, we continue to make great progress in Pharmaceutical Solutions. We have strong, value-based relationships across our balanced mix of customers, many of which are leaders in their market segments. This should enable sustained revenue growth at market rates. We have gained a significant amount of predictability in the compensation we receive from manufacturers while developing stronger relationships with them. We are managing our operations to deliver efficiencies to McKesson and high quality of service to our customers. We are well-positioned to benefit from market dynamics such as the Medicare Modernization Act, increased use of generics and a growing use of disease management programs to manage costs and improve health outcomes.

## Medical-Surgical Solutions

Medical-Surgical Solutions revenues were up for the full year, driven by strong growth among our alternate site customers, but operating profit was down due to challenges in our acute care business. Our operating profit result was clearly disappointing, and well below our expectations for this business when the year began. Over the past several years, we have invested time, money and resources in programs to improve our competitive differentiation in the acute care sector. To compensate for our lack of scale, we made structural changes designed to cut costs, and also evaluated potential acquisitions. These strategies have not closed the gap with competitors, and it is clear that we continue to be at a competitive disadvantage in the acute care sector. As a result, we are examining strategic alternatives for the acute care portion of the business.

## Provider Technologies

The momentum generated by McKesson Provider Technologies (MPT) in Fiscal 2005 accelerated in Fiscal 2006. Clearly, we are benefiting from our previous significant investments in product development, customer service and support. Market demand remains strong and we continue to see solid demand for our clinical software, our industry-leading digital medical imaging and document imaging solutions and our automation systems. We expanded our digital medical imaging position with our Fiscal 2006 acquisition of Medcon, a leading cardiology imaging and departmental management software provider. We are rapidly integrating the Medcon product into our imaging offering, and expect it will be well-received as we use our sales reach to bring these new products to our large installed base.

A major priority for MPT in Fiscal 2006 was to accelerate the speed of its clinical implementations, to drive revenues and accelerate our sales process with other customers. We made great progress. In June 2005, Duke University completed its hospital-wide implementation of Horizon Expert Orders™, a little more than nine months after we began the conversion with the cardiology department. Horizon Expert Orders is now fully in use across all specialties in Duke's adult hospital. With more than 1,800 clinicians, including 500 physicians, now using the system, Duke averages 20,000 orders per day, with a total of more than 7.5 million orders entered in the system since fall 2004.

Following the go-live of Horizon Expert Orders, Duke signed an agreement with us to partner on the development of best-practice clinical content embedded in our solution. In January, we signed another agreement with Duke, to provide electronic prescribing and electronic health records to approximately 80 health clinics and physician practices in the communities surrounding Duke, encompassing 1,500 physicians. This initiative bridges inpatient and outpatient clinical care and documentation and represents a potential best-practice model for ambulatory solutions for hospitals and health systems. I am very proud of the relationship that McKesson and Duke have created together.

MPT signed a number of large clinical deals during FY06, but none was larger, literally or figuratively, than our contract with Triad Hospitals. In January, Triad announced a 10-year, $1.3 billion initiative to install a suite of standardized, world-class clinical and financial applications across all 49 Triad hospitals and 10 ambulatory surgery centers. Our role in this initiative is a $120 million software and services contract to provide our Horizon Clinicals® and revenue cycle solutions, and to work with Triad and the other vendors to implement our applications. We also have another $42 million contract to support the outsourcing vendor, EDS. The $162 million in total revenues over the next three years represents the largest clinical and revenue cycle deal we have ever signed.

We are now selling effectively, not only among our historical base of community hospitals with more than 200 beds, but also among both large academic centers and hospitals with 100 beds or less; and, with the Triad contract, we are the leading healthcare information technology solutions vendor to for-profit hospitals. Of the five largest chains as measured by number of acute-care facilities, we are the sole source for healthcare IT products in three, and a dual source for either clinical or medical imaging solutions in the other two. Each of these organizations is well-known for disciplined decision-making. Their decisions followed a rigorous evaluation of available products. Triad chose McKesson based on our product functionality, ease of use, clinical value and return on investment. Their decision is a strong endorsement of the power of our Horizon Clinical solutions.

We are clearly continuing to win in the U.S. market, but we are also quietly working on some big projects in Europe. In June 2005, we completed the extension of our contract with the National Health System of England and Wales (NHS) to a term of nearly 13 years, which included a cash payment of approximately $143 million to McKesson, primarily for our investment in the project to that point. The implementation continues to go very well. To date, 220,000 employees out of approximately 1.2 million total employees have been activated on the system. About half of the NHS sites are nearing full implementation, and we are right on schedule for our goal of full implementation during Fiscal 2009. Our success with this large project sets the stage for more opportunity in the UK. We are one of the few NHS vendors to get it right, and it is a privilege to serve this important customer.

On the continent, on March 31, McKesson France signed a contract to provide electronic health records, Horizon Physician Portal*WP*®, a bedside information system and Horizon Medical Imaging™ to Clermont Ferrand University Hospital, one of the largest hospitals in France. This win came after a successful go-live and system acceptance by the first of nine French Army Hospitals that are currently on track to deploy McKesson solutions, including a full electronic patient record and the French version of the Horizon Physician Portal*WP*. Both of these prestigious wins came against major European and U.S. competitors.

We are also winning the hearts and minds of our customers with our drive to innovate. In the *Top 20: 2005 Best in KLAS* year-end report, McKesson had 15 products rated in the top three in their categories, up from 12 last year. Two McKesson solutions received ''Best in KLAS'' ratings: Horizon Medical Imaging in the community sector and the combination of Pathways Materials Management and Pathways Financial Management, which was rated #1 in the financial/ERP category for the third straight year. By comparison, one other competitor had eight products in the top three and two smaller competitors each had three. Our results in the area of medication management technology to prevent drug errors are also strong. In the latest KLAS report on Closed-Loop Medication Management Solutions, McKesson was the vendor most often considered for bar-code medication administration. I believe that we have the clearest vision of our customers' needs, and the most aligned strategy for realizing that vision.

I am extremely pleased with our continuing progress at MPT. Given the sustained demand we are seeing for healthcare information technology solutions, the market's positive response to our offering, and our commitment to product innovation, customer quality and organizational efficiencies, we expect to see sustained strong growth in McKesson Provider Technologies, and continued long-term margin expansion.

### Financial Summary and Outlook

This year's strong performances of our Pharmaceutical Solutions and Provider Technologies segments, our new pharmaceutical manufacturer agreements and our continuing focus on supply chain efficiencies combined to generate exceptional cash flow from operations of $2.7 billion. Over the past four years, we have generated cumulative operating cash flow of almost $6 billion, which has transformed our balance sheet and enabled us to resolve the shareholder litigation while pursuing a more aggressive strategy for value creation. We continued to deploy our capital in a measured, flexible way. In Fiscal 2006, we allocated $603 million to acquisitions, $958 million to share repurchases and $73 million to dividend payments. Even after securities settlement payments of $1.2 billion, including $960 million for the final payment of all amounts due to the plaintiff class under the consolidated class action settlement, we ended the year with a cash balance of $2.1 billion and a very low debt-to-capital ratio, providing a great platform for our strategic planning for shareholder value creation.

Based on our operating progress and strategic investments over the past six years, McKesson enters Fiscal 2007 well-positioned in large and growing markets for healthcare services and technology. We sit in the middle of healthcare during a period of great challenge, but opportunity. We are the #1 pharmaceutical distributor in the United States and Canada. We are the largest distributor of generics in North America, at a time when the availability and consumption of these drugs is projected to increase significantly, and we continue to focus on expanding sales to existing wholesale distribution customers. Our business providing software and disease management services to payors is poised for significant growth. We are well-positioned in the attractive alternate site medical-surgical market. Demand for software and automation solutions across healthcare remains strong. McKesson has a large installed base of hospital customers and a well-regarded product offering for both acute care and ambulatory care. The improving performances of our Pharmaceutical Solutions and Provider Technologies segments, combined with our strong balance sheet and solid cash flow, should enable McKesson to continue a disciplined but flexible and opportunistic strategy for further shareholder value creation. And our vision for what healthcare can be will continue to drive our strategies and motivate our efforts.

My thanks to our employees for their hard work and deep commitment to our success, to our customers for their loyalty and cooperative spirit, to our supplier partners for their collaborative approach to our mutual goals, and to our shareholders for their continued support. I look forward to another strong performance in Fiscal 2007.

John H. Hammergren
*Chairman and Chief Executive Officer*

**Special Note Regarding Forward-looking Statements**

Certain matters discussed in this letter constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended. Some of the forward-looking statements can be identified by the use of forward-looking words such as ''believes,'' ''expects,'' ''may,'' ''will,'' ''should,'' ''seeks,'' ''approximately,'' ''intends,'' ''plans,'' ''estimates'' or ''anticipates,'' and the negative of those words or other comparable terminology. The discussion of financial trends, strategy, plans or intentions may also include forward-looking statements. Forward-looking statements involve risks and uncertainties that could cause actual events and results to differ materially from those projected. These include, but are not limited to, the factors discussed in the company's Fiscal 2006 Annual Report on Form 10-K that accompanies this letter.

A reconciliation between our net income (loss) per share reported for U.S. GAAP purposes and our earnings per diluted share, excluding charges for our Securities Litigation, is included on page 34 of the Company's 2006 Annual Report on Form 10-K.