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MCKESSON
Empowering Healthcare

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To Our Stockholders:

In Fiscal 2007, McKesson again delivered solid financial results by executing well on our operating objectives and meeting our commitments to our customers. For the year, our revenues grew 7% to $93 billion. Earnings per diluted share of $2.89 from continuing operations, excluding adjustments to the Securities Litigation reserve, were up 17% from the prior year, the second straight year that our earnings grew 15% or more.

Each of our three segments contributed to the company's growth. Pharmaceutical Solutions revenues grew 6%, operating profit was up 12% and full-year operating margin rate expanded to 1.53%, an increase of 8 basis points. Medical-Surgical Solutions grew revenues 16% while completing a seamless transition out of the acute care medical-surgical products business. Provider Technologies revenues grew 24% and operating profit increased 11%. In this segment, we continued to invest in product development, expand our sales force and complete acquisitions to strengthen our position in emerging markets for physician office information solutions, consumer-directed healthcare and health-care connectivity.

In Fiscal 2007, we invested $306 million in capital expenditures and capitalized software to grow our businesses. We repurchased $1 billion in shares, bringing to $2 billion our total share repurchases over the past two years, and paid $72 million in dividends. At its meeting in April, the Company's Board of Directors authorized an additional $1 billion share repurchase program. We made $1.9 billion in acquisitions that have the potential to accelerate future growth and stockholder value creation, including Per-Se Technologies, which we acquired in January for $1.8 billion. We financed our purchase of Per-Se with $800 million in cash and $1 billion in new debt, bringing our debt-to-capital ratio to 24%, closer to our long-term target of 30% to 40%. Cash flow from operations of $1.5 billion in Fiscal 2007 combined with our sound balance sheet will enable us to continue to execute a balanced capital deployment strategy designed to create additional stockholder value in Fiscal 2008 and beyond.

All in all, Fiscal 2007 was a great year for McKesson. We are seeing the benefits of our strategy to deliver products, services and solutions that are helping our customers make healthcare safer, more efficient and higher quality. Our dedication to operating excellence and our balanced capital deployment strategy provide momentum for continued stockholder value creation in Fiscal 2008.

Achieving our great results and realizing our exciting future rests on our ability to attract, motivate and retain great people. My thanks to the people of McKesson for their hard work and engagement that drove our results this past year. My thanks also to our customers for their loyalty and collaborative spirit to change healthcare for the better, to our supplier partners for their innovation and partnership and to our stockholders for their continued support.

McKesson and Healthcare

In my letter last year, I described some of the ways that McKesson is helping transform and improve the quality and cost of healthcare. Our employees continue to focus not only on delivering superior financial results, but also on making healthcare simpler, safer, more efficient and more connected. Over the past year, through new programs and acquisitions, we have strengthened and expanded our capabilities. We added customers, enhanced our product and service offerings, entered new markets and introduced unique new solutions to the most pressing issues in healthcare.

McKesson sits at the center of healthcare. We touch more participants across the healthcare spectrum than any other company. For our 25,000 pharmacy customers, we have the highest service levels in the industry, ensuring that both branded and generic pharmaceuticals are available to be dispensed to patients whenever needed.

For our largest customers, our sophisticated information systems and working capital management capabilities streamline product flows and optimize inventory investments. The largest percentage of our customer orders are now via our Internet portal, Supply Management On-line, which accounts for $1.7 billion of pharmaceutical orders each month. Through our Per-Se acquisition, we now process 70% of retail pharmacy claims.

For independent pharmacies, our Health Mart franchise program levels the playing field by providing its members with the resources they need to compete more effectively in today's increasingly competitive marketplace. Our services include a managed care network, consumer-preferred branding, dedicated merchandising support and access to our OneStop proprietary generics program. Since introducing an enhanced Health Mart® program July 1, our franchise count increased from 350 stores to more than 1,400 stores, making Health Mart the largest independent domestic pharmacy franchise network. Health Mart was recently recognized as "Pharmacy Chain of the Year" by *Drug Topics* magazine.

Last September, McKesson Specialty was selected by the Centers for Disease Control and Prevention (CDC) to provide nationwide distribution services for its Vaccine for Children program, replacing a previous network of vendors. The Vaccine for Children program purchases 40 percent of the total doses of routinely recommended pediatric vaccines distributed in the U.S. to 1.8 million uninsured and underinsured children, as well as American Indian, Alaska Native and Medicaid-eligible children.

Among hospitals, we are seen as a leader in quality of service and support because of our One McKesson approach providing comprehensive supply chain, information and automation solutions. Hospital surveys rank McKesson first in overall hospital customer satisfaction with our pharmaceutical distribution services and contract administration accuracy, and we have more category-leading software product rankings than any other company. Our clinical and administrative software solutions are used by more than 3,500 hospitals, 200,000 physicians, 500,000 nurses and 600 payors to ensure that patient records and clinical information are available across the healthcare system, that best medical practices are being applied at the place and time care is delivered and that transactions and funds flows are seamless and timely. Our market-leading medical imaging systems provide digital access to clinicians anytime, anywhere, and eliminate the need to buy and store film images. Our market-leading document scanning solutions provide physicians with patient information via computer, reducing paperwork and freeing up valuable storage space for clinical use. We are the leader in medication safety, with the only fully integrated solution spanning information systems, automated drug dispensing and bedside error prevention. McKesson's Robot-Rx® dispenses half a billion doses annually, error-free. McKesson's Horizon Admin-Rx™ bedside scanning device prevents more than 325,000 errors weekly.

Through a series of acquisitions during Fiscal 2007, we significantly expanded our footprint in the physician market and today reach 120,000 physicians, including tens of thousands of mid-size and small-office physician practices. We now offer a comprehensive solution including software, medical supplies, vaccines, specialty pharmaceuticals, connectivity and transaction processing. Our physician information solutions for patient scheduling, electronic health records, electronic prescribing, electronic billing and online medical consultation enables doctors to spend more time interacting with patients, improving the quality of care and the patient's experience. We have an expanding presence delivering medical supplies to clinics, surgery centers and the home.

Employers, government, patients and payors are seeking solutions that make healthcare more affordable and more accessible. A handful of chronic diseases, including asthma, diabetes and congestive heart failure, account for 80% of healthcare spending. Early intervention and better management of these diseases can keep patients out of hospitals, in their homes and on their jobs, substantially reducing costs, improving quality of life and allowing a reallocation of medical resources. McKesson is the leader in disease management in the public market, where we provide these services for 1.5 million Medicaid patients in nine states. We continue to expand our disease management services. Today, we are augmenting our nurse call centers for monitoring and advising patients with additional support from physicians, pharmacists, social workers, health coaches and psychologists, to deliver the right care and right treatment at the right time.

Following our acquisition of Per-Se, we combined the connectivity and claims processing capabilities of our two companies into a new business that we have branded RelayHealth™. RelayHealth expands on McKesson's previous physician-patient communications business with a focus on helping to decrease administrative costs and improve care by connecting physicians and other providers, pharmacies, payors and consumers. We believe this very powerful collection of assets can become a strong differentiator as consumerism in healthcare grows. Increasing demand for online healthcare transactions such as real-time eligibility checking, online lab results and electronic formulary compliance and prescribing creates a great opportunity to use our Web-based solutions and pharmacy and payor networks to make care delivery more interactive and better connected. We're also excited about the ability to accelerate growth in markets like small physician practices and retail pharmacies while building even stronger relationships in our hospital and payor customer base.

As a result of our capabilities, execution and strategy, McKesson has both a tremendous opportunity and a weighty responsibility to help shape the future of healthcare. Every day, McKesson and its people are making healthcare safer and more efficient. At the same time, we are creating value for our customers, employees and stockholders. It's a terrific combination and a great place to be.

Business Segment Review

During Fiscal 2007, our Pharmaceutical Solutions team executed on every facet of the business. We continue to strengthen our relationships with our customers. We successfully renewed all major contracts that expired, by focusing on the value and quality of the higher-margin products and services we provide. We performed well on our agreements with branded pharmaceutical manufacturers. We focused on improving the efficiency of our operations to leverage our revenue growth.

For the year, Pharmaceutical Solutions revenues grew 6%. Adjusting for the mid-May 2006 termination of a large customer contract, U.S. Healthcare direct store revenues were up 11% for the year. Warehouse sales increased 8% for the year. Our revenue growth reflects the success of our customers, partially driven by the implementation of Medicare Part D drug coverage for seniors early in our fiscal year.

Since the transition to more predictable compensation from branded pharmaceutical manufacturers two years ago, we have focused our sales force on the profitability of our customer relationships during contract renewals. During Fiscal 2007, our sell margin remained relatively stable. We renewed longstanding relationships with several of our largest customers, including Wal-Mart, Target and Aetna, and expanded our relationships with CVS and Broadlane, the hospital group purchasing organization.

Fiscal 2007 represented a great opportunity to grow our generics business, with a significant number of major branded pharmaceuticals losing patent protection. The use of cost-efficient generics is a huge focus of payors and employers. As a result, the branded-to-generic conversion cycle is now extremely rapid. On average, within several months more than 90% of branded drug volume is converted to the generic form of the drug.

We have an experienced team managing our generics business. To maximize our generics opportunity in Fiscal 2007, the team put together a plan that included an expanded customer base for our proprietary generics programs, a new information system that could better track buying compliance among customers and a new telemarketing capability into our base — the planning paid off. The generic conversions of Zocor and Zoloft early in our fiscal year went very well. According to IMS Health, Zocor is the first case where the conversion to a generic led to an increase in overall units of the molecule dispensed, further enhancing the market opportunity. We also benefited from the brief introduction of a generic form of Plavix. We executed on these opportunities, and, as a result, sales growth for our OneStop program increased 51% for the year. We believe we have the industry-leading generics program.

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

In Medical-Surgical Solutions, while operating profit was relatively flat for Fiscal 2007, we made significant market progress, positioning this business for future growth. Revenues were up 16% over the prior year despite it being a year of transition. In September, we sold our acute care business that provides medical-surgical supplies to hospitals. Many of these hospitals are also customers of our U.S. pharmaceutical distribution business or McKesson Provider Technologies. It was crucial that the transition be handled well and that we maintain our positive brand reputation within this sector of the market. We completed the transition of our acute care business ahead of schedule. Most important, the handoff was seamless and the feedback from customers has been very positive.

During Fiscal 2007, Provider Technologies solidified its leadership position for comprehensive information solutions in our traditional core hospital customer base. Demand remains strong, especially for our market-leading clinical and medical imaging solutions. Last year, we increased our new business win rate by 27%. Our Medical Imaging solutions received two "Number One" rankings in the *2006 Top 20 Year-End Best in KLAS* report — one in the community health information category for Horizon Medical Imaging, and another in the cardiology reporting and documentation category for Horizon Cardiology. With our tremendous growth over the past four years, we are poised to take a market-leading position in the medical imaging market. Not surprisingly, our Medical Imaging Group is the recipient of the Frost and Sullivan Market Penetration Leadership Award in the U.S. PACS industry for the second consecutive year, reflecting our market share gains.

We expanded the customer base for Paragon™, our top-ranked solution for smaller community hospitals. In addition, we signed contracts representing 140 hospitals for Patient Compass™ online patient billing, clearly a high-growth differentiator for McKesson as consumer-directed healthcare becomes more prevalent.

Adoption of our systems continues to grow. By the end of Fiscal 2007, we had crossed the 4 million mark on monthly logins to Horizon*WP*® Physician Portal and radiology installations increased 30% over the prior year. McKesson bedside bar-code scanning systems were issuing 332,000 "near misses" to flag potential medication errors each week, and we increased by 150% the number of facilities with nurses and other care team members documenting patient care electronically. Looking beyond clinicals, our RelayHealth financial transaction clearinghouses together processed claims totaling more than three-quarters of a trillion dollars.

Internationally, we continue to make great progress in Europe. In the United Kingdom, we have more than 50% of National Heath Service sites operating with a new payroll and human resources information system from McKesson. In France, we achieved go-lives for all nine SSA Ministry of Defense army hospitals, which run the complete McKesson solution suite. We now have a presence in the largest 262 out of 1,000 French public hospitals.

We announced in our year-end press release issued May 7 that beginning next quarter, we will report our results in two segments: McKesson Distribution Solutions, which includes what was previously reported as Pharmaceutical Solutions and Medical-Surgical Solutions, with the exception of our Payor business, which will now be reported together with McKesson Provider Technologies in the second segment, McKesson Technology Solutions. This change reflects our decision to more closely align our Payor business with the strategy we are pursuing in McKesson Provider Technologies and Relay-Health to create value by promoting connectivity, economic alignment and transparency of information between payors and providers. We have a very large installed base of payor software customers and continue to introduce new products to maintain our market leadership. We believe that aligning the two solution sets produces a powerful value proposition unique to McKesson. The combination of Pharmaceutical Solutions and Medical-Surgical Solutions into a single segment reflects the increasing synergies we are seeking through combined back office activities and best-practice process improvements under common management.

Subsequent to the filing of our Annual Report on Form 10-K, on May 30, 2007 we filed a Current Report on Form 8-K with the Securities and Exchange Commission that reclassifies our results for the past two fiscal years into our two new operating segments. For perspective, in Fiscal 2007 as reclassified, Distribution Solutions revenues of $90.7 billion were up 7% from the prior year. Operating profit of $1.4 billion was up 12% from the prior year and operating profit as a percentage of revenues was 1.54%. Technology Solutions revenues of $2.2 billion were up 21% from the prior year. Operating profit of $206 million was up 10% from the prior year and operating profit as a percentage of revenues was 9.20%.

Summary and Outlook

In summary, McKesson delivered outstanding performance in Fiscal 2007. Based on the demonstrated value of our product and service offering, our operating progress and strategic investments, we enter Fiscal 2008 well-positioned for growth in both existing and emerging markets for healthcare distribution services and healthcare information technology. We are in the right markets with the right offerings at the right time.

Within Distribution Solutions, we are the largest pharmaceutical distributor in the United States and Canada, and own 49% of the leading pharmaceutical distributor in Mexico. We are the largest distributor of generics in North America, at a time when the consumption of these drugs is growing due to their great value. We are the leading distributor of medical-surgical supplies to the fastest-growing segments of the market, such as physician offices, surgery centers, clinics and nursing homes.

Our Technology Solutions segment has the largest installed base of hospital and payor customers in the industry, and we continue to see strong demand for our solutions. Software and automation solutions that can improve the efficiency and quality of healthcare have tremendous value for our customers. We have unique offerings for the emerging sectors of the market and are using technology to connect all participants across the healthcare spectrum.

We are pleased with our overall performance in Fiscal 2007, the momentum we are taking into Fiscal 2008, the upsides in our businesses and the tremendous assets and opportunities we have to create additional stockholder value while positively influencing the evolution of healthcare. I look forward to another strong performance in Fiscal 2008.

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, that involve risks and uncertainties that could cause actual results to differ materially from those projected, anticipated or implied. Some of the forward-looking statements can be identified by the use of forward-looking words such as “believes,” “expects,” “anticipates,” “may,” “should,” “seeks,” “approximately,” “intends,” “plans,” “estimates” or the negative of those words or other comparable terminology. The discussion of financial trends, strategy, plans or intentions may also include forward-looking statements. It is not possible to predict or identify all such risks and uncertainties; however, the most significant of these risks and uncertainties are described in the Company’s 2007 Annual Report on Form 10-K that accompanies this letter.

A reconciliation between our income from continuing operations per share reported for U.S. GAAP purposes and our earnings per diluted share from continuing operations, excluding charges for our Securities Litigation, is referenced in our Form 8-K dated May 7, 2007.