Rite Aid Corp.: Moody's accounting adjustments and credit report[1, 2]

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ABSTRACT

Arlene Webb, a recently hired credit analyst at Moody's Investor Services, had the challenging task of making the necessary accounting adjustments to the financial statements of Rite Aid Corporation as per Moody's August 2018, document, *"Financial Statement Adjustments in the Analysis of Non-Financial Corporations."* Moody's adjusted a company's reported financial statements to improve analytical insights from the perspective of determining credit risk and to improve the comparability of financial data between peers. Moody's then used the adjusted financial statements to compute credit-relevant ratios that, in turn, determined the company's credit rating. Arlene's task was to restate the reported numbers by incorporating the accounting adjustments that undid the distortions in the financial statements. Finally, she had to prepare a preliminary credit report for the Rite Aid Corporation for 2019 based on relevant ratios calculated using the restated financial statements.

Keywords: Moody's, accounting adjustments, credit rating

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[2] A detailed Teaching Note is available upon request by emailing the author at sudpa@pugetsound.edu

INTRODUCTION

Arlene Webb sat at her desk and pondered her plan of action. She had been hired as a credit analyst at Moody's Investors Service right out of graduate school and now faced her first significant independent assignment. She had been asked by her supervisor, Carl Manning, Vice President and Senior Credit Officer, to make the necessary accounting adjustments to the financial statements of Rite Aid Corporation as per Moody's August 2018, document, *"Financial Statement Adjustments in the Analysis of Non-Financial Corporations."* Moody's adjusted a company's reported financial statements to improve analytical insights from the perspective of determining credit risk and to improve the comparability of financial data between peers. Moody's then used the adjusted financial statements to compute credit-relevant ratios that, in turn, determined the company's credit rating. Arlene's task was to complete the Excel template that employed Moody's standardized terminology and classifications for the three financial statements (Exhibits 1, 2, and 3). The Excel template restated the reported numbers by incorporating the accounting adjustments that undid the distortions in the financial statements. Finally, she had been asked to prepare a preliminary credit report for the Rite Aid Corporation for 2019. Arlene had on her desk Moody's Credit Report dated October 15, 2018, in which Moody's had downgraded Rite Aid to a B3 with a negative outlook. Exhibit 4 provides select data for Rite Aid and its chief competitors – Walgreens Boots Alliance and CVS Health.

Rite Aid Corporation is a pharmacy retail healthcare company operating through two reportable business segments – Retail Pharmacy and Pharmacy Services. The Retail Pharmacy segment, which accounted for 73% of its revenues and 91% of its gross profit in 2019, sells brand and generic prescription drugs as well as other personal care merchandise at its 2,469 retail stores. The Pharmacy Services segment provides a full range of pharmacy benefit services to health plans, unions, insurance companies, and health benefit plan sponsors.

In February 2018, Rite Aid entered into a merger agreement with Albertsons, a grocery company. However, in August 2018, the two parties terminated the merger agreement because the management of Rite Aid was unable to convince its shareholders of the merits of the merger. In March 2018, Rite Aid sold 1,932 stores, three distribution centers, and related inventory to Walgreens Boots Alliance for $4.375 billion and used the proceeds to repay and retire some of its debt.

As a first step in this process, Arlene Webb decided to read the Moody's document and summarize the suggested methodologies for various accounting adjustments in language she could understand and apply. Since not all of the adjustments suggested by Moody's would apply to Rite Aid, she decided to skim the footnotes to the financial statements of Rite Aid and extract the relevant footnote information. The Balance Sheet, Income Statement, and Statement of Cash Flows for Rite Aid Corporation for the year ended March 2, 2019, are in Exhibits 5, 6, and 7 respectively.

MOODY'S FINANCIAL STATEMENT ADJUSTMENTS IN THE ANALYSIS OF NON-FINANCIAL CORPORATIONS

Moody's classifies adjustments to financial statements as standard and non-standard. Standard adjustments are adjustments made across all companies and typically reflect distortions introduced in financial statements as a result of GAAP implementation. For instance, a standard adjustment is required to correct for the distortion resulting from LIFO (last-in-first-out)

accounting for inventory. LIFO accounting is allowed under US GAAP but not under IFRS. Because LIFO accounting results in inventory costs in the balance sheet to include old inventory layers, the amount for inventory in the balance sheet does not reflect current replacement cost. Hence, Moody's suggests an adjustment to correct for this distortion and to improve comparability of statements across companies. In addition to standard adjustments, Moody's suggests non-standard adjustments to financial statements of individual companies so that they better reflect the firm's underlying economic reality. For instance, an adjustment may be required if the firm's estimate of the allowance for doubtful accounts as a percentage of gross receivables is significantly different from its peers and the industry average. Standard and non-standard adjustments affect all the three primary financial statements – the balance sheet, the income statement, and the statement of cash flows.

Based on her perusal of the Moody's document and Rite Aid's 10K for the year ended March 2, 2019, Arlene identified the following standard and non-standard adjustments as relevant:

Standard Adjustments:

a. Defined Benefit Pension Plans
b. Multiemployer Pension Plans
c. Leases
d. Inventory Reported on LIFO Basis
e. Unusual and Non-recurring Items

Non-standard Adjustments:

f. Allowance for Uncollectible Accounts
g. Depreciation Expense Computation

a. Defined Benefit Pension Plans

Pension plans can be defined contribution plans and defined benefit plans based on the nature of the promise made to retirees. Defined contribution plans specify the amount of cash that the employer puts into the pension plan trust. However, the plan does not guarantee the size of the periodic benefits that employees will receive on retirement. As a result, the accounting for defined contribution plans is simple. The company records pension expense equal to the amount of cash contributed to the plan. Moody's does not recommend any adjustment for defined contribution plans.

Defined benefits plans specify the formula, typically based on each employee's years of service and salary at retirement that determines the annual benefit amount to be paid to employees during retirement. The accounting for defined benefit plans is complex and involves a number of estimates and forecasts, such as the life expectancy of the covered employee after retirement, the appropriate discount rate in computing the present value of future benefits, and the salary of employee at retirement. *ASC Topic 715, Compensation – Retirement Benefits* specifies the pension measurement and reporting requirements. The accounting for defined benefits plans includes several smoothing features to make the annual pension expense less volatile. The smoothing techniques and recognition rules distort the measurement of pension expense on the income statement and fails to fully recognize the amount and nature of the company's economic obligations to its pension trust on the balance sheet. The standard also requires a company to classify cash contributions to the pension trust as an operating cash flow

in the statement of cash flows, including the portion that is reducing plan underfunding, which technically represents a reduction of pension debt.

Moody's recommends the following adjustments for defined benefit plans:

> Balance Sheet
> We record as debt the amount by which the defined benefit pension obligation is underfunded. Our adjustment recognizes the gross underfunded pension obligation (PBO – Fair Market Value of assets) as debt, and removes any remaining intangible pension assets and liabilities. PBO is the Projected Benefit Obligation.
> Income Statement
> We remove all as-reported defined benefit costs (or income) with the exception of the actuarially determined current period service cost.
> We attribute interest expense to pension-related debt using an interest rate that represents a
> theoretical average borrowing cost for each issuer based upon its rating.
> We recognize interest cost on the PBO in excess of interest attributed to pension-related debt in other non-recurring income/expense; add or subtract actual losses or gains on pension assets (but only in an amount up to the interest cost after attributing interest expense to pension-related debt) in other non-recurring income/expense.
> Statement of Cash Flows:
> We reclassify employer cash pension contributions in excess of service cost from cash flow from operations to a financing cash outflow. We do not adjust the cash flow statement if pension contributions are less than the service cost. (Moody's, 2018)

Exhibit 8 contains excerpts from footnote 18: Retirement Plans from Rite Aid's 10k for the year ended March 2, 2019. Exhibit 9 contains excerpts from Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Continuing Operations. The annual weighted average interest rates on Rite Aid's indebtedness in fiscal 2019, 2018 and 2017 were 5.6%, 7.1% and 5.4%, respectively. Exhibit 10 contains excerpts from Note 7: Income Taxes. The income tax rate for fiscal 2019 was 21%.

b. Multiemployer Pension Plans

Under US GAAP, multiemployer pension plans (MEPP) are not reflected as a liability on the balance sheet. MEPPs generally cover workers from more than one employer, and employer contributions, determined by collective bargaining with a labor union, fund the plans. If one participating employer in a MEPP fails, the remaining employers participating in the plan could be required to share in the failed employer's obligation.

Consistent with its treatment of single-employer pension plans, Moody's believes that a company's share of multiemployer pension plan underfunding represents a long-term debt-like liability. The ability to precisely estimate a company's share of MEPP under-funding is limited, as companies are not required to disclose their share of any under-funding. Moody's rating methodology estimates a company's share of under-funding by multiplying the company's most

recent annual contribution to its plans by the applicable industry's under-funding multiple. Moody's recommends the following adjustments for multiemployer pension obligations:

> Balance Sheet:
> We increase debt by the amount attributed as the company's share of underfunding, record a
> deferred tax asset related to the resulting temporary difference, and record the remainder as a
> reduction to shareholders' equity.
> Income Statement:
> We recognize related interest expense using an interest rate that represents a theoretical
> average borrowing cost for each issuer based upon its rating.
> Statement of Cash Flows:
> We do not adjust the cash flow statement. (Moody's, 2018)

Exhibit 11 contains excerpts from footnote 19: Multiemployer Plans that Provide Pension Benefits from Rite Aid's 10k for the year ended March 2, 2019. The under-funding multiple for the retail industry (the relevant industry for Rite-Aid) was 9.2

c. Leases

Under *ASC Topic 840: Leases,* lessees classify leases as operating or capital leases. Operating leases are not reported on the balance sheet, but capital leases are treated as secured borrowing. Under a capital lease, the lessee accounts for the leased asset as a long-lived asset and the lease liability partly as a current liability (due within one year) and partly as a long-term liability.

Lease accounting under *ASC 840* has been criticized since it allowed lessees to engage in off-balance sheet financing by classifying leases as operating leases even though they were economically similar to capital leases. To address these criticisms, the FASB issued *ASC Topic 842: Leases* and IASB issued *IFRS 16*. The new standards require lessees to recognize right-of-use (ROU) assets and related lease liabilities on the balance sheet for all lease arrangements with terms longer than 12 months. During July 2018, the FASB issued *ASU 2018-11, Leases (Topic 842): Targeted Improvements*. Among other things, *ASU 2018-11* provides administrative relief by allowing entities to implement the lease standard on an alternative transition method. Effectively, the alternative transition method permits adoption of *ASC 842* through an adjustment to its opening balance sheet for the period of adoption, with the cumulative effect accounted for as an adjustment to retained earnings, without restating prior periods. Rite Aid Corporation will adopt the new lease standard during the first quarter of fiscal 2020. Therefore, the financial statements of Rite Aid for the year ending March 3, 2019 reflects *ASC 840.*

Moody's adopts the following rationale and approach for issuers that do not record operating leases on the balance sheet. ASC 840 distinguishes between capital and operating leases using arbitrary bright-line tests. As a result, companies structure transactions to achieve different accounting for its leases, even though the economic distinction between capital and operating leases is generally insignificant. This results in diminished comparability between

companies that account for similar economic transactions differently and between companies that lease assets versus those that buy them.

Moody's recommends the following adjustments for leases accounted under *ASC 840*.

> Balance Sheet:
> We increase debt and fixed assets by an amount that equals the greater of (i) the present value of minimum lease commitments, capped at 10x rent expense, or (ii) a sector multiple times annual rent expense.
> The present value of minimum lease commitments is calculated by discounting minimum lease commitments disclosed in the company's footnotes by the interest rate that is estimated based on the issuer rating. The "thereafter" portion is discounted assuming that the year five liability will remain flat in subsequent years.
> Sector multiples have been set to levels that approximate the sector's median-implied PV multiple and range from 3 to 6. The Appendix to the Moody's document, *Financial Statement Adjustments in the Analysis of Non-Financial Corporations,* provides a listing of sector multiples. The sector multiple for the retail industry is 5.
> Income Statement:
> We reclassify rent expense to interest and depreciation expense using the following calculation, and we adjust operating expenses (or cost of goods sold and selling, general & administrative expenses) proportionally:
> - Lease Interest Expense = Lease debt times an intermediate term interest rate based on the issuer's rating (capped at rent expense)
> - Lease Depreciation Expense = Rent Expense less Lease Interest Expense
>
> Cash Flow Statement:
> We reclassify lease depreciation expense from operating cash flow to capital expenditures. (Moody's, 2018)

Exhibit 12 contain excerpts from footnote 16: Leases from Rite Aid's 10k for the year ended March 2, 2019.

d. Inventory Reported on a LIFO Basis:

The LIFO (last-in-first-out) cost method for carrying inventories on the balance sheet is allowed under US GAAP but is not an option under other GAAPs, including IFRS. In periods of rising prices, the LIFO method can cause the carrying value of inventory on the balance sheet to be well below FIFO (first-in-first-out) value, replacement cost, and market value because LIFO inventory include old layers of inventory purchased at much lower cost. As a result, the balance sheets of companies electing the LIFO cost method are not comparable to those that follow FIFO or other methods.

Moody's recommends the following adjustment for LIFO Inventory:

<u>Balance Sheet:</u>
If FIFO cost exceeds LIFO costs, we increase inventories by the amount of the LIFO inventory valuation reserve, increase deferred tax liabilities for applicable tax effects, and increase retained earnings.
<u>Income Statement:</u>
No adjustments made.
<u>Cash Flow Statement:</u>
No adjustments made. (Moody's, 2018)

Exhibit 13 contain excerpts from footnote 11: Inventory from Rite Aid's 10k for the year ended March 2, 2019.

e. Unusual and Non-Recurring Items

The income statement separates earnings into two components: continuing operations and discontinued operations. Income from continuing operations comprises the earnings that are believed to sustainable or likely to be repeated in future reporting periods. Income from discontinued operations are earnings related to operations the firm intends to discontinue or are already discontinued and are, therefore, clearly non-recurring. Unusual and non-recurring items are gains and losses that arise from a firm's continuing operations, but that are not typical and recurring. Companies report some unusual and non-recurring items as separate line items within continuing operations, such as losses from floods, fires, or other disasters, gains and losses from the sale of assets, merger termination fees, and corporate restructuring charges. However, many unusual and non-recurring items that relate to the firm's continuing operations are not shown separately but are included as part of other items in the continuing operations sections of the income statement.

Moody's identifies unusual and non-recurring items that arise from the firm's continuing operations, whether they are shown separately or not, and excludes them from income from continuing operations and operating cash flows in the income statement and the statement of cash flows respectively. It is important to note that Moody's considers goodwill and lease impairment charges as unusual and non-recurring and excludes them from the income statement and statement of cash flows. The justification for classifying and excluding these items as unusual and non-recurring is that even though these items might recur, the amounts are arbitrary and subject to management discretion and are not likely to be similar from one period to the next. In addition, Moody's generally does not adjust the balance sheet for unusual or non-recurring items.

Moody's recommends the following adjustment for unusual and non-recurring items:

<u>Balance Sheet:</u>
We adjust the balance sheet in those instances where it is material to our analysis.
<u>Income Statement:</u>
We reclassify the effects of unusual or non-recurring revenues, gains or costs, net of the related tax effect, to a special income statement caption that is below net profit after tax. Our calculation of key ratios excludes amounts in the special income statement caption.
<u>Cash Flow Statement</u>

> We reclassify the effects of unusual or non-recurring operating cash inflows and outflows to a
> special caption in the operating section of the cash flow statement. Our calculation of key ratios
> excludes amounts in the special cash flow statement caption. (Moody's, 2018)

Exhibit 14 contain excerpts from footnote 6: Lease Termination and Impairment Charges from Rite Aid's 10k for the year ended March 2, 2019.

f. Allowance for Uncollectible Accounts

Arlene remembered from her Corporate Financial Reporting course that companies could use two alternative approaches to estimate uncollectible accounts – the sales revenue approach in which one multiplied a specific loss percentage by sales revenue and the gross receivable (or the aging of receivables) approach in which one multiplied the specific loss percentage to gross receivables. Furthermore, research evidence in McNichols and Wilson (1988) suggests that companies have incentives to "manage" earnings using bad debt accruals. Regardless of the approach used by the company, since a company could manage its earnings using the accounting for uncollectible accounts, an analyst needed to test for the reasonableness of the allowance of uncollectible balance given existing economic conditions and the company's customer circumstances.

One of the methods to test for the adequacy of the allowance for uncollectible accounts is to compare the ratio of the allowance for uncollectible accounts to gross receivables for Rite Aid with other firms in the industry. Arlene calculated the ratios for two of Rite Aid's closest competitors – CVS Health and Walgreens Boots Alliance. They are provided in Exhibit 15. Although both CVS and Walgreens are significantly larger than Rite Aid, they can be assumed to have similar customer (receivable) profiles. For all three firms, the bulk of accounts receivables are due from third-party payors, such as pharmacy benefit management programs, insurance companies, and governmental agencies.

Exhibit 16 contains excerpts from footnote 8: Accounts Receivable for the Rite Aid Corporation for the year ended March 2, 2019.

g. Depreciation Expense Computation

Depreciation is the apportionment of the cost of the long-lived asset to the periods in which they provide the benefits. Computing the depreciation expense requires a company to estimate the following: a) the expected useful life of the asset, b) the expected salvage value at the time the asset is expected to be retired, and c) the depreciation pattern over the estimated life. In terms of the assumption regarding the depreciation pattern, Arlene noted that Rite Aid as well as its two competitors, CVS Health and Walgreens Boots Alliance, used the straight-line method of depreciation. The straight-line method allocates the cost minus the estimated salvage value evenly over the expected useful life of the asset. Since the depreciation calculations require firms to make estimates of the useful life and salvage value of the asset, management has opportunities to manage earnings by distorting its depreciation expense.

Arlene knew from her Corporate Financial Reporting course that it was possible to detect and undo such distortions by making a few reasonable assumptions. Assuming the estimated

salvage value at the time of retirement is zero, the ratio of the average gross depreciable property, plant and equipment divided by the depreciation expense provides a rough approximation of the estimated life the company used in calculating the depreciation expense. The estimated life calculated for Rite Aid could be compared to those calculated for CVS Health and Walgreen Boots to ascertain if Rite Aid is being more aggressive or conservative than its competitors. To undo the distortion, one could recalculate the depreciation for Rite Aid using the average estimated lives of CVS Health and Walgreen Boots. Arlene collected relevant information for CVS Health and Walgreen Boots and is provided in Exhibit 17

This analysis is based on a number of assumptions. First, the analysis assumes that differences in estimated lives between the companies are primarily due to management discretion and manipulation and do not reflect real differences in the estimated lives. Second, it assumes that the estimated salvage value proportions are equivalent across the three firms. Finally, it assumes that the breakdown of the various asset categories as a percentage of gross long-lived assets are similar across the three firms.

Exhibit 18 contains excerpts from footnote 12: Property, Plant & Equipment for Rite Aid Corporation for the year ended March 2, 2019.

THEORETICAL LINKAGES

The purpose of accounting analysis or the quality of earnings analysis is to evaluate the degree to which the firm’s financial statements capture its underlying business and economic reality. The process involves identifying the accounting distortions and then undoing them using information in the footnotes to the financial statements. The accounting distortions can arise due to the limitations in GAAP standards, forecast errors, and the deliberate accounting choices made by managers to “manage” the reported numbers in the financial statements. The case offers numerous opportunities for instructors to bring accounting research into the classroom.

The instructor can use the case to explain the incentives for firms to manage earnings. Sweeney (1994) examined accounting changes, costs of default, and accounting based debt covenants and found that managers of firms approaching default made income-increasing accounting changes. This incentive is particularly relevant in this case, since Rite Aid has significant debt and numerous restrictive debt covenants. Based on the analysis of its accounting for bad debt expense and its accounting for depreciation, it appears that Rite Aid used aggressive estimates to report higher net income. Guidry, Leone, and Rock (1999) found that business-unit managers made discretionary accrual decisions to maximize their short-term bonuses. Stevenson (1987) shows that, on average, firms that adopt LIFO inventory experience an increase in their share prices presumably because of the tax savings in periods of rising prices. In addition, the instructor can when discussing questions relating to specific topics, such as pension accounting or lease accounting, use research papers in those specific areas. A few relevant research papers are: Glaum (2009) provides a comprehensive review of the empirical research on pension accounting, including the value relevance of pension accounting information and earnings management in pension accounting; Bratten, Choudhary, and Schipper (2013) provide evidence suggesting that market participants impound as-if recognized operating lease obligations and recognized capital lease obligations similarly into cost of capital calculations; Fairfield, Sweeney, and Yohn (1996) provide evidence that disaggregation of net income into specific components (including unusual and non-recurring items) improves profitability forecasts; and

finally, McNichols and Wilson (1988) provide evidence that firms manage earnings using the provision for bad debts.

CASE QUESTIONS

1. Refer to the section on Defined Benefit Pension Plans and Exhibit 8 of the case. Prepare the necessary adjusting journal entries related to the underfunded defined benefit pension obligations. Enter these adjustments in the spreadsheets for the income statement, balance sheet, and the statement of cash flows.
2. Refer to the section on Multipleemployer Pension Plans and Exhibit 11 of the case. Prepare the necessary adjusting journal entries related to multiemployer pension obligations. Enter these adjustments in the spreadsheets for the income statement, balance sheet, and the statement of cash flows.
3. Refer to the section on Leases and Exhibit 12 of the case. Prepare the necessary adjusting journal entries to reclassify operating leases to debt and rent expense to interest and depreciation expense. Enter these adjustments in the spreadsheets for the income statement, balance sheet, and the statement of cash flows.
4. Refer to the section of Inventory Reported on a LIFO basis and Exhibit 13 of the case. Prepare the necessary journal entries to convert inventory under the LIFO cost method to the FIFO cost method. Enter these adjustments in the spreadsheets for the income statement, balance sheet, and the statement of cash flows.
5. Refer to the section on Unusual and Non-recurring items and Exhibits 6 and 14 of the case. Prepare the necessary journal entries to reclassify unusual and non-recurring transactions to portray more accurately the underlying recurring core business of Rite Aid. Enter these adjustments in the spreadsheets for the income statement and the statement of cash flows.
6. Refer to the section on Allowance for Uncollectible Accounts and Exhibit 16 of the case. Based on your analysis, is Rite Aid being conservative (accounting policies that decrease income) or aggressive (accounting policies that increase income) in its accounting for the allowance for uncollectible accounts? Prepare the necessary journal entries to correct for the distortions as a result of Rite Aid's accounting for uncollectible accounts. Enter these adjustments in the spreadsheets for the income statement, balance sheet, and the statement of cash flows.
7. Refer to the section on Depreciation Expense Computation and Exhibit 18 of the case. Based on your calculations, is Rite Aid being conservative or aggressive in its accounting for depreciation? Prepare the necessary journal entries to correct for the distortions as a result of Rite Aid's accounting for depreciation. Enter these adjustments in the spreadsheets for the income statement, balance sheet, and the statement of cash flows.
8. Complete Exhibit 4 by entering the figures for Rite Aid for the year ending March 2, 2019. Based on the comparison of Rite Aid's relevant ratios for the year ended March 3, 2018, and year ended March 2, 2019, and Rite Aid's ratios vis-à-vis its two main competitors prepare a preliminary credit report for the Rite Aid Corporation. Would you recommend an upgrade or downgrade to its fiscal 2018 credit rating of B3? Briefly justify your recommendations.

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Exhibit 1: Income Statement and Adjustments Template

Income Statement	03/03/2019 (Annual) As Rep	Standard Adjustments						Non-Standard Adjustments			03/03/2019 (Annual) As Adj.
(Adjustments)		Pensions	MEPP	Operating Leases	LIFO	Unusual	*Total*			*Total*	
Net Sales / Revenues											
Cost of Goods / Products / Services Sold											
Gross Margin											
Operating Expenses											
Selling, general and administrative expenses											
Depreciation - Capitalized Operating Leases											
Unusual Expense (Gains)											
Operating Profits											
Unusual Items - Expenses / (Gains)											
EBIT											
Interest Expense											
Pretax Income											
Taxes											
Net Profit After-tax Before Unusual Items											
Income (loss) from discontinued operations											
Unusual & Non-Recurring Items - Adjust. After-tax Inc / (Dec)											
Net Income after ADJ for Unusual & Non-Recur Items											
Income Available to Common Shareholders											

Exhibit 2: Balance Sheet and Adjustments Template

03/03/2019 (Annual) As Rep	Standard Adjustments						Non-Standard Adjustments			03/03/2019 (Annual) As Adj.
	Pensions	MEPP	Op Leases	LIFO	Unusual	*Total*			*Total*	

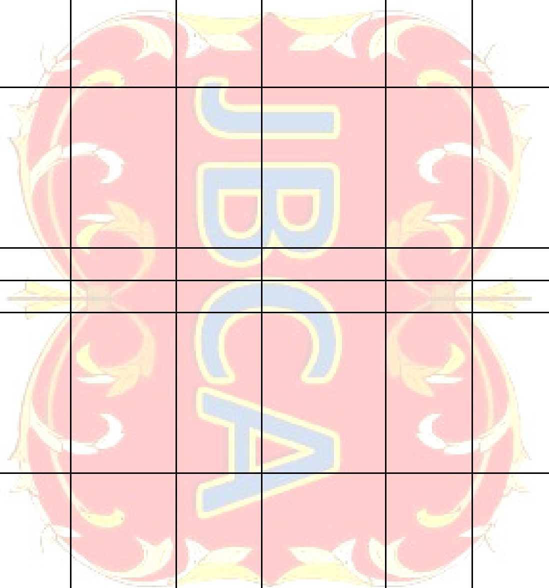

Exhibit 3: Statement of Cash Flows and Adjustments Template

03/03/2019 (Annual) As Rep	Standard Adjustments						Non-Standard Adjustments			03/03/2019 (Annual) As Adj.	Balance Sheet
	Pensions	MEPP	Op Lease	LIFO	Unusual	*Total*			*Total*		*(Adjustments)*
											ASSETS
											Cash & Cash Equivalents
											Accounts Receivable - Trade (net)
											Inventories
											Other Current Assets
											CURRENT ASSETS
											Gross Plant
											Less: Accumulated Depreciation
											Net Property Plant and Equipment
											Goodwill
											Intangibles - Other
											Deferred Tax Asset - Non-Current
											Other Assets
											TOTAL ASSETS
											LIABILITIES & EQUITY
											Current portion of long-term debt
											Accounts Payable – Trade
											Accruals
											Other Current Liabilities
											CURRENT LIABILITIES
											Secured Debt
											Senior Debt
											Lease Obligation
											Long-Term Debt-Gross
											Less: Current Maturities
											Net Long-term Debt
											Other Long-term Liabilities

Cash Flow
(Adjustments)
OPERATING ACTIVITIES
Net Income
Depreciation & Amortization
Deferred Income Taxes
Other Non-Cash Items
Other Operating Cash Flow
Funds from Operations
Changes in Working Capital Items
Changes in Other Oper. Assets & Liabilities – LT
CASH FLOW FROM OPERATIONS
CASH FLOW FROM OPER After Unusual & Non-Recur
INVESTING ACTIVITIES
Additions to PP&E (Capital Expenditures)
Proceeds from Disposal of PP&E
Other investment activities
NET CASH FROM INVESTING ACTIVITIES
FINANCING ACTIVITIES
Long-term Debt Proceeds
Long-term Debt Payments
Long-term Debt Proceeds / (Repayment)-net
Net Short-term Debt Changes
Other financing activities-net
Common Stock Issued / Repurchased
NET CASH FROM FINANCING ACTIVITIES
Discontinued operations
NET INC(DEC) IN CASH & EQUIVALENT

Exhibit 4: Peer Comparison Table

In US $ millions	**Rite Aid Corporation B3 Negative**		**Walgreens Boots Alliance Baa2 Stable**		**CVS Health Baa2 Negative**	
	FYE Mar – 18	**FYE Mar - 19**	**FYE Aug -17**	**FYE Aug - 18**	**FYE Dec - 17**	**FYE Dec - 18**
Revenues	$21,529		$118,214	$131,537	$184,765	$194,579
EBITDA	$1,146		$10,959	$12,282	$15,161	$16,345
Total Debt	$7,786		$39,601	$40,744	$49,314	$73,429
Cash & Cash Eq.	$447		$3,099	$595	$1,696	$4,059
EBITDA Margin	5.3%		9.3%	9.3%	8.2%	8.4%
EBIT/Int. Exp.	0.8x		4.3x	4.7x	6.1x	5.2x
Debt/EBITDA	6.8x		3.6x	3.3x	3.3x	4.5x
RCF/Net Debt	13.8%		17.3%	18.8%	17.1%	18.8%
FCF/Debt	3.9%		10.7%	12.8%	8.8%	2.7%

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Exhibit 5: Balance Sheet (Rite Aid Corporation, 2019)

RITE AID CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)

	March 2, 2019	March 3, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 144,353	$ 447,334
Accounts receivable, net	1,788,712	1,869,100
Inventories, net	1,871,941	1,799,539
Prepaid expenses and other current assets	179,132	181,181
Current assets held for sale	117,581	438,137
Total current assets	4,101,719	4,735,291
Property, plant and equipment, net	1,308,514	1,431,246
Goodwill	1,108,136	1,421,120
Other intangibles, net	448,706	590,443
Deferred tax assets	409,084	594,019
Other assets	215,208	217,208
Total assets	$ 7,591,367	$ 8,989,327
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt and lease financing obligations	$ 16,111	$ 20,761
Accounts payable	1,618,585	1,651,363
Accrued salaries, wages and other current liabilities	808,439	1,231,736
Current liabilities held for sale	—	560,205
Total current liabilities	2,443,135	3,464,065
Long-term debt, less current maturities	3,454,585	3,340,099
Lease financing obligations, less current maturities	24,064	30,775
Other noncurrent liabilities	482,893	553,378
Total liabilities	6,404,677	7,388,317
Commitments and contingencies	—	—
Stockholders' equity:		
Common stock, par value $1 per share; 75,000 shares authorized; shares issued and outstanding 54,016 and 53,366	54,016	53,366
Additional paid-in capital	5,876,977	5,864,664
Accumulated deficit	(4,713,244)	(4,282,471)
Accumulated other comprehensive loss	(31,059)	(34,549)
Total stockholders' equity	1,186,690	1,601,010
Total liabilities and stockholders' equity	$ 7,591,367	$ 8,989,327

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Exhibit 6: Income Statement (Rite Aid Corporation, 2019)

RITE AID CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	Year Ended		
	March 2, 2019 (52 Weeks)	March 3, 2018 (52 Weeks)	March 4, 2017 (53 Weeks)
Revenues	$ 21,639,557	$ 21,528,968	$ 22,927,540
Costs and expenses:			
Cost of revenues	16,963,205	16,748,863	17,862,833
Selling, general and administrative expenses	4,592,375	4,651,262	4,776,995
Lease termination and impairment charges	107,994	58,765	45,778
Goodwill and intangible asset impairment charges	375,190	261,727	—
Interest expense	227,728	202,768	200,065
Loss on debt retirements, net	554	—	—
Walgreens Boots Alliance merger termination fee	—	(325,000)	—
Gain on sale of assets, net	(38,012)	(25,872)	(6,649)
	22,229,034	21,572,513	22,879,022
(Loss) income from continuing operations before income taxes	(589,477)	(43,545)	48,518
Income tax expense	77,477	305,987	44,438
Net (loss) income from continuing operations	(666,954)	(349,532)	4,080
Net income (loss) from discontinued operations, net of tax	244,741	1,293,002	(27)
Net (loss) income	$ (422,213)	$ 943,470	$ 4,053
Computation of income attributable to common stockholders:			
(Loss) income from continuing operations attributable to common stockholders—basic and diluted	$ (666,954)	$ (349,532)	$ 4,080
Income (loss) from discontinued operations attributable to common stockholders—basic and diluted	244,741	1,293,002	(27)
(Loss) income attributable to common stockholders—basic and diluted	$ (422,213)	$ 943,470	$ 4,053

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Exhibit 7: Statement of Cash Flows (Rite Aid Corporation, 2019)

RITE AID CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended		
	March 2, 2019 (52 Weeks)	**March 3, 2018 (52 Weeks)**	**March 4, 2017 (53 Weeks)**
OPERATING ACTIVITIES:			
Net (loss) income	$ (422,213)	$ 943,470	$ 4,053
Net income (loss) from discontinued operations, net of tax	244,741	1,293,002	(27)
Net (loss) income from continuing operations	$ (666,954)	$ (349,532)	$ 4,080
Adjustments to reconcile to net cash (used in) provided by operating activities:			
Depreciation and amortization	357,882	386,057	407,366
Lease termination and impairment charges	107,994	58,765	45,778
Goodwill and intangible asset impairment charges	375,190	261,727	—
LIFO charge (credit)	23,354	(28,827)	(3,721)
Gain on sale of assets, net	(38,012)	(25,872)	(6,649)
Stock-based compensation expense	12,115	25,793	23,482
Loss on debt retirements, net	554	—	—
Changes in deferred taxes	95,638	260,411	35,038
Excess tax benefit on stock options and restricted stock	—	—	(543)
Changes in operating assets and liabilities:			
Accounts receivable	(75,844)	(349,481)	(159,590)
Inventories	(44,645)	18,835	(49,381)
Accounts payable	125,925	211,511	39,542
Other assets	1,000	(10,082)	(50,986)
Other liabilities	(439,906)	52,165	(101,389)
Net cash (used in) provided by operating activities of continuing operations	(165,709)	511,470	183,027
INVESTING ACTIVITIES:			
Payments for property, plant and equipment	(196,778)	(185,879)	(254,149)
Intangible assets acquired	(47,911)	(28,885)	(39,648)
Proceeds from insured loss	—	4,239	—
Proceeds from sale-leaseback transactions	2,587	—	—
Proceeds from dispositions of assets and investments	43,550	27,586	16,852
Net cash used in investing activities of continuing operations	(198,552)	(182,939)	(276,945)
FINANCING ACTIVITIES:			

Proceeds from issuance of long-term debt	450,000	—	—
Net proceeds from (payments to) revolver	875,000	(265,000)	330,000
Principal payments on long-term debt	(440,370)	(9,882)	(16,588)
Change in zero balance cash accounts	(59,481)	35,605	43,080
Net proceeds from the issuance of common stock	2,294	5,796	6,951
Financing fees paid for early debt redemption	(171)	—	—
Excess tax benefit on stock options and restricted stock	—	—	543
Deferred financing costs paid	(21,564)	—	—
Payment for taxes related to net share settlement of equity awards	(2,419)	(4,103)	(6,254)
Net cash provided by (used in) financing activities of continuing operations	803,289	(237,584)	357,732
Cash flows from discontinued operations:			
Operating activities of discontinued operations	(62,956)	(245,126)	49,090
Investing activities of discontinued operations	664,740	3,496,222	(187,314)
Financing activities of discontinued operations	(1,343,793)	(3,140,119)	(4,651)
Net cash (used in) provided by discontinued operations	(742,009)	110,977	(142,875)
(Decrease) increase in cash and cash equivalents	(302,981)	201,924	120,939
Cash and cash equivalents, beginning of year	447,334	245,410	124,471
Cash and cash equivalents, end of year	$ 144,353	$ 447,334	$ 245,410

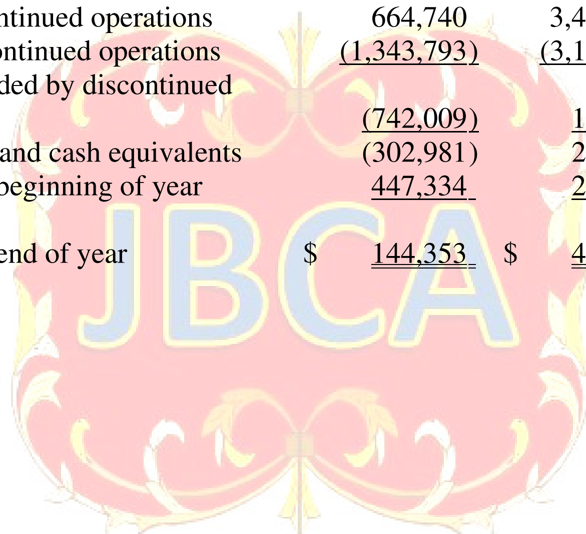

Exhibit 8: Excerpts from Footnote 18: Retirement Plans (Rite Aid Corporation, 2019)

Defined Benefit Plans

The Company and its subsidiaries also sponsor a qualified defined benefit pension plan that requires benefits to be paid to eligible associates based upon years of service and, in some cases, eligible compensation. The Company's funding policy for The Rite Aid Pension Plan (the "Defined Benefit Pension Plan") is to contribute the minimum amount required by the Employee Retirement Income Security Act of 1974. However, the Company may, at its sole discretion, contribute additional funds to the plan. The Company made contributions of $2,715 in fiscal 2019, $9,023 in fiscal 2018 and $0 in fiscal 2017.
Net periodic pension expense and other changes recognized in other comprehensive income for the defined benefit pension plans included the following components:

	Defined Benefit Pension Plan		
	2019	**2018**	**2017**
Service cost	$ 597	$1,212	$ 1,291
Interest cost	6,159	6,340	6,634
Expected return on plan assets	(5,673)	(4,525)	(4,512)
Amortization of unrecognized prior service cost	—	—	—
Amortization of unrecognized net loss (gain)	1,769	3,393	5,085
Net pension expense	$ 2,852	6,420	$ 8,498
Other changes recognized in other comprehensive loss:			
Unrecognized net (gain) loss arising during period	$ (3,486)	(8,704)	$(3,979)
Prior service cost arising during period	—	—	—
Amortization of unrecognized prior service costs	—	—	—
Amortization of unrecognized net (loss) gain	(1,769)	(3,393)	(5,085)
Net amount recognized in other comprehensive loss	(5,255)	(12,097)	(9,064)
Net amount recognized in pension expense and other comprehensive loss	$ (2,403)	$(5,677)	$ (566)

The table below sets forth reconciliation from the beginning of the year for both the benefit obligation and plan assets of the Company's defined benefit plans, as well as the funded status and amounts recognized in the Company's balance sheet as of March 2, 2019 and March 3, 2018:

	Defined Benefit Pension Plan	
	2019	2018
Change in benefit obligations:		
Benefit obligation at end of prior year	$161,851	$164,349
Service cost	597	1,212
Interest cost	6,159	6,340
Distributions	(8,816)	(7,963)
Change due to change in assumptions	—	—
Actuarial loss (gain)	(9,086)	(2,087)
Benefit obligation at end of year	$150,705	$161,851
Change in plan assets:		
Fair value of plan assets at beginning of year	$130,860	$118,658
Employer contributions	2,715	9,023
Actual return on plan assets	72	11,142
Distributions (including expenses paid by the plan)	(8,815)	(7,963)
Fair value of plan assets at end of year	$124,832	$130,860
Funded status	$ (25,873)	$ (30,991)
Net amount recognized	$ (25,873)	$ (30,991)
Amounts recognized in consolidated balance sheets consisted of:		
Prepaid pension cost	$ —	$ —
Accrued pension liability	(25,873)	(30,991)
Net amount recognized	$ (25,873)	$ (30,991)
Amounts recognized in accumulated other comprehensive loss consist of:		
Net actuarial loss	$ (27,409)	$ (32,664)
Prior service cost	—	—
Amount recognized	$ (27,409)	$ (32,664)

The estimated net actuarial loss and prior service cost amounts that will be amortized from accumulated other comprehensive loss into net periodic pension expense in fiscal 2020 are $1,661 and $0, respectively.

The accumulated benefit obligation for the defined benefit pension plan was $150,705 and $161,851 as of March 2, 2019 and March 3, 2018, respectively.

Exhibit 9: Excerpt from Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Continuing Operations (Rite Aid Corporation, 2019)

In fiscal 2019, 2018 and 2017, interest expense was $227.7 million, $202.8 million and $200.1 million, respectively. Interest expense for fiscal 2019 increased by $24.9 million due to higher outstanding debt in fiscal 2019 than our final capital structure as determined under discontinued operations in fiscal 2018. The higher outstanding debt during fiscal 2019 resulted from the tender offer requirements in our 9.25% senior notes due 2020, the 6.75% senior notes due 2021, and the 6.125% senior notes due 2023, which caused a delay in the redemption of our 9.25% senior notes due 2020 and our 6.75% senior notes due 2021 as assumed in our final capital structure under discontinued operations. Interest expense for fiscal 2018 was flat to fiscal 2017.

The annual weighted average interest rates on our indebtedness in fiscal 2019, 2018 and 2017 were 5.6%, 7.1% and 5.4%, respectively.

Exhibit 10: Excerpt from Note 7: Income Taxes (Rite Aid Corporation, 2019)

On December 22, 2017 (the ''Enactment Date''), H.R. 1, originally known as the Tax Cuts and Jobs Act, was enacted. The new law (Public Law No.115-97 hereinafter referred to as the ''Tax Act'') includes significant changes to the U.S. corporate income tax system including, but not limited to, lowering the statutory corporate tax rate from 35% to 21%, limiting or eliminating certain deductions and the repeal of Corporate AMT tax regime. The majority of the provisions are applicable to the Company for fiscal 2019. For fiscal 2018, the Company computed its income tax expense using a blended federal tax rate of 32.6%. The 21% federal tax rate applies to the fiscal year ending March 2, 2019 and each year thereafter.

Exhibit 11: Excerpt from Note 19: Multiemployer Plans that Provide Pension Benefits (Rite Aid Corporation, 2019)

The Company contributes to a number of multiemployer defined benefit pension plans under the terms of collective-bargaining agreements that cover certain of its union-represented employees. The risks of participating in these multiemployer plans are different from single-employer plans. Assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers. Additionally, if the Company chooses to stop participating in some of its multiemployer plans, the Company may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

The Company's participation in these plans for the annual period ended March 2, 2019 is outlined in the table below:

Pension	EIN/Pension Plan Number	Pension Protection Act Zone Status		FIP/ RP Status Pending/ Implemented	Contributions of the Company			Surcharge Imposed	Expiration Date of Collective-Bargaining Agreement
		2019	2018		2019	2018	2017		
1199 SEIU Health Care Employees Pension Fund	13-3604862-001	Green—12/31/2017	Green—12/31/2016	No	$9,670	$7,372	$7,152	No	4/18/2019
Southern California United Food and Commercial Workers Unions and Drug Employers Pension Fund	51-6029925-001	Red—12/31/2018	Red—12/31/2017	Implemented	8,273	8,149	8,021	No	7/17/2021
UFCW Pharmacists, Clerks and Drug Employers Pension Trust	94-2518312-001	Green—12/31/2018	Green—12/31/2017	No	2,666	2,739	2,970	No	7/13/2019
United Food and Commercial Workers Union-Employer Pension Fund	34-6665155-001	Red—9/30/2018	Red—9/30/2017	Implemented	772	786	827	No	2/28/2021
United Food and Commercial Workers Union Local 880—Mercantile Employers Joint Pension Fund	51-6031766-001	Yellow—9/30/2018	Yellow—9/30/2017	Implemented	470	495	504	No	2/28/2021
Other Funds					1,648	1,438	1,862		
					$23,499	$20,979	$21,336		

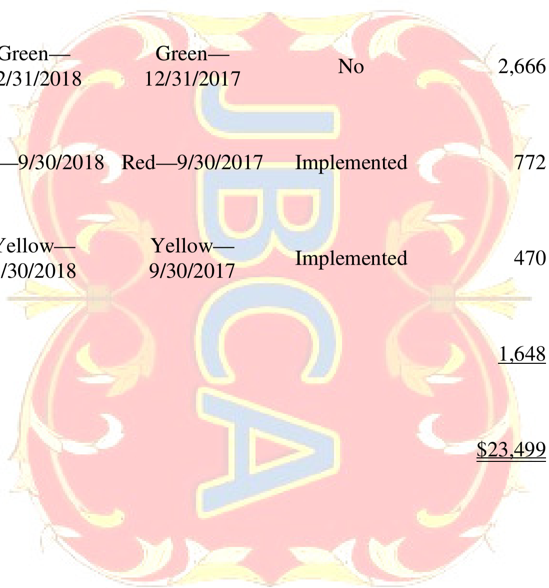

Exhibit 12: Excerpt from Note 16: Leases (Rite Aid Corporation, 2019)

The Company leases most of its retail stores and certain distribution facilities under noncancellable operating and capital leases, most of which have initial lease terms ranging from 5 to 22 years. The Company also leases certain of its equipment and other assets under noncancellable operating leases with initial terms ranging from 3 to 10 years. In addition to minimum rental payments, certain store leases require additional payments based on sales volume, as well as reimbursements for taxes, maintenance and insurance. Most leases contain renewal options, certain of which involve rent increases. Total rental expense, net of sublease income of $4,509, $4,682 and $4,813, was $626,166, $628,511 and $634,539 in fiscal 2019, 2018 and 2017, respectively. These amounts include contingent rentals of $7,084, $8,339 and $10,229 in fiscal 2019, 2018 and 2017, respectively.

Following is a summary of lease finance obligations at March 2, 2019 and March 3, 2018:

	2019	2018
Obligations under financing leases	$ 40,176	$ 51,446
Less current obligation	(16,112)	(20,671)
Long-term lease finance obligations	$ 24,064	$ 30,775

Fiscal year	Lease Financing Obligations	Operating Leases
2020	$ 19,300	$ 687,412
2021	4,811	610,874
2022	4,588	545,863
2023	4,383	490,864
2024	4,042	431,714
Later years	20,470	1,541,408
Total minimum lease payments	57,594	$ 4,308,135
Amount representing interest	(17,418)	
Present value of minimum lease payments	$ 40,176	

Exhibit 13: Excerpt from Note 11: Inventory (Rite Aid Corporation, 2019)

At March 2, 2019 and March 3, 2018, inventories were $604,444 and $581,090, respectively, lower than the amounts that would have been reported using the first-in, first-out (''FIFO'') cost flow assumption. The Company calculates its FIFO inventory valuation using the retail method for store inventories and the cost method for distribution facility inventories. The Company recorded a LIFO charge for fiscal year 2019 of $23,354, compared to a LIFO credit of $28,827 for fiscal year 2018 and a LIFO credit of $3,721 for fiscal year 2017. During fiscal 2019, 2018 and 2017, a reduction in nonpharmacy
inventories resulted in the liquidation of applicable LIFO inventory quantities carried at lower costs in prior years. This LIFO liquidation resulted in a $5,884, $2,707 and $2,375 cost of revenues decrease, with a corresponding reduction to the adjustment to LIFO for fiscal 2019, fiscal 2018 and fiscal 2017, respectively.

Exhibit 14: Excerpt from Note 6: Lease Termination and Impairment Charges (Rite Aid Corporation, 2019)

The following table summarizes the impairment charges and number of locations, segregated by closed facilities and active stores that have been recorded in fiscal 2019, 2018 and 2017:

	March 2, 2019		March 3, 2018		March 4, 2017	
(in thousands, except number of stores)	**Number**	**Charge**	**Number**	**Charge**	**Number**	**Charge**
Active stores:						
Stores previously impaired(1)	288	$ 17,939	218	$ 7,313	174	$ 5,022
New, relocated and remodeled stores(2)	22	10,595	28	13,100	22	13,232
Remaining stores not meeting the recoverability test(3)	74	17,885	60	14,369	17	2,369
Total impairment charges—active stores	384	46,419	306	34,782	213	20,623
Total impairment charges—closed facilities	62	2,788	67	3,091	53	2,008
Total impairment charges—other(4)	—	14,285	—	—	—	—
Total impairment charges—all locations	446	$ 63,492	373	$ 37,873	266	$ 22,631

Exhibit 15: Allowance for Uncollectible Accounts/Gross Receivables for CVS and Walgreens

CVS Health (in millions)	**Year ended December 31, 2019**	**Year ended December 31, 2018**
Gross Receivables	$19,936	$17,918
Allowance for Uncollectible Accounts	319	287
Allowance for Uncollectible Accounts/Gross	1.60%	1.60%

Walgreens Boots Alliance (in millions)	**Year ended December 31, 2019**	**Year ended December 31, 2018**
Gross Receivables	$7,321	$6,648
Allowance for Uncollectible Accounts	95	75
Allowance for Uncollectible Accounts/Gross	1.30%	1.13%

Exhibit 16: Excerpt from Footnote 8: Accounts Receivable (Rite Aid Corporation, 2019)

The Company maintains an allowance for doubtful accounts receivable based upon the expected collectability of accounts receivable. The allowance for uncollectible accounts at March 2, 2019 and March 3, 2018 was $13,106 and $25,134 respectively. The Company's accounts receivable are due primarily from third-party payors (e.g., PBM companies, insurance companies or governmental agencies) and are recorded net of any allowances provided for under the respective plans. Since payments due from third-party payors are sensitive to payment criteria changes and legislative actions, the allowance is reviewed continually and adjusted for accounts deemed uncollectible by management.

Exhibit 17: Average Estimated Useful Life for CVS and Walgreens

CVS Health (in millions)	Year ended December 31, 2019	Year ended December 31, 2018
Gross Depreciable PP&E	$26,953	$24,997
Depreciation Expense	1,900	
Average Estimated Useful Life =		
Average Gross Depreciable PP&E/Depreciation	13.67 years	

Walgreens Boots Alliance (in millions)	Year ended December 31, 2019	Year ended December 31, 2018
Gross Depreciable PP&E	$21,282	$20,831
Depreciation Expense	1,500	
Average Estimated Useful Life =		
Average Gross Depreciable PP&E/Depreciation	14.03 years	

Exhibit 18: Excerpt from Note 12: Property, Plant & Equipment (Rite Aid Corporation, 2019)

Following is a summary of property, plant and equipment, including capital lease assets, at March 2, 2019 and March 3, 2018:

	2019	2018
Land	$ 139,406	$ 138,768
Buildings	533,580	528,026
Leasehold improvements	1,527,371	1,567,635
Equipment	1,765,575	1,795,337
Software	38,680	25,944
Construction in progress	49,344	59,635
	4,053,956	4,115,345
Accumulated depreciation	(2,745,442)	(2,684,099)
Property, plant and equipment, net	$ 1,308,514	$ 1,431,246

Depreciation expense, which included the depreciation of assets recorded under capital leases, was $232,242, $238,318 and $241,787 in fiscal 2019, 2018 and 2017, respectively.

Included in property, plant and equipment was the carrying amount, which approximates fair value, of assets to be disposed of totaling $452 and $972 at March 2, 2019 and March 3, 2018, respectively.