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McKesson Corp. (MCK)

Q3 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to McKesson's Third Quarter Fiscal 2022 Earnings Conference Call. Please be advised today's conference is being recorded.

At this time, I'd like to turn the call over to Rachel Rodriguez, VP of Investor Relations. Please go ahead.

Rachel Rodriguez
Investor Relations Contact, McKesson Corp

Thank you, Keith. Good afternoon and welcome, everyone, to McKesson's third quarter fiscal 2022 earnings call. Today I'm joined by Brian Tyler, our Chief Executive Officer; and Britt Vitalone, our Chief Financial Officer. Brian will lead off, followed by Britt, and then we will move to a question-and-answer session.

Today's discussion will include forward-looking statements such as forecasts about McKesson's operations and future results. Please refer to the cautionary statements in today's earnings release and presentation slides available on our website at investor.mckesson.com and the Risk Factors section of our periodic SEC filings for additional information concerning risk factors that could cause our actual results to materially differ from those in our forward-looking statements.

Information about non-GAAP financial measures that we will discuss during this webcast, including a reconciliation of these measures to GAAP results, can be found in today's earnings release and presentation slides. The presentation slides also include a summary of our results for the quarter and updated guidance assumptions.

With that, let me turn it over to Brian.

Brian S. Tyler

Chief Executive Officer & Director, McKesson Corp.

Thank you, Rachel, and thank everyone for joining us on our call today. Today, we reported third quarter fiscal 2022 results, another quarter with double-digit adjusted operating profit growth in all four segments, reflecting strength in the fundamentals across our businesses. Our focus and execution against our company priorities positions us to consistently generate strong financial results despite fluidity we continue to see in the macroeconomic environment.

Before I discuss the business performance, I would like to just quickly remind everyone of our company priorities. We have been sharing with you our strategic transformation to a diversified healthcare services company centered around a set of four enterprise priorities. We believe the execution against these priorities is critical to our ability to generate long-term sustainable growth, and we want to reiterate our focus and commitment to each one of them.

Our first priority is our people, our teams, and our culture. Through our diversified portfolio of assets and operations, we as a company touch and impact many aspects of health and the healthcare system, including patients. Embedded in our daily operations is our purpose, advancing health outcomes for all, and our mission of building an impact-driven organization. We have been focused on enabling change in three areas: improving access to healthcare, advancing health equity, and protecting our environment.

In the past year, our employees came together and shared countless moments of impact, finding new ways to get involved and to contribute. In 2021 alone, we completed more than 26,500 volunteer hours and supported nearly 1,500 charities. I couldn't be more proud of what we've achieved so far, and I'm confident in our ability to build a brighter future that in fact offers greater health outcomes for all.

Part of our focus on culture is our continued improvement in diversity and inclusion. We put a particular focus on hiring, developing, and promoting what we call a best talent strategy at McKesson. Recently, we were recognized as one of the Best Places to Work for LGBTQ Equality, the ninth year in a row we've received this honor.

Our commitment to diversity and refreshment includes our board of directors. In January, we welcomed James Hinton and Kathleen Wilson-Thompson as new Independent Directors to our board of directors. Both James and Kathleen have served in multiple senior leadership roles within the healthcare industry. Currently, Jim serves as an operating partner for the private equity firm Welsh, Carson, Anderson & Stowe, and prior to that, he held the role of Chief Executive Officer at Baylor Scott & White Health. And Kathleen most recently held the role of Executive Vice President and Global Chief Human Resource Officer at Walgreens Boots Alliance, where she led the human capital strategy, including merger integration and HR transformation through digitization. Their decades of healthcare experience and proven record leading complicated organizations and executive leadership roles will be instrumental to McKesson, and we are excited to welcome them to our board.

Additionally, we announced today that Don Knauss has been elected as the next Independent Chairman of our Board, which will go into effect on April 1, following a planned transition led by our current Independent Chair, Edward Mueller. I want to thank Ed for his years of steady leadership and invaluable contributions as the Independent Chair to McKesson's board of directors. And I also want to welcome Don to his new role. He brings deep leadership expertise and shares McKesson's values, culture, strategy and vision, including his commitment to board diversity. We look forward to his leadership and stewardship.

Our next priority is to drive sustainable growth in our core pharmaceutical and medical distribution businesses. We have a vast skilled distribution network and deep expertise in global supply chain management, which have been a critical and foundational part of our long history. We're proud of our operational excellence and our ability to capture efficiency and deliver consistent and high quality service to our customers while optimizing operating margin.

Building off of this core capability, we've been very successful in expanding into new product categories and new adjacent markets like our lab solutions and our government partnership strategies. Our scaled assets and capabilities also enable us to play an integral role in the response to the COVID-19 pandemic. We're proud to serve as the centralized distributor of vaccines and ancillary supplies for the US government.

We've also been working closely with our partners, suppliers, and manufacturers to navigate the complex supply chain system. These relationships have allowed us to continue to provide stability of supply and low cost for our customers, and as a result, we've been able to manage through some of the challenges that the market has been seeing.

Our third priority is to streamline the business, which includes initiatives like the split-off of Change Healthcare and our strategic intent to fully exit the European region. We recently announced the sale of our Austrian business, which was completed on January 31, and we have agreements to sell 10 of the 12 countries where we operate. As a reminder, Norway and Denmark remain the only countries that we have not entered into an agreement to sell.

We continue to work towards the closing of the other pending divestitures. These transactions are the result of our intentional effort to evaluate and assess our portfolio for strategic alignment. We believe that by fully exiting the Europe region, we'll be able to better focus our human and financial capital into higher growth and higher margin areas, which leads me naturally to our next company priority.

The last company priority is our strategic growth pillars, oncology and biopharma services. Over the past few years, we set out to accelerate the growth in these two areas and build out what we refer to as ecosystems. As we shared at our Investor Day in December, these are both large and growing markets that have significant unmet needs and opportunities, and we are tackling some of the most complex problems in the healthcare system, with the goal to bring efficiency and benefits to all stakeholders across these ecosystems.

In the oncology ecosystem, our growth strategy is centered around our support for the large, growing and diversified US Oncology Network. With the reach of over 1,400 physicians, The US Oncology Network treats 15% of all new cancer patients in the US at one of its 500 sites of service.

One of The US Oncology Network's important initiatives is its participation in the oncology care model, which is a five-year experimental payment model with the goal of bringing down the cost of cancer. Based on the latest results, The US Oncology Network practices participating in the program achieved high marks on quality metrics and provided significant cost savings to Medicare. By representing approximately one-fourth of all providers participating in the program, The US Oncology Network demonstrated its leadership role in transitioning healthcare to a more value-based approach.

Building upon our deep reach in the community oncology space, we're creating an oncology ecosystem with multi-faceted service offerings that are all interconnected. At the center of this connectivity is Ontada, an oncology, technology and insights business dedicated to help advance cancer research and advance patient care. We recently highlighted this business at our Investor Day.

Since its launch in December of 2020, the team has made great progress transforming ideas into reality. Ontada signed two agreements with strategic partners to improve patient outcome and quality of patient care, and it was instrumental in the launch of the MYLUNG Consortium, which through real-world research and study, provides critical information to improve the patient's journey.

Within our biopharma ecosystem, we've built a set of differentiated assets and capabilities, including businesses like RelayHealth Pharmacy, CoverMyMeds and RxCrossroads. They're combined under the Prescription Solutions business, with a shared goal to improve access, adherence and affordability of medicines.

One of the key customers of our business is biopharma companies. Through our scaled and interconnected technology network, we provide biopharma a range of commercialization services. And by automating and simplifying the process of prior authorization, we reduce prescription abandonment and provide biopharma access to new patients. Our unique technology capabilities also generate insights into patients' needs and challenges, enabling greater ability to impact patient actions and get better outcomes.

We support over 650 brands today, covering 94% of the therapeutic areas, and we're connected to all the major insurance companies and most of the regional payers in the United States. The reach of our network is deep and broad, which is why it's the foundation of our biopharma ecosystem, and we are incredibly excited about the market opportunities it brings.

Our progress with each of the company priorities has been truly outstanding, and we see the strategies working. The strong conviction in these priorities will be our North Star as we seek to advance and win in the marketplaces as a diversified healthcare service company and to drive long-term sustainable growth for our shareholders.

Now, before I turn to our third quarter results, I want to provide a brief update on the progress made towards a broad resolution of governmental opioid-related claims. To date, 46 states, all 5 US territories and Washington D.C. have joined the proposed settlement. The sign-on period for political subdivisions in participating states to join the previously announced proposed opioid settlement agreement ended on January 26. We have now entered into the evaluation period. The deadline for our decision is February 25, 2022. We continue to work with all parties to bring meaningful relief to affected communities and towards resolutions, which will allow us to further focus on the strategic priorities of our business.

Now, let me get to the results. We're pleased to report a strong third quarter with total company revenues of $68.6 billion and an adjusted earnings per diluted share of $6.15, ahead of our expectations. As a result of our performance in the underlying business and the contribution from COVID-19-related items, we are raising our adjusted earnings per diluted share guidance to $23.55 to $23.95. This is from the previous range of $22.35 to $22.95.

The third quarter was another example of the non-linear nature of the recovery from the pandemic. At the beginning of the quarter, volume and utilization trends were recovering as COVID-19 cases continue to decline across the country. Although we expected a non-linear recovery trend, the emergence and the spread of the Omicron variant in December was unexpected. Since then, we've been closely monitoring its impact.

One thing we've learned in the past two years is the resilience of our business and our communities. Regardless of the trajectory of the pandemic, we're confident about our ability to adjust and adapt to support our customers and their patients in these challenging times.

Let's turn to the US Pharmaceutical segment. US Pharmaceutical segment saw 12% adjusted operating profit growth, which was underpinned by the contribution from COVID-19 vaccine distribution and increased specialty volume. Through the third quarter and into January, branded pharmaceutical pricing has tracked in line with our original expectations and consistent with our experience over the past several years.

For generics, we continue to benefit from the success and strength of our sourcing operation with ClarusONE. We have not only the scale, but the procurement expertise to consistently source products at low cost, while protecting the integrity and the safety of the supply chain.

We are also proud of our role in supporting the US government's pandemic response effort as the vaccine and booster recommendations for various age groups continues to expand and evolve. Through January 31, our US Pharmaceutical business has successfully distributed over 370 million Moderna and Johnson & Johnson COVID-19 vaccines to administration sites all across the United States and in support of the US government's international donation mission. In January, the US government extended the existing COVID-19 vaccine distribution contract through July of 2022, which is roughly in line with the first quarter of our fiscal 2023.

In Prescription Technology Solutions, the segment had excellent momentum and delivered an 11% increase to segment adjusted operating profit in the third quarter. As I mentioned earlier, we offer a range of commercial services primarily to biopharma companies, and this quarter, the growth was led by third-party logistic services and our access, adherence and affordability solutions, including our access for more patients' product.

This segment aligns with our focus on developing the biopharma services ecosystem. The market that we're focused on presents many exciting opportunities, and we estimate the total addressable market to be around $15 billion with good growth potential and an attractive margin profile. We are pleased with the financial performance and expect to continue to drive growth and innovation for McKesson.

In Medical-Surgical, we're navigating a dynamic market while growing the business. With surging demand and a complex supply chain, our employees are working tirelessly to secure and deliver key products, playing an important role in the fight against the pandemic. The dedicated team in Med-Surg is the foundation to our business growth, and we continue to invest to ensure operational continuity and excellence.

As it relates to our International segment, we continue to benefit from COVID-19-related programs in our European operations and Canada. Through December, we've distributed over 81 million vaccines to administration sites in select markets across our international geographies.

As we look forward to fiscal 2023, I'm most excited about the progress on the four company priorities. Since the rollout of these multi-year strategic initiatives in our fiscal 2019, we've been very focused on execution, making impact and delivering results. While the pandemic continues to present unknowns, what is certain is that fiscal 2023 will be another year in which we focus on strong execution and strategic advancement. Our continued progress towards these four priorities will be a key driver to our sustainable profit growth, strong cash flow, and shareholder value creation. We continue to focus on the things that matter most to our customers, to our patients, to our employees, and to our shareholders.

In closing, we continue to be excited about our future growth prospects as we meet the opportunity as a diversified healthcare services company. We have unique and differentiated assets in oncology and biopharma services with unmatched scale and connectivity, and we're strategically positioned to win in these growing markets.

And lastly, before I conclude, I want to take a moment to thank our dedicated team, including every one of the 76,000 employees that make up Team McKesson. We share a mission to improve healthcare in every setting, and that will be achieved only with the dedication and the commitment from our people. And for the opportunity to work alongside this amazing team, I continue to be humbled and deeply grateful.

Thank you for your time this afternoon. Britt, I'll toss it to you.

Britt Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

Thank you, Brian, and good afternoon, everyone. I'm pleased to be here today to discuss our fiscal third quarter results, which reflect another quarter of strong performance across the business, driven by operational execution against our growth strategies. In the third quarter, we delivered overall growth compared to the prior-year results across each of our segments, including growth over the prior year when excluding COVID-19-related programs.

Let me start with an update on Europe. We remain committed to fully exit the European region, and the progress of our exit activities are on track. Today, we announced that the transactions to sell our Austrian business to Quadrifolia Management and the sale of McKesson's remaining share of our German joint ventures to Walgreens Boots Alliance closed on January 31, 2022. The assets involved in the Austrian transaction contributed approximately $1.5 billion in revenue and $50 million in adjusted operating profit in fiscal 2021. The earnings related to our German joint venture were immaterial.

Next, pursuant to the satisfaction of customary closing conditions, including receipt of regulatory approvals, we anticipate the pending divestiture to sell McKesson's UK retail and distribution businesses will close in the fourth quarter of fiscal 2022, and the transaction to sell certain European assets to the PHOENIX Group will close in the first half of fiscal 2023.

The net assets included in these transactions are classified as held-for-sale. Our fiscal 2022 guidance includes approximately $0.49 of adjusted earnings per diluted share accretion related to these pending transactions, which is recorded within our International segment. This $0.49 of accretion resulting from the held-for-sale accounting will conclude once each transaction has closed.

For fiscal 2023, we currently anticipate approximately $0.10 of adjusted earnings per diluted share accretion related to the held-for-sale accounting based on the current estimated close date for the PHOENIX Group transaction. Norway and Denmark remain the only countries that we have not entered into an agreement to sell. As previously discussed, we anticipate we will deploy capital to offset dilution resulting from all European divestitures, principally through share repurchases.

Before I provide more details on our third quarter adjusted results, I want to point out one additional item that impacted our GAAP-only results in the quarter. We recorded a GAAP-only after-tax charge of $829 million related to the sale of retail and distribution businesses in the UK to account for the remeasurement of the net assets to the lower carrying amount or fair value, less cost to sell. These charges were largely driven by declines in the British pound sterling.

Moving now to our adjusted results for the third quarter, beginning with our consolidated results which can be found on slide 7. As discussed at our Investor Day back in December, we managed the business for the long term, and our financial and strategic framework is focused on shareholder value creation. Our financial framework combines three key elements to generate sustainable adjusted EPS growth: organic growth, operating leverage, and capital allocation. This framework is once again demonstrated by our strong third quarter fiscal 2022 results.

Additionally, our leadership supporting the US government's COVID-19 domestic and International vaccine and kitting efforts continue to contribute to growth and the momentum we have built across the business.

Third quarter adjusted earnings per diluted share was $6.15, an increase of 34% compared to the prior year. This result was driven by strong operational performance across the segments, COVID-19-related items, which include the contribution from COVID-19 vaccine distribution, kitting, and storage programs of the US government, COVID-19 tests and fiscal 2021 impairments for personal protective equipment and related products, and a lower share count.

Consolidated revenues of $68.6 billion increased 10% above the prior year, primarily driven by growth in the US Pharmaceutical segment largely due to higher volumes from our retail national account customers and branded pharmaceutical price increases, which were in line with our initial guidance, partially offset by branded to generic conversions.

Adjusted gross profit was $3.4 billion for the quarter, an increase of 8% compared to the prior year which benefited from the increased contribution from our strong operational performance and previously mentioned COVID-19 programs and related items.

Adjusted operating expenses in the quarter increased 1% year-over-year. Excluding the impact of held for sale accounting on announced divestitures in the International segment, adjusted operating expenses increased 2% year-over-year.

Adjusted operating profit was $1.3 billion for the quarter, an increase of 19% compared to the prior year, led by strong operational performance across the segments.

Moving below the line, interest expense was $41 million in the quarter, an improvement of 25% compared to the prior year. Our adjusted tax rate was 19.6% for the quarter. And wrapping up our consolidated results, third quarter diluted weighted average shares were 153.5 million, a decrease of 5% year-over-year.

Moving now to our third quarter segment results, which can be found on slides 8 through 13, starting with US Pharmaceutical. Revenues were $55 billion, an increase of 11% year-over-year, driven by higher volumes from our retail national account customers and branded pharmaceutical price increases, partially offset by branded to generic conversions. Adjusted operating profit increased 12% to $735 million driven by the contribution from COVID-19 vaccine distribution and growth in the distribution of specialty products to hospitals and community clinicians.

The contribution from our contract with the US government for the distribution of COVID-19 vaccines provided a benefit of approximately $0.26 per share in the quarter, which was in line with our expectations.

In the Prescription Technology Solutions segment, revenues were $1 billion, an increase of 33% driven by higher volume growth related to biopharma services including third-party logistic services and increased technology service revenue, partially resulting from the growth of prescription volumes. Adjusted operating profit increased

11% to $145 million driven by growth from access and adherence solutions. We continue to experience growth across our broad spectrum, higher margin capabilities and offerings in this segment. We're pleased with the increased transaction volumes related to our access and adherence solutions and the increasing number of brands that joined our platforms this year. We also experienced increased volumes in our logistics and hub services due to the continued recovery of prescription volumes.

Moving now to Medical-Surgical Solutions. Revenues were $3.1 billion, an increase of 1% driven by growth in the primary care business and the contribution from kitting, storage, and distribution of ancillary supplies for COVID-19 vaccines, partially offset by lower revenue from COVID-19 tests in our primary care and extended care businesses as compared to the prior year.

Adjusted operating profit increased 18% to $330 million driven by the contribution from kitting, storage, and distribution of ancillary supplies for the US government's COVID-19 vaccine program, the prior year impact of an inventory impairment charge related to PPE that incurred in the third quarter of fiscal 2021, and growth in the primary care business.

The contribution from our contract with the US government related to the kitting, distribution, and storage of ancillary supplies for COVID-19 vaccines provided a benefit of approximately $0.31 per share in the quarter, which was above our original expectations.

Next, let me address our International results. Revenues in the quarter were $9.5 billion, an increase of 2% driven by new customer growth in our Canadian business and volume increases in the pharmaceutical distribution and retail businesses across the segment, which were partially offset by the contribution of McKesson's German wholesale business to a joint venture with Walgreens Boots Alliance.

On an FX-adjusted basis, adjusted operating profit increased 41% to $223 million driven by the reduction as compared to the prior year of depreciation and amortization on certain European assets classified as held for sale, the distribution of COVID-19 vaccines and tests in Europe, and strong distribution results in our Canadian business.

The held for sale accounting in the International segment contributed $0.18 to adjusted earnings in the quarter.

Moving on to Corporate. Adjusted Corporate expenses were $159 million, an increase of 1% year-over-year. We incurred opioid-related litigation expenses of $33 million for the third quarter, and we anticipate that fiscal 2022 opioid-related litigation expenses will be approximately $135 million.

Let me now turn to our cash position, which can be found on slide 14. We ended the quarter with a cash balance of $2.8 billion. For the first nine months of the fiscal year, we generated free cash flow of $1.2 billion. Year-to-date, we made $380 million of capital expenditures, which included investments to support our strategic pillars of oncology and biopharma services.

For the first nine months of the fiscal year, we returned $2.2 billion of cash to our shareholders, which included $2 billion of share repurchases and the payment of $206 million in dividends. At our Investor Day event in December, we announced that our board of directors approved an increase of $4 billion to our existing share repurchase program. At the end of our third quarter, $4.8 billion remains on our share repurchase authorization.

With this increased authorization, the completed sales of the Austrian business and remaining share in the German joint venture and the anticipated fiscal fourth quarter closure of the sale of the UK business, we anticipate executing share repurchases of up to $1.5 billion in the fourth quarter. As a result, we now anticipate returning approximately $3.5 billion to shareholders through share repurchases in fiscal 2022.

Our strong operating performance, combined with our return of capital to shareholders, reinforces our commitment to driving shareholder value.

Let me transition and speak to our outlook for the remainder of fiscal 2022. A full list of our fiscal 2022 assumptions can be found in slides 16 through 18. We continue to anticipate a full recovery of prescription volumes. However, the persistence of COVID-19 and its variants, such as Omicron, is leading to a non-linear trajectory.

In the US Pharmaceutical segment, we anticipate revenue to increase 8% to 11% and adjusted operating profit to deliver 8% to 10% growth over the prior year. We continue to see stable fundamentals in our US Pharmaceutical business. Specifically, our outlook for branded pharmaceutical pricing of mid-single digit increases in fiscal 2022 remains consistent with both our original guidance and prior year and our view of the generics environment remains competitive, yet stable.

Our guidance remains aligned to the volume distribution schedule provided by the CDC and US government and includes the contribution related to our role as a centralized distributor for the US government's COVID-19 vaccine distribution program. We'll continue to update you on the progress and contribution from this program.

When excluding COVID-19 vaccine distribution in this segment, we anticipate approximately 3% to 6% adjusted operating profit growth. And as a reminder, our investments in our leading and differentiated position in oncology will continue to represent an approximate $0.20 headwind in fiscal 2022.

In our Prescription Technology Solutions segment, we anticipate revenue growth of 32% to 36% and adjusted operating profit growth of 24% to 28%. This growth reflects the strong momentum in the business as we project increased volumes across new and existing biopharma solutions and customers.

Transitioning to Medical-Surgical, our outlook assumes 15% to 19% revenue growth and adjusted operating profit growth of 51% to 55% over the prior year. Our outlook includes $0.85 to $1.05 related to the contribution from the US government's distribution of ancillary supply kits and storage programs and $0.75 to $0.95 related to the net impact of COVID-19 tests and PPE impairments and related products. When excluding the impacts of these items in this segment, we anticipate 22% to 26% growth over the prior year.

One additional reminder related to our US distribution businesses. On our earnings call in November, we discussed the highly competitive labor market, which continues to persist. We also outlined an assumption for modest labor-related expense impact to ensure support of our talent strategy and continued service continuity through the second half of our fiscal year.

Based on labor market trends experienced in the third quarter and our expectations for remainder of the fiscal year, we continue to anticipate approximately $0.10 to $0.20 of adjusted operating expense impact in our US distribution businesses in the second half of the year, weighted slightly higher in our Medical segment.

Finally, in the International segment, our revenue guidance is 2% decline to 1% growth as compared to the prior year. And as a reminder, this reflects the impact from the contribution of our German wholesale business to a joint venture with Walgreens Boots Alliance in the third quarter of fiscal 2021.

For adjusted operating profit, our guidance reflects growth in the segment of 43% to 47%. This includes approximately $0.49 of adjusted earnings accretion in fiscal 2022 resulting from held-for-sale accounting related to our agreement to sell certain European assets.

Turning now to the consolidated view. Our increased guidance assumes 8% to 11% revenue growth and 24% to 27% adjusted operating profit growth compared to fiscal 2021. Our full year adjusted effective tax rate guidance of 18% to 19% remains unchanged. And we anticipate corporate expenses in the range of $570 million to $620 million, an improvement from the previous range of $610 million to $660 million related to our focus on operating leverage, which we highlighted at our recent Investor Day event.

Let me now turn to cash flow and capital deployment. We expect our businesses to continue to drive strong free cash flows and returns on capital, even as we continue reinvesting to support sustainable, long-term growth. This strong free cash flow generation provides financial flexibility to execute a balanced capital allocation approach, including investing in our strategic growth pillars of oncology and biopharma services, while remaining committed to returning capital to shareholders through our growing dividend and share repurchases. Our investment-grade credit rating remains a priority, and it underpins our financial flexibility.

For fiscal 2022, we continue to anticipate free cash flow of approximately $3.5 billion to $3.9 billion, which is net of property acquisitions and capitalized software expenses. As a reminder, historically we generate a larger portion of our cash flows in the fourth quarter of our fiscal year. Our working capital metrics and resulting cash flows vary from quarter to quarter, impacted by timing, which could include the timing of planned European divestiture activity.

We also now anticipate diluted weighted shares outstanding to range from 154 million to 155 million for fiscal 2022. This includes the impact of the anticipated $1.5 billion of fourth quarter share repurchases mentioned earlier.

As a result of our strong year-to-date performance and our outlook for the remainder of the fiscal year, we are raising and narrowing our previous adjusted earnings per share guidance range to $23.55 to $23.95, which is above our previous range of $22.35 to $22.95. Our updated outlook for adjusted earnings per diluted share reflects 37% to 39% growth compared to the prior year.

Fiscal 2022 adjusted earnings per diluted share guidance also includes $2.99 to $3.59 of contribution attributable to the following items: $0.90 to $1.10 related to the US government's COVID-19 vaccine distribution, $0.85 to $1.05 related to the kitting, storage, and distribution of ancillary supplies, $0.75 to $0.95 related to COVID-19 tests and the fiscal 2021 impairments for PPE and related products, which is an increase from the previous range of $0.50 to $0.75, and approximately $0.49 from gains and losses associated with McKesson Ventures' equity investments, which are within our Corporate segment.

Excluding the impacts of these items from both fiscal 2022 guidance and fiscal 2021 results, this indicates 27% to 33% forecast growth over the prior year.

When you pull it all together, our strong performance in our outlook equates to an adjusted earnings per diluted share guidance increase of $1.10 compared to our previous fiscal 2022 outlook provided at Investor Day. The $1.10 adjusted earnings per diluted share increase includes the following: approximately $0.45 driven by strong underlying business performance and operating leverage, approximately $0.22 related to COVID-19 tests, approximately $0.22 related to held for sale accounting and reduced opioid litigation expenses, and approximately $0.20 related to NCI, interest expense and lower weighted average shares outstanding.

Let me spend just a minute providing some initial thoughts on fiscal 2023. I want to point out that we are not providing fiscal 2023 guidance at this time. However, I thought it would be instructive to walk you through some of the items that could impact fiscal 2023 as we sit here today.

First, the COVID-19 pandemic continues to present many unknowns. We continue to expect a full recovery. However, it is likely to continue to be nonlinear into fiscal 2023, and it could impact the quarterly cadence.

In the US Pharmaceutical and Medical-Surgical Solutions segments, our contract with the US government to serve as a centralized distributor of COVID-19 vaccines and to assist with the kitting, storage, and distribution of ancillary supplies are scheduled to expire in July of 2022. Outside the contract with the US government for COVID-19 vaccine distribution, we anticipate normal customer renewal activity in the US Pharmaceutical segment.

As it relates to COVID-19 tests, we continue to anticipate that demand will be closely associated with the rate of COVID case levels and impact from variants will moderate from prior-year levels.

For the International segment, we anticipate $0.10 of adjusted earnings per diluted share accretion in the first half of fiscal 2023 related to the held for sale accounting based on the current estimated close date for the PHOENIX Group transaction. We will no longer report revenue, adjusted operating profit, or held for sale accounting benefits related to these transactions once the transactions close.

We anticipate that opioid litigation expenses will remain relatively in line with our fiscal 2022 guidance until we have a completed assessment of government entity participation in the proposed settlement and a final determination regarding that settlement. We'll continue to update you on the outcome of that determination and remaining opioid litigation expenses. We anticipate further investment to support the growth of our two key strategies of oncology and biopharma services.

Overall, we continue to see strength and stability in the underlying fundamentals of the business heading into fiscal 2023, and we remain optimistic about future growth opportunities. We'll share more details with you about our fiscal 2023 outlook in our fourth quarter earnings call in May.

In closing, we are pleased with the results of our fiscal third quarter, and we have a strong financial outlook. McKesson continues to deliver strong results as we successfully execute against our strategic and financial framework. We continue to focus on the things that matter most to our customers, patients and shareholders as a diversified healthcare services company.

We want to thank you and thank all of our employees for all their hard work and dedication. And now I'll turn the call over to the operator for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question will come from Eric Percher with Nephron Research.

Eric Percher
Analyst, Nephron Research LLC

Q

Thank you, and appreciate the commentary on fiscal year 2023 at this point. One thing I want to zero in on relative to the EU, so you'll remove most of the factors, $0.10 of benefit continuing to flow through. As you speak to offsetting with repurchase, is that part of what the repo that you suggested for Q4 is getting in front of? And do you expect you'll – how will you judge that? Will you judge it over the full fiscal year given that the timing is still variable?

Britt Vitalone
Chief Financial Officer & Executive Vice President, McKesson Corp.

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Thanks, Eric, for that question. As I talked about in my remarks, we do anticipate that the Austrian transaction, the German transaction, which have already closed, we anticipate that the UK transaction will also close in the fourth quarter. So consistent with our comments, we do intend to offset the dilution, and that is one of the reasons why we intended to do some fourth quarter share repurchases.

We will continue to apply the principles of our share repurchase activity, and certainly we'll look at cash that is in excess of what we need to operate the business as well as other opportunities that we have to deploy that capital, whether that be additional share repurchases for our shareholders or if we have M&A transactions

So certainly we told you we would offset the dilution, and we're closing transactions now and anticipate more in the fourth quarter. And so that was one of the reasons why we wanted to begin the share repurchase activity in addition to being very consistent with our share repurchase principles.

Rachel Rodriguez
Investor Relations Contact, McKesson Corp

A

Next question, please?

Operator: And our next will be from Lisa Gill with JPMorgan.

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Q

Thanks very much. Good afternoon, and thanks for all the detail. Britt, I just want to go back and talk about inflation. You talked a little bit about labor, and I know you and Brian talked last quarter about some special bonuses and increasing wages, but how do we think about wages going forward as we continue to have wage inflation would be my first part of the inflation question.

And then secondly, as we think about product inflation or transportation, I know generally speaking, it's a pass-through on the pharmaceutical side of things, but how do we think about any PPE on your Medical side of your business?

Britt Vitalone
Chief Financial Officer & Executive Vice President, McKesson Corp.
A

Lisa, thanks for that question. Maybe I'll just step back for a minute and just address labor and inflation separately, and maybe I'll just start with inflation. Our business model has a normal component that's built into it that relates to pricing. When you have a model like we do that's founded on both supply and service stability and consistency that solves problems in a better way for customers and patients, you're able to incorporate some of these higher input costs through pricing.

Our organization, Brian has talked about, continues to do really a tremendous job on productivity efforts, and those productivity efforts enable us to offset some of this cost. And then of course, there is a pricing component.

And just finally, we have an organization of really smart people that are continuously working to find better solutions, greater efficiencies, and leveraging the scale and the broad expertise that we have to provide quality and reliability that our customers have come to expect from McKesson.

So that's maybe just answering some of the questions on the inflation front.

On the labor front, Brian's talked about talent being one of our key components of our strategy. It will remain that. And of course, this is a very challenging market. We're seeing pressures in the labor market. And so we've talked about the fact that we expect some of these labor pressures to find their way into operating expenses in the second half of the year, $0.10 to $0.20. We've not guided beyond FY 2022. We'll obviously assess if we think that those costs are going to be sustained at any way. At this point we just see a $0.10 to $0.20 impact in our US distribution businesses in the second half. And what we've seen so far in the third quarter it's tracking right in line with that.

Brian S. Tyler
Chief Executive Officer & Director, McKesson Corp.
A

Yeah. We'll stay on top of the market. We'll be responsive to it. We've got a lot of confidence in our team's ability to adjust, and we actually think we've got an asset in terms of the company culture, our purpose, our mission, the investments we make in our teams. We think this is a great place to work, and we'll continue to find ways to attract the best talent.

Rachel Rodriguez
Investor Relations Contact, McKesson Corp
A

Next question, please?

Operator: And next will be Charles Rhyee with Cowen. Please go ahead.

Charles Rhyee
Analyst, Cowen & Co. LLC
Q

Yeah. Hey. Thanks for taking the question. Britt, you talked earlier in your prepared comments about – in the Pharma (sic) [Prescription] Technology Solutions segment about access to medications, and you highlighted a couple businesses. You mentioned a $15 billion market opportunity here. Maybe if you can just give us a little more details around sort of your position in the market, in this part of the market particularly? And what is the competitive landscape? And do you see an opportunity here for McKesson to consolidate this industry?

Brian S. Tyler
Chief Executive Officer & Director, McKesson Corp.

A

Thank you for the question. I think you addressed it to Britt, but I'll jump in and start with my thoughts. I mean, so this – we think we're extremely well-positioned in this marketplace, and one of the things when we're anchoring our growth strategies we try to anchor around is making sure we have differentiation, that we have things that are difficult to replicate. And the reason we brought these businesses together as a segment is because we think individually they all had their strengths and were winning in their market, but collectively together, accessing the reach of our networks, utilizing the advanced technologies we have in CoverMyMeds and then the clinical expertise and the biopharma relationships we had in RxCrossroads, that they kind of reinforce and compound each other.

And so, when we think about the access is a distinct market, adherence is a distinct market, outcomes is a distinct market; but putting these together, it allows us to really more effectively compete across all of those. Some of that is reinventing a better solution for a market that exists. That's sort of what we did with AMP. We brought an infusion of technology to really redesign and greatly enhance the value we deliver to manufacturers, giving us what we think is significant competitive advantage. We'll continue to do those kinds of innovations as we grow into it.

I mean, it is a pretty fragmented landscape. There are some competitors' names you know. There's frankly lots of little ones. This is an area that we would like to use the strength of our balance sheet to be acquisitive, to be additive to that ecosystem through additional capability or additional scale. As long as we find that strategically aligned asset and it can meet our financial hurdles and stand up well to other means we have to deploy capital, we'll certainly look to execute on that.

Rachel Rodriguez
Investor Relations Contact, McKesson Corp

A

Next question, please?

Operator: And the next one will be from Jailendra Singh with Credit Suisse. Please go ahead.

Jailendra Singh
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you, and hello, everyone. So with respect to $0.45 core business outperformance you called out, which is now captured in your fiscal 2022 outlook, how do you think about the sustainability of some of those drivers behind that outperformance? And related to that, how should we think about the fiscal 2022 baseline EPS of $17.50 to $18 you shared at your Investor Day?

Britt Vitalone
Chief Financial Officer & Executive Vice President, McKesson Corp.

A

Let me take those in two pieces. We're pleased with another quarter of strong operating performance, and obviously, you saw growth across each of our segments. So as we look at the outlook for the remainder of the year, we expect that the momentum in our business is going to continue.

And we haven't provided any guidance as it relates to FY 2023, but at our Investor Day, we did provide long-term targets, where we suggested and felt very confident that we'll continue to see growth in each of those segments for the long term. So, we feel very good about the performance that we're seeing in our business. And consistent with our Investor Day, we expect that to continue.

So, I think that is really the point that you should see here is just continued strong performance for several years now across all of our segments. The fundamentals of our businesses are strong. We're investing in these businesses for future growth. And we're in markets that we think are going to continue to grow, and we're in very good positions to take advantage of that with some differentiated capabilities.

Rachel Rodriguez A
Investor Relations Contact, McKesson Corp

Next question, please?

Operator: And next will be Michael Cherny with Bank of America.

Michael Cherny Q
Analyst, BofA Securities, Inc.

Afternoon, and thanks for all the color so far. I want to talk a little bit about the US Pharma segment. As you think about into next year and thinking more qualitatively as much as anything else, but how do you think about outside of the COVID-related script and volume recovery, the other moving pieces? You did comment on a normalized renewal year. So, are there anything you're seeing there, big renewals? And how do you think about the areas of growth that have remained steady maybe within specialty and the potential for biosimilars, and how that should factor into that long-term growth trajectory and where that falls relative to 2023 broadly?

Britt Vitalone A
Chief Financial Officer & Executive Vice President, McKesson Corp.

Mike, thanks for the question. Maybe I'll start and then I'll let Brian jump in here. Again, as we think about it and some of the things that I mentioned here, we do expect a full recovery of prescription transaction volumes. And we're certainly pleased that transaction volumes have continued to increase throughout the year. It has not been in a straight line, but we do expect that full recovery to continue.

We're very well-positioned in the specialty clinic space as well as oncology. We're making investments in those areas that we think are going to continue to pay off over the long term. And biosimilars is one of those areas that given our position, particularly in oncology, we believe that it's going to be a growth driver for us over the long term. And we're pleased with the development of biosimilars to this point. We think that they offer better returns than branded and specialty products, maybe not at the same level as generics from a margin perspective, but still, we believe and we're optimistic that they're going to continue to add value to the segment over time.

So, the position that we have, the strength that we have across segments, particularly our differentiated capabilities in oncology, positions us very well for further growth.

Rachel Rodriguez A
Investor Relations Contact, McKesson Corp

Next question, please?

Operator: And next will be Brian Tanquilut with Jefferies.

Brian Tanquilut
Analyst, Jefferies LLC

Q

Hey. Good afternoon, guys. Congrats on the quarter. I guess, Britt, my question is the Medical segment operating income raise was pretty significant even if you backed out COVID. Can you just dissect for us that outperformance and how should we be thinking about the sustainability of earnings in that segment past 2022?

Britt Vitalone
Chief Financial Officer & Executive Vice President, McKesson Corp.

A

Yeah. Thanks for the question, Brian. Maybe I'll just start. Just to remind you, since fiscal 2019, this business has grown at 10% from an adjusted operating profit perspective on the core basis, outside of COVID programs. So, we've seen strong growth in this business now for a number of years. It's one of our higher-margin segments. We have very strong positions across the primary care segment of the business and across all alternate sites. Our extended care business has grown nicely over time as well.

We've added a lot of capabilities and investment over time, whether that be acquisitions to position us well in the lab. We've seen private brand be an important component and we've seen growth in Rx as well. So, we've got a lot of capabilities across the entire alternate site. We've invested in these capabilities over time. It's positioned us well not only from a core perspective, but certainly now, as COVID has taken on, we've been in a really good position to handle the kitting and the storage programs as well.

Rachel Rodriguez
Investor Relations Contact, McKesson Corp

A

Next question, please?

Operator: And next will be Ricky Goldwasser with Morgan Stanley.

Ricky R. Goldwasser
Analyst, Morgan Stanley & Co. LLC

Q

Yeah. Hi. Good evening and thanks for the very comprehensive details. So, two follow-ups here. One, just to clarify, as you think about 2023, should we assume that all the buyback activity is going to be offsetting the dilution from the European divestitures? That's first.

And then, secondly, as we think about the COVID impact, I mean, clearly, nice contribution in the last couple of years. How do you think the economics of vaccine and testing will evolve as sort of COVID becomes more of an annuity? Should we think about it as flu-type economics?

Britt Vitalone
Chief Financial Officer & Executive Vice President, McKesson Corp.

A

Ricky, let me take the first one and then I'll let Brian comment on the second just because it's a more mechanical question. As I mentioned in my comments, we do expect to offset any dilution from the European divestitures through capital deployment, and that could be share repurchase activity like we're doing in the fourth quarter. So just to reaffirm that, we will be – we do plan on offsetting that dilution.

Brian S. Tyler
Chief Executive Officer & Director, McKesson Corp.

A

Ricky, relative to, I guess let's call it the future of testing, that's a little bit, I think, difficult to forecast. A lot of it will depend on the science, the development. A lot of it will depend on the current testing hold-up to current and future potential variants, what will be the mix between in a medical setting versus over-the-counter, do those become more reliable. I think there's a lot of questions that still have to resolve themselves there.

What I would say, though, is that regardless of how that evolves, we think McKesson is in an excellent position to capitalize on that. We are currently the largest distributor. We distribute more flu vaccines than anyone. We have a great franchise in the physician alternate site setting. We distribute to pharmacies because of our presence in the communities in both our Medical and Pharmaceutical business, our relationships with the labs and I think the real credibility we've built up over the last couple of years, I think we're extremely well-positioned to capture that opportunity, however it unfolds.

Rachel Rodriguez A

Investor Relations Contact, McKesson Corp

And we have time for one more question.

Operator: Most certainly. This question will come from Steve Valiquette with Barclays.

Steve J. Valiquette Q

Analyst, Barclays Capital, Inc.

Thanks. Good afternoon. I also had a question just around the – your comment around the normal customer renewal activity in fiscal 2023. I guess I just wanted to make sure and confirm the messaging around that. So I guess first, can you remind us how customer renewal activity and any related pricing step-downs trended for fiscal 2022? And thus, if that activity is going to be normal in 2023, is that net positive, net negative or net neutral as you think about the – how all that flows year-over-year? Hopefully, that question makes sense. Thanks.

Britt Vitalone A

Chief Financial Officer & Executive Vice President, McKesson Corp.

Yeah. Thanks, Steve. That's a good question. I'm happy to answer that and I'm happy to clarify. When I speak of normal, what I mean by that is in any year, we typically see about a third of our US Pharmaceutical book renew. As we have seen over the last few years, there have been no material impacts to that and certainly have been able to renew all of our customers successfully within our guidance and I would not anticipate that we would see anything material from our renewal next year.

It's early, obviously. If there's an update to that information, we'll provide it on our May earnings call. But normal, what I was referring to is that about a third of our book renews every year would not anticipate anything that would be a material driver from that activity.

Brian S. Tyler

Chief Executive Officer & Director, McKesson Corp.

Great. Well, thanks again, everyone, for joining us on this call, and thank you for the insightful and very thoughtful questions. Keith, thank you for help facilitating the call.

I want to just conclude by reiterating McKesson executed really well in the third quarter with double-digit adjusted operating profit growth in all segments. I continue to be excited about the focus on our company priorities and the contributions we can see that making the strong financial results. It's really the driver between – the driver of our shareholder value creation.

So, none of that happens without the team that makes up McKesson. And so, to everyone in McKesson, no matter what your role, no matter what geography you work in, whether you're on the frontline or elsewhere in the business, I'm so appreciative of their hard work, their dedication to our purpose and our mission, their commitment to our customers. They really are what makes this a special place. So, thanks for them.

Again, thank you, everyone. I hope you have a terrific evening. Be safe and stay healthy.

Operator: Thank you for joining today's conference call. You may now disconnect and have a great day.