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McKesson Corp. (MCK)

Q3 2024 Earnings Call

CORPORATE PARTICIPANTS

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.

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

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

OTHER PARTICIPANTS

Charles Rhyee
Analyst, Cowen & Co. LLC

Eric Percher
Analyst, Nephron Research LLC

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Allen Lutz
Analyst, BofA Securities, Inc.

Brian Tanquilut
Analyst, Jefferies LLC

Kevin Caliendo
Analyst, UBS Securities LLC

Eric White Coldwell
Analyst, Robert W. Baird & Co., Inc.

Stephanie July Davis
Analyst, Barclays PLC

Erin Wilson Wright
Analyst, Morgan Stanley & Co. LLC

Daniel Grosslight
Analyst, Citigroup Global Markets, Inc.

Elizabeth Anderson
Analyst, Evercore ISI

George Hill
Analyst, Deutsche Bank Securities, Inc.

Carol Wong
Analyst, Wells Fargo Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Welcome to McKesson's Third Quarter Fiscal 2024 Earnings Conference Call. Please be advised that today's conference is being recorded.

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

Rachel Rodriguez

Vice President of Investor Relations, McKesson Corp.

Thank you, operator. Good afternoon and welcome everyone to McKesson's third quarter fiscal 2024 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 at our website at investor.mckesson.com and to the Risk Factors section of our most recent annual and 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 those measures to GAAP results, may be found in today's earnings release and presentations slides. The presentation slides also include summary of our results for the quarter and updated guidance.

With that, let me turn it over to Brian.

Brian Scott Tyler

Chief Executive Officer & Director, McKesson Corp.

Thank you, Rachel, and good afternoon to everybody. Thanks for joining our call. McKesson reported a really solid fiscal third quarter, highlighting the continued momentum across the business. We delivered total revenues of $80.9 billion and adjusted earnings per diluted share of $7.74, both of which grew by double-digits when compared to the prior year.

As a result of the recent performance and our latest outlook, we are raising and narrowing our guidance range for fiscal 2024 adjusted earnings per diluted share from $26.80 to $27.40 to an updated range of $27.25 to $27.65. This solid financial performance is driven by the focused execution against our company priorities.

As a diversified healthcare services company, we are uniquely positioned to improve healthcare in every setting. This includes the areas of oncology and biopharma services. We continue to make significant progress in advancing our strategy and priorities, and I'm pleased to share some of the updates with you today.

Let me start where I always like to start, and that's with our focus on people and culture. I start here because it is foundational to everything we do at McKesson. In January, our board of directors welcomed Kevin Ozan as a new independent Director. As the former Chief Financial Officer of McDonald's Corporation, Mr. Ozan has over two decades of experience in both strategy and finance and will contribute a valuable perspective to our boardroom. We look forward to his leadership as we work together to deliver on our growth initiatives.

Driving the growth of our company requires a talented and diverse leadership team and equally important, a diverse workforce where each individual is empowered to bring their own opinion, their own ideas and perspectives. Our commitment to best talent and inclusion is reflected in every aspect of our operations. It's how we build the support network for our employees and how we each live these values through everyday interactions. And I'm pleased to see our efforts being recognized.

For the 11th consecutive year, McKesson was named as a Military Friendly Employer. We were also recognized by Newsweek as one of America's Greatest Workplaces for Diversity, and the Equality 100 Award winner by the Human Rights Campaign. I'm proud of what we've achieved as a team, and I'm truly grateful to the McKesson employees for upholding our culture, values and delivering for all of our stakeholders, our patients, our customers, our partners, our shareholders and importantly, each other.

Moving on to our next priority of driving sustainable core growth, in the fiscal third quarter, we saw good performance in our distribution businesses. In US Pharmaceutical, adjusted operating profit grew 6%, reflecting broad-based momentum within the segment.

We continue to enhance our scaled distribution network, improving efficiency through investments in automation and technology. Over the past year, we opened two new distribution centers in the US that are equipped with innovative technology and employee-friendly design.

These enhancements will enable our facilities to pick, pack and ship medications to customers faster, while simultaneously helping to optimize employee productivity levels by reducing redundant tasks.

The investments in our foundational distribution assets continue to support the growth of our business and the success of our customers. During the third quarter, we saw solid volume increases across customer channels, which includes distribution to retail national accounts customers.

At the consolidated level, prescription volume growth remains stable. Certain product categories, including specialty pharmaceuticals and GLP-1 medications continue to grow at a faster pace and contribute as a tailwind to our revenue growth.

As a reminder, we anticipate the growth from GLP-1 medications to slow in our fiscal fourth quarter, reflecting the inflection in volumes for these medications in the fourth quarter of fiscal 2023.

In the Medical Surgical segment, primary care visits showed modest improvement on a sequential basis, after we observed general market moderations last quarter. The improvement was partially driven by overall increase in primary care visits. However, when compared to the prior year, patient visit volumes in the Medical segment remain a headwind to this quarter's performance.

In the International segment, our Canadian business continues to perform well. It has a valuable portfolio of assets, including pharmaceutical distribution, retail pharmacies, digital offerings, we're committed to strengthen and grow the business there. And as a part of that commitment, we're executing on a multiyear initiative that will modernize the distribution centers across Canada and deliver significant value to our employees and customers.

Let me now continue on to talk about our Oncology and Biopharma platforms. We continue to build on the foundation of our distribution capabilities, but we have strategically assembled a differentiated set of assets in oncology and biopharma services.

Within the Oncology business, The US Oncology Network expanded its footprint by entering the state of Tennessee. Over the past quarter, we welcomed two new practices, Nashville Oncology Associates and SCRI Oncology Partners to the network.

Through the combination of onboarding new practices and organic growth, The US Oncology Network has grown its provider base to over 2,500, spreading across nearly 600 sites in 30 states. The expansion of the network strengthened our unique market position in community-based oncology practices and demonstrates our strong value proposition to providers.

Through The US Oncology Network, we provide a range of comprehensive solutions to ease the administrative and operational burden, and to help enable the success of these community practices.

In the past quarter, we started integrating new artificial intelligence capabilities into the network, assisting providers with revenue cycle management and evaluating clinical solutions. With the help of AI and machine learning technologies, practices will be able to navigate complex insurance coverage and reimbursement processes more efficiently, allowing providers to spend more time focused on their patients.

Within the Biopharma Services business, we continue to see strong market demand for our differentiated solutions that help improve access, affordability and adherence to medications. In the third quarter – or this fiscal third quarter, the Prescription Technology Solutions segment delivered strong performance, primarily driven by the growth at access solutions, including prior authorization solutions for branded pharmaceuticals, such as GLP-1 medications.

Today, we provide prior authorization services for the vast majority of the GLP-1 medications in the market. Our integrated technology streamlines the prior authorization process and helps overcome medication access challenges that patients are facing. The main customers we serve are biopharma companies and through our scaled network connection, we can electronically process requests, both at the pharmacy counter and the provider's offices.

The prior authorization solution is an example of the power of our capabilities and as part of a broader portfolio of patient support services we provide. We believe our solutions are highly differentiated and provide value to all stakeholders through a patient's journey. We're connected to over 50,000 pharmacies and approximately 900,000 providers. The scale of our network provides a strong foundation that enables us to reach key stakeholders effectively and seamlessly.

The integrated solutions we offer can often be accessed through a single digital entry point. For our biopharma customers, the integration helps streamline workflows and increase transparency into how programs work together.

In the past quarter, our team has been working diligently to prepare for what we call the blizzard season. For the Prescription Technology Solutions segment, our fiscal fourth quarter is usually the busiest time of the year, due to customer annual verification activities. The annual reset of insurance policies typically drives a large influx of seasonal volumes for many of our programs. Each year, our teams come together to tackle the challenge of these significant volume increases.

I'm pleased to report that we're on track to deliver another successful blizzard season that is in line with our expectations. Our products and solutions in both oncology and biopharma services provide significant value to our customers, as reflected in the continued growth of these businesses. We're excited about the market opportunities in both areas, and we're confident in the scale and depth of our assets and expertise. We will continue to invest and innovate to support the evolving needs of our customers and their patients.

So let me pull it all together. McKesson reported another solid quarter in fiscal 2024, that allowed us to raise and narrow our full-year guidance for adjusted earnings per diluted share. We're committed to our shareholders to delivering long-term sustainable growth, and this quarter's results reflect the continued progress in delivering on our commitment.

Healthcare is an ever-evolving market. But thanks to the hard work and dedication of our employees, we never stopped finding new ways to drive positive impacts on our customers and their patients. I want to thank the over 50,000 McKesson employees, who are working so tirelessly to advance our mission.

And with that, I'll hand it over to Britt for some additional insight and comments.

Britt J. Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

Thank you, Brian, and good afternoon. We're pleased with our fiscal third quarter 2024 results, which reflect another quarter of solid momentum with growth across our North American businesses. Our results exceeded expectations, demonstrating our ability to consistently execute against company priorities and create long-term sustainable value for our shareholders.

Before I turn to our consolidated results, I want to highlight one item that impacted our third quarter GAAP-only results. We recorded an additional pre-tax GAAP provision for bad debts of $515 million or $381 million after tax within the US Pharmaceutical segment. This provision is for uncollected trade accounts receivable from sales to Rite Aid in October of 2023, prior to its bankruptcy petition filing.

We continue to provide distribution services to Rite Aid through an interim distribution agreement, providing the same efficiency and operational excellence, as we have for over 20 years. We're closely monitoring developments. Rite Aids bankruptcy will not have a material impact on our fiscal 2024 adjusted earnings per diluted share results.

The remainder of my comments will refer to our fiscal 2024 adjusted results. Let me start with a review of the fiscal third quarter. McKesson delivered solid growth in the third quarter, led by sustained strong performance in the US Pharmaceutical and Prescription Technology Solutions segments.

This year-over-year growth underscores operating execution across our diversified and differentiated portfolio, including investments in oncology and biopharma services. As a result of the third quarter operating performance and our confidence in the business, we're increasing and narrowing our full-year outlook for fiscal 2024 adjusted earnings per diluted share, to a new range of $27.25 to $27.65.

Let me move to our consolidated results. Revenues increased 15% to $80.9 billion, led by continued strong utilization trends, growth in the US Pharmaceutical segment, including higher volumes from specialty products, retail national account customers and GLP-1 medications, partially offset by lower revenues in the International segment, resulting from fiscal 2023 divestitures within McKesson's European business.

Excluding the impact of our European business operations, including completed divestitures, revenues increased 16%. Gross profit was $3.1 billion for the quarter, an increase of 3%. When excluding the impact of our European business operations, including completed divestitures and the impact from the US government COVID-19 programs in fiscal 2023, gross profit increased 10%.

Operating expenses increased 4% in the quarter, due to higher costs to support growth in the US Pharmaceutical and Prescription Technology Solutions segments. When excluding the impact of our European business operations, including the completed divestitures, operating expenses increased 6% year-over-year.

Third quarter operating profit decreased 9% to $1.3 billion. Fiscal 2023 results included a pre-tax benefit of $126 million, related to the early termination of the tax receivable agreement, or TRA, with Change Healthcare.

Year-over-year results were also impacted by anticipated lower contributions from the US government COVID-19 programs, which were mitigated by contributions from commercial COVID-19 distribution and a non-recurring $30 million charge in our US Pharmaceutical segment.

These items were partially offset by growth in the US Pharmaceutical and Prescription Technology Solutions segment. When adjusting for these items, including $126 million or $0.65 benefit from the early termination of the TRA in fiscal 2023 and gains and losses associated with McKesson Ventures equity investments in fiscal 2023 and 2024, operating profit increased 7% in the quarter.

Moving below the line, interest expense was $58 million, a decrease of 16% year-over-year, driven by effective management of our loan portfolio. The effective tax rate for the quarter was 10.6%, resulting from the recognition of discrete tax benefit in the quarter.

As a reminder, our effective tax rate can vary quarter-to-quarter, driven by our mix of income and the timing of discrete tax items. Third quarter diluted weighted average shares outstanding was $133.3 million, a decrease of 5% year-over-year.

Consolidated third quarter earnings per diluted share, was $7.74, which represents an increase of 12% over the prior year. This increase includes the impacts of approximately $0.63 related to the US government COVID-19 program and the $0.65 benefit from the termination of the TRA in fiscal 2023 and increased commercial COVID-19 vaccine distribution and a non-recurring charge in our US Pharmaceutical segment in fiscal 2024.

Turning to our third quarter segment results, which can be found on slide 7 through 11, and starting with US Pharmaceutical, during the quarter, we experienced volume increases across all product categories and customer channels.

Specialty pharmaceuticals and GLP-1 medications continue to grow at a faster pace compared to the prior year. Third quarter revenues were $73 billion, an increase of 18% year-over-year, driven by increased prescription volumes, including higher volumes from specialty products, retail national account customers and GLP-1 medications.

In the quarter, GLP-1 revenues were $7.5 billion, an increase of approximately $2.8 billion or 60%, compared to fiscal 2023. During the quarter, we also noted increased contributions from commercial COVID-19 vaccine distribution.

In our fiscal third quarter, commercial COVID-19 vaccine distribution peaked in October then declined significantly in November and December. We do not anticipate material contributions from commercial COVID-19 vaccine distribution in our fiscal fourth quarter.

For the third quarter, operating profit increased 6% to $828 million, driven by growth in the distribution of specialty products to providers and health systems. Adjusting for the impact of the US government COVID-19 vaccine distribution in fiscal 2023, commercial COVID-19 distribution in fiscal 2024, and the $30 million non-recurring charge in the US Pharmaceutical segment, delivered operating profit growth of 8% year-over-year.

In our Prescription Technology Solutions segment, the growth of GLP-1 medications and new brand launches led to increased demand for our access solutions, such as prior authorization services. For the third quarter, revenues increased 7% year-over-year to $1.2 billion, and operating profit increased 25% to $193 million.

Third quarter results reflect increased prescription transaction volumes, which drove higher demand for our access solutions, principally prior authorization services and growth in our third-party logistics business.

In addition to the strength of prior authorization services, Year-over-year growth was also supported by increased sales to new customers and programs across our access and affordability solutions.

Turning to Medical Surgical Solutions, revenues were $3 billion in the quarter, an increase of 2%, primarily driven by growth in the primary care and extended care businesses, partially offset by anticipated lower contributions in the kitting, storage, and distribution of ancillary supplies for the US government's COVID-19 vaccine program compared to the prior year.

In the third quarter, primary care patient visits moderately increased on a sequential basis. Demand for commercialized COVID-19 vaccine distribution, across the alternate sites of care that we serve, was also modestly higher compared to prior expectations.

The overall illness season dynamics, including vaccinations and testing, continue to be an operating profit headwind in the quarter when compared to the prior year. As a reminder, each illness season is unique, depending on the onset and severity of various respiratory illnesses during that particular year.

Operating profit was $282 million, a decrease of 16%, driven by anticipated lower contributions from the kitting, storage, and distribution of ancillary supplies for the US government's COVID-19 vaccine program, and a softer illness season as compared to fiscal 2023. When excluding the impact of COVID-19-related items from the third quarter of fiscal 2023, the segment delivered operating profit growth of 7%, driven by growth in the primary care and extended care businesses.

Next, let me address our International results. Revenues in the third quarter were $3.6 billion, a decrease of 18% year-over-year, driven by divestitures with McKesson's European business, partially offset by higher pharmaceutical distribution volumes in Canada. Operating profit was $105 million, a decrease of 27%, driven by divestitures within the McKesson's European business.

Wrapping up our segment review. Corporate expenses were $147 million in the quarter, which included losses of $8 million or $0.05 per share, related to equity investments within the McKesson Ventures portfolio. McKesson Ventures impact on consolidated financials can be influenced by the performance of each individual investment quarter-to-quarter. As a result, McKesson's investments may result in gains and losses, the timing and magnitude which can vary for each investment. We remain pleased with the insights and the results that we're obtaining through this portfolio.

Excluding the benefit from the early termination of the tax receivable agreement in fiscal 2023 and gains and losses within our McKesson Ventures portfolio in fiscal 2023 and 2024, corporate expenses in the third quarter decreased 5% year-over-year.

Turning now to cash flows and capital deployment, which can be found on slide 12. We ended the quarter with $2 billion in cash and cash equivalents. We delivered free cash flow of $100 million in the third quarter and $2.9 billion for the trailing 12 months. Third quarter free cash flow was impacted by the Rite Aid bankruptcy in October and its associated $725 million provision for bad debts.

As a reminder, our cash position, working capital metrics and resulting cash flows can each be impacted by timing, which includes the day of the week that a quarter ends on and, therefore, can vary from quarter-to-quarter.

During the first nine months of the fiscal year, we made capital expenditure investments of $418 million, which included new and existing distribution centers, as well as investments in technology, data and analytics to support our growth priorities. Year-to-date, we returned $2.6 billion of cash to shareholders, which included $2.3 billion of share repurchases and $232 million in dividend payments.

Now, let me turn to our updated fiscal 2024 outlook. As a reminder, we do not provide forward-looking guidance on a GAAP basis. The following metrics are provided on an adjusted non-GAAP basis. A full list of our assumptions can be found on slides 13 through 17 in our supplemental slide presentation.

Let me start with the fiscal 2024 outlook for our segments. For the full year, we now anticipate US Pharmaceutical revenues to increase 16% to 18% and operating profit to increase 6% to 8% year-over-year. Excluding the impact of COVID-19 vaccine distribution for the US government in fiscal 2023, we anticipate operating profit to increase 11% to 14%. The impact of elevated commercial COVID-19 distribution in the third quarter, net of the $30 million non-recurring charge also in the third quarter of fiscal 2024 accounts for approximately 2% of segment growth.

The updated segment revenue outlook incorporates the strong third quarter performance and continued growth in specialty distribution, supported by stable utilization trends. Revenue growth assumes that GLP-1 medication volumes will continue to be robust, although the rate of growth will moderate in our fiscal fourth quarter. These medications are lower margins and represent a headwind to year-over-year operating profit growth.

Our full-year operating profit growth also reflects our leading generics program, which continues to deliver on the dual mandate of lower cost and product availability. And we continue to be pleased with the strength of our scaled and broad oncology platform. This quarter, as Brian mentioned, we expanded into Tennessee with the addition of two practices. With these additions and organic growth, US Oncology is now over 2,500 providers.

In the Prescription Technology Solutions segment, we anticipate revenue growth of 9% to 13%, and we've increased our operating profit growth outlook to 24% to 28%, reflecting strong third quarter performance, continued organic growth and higher transaction volumes across the access and affordability solutions.

The quarter-to-quarter variability in this segment is driven by prescription and transaction volumes, the timing and pace and trajectory of new product drug launches, the timing and size of investments to support and expand our product portfolio, and the annual verification programs that we provide for our customers that occur in our fiscal fourth quarter.

Our Medical Surgical Solutions segment continues to be a leader across all the alternate sites of care. We anticipate revenues to be approximately flat to 4% growth and operating profit to decrease 11% to 15%.

When excluding the impact of COVID-19-related items from fiscal 2023 results, we anticipate operating profit to increase 6% to 8% year-over-year. Our updated outlook incorporates the third quarter results that I discussed earlier, which reflect a modest improvement in sequential primary care traffic.

Finally, in the International segment, we anticipate revenues to decline by 29% to 33%. And operating profit to decline by 21% to 26%, reflecting divestitures within McKesson's European business that closed during fiscal 2023.

In the Corporate segment, we anticipate expenses to be in the range of $615 million to $655 million, which includes losses associated with McKesson Ventures equity investments, recorded in the first nine months of the year and elevated technology spend to support the growth of our business.

Moving below the line, we anticipate interest expense to be approximately $220 million to $230 million and income attributable to non-controlling interests to be in the range of $155 million to $165 million. We anticipate no change to the full-year effective tax rate of approximately 18% to 19%. The timing of discrete tax item is difficult to predict, and therefore, we do not provide quarterly effective tax rate guidance.

Turning to cash flow and capital deployment. We now anticipate free cash flow of approximately $3.2 billion to $3.6 billion. Our working capital metrics and resulting free cash flow will vary from quarter-to-quarter, impacted by timing, including the day of the week that marks the close of the quarter. Our outlook also incorporates the impact of the October Rite Aid bankruptcy.

Our guidance reflects plans to repurchase approximately $3 billion to $3.5 billion of shares. As a result of the share repurchase activity, we estimate weighted average diluted shares outstanding to be in the range of approximately 134 million.

Wrapping up fiscal 2024 guidance. As a result of solid performance in the third quarter of fiscal 2024, combined with our momentum and confidence moving forward, we are increasing and narrowing our earnings per diluted share outlook for fiscal 2024, to a new range of $27.25 to $27.65.

We anticipate operating profit will be a 2% decline to 1% growth compared to the prior year, excluding certain items, we anticipate operating profit to increase by approximately 8% to 11% year-over-year, above the long-term target range.

As a reminder, certain items include the following: $1.90 related to fiscal 2023, US government COVID-19 program and COVID-19 tests in our US Pharmaceutical and Medical Surgical segments. A $0.65 benefit related to the early termination of the tax receivable agreement with Change Healthcare in fiscal 2023, and gains and losses associated with McKesson Ventures' equity investments in fiscal 2023 and 2024. The increase to our outlook for adjusted earnings per diluted share indicates growth of 16% to 18%, when excluding these certain items.

Before I close, I'd like to share some initial thoughts on fiscal 2025. The momentum we've seen across our business over the past several years is expected to continue in fiscal 2025. We anticipate the US Pharmaceutical and Medical Surgical Solutions segments will be more closely aligned to the long-term growth targets that we've previously provided for these segments, demonstrating our leading market positions and stable financial performance.

We anticipate that the strength we're seeing across our solution set and Prescription Technology Solutions, will lead to growth at the top end or slightly above the long-term target.

In US Pharmaceutical, we remain confident in our long-term target of 5% to 7% growth, supported by sustainable momentum in the core distribution business and across our oncology platform, The US Oncology Network, Ontada and the joint venture with Sarah Cannon Research Institute.

As the leader in the alternate site market, we believe that the Medical Surgical Solutions segment is well positioned as care continues to move across the alternate site settings. Our experience and our relationships in every channel and setting of the alternate site markets enable us to capture the [ph] growth (29:59) opportunity in the years ahead.

We anticipate that the Prescription Technology Solutions segment may perform modestly above the long-term growth target of 11% to 12%, driven by organic growth, as we expand our higher-margin biopharma services platform.

For the International segment, we anticipate continued growth in our Canadian operations. And throughout fiscal 2023, we completed divestitures of the business operations in 11 of the 12 countries that we operated in Europe.

As a reminder, Norway remains the only country that we have not entered into an agreement to sell. And we intend to exit Norway, as part of the completion of our European exit.

Finally, we will continue to materially invest in the business on multiple fronts. We will sustain the pace and cadence of investment in product development and enhancements across our oncology and biopharma services platforms. These investments will further our differentiated capabilities and market-leading positions.

We will also continue to invest in adding capacity and capabilities to our North American distribution footprint. These investments include increased capacity, automation, and regulatory excellence capabilities. And we will continue to invest in data and analytics, including the acceleration of several investments in artificial intelligence. We see AI as unlocking the potential to deliver customer and foundational enhancements.

Although in the early stages, we're using AI to improve patient intake and workflow, and improve productivity throughout the system, including automatic clinical note generation and several supply-chain use cases, including supply-chain disruption predictions, forecast accuracy algorithms and fraud detection. Although, we're in the early stages of our AI development and implementation, we're committed to increased investment to further extend our leadership positions and deliver value to our partners and stakeholders.

To sum up, we see strength and stability in the underlying fundamentals of the business. We're pleased with our strong fiscal 2024 performance, and we remain optimistic about the outlook. McKesson is well positioned to continue to deliver strong results, as we successfully executed against our strategic and financial framework to drive long-term sustainable growth for all stakeholders.

And with that, let's move to our Q&A session.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question will come from Charles Rhyee with TD Cowen. Please go ahead.

Charles Rhyee
Analyst, Cowen & Co. LLC

Q

Yeah. Thanks for taking the questions. Obviously, strong performance in RxTS, as implied in the guidance. Maybe you can kind of give us a feel for the mix between reauthorizations versus new prior auths in that mix.

And as we think about through the course of the year as kind of new category, like this is sort of a category that's kind of grown significantly over the last year or so, particularly and if we think about the launch of Zepbound as well from Lilly. Can you give us a sense of what the life cycle typically is for prior auths? Over time as products mature, what does that activity looks like? And maybe give us a sense for what you kind of expect right now, particularly in this the GLP-1 category?

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

A

Thanks, Charles. I'll start, and Britt, as always, feel free to add on. First off, we're very pleased with the solutions that we have in this segment. We think the growth over the last several quarters demonstrates the value that they bring to providers. Just as a reminder, this segment, new brand launches, particularly high-cost drugs, are drivers for this segment. They typically require prior authorization. We have automated solutions there. So, as those volumes grow, that's generally good for this business. The GLP-1s were a strong contributor in the current quarter.

How the programs evolve will largely be dependent on payer decisions in terms of how frequently they require an authorization or a reauthorization, but certainly it's been a good tailwind for us. And that's to the blizzard season. I'm pleased to say it played out in accordance to how we expected it to. It's a lot of work. The team really put their head down, had a good plan, and is pushing through that work. And we're very confident, we'll end this blizzard season more or less in line with our expectations at the outset of the year.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.

A

Next question, please?

Operator: And next will be Eric Percher with Nephron Research. Please go ahead.

Eric Percher
Analyst, Nephron Research LLC

Q

Thank you. I appreciate the 2025 initial commentary, and I wanted to focus in on specialty. I thought coming out of the pandemic, we saw elevated growth and you're calling out higher growth this year. And I'd like to understand how much of that is organic growth versus gaining of share and beyond oncology, an increase of share in multi-specialty? And then finally, I'd ask for those practices you're acquiring now, I think you've known them for quite some time, what is it that's driving them to join today?

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

Let me start. I guess I'll start where you ended with the practices. First thing I think I would say is, we are very pleased with the solid growth in our same store. We can obviously grow our US Oncology Network in multiple ways, we can add – we could add oncologists or providers to an existing practice that we have. We could greenfield the new practice. We did onboard new practices. And really, we've been benefiting over the last few years from all three of those.

We have been very pleased with our ability to attract new members to The US Oncology Network. We've added, I don't know, 500 or 600 providers over the last couple of years. We've entered into six new – we added six new practices and eight new geographies over the calendar year of 2023.

Why are we able to do that? We think it's not just great practice management. We've been at this for 15 years. So we've got a leading EMR. We've got leading technologies. Britt talked about investments we're making to extend that lead. But I think, we also have this broad ecosystem that includes Ontada, which helps us provide insights to our providers. It includes SCRI, which brings them clinical research and trial capabilities. And so we think it's that really broad value proposition, Eric, which allows us to compel the growth we're seeing in The US Oncology Network today.

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

And Eric, maybe I'll just add on, when we think about specialty product growth, we're certainly seeing specialty product growth across not only our largest customers, but across, as I mentioned, health systems. And certainly, as we continue to grow The US Oncology Network and oncology in general, we're certainly seeing more growth in that area as well.

So we're seeing growth in specialty products. We're seeing growth across the specialty providers that we service. And as I mentioned, we're also seeing significant growth from GLP-1 medication. So, we're really waiting across the entirety of our scaled business. And of course, as our customers continue to win, that's reflected in the volume increases also.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.
A

Next question, please?

Operator: And next will be Lisa Gill with JPMorgan. Please go ahead.

Lisa C. Gill
Analyst, JPMorgan Securities LLC
Q

Great. Thanks and good afternoon. I just want to go to your International business, and you talked about how strong Canada is, but there's been some speculation in the marketplace around Rexall. Can you talk about the strategy in Canada and specific to owning a drug retail?

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

Well, I won't comment, obviously, on rumors. Let me say this about Canada. We have a very scaled, broad and impactful healthcare services business there. It's obviously anchored in our distribution assets, but it includes specialty distribution capabilities. It includes retail pharmacies. It includes one of the best online brands in Well.ca, includes infusion clinics, and it includes a growing biopharma manufacturer services business.

So we're very, very broad in our capabilities and really one of the leading players in the Canadian Healthcare landscape in general. We've been very pleased with the performance of the business. Britt talked about some of the investments we continue to make into that business to keep our growth trajectory going. And I'd say we just – we're very pleased with the performance and very committed to the current strategy.

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

The only thing I would add is similar to our US business, in Canada, we have very strong strategic sourcing capabilities as well, which our customers benefit from. And it's helping our customers win. And helping us drive increased distribution volume. So very similar to the US, we utilize our strong scaled strategic sourcing capabilities to help our customers win.

Rachel Rodriguez A
Vice President of Investor Relations, McKesson Corp.

Next question, please?

Operator: And next will be Allen Lutz with Bank of America. Please go ahead.

Allen Lutz Q
Analyst, BofA Securities, Inc.

Good afternoon. And thanks for taking the question. Britt, you mentioned core operating expense growth was about 6%, excluding divestitures. As we think about the current growth across your different businesses, is that 6% growth rate the right way to think about operating expense growth from here? And then is there any reason why that would tick higher or lower versus that 6%? Thanks.

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

Thanks for the question, Allen. I think when you look at our operating expenses, what we tried to do, and what we've been able to do over a long period of time is gain leverage on our gross profit. And so what we strive to do and we've demonstrated that, our operating expenses typically will grow at a slower pace than gross profit.

Now we've been investing back in the business. And so as we've been investing not only in distribution capabilities, data and analytics and now an accelerated investment in artificial intelligence, quarterly variability in that operating expense number, you can expect to see that. But generally speaking, you will see us generate operating leverage on our gross margin.

Rachel Rodriguez A
Vice President of Investor Relations, McKesson Corp.

Next question, please?

Operator: And next will be Brian Tanquilut with Jefferies. Please go ahead.

Brian Tanquilut
Analyst, Jefferies LLC

Q

Hey. Good afternoon, guys. Maybe, Britt, just curious what you're seeing on the generic pricing front? And what opportunities we should be thinking about, as we think about combination of drug shortages and just broader inflation trends in generic?

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

A

Yes. Thanks for the question, Brian. In generics, we continue to have a very scaled sourcing operation in ClarusONE. ClarusONE continues to partner very closely with our broad set of customers, is generating good sourcing benefits. I talked about the dual mandate that we focus on, which is driving low-cost capabilities – low-cost positions for our customers. At the same time, it's driving the highest availability of supply. We've been able to do that over a long period of time.

Our generics business continues to grow. And we're quite pleased with the sourcing spread that we're able to generate from our sourcing buy-side capabilities. And we think that our customers are benefiting as well, and we see that in high compliance rate.

So it's been a competitive but stable marketplace in the Generic space, but the capabilities that we have on sourcing, the ability for us to drive lower cost and high availability of product, and generate spread for our customers in a disciplined way, that has proven to be a good formula for us over a long period of time.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.

A

Next question, please?

Operator: And next will be Kevin Caliendo with UBS. Please go ahead.

Kevin Caliendo
Analyst, UBS Securities LLC

Q

Thanks. Thanks for taking my question. I appreciate the color on the Rite Aid impact. I'm guessing my question is, I know we don't know exactly what's going to happen with the rest of Rite Aid, we should hopefully know soon.

But what are the assumptions built in for fiscal 2025 around the potential impact from whatever happens with Rite Aid from here? Like is it built in, in your comments and how meaningful can it be?

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

A

I appreciate the question. I obviously can't – am not in a position to comment a lot on Rite Aid. What I can tell you is what we've talked about for fiscal 2024. And Rite Aid is not going to have a material impact on our financial results. So I would leave it at that. In terms of 2025, we'll learn more over the next few months. We'll give you more information as we give you further information on all of our fiscal 2025 assumptions. But Rite Aid is not material to our financial results in fiscal 2024.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.

A

Next question, please?

Operator: And next will be Eric Coldwell with Baird. Please go ahead.

Eric White Coldwell
Analyst, Robert W. Baird & Co., Inc.
Q

Thank you. Good afternoon. This one, I think, is fairly obvious and fairly simple, but I just want to make sure. The free cash flow reduction versus prior guide, is that specifically and only due to the Rite Aid impact? And if so, I guess the question is why you didn't take that last quarter, perhaps when – I guess maybe that's not a fair question given the timing, but I just want to make sure that's the only topic there.

And then on the repo activity as well, slightly lower outlook here, $3 billion to $3.5 billion versus prior $3.5 billion. Is that also the Rite Aid impact or perhaps due to valuation in the market or some other topic? Those are my only two. Thank you very much.

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

Yeah. Appreciate the question, Eric. And you'll note that in our free cash flow guide for the rest of the year, the reduction versus the prior guidance that we gave you is not the full impact of the Rite Aid provision for bad debt. So it is a key driver to that. So to answer your question very simply as Rite Aid and the bankruptcy is a driver on free cash flow reduction.

In terms of share repo, I'd say that there's two things that are driving that. Clearly, we are taking a look at our free cash flow guide. But going back to our principles of how we deploy capital, one of the things that we've talked about is, a, we will buy back shares when cash – there's excess cash on hand that we can deploy in a growth format.

And secondly, we're going to be looking at the intrinsic value of the stock. We want to be in the market, and we want to return capital to our shareholders through share repurchases, but those two factors are going to be important to us. And so we're going to continue to be disciplined. And so a portion of that is reflected in the lower share buyback.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.
A

Next question, please?

Operator: And next will be Stephanie Davis with Barclays. Please go ahead.

Stephanie July Davis
Analyst, Barclays PLC
Q

Hi, guys. Thanks for taking my question. I was – I know you've given a lot of great color on this, but I was hoping we could dig a little bit more into the strong US Pharmaceutical growth and how to think about the lighter flow through the margin, is there anything beyond GLP-1s kind of doing that? And you made a comment on commercial COVID net of $30 million non-recurring accounting for some of the growth that we saw. Could you clarify kind of any impact that would have on the margin flow through?

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

A

Yes. So let me comment on a couple of things. We're really pleased with our US Pharmaceutical results. They delivered another strong quarter. Included in that, obviously, we are lapping the effects of the government program, the COVID last year. This year, we do have commercial COVID vaccines, that peaked in October and then it really fell off. We did have a one-time non-recurring charge in the quarter. When you net the commercial COVID vaccine contribution in that charge, it roughly offsets the government program contribution from last year.

So the performance within this segment is just strong continued utilization that we're seeing in the marketplace, continued strong growth of specialty across all of our customer channels. And the continued growth in our oncology business, as well as, as I mentioned, I provided a number on the revenue impact from GLP-1s, which again come at a lower margin rate and have been a headwind to year-over-year.

So just sort of sum up, it's just continued strong utilization in the marketplace in general, continued good growth of our customers and channels and continued growth within our oncology business.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.

A

Next question, please?

Operator: And next will be Erin Wright with Morgan Stanley. Please go ahead.

Erin Wilson Wright
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Thanks. So if I think about 2025, why is 5% to 7% still the right growth target for US Pharma, just given the specialty contributions and growth there, and favorable generics environment? And just do you think kind of the long-term growth has inflected higher at this point for longer? Or what are some of those offsets that we should be thinking about in 2025? Thanks.

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

A

Appreciate the question. Let me just start by stating at the beginning of the year, when we gave guidance, the long-term growth rate for the segment was 4% to 6%, given the performance that we've seen this year, we increased that target, that long-term target rate to 5% to 7%.

What I'm trying to provide you now is an early view into some of the qualitative factors that we're looking at and some of the momentum that we see going forward and indicating that, that long-term range that we increased this year, we still see that as being the right number today.

Now, we'll continue to do some analysis and work, and we come forward with our full-year assumptions, we'll give you more insight into that. But just as a reminder, we have already increased the long-term target range this year from 4% to 6% to 5% to 7% and we're certainly pleased with the momentum that we're seeing in the segment.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.

A

Next question, please?

Operator: And next will be Daniel Grosslight with Citi. Please go ahead.

Daniel Grosslight
Analyst, Citigroup Global Markets, Inc.
Q

Thanks for taking the question. One of your competitors mentioned that there may be an ability to renegotiate GLP-1 contracts as they come due, to potentially extract a bit more margin for the drug supply chain. I was wondering if you could comment on your views of contract negotiations as those contracts renew, and if there may be an ability to boost the margin profile of GLP-1s going forward?

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

Well, I would say this, I think we've talked many times on these calls that the first most important thing for us to do is make sure we get fair value for the services that we provide. And then obviously, we want to provide as many services as we can in support of those products. And that philosophy is no different for the GLP-1 class than it is, frankly, for all of the products that we distribute.

So, we are always in close contact and communication with our biopharma partners to talk about the value that we deliver, to talk about maybe the ancillary services that we could offer in support of those programs, and to find ways that we can both support the growth of our respective businesses. And that's exactly the lens we'll bring to this product class and it's really no different than the way we run the business day-to-day.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.
A

Okay. Next question, please?

Operator: And next will be Elizabeth Anderson with Evercore ISI. Please go ahead.

Elizabeth Anderson
Analyst, Evercore ISI
Q

Hi, guys. Thanks so much for the question. You guys talked about continuing to invest in some of the longer-term drivers of the Pharma growth in terms of oncology, biopharma services, et cetera. I was hoping you could unpack that a little bit more and sort of talk a bit more about where you sort of see the most attractive opportunities versus the assets that you already have? Thanks.

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

Sure, I'll start, and Britt can tack on. First thing I would say is, I'm really pleased over the last several years, we have been very disciplined in making sure that we made organic investment or reinvestment back into the business. And we view that as part of good portfolio management. I mean, our goal is to continue to extend the growth that we see in our markets and to innovate – innovating new solutions as part of that.

So, across now when we allocate that investment capital, certainly, some goes into the core, where we think we can get efficiency, better services, extend our base value proposition. But a lot will go into, we call our growth pillars, and that would be oncology. So in one instance, we've talked a lot is about greenfielding our Ontada business or our data and analytics business. Obviously, we've gone inorganic with SCRI and extended into clinical trials and research.

Talked about a quarter or two ago about some innovations that we've made in RxTS segment and enhancing some of our solutions and frankly, building and innovating and bringing new solutions. So it's much like our inorganic investment. We are tied to our strategy and committed to business cases that we think will deliver more returns.

I think the one area that we probably highlighted more this quarter than we have in the past is investments in technology AI, machine learning, obviously, that the developments and advancements in that field have come on fast. And when you think about a business that operates at our kind of scale, we're very excited about the opportunities we see there.

And when you think about like the US Oncology, Britt highlighted several places where we think we can use this kind of technology to make a better patient experience, make our provider experience better and to continue to drive efficiencies through that business. So, we will continue to be committed to investing back in the business, where we see good financial returns tied to our strategy.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.
A

Okay. Next question, please?

Operator: And next will be George Hill with Deutsche Bank. Please go ahead.

George Hill
Analyst, Deutsche Bank Securities, Inc.
Q

Hey. Good afternoon, guys. And thanks for taking the question. Britt, first one is just kind of a point of clarification. When you say GLP-1s as an EBIT headwind, you mean to margins not to dollars?

And then for Brian, I have a follow-up question on Oncology. I guess, could you just kind of talk about the greenfield opportunity that remains in the USO business? And do you think more about the opportunity to add providers kind of add regions or add services into the installed base as kind of the way to continue to grow that business? Thank you.

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

I'll start with your second question and then Britt, can come on. So I talked about three ways to drive the US Oncology business. One is to acquire a practice in a geography we're not, obviously, to add providers to an existing geography. And in instances where our criteria are met, meaning we think we can attract the right level of scale, we can find oncologists that want to practice consistent with the way we practice oncology in our network. We are not afraid to greenfield.

Obviously, adding to an existing is faster, acquiring an established practice that we feel fits our criteria is probably second and greenfield would be third, but we have all those avenues open to us. And so we look at the criteria, the population, the growth, the payer mix, these all kind of go into our formula, as we identify which of those three avenues is the most viable.

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

And the answer to your first question as we've talked about GLP-1s previously and today, we are talking about margin rate. They usually come at a lower margin rate than other products that we distribute. And as I mentioned, they have been an operating profit headwind year-over-year.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.

A

And we have time for one more question, please?

Operator: Certainly. That question will come from Stephen Baxter with Wells Fargo. Please go ahead.

Carol Wong
Analyst, Wells Fargo Securities LLC

Q

Hi. This is Carol on for Steve. Just a follow-up on the Prescription Technology segment of GLP-1. Now that we're starting to come up against some harder comps. Just how should we think about growth for this business tied to new versus renewed prescriptions? And what are some of the other categories we should be focused on as growth drivers outside of GLP-1s? Thank you.

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

A

Well, I think as we think about GLP-1s, obviously, four quarters ago was a big growth quarter. We're going to start to lap that. I think my characterization is there will continue to be growth, that growth may or may not be linear depending on product launches, uptakes, how commercial, government, other payers adopt policies to manage these products. So I think it's going to be growth, it's going to be slowed compared to what it has been historically, and it's probably going to be a little bit lumpier than we would typically expect just because of the size of the class.

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

A

And I would just remind you that while the growth has been robust, and we do expect the rate of growth to moderate, as we go into future quarters beginning in the fourth quarter, we did increase the guide for the operating profit for the segment. So the momentum in that segment is really good. Prior authorizations in general, GLP-1 specifically, but also seeing good growth across other access and affordability solutions within this segment.

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

Well, thank you again, everyone, for joining our call. I appreciate, as always, the great questions. I want to thank you, Cynthia, for facilitating the call and maybe just a concluding comment.

McKesson continues to make really meaningful progress in advancing our strategy and our mission. I couldn't be more pleased with the consistent and solid performance we're delivering, and we remain confident in our ability to continue to deliver sustainable long-term growth.

I want to make sure I acknowledge the contribution of the McKesson employees, across really all our teams, all of our business. It is one team executing this enterprise strategy. And I'm proud of what we've been able to achieve as a team, and I look forward to sharing more updates and more of our progress with you next quarter. Thanks again, everybody. I hope everyone has a terrific evening.

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