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McKesson Corp. (MCK)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to McKesson's First Quarter Fiscal 2023 Earnings Conference Call. Please be advised that today's conference is being recorded. At this time, I would 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, operator. Good afternoon, and welcome, everyone, to McKesson's first quarter fiscal 2023 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 to 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 those 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.

Thanks, Rachel. And thanks to everyone joining us on our call this afternoon.

Earlier today, we announced our first quarter fiscal 2023 results with strong growth in total company revenue and adjusted operating profit across the North American businesses. As a result of our first quarter performance and McKesson's continued role in the COVID-19 response efforts, we are raising our guidance range for fiscal 2023 adjusted earnings per diluted share from $22.90 to $23.60 to a new range of $23.95 to $24.65.

Successful execution against our company's priorities, priorities of people and culture, sustainable core growth, streamlining the portfolio, and expanding the oncology and biopharma services ecosystems are really what underpin our fiscal 2023 outlook and our long-term growth framework, so I wanted to center my remarks today around those themes. And I thought I would start maybe with a highlight of the progress we've made against our company priorities, and then I will wrap up with a few brief comments on the performance in the business itself.

Foundational to our company, foundational to our company's history, quite frankly, and our strategy, are really the core Pharmaceutical and Medical Distribution businesses. As we expand the reach of our services, we remain focused on generating sustainable growth in these core businesses. Our operational excellence and ability to leverage our scale with global suppliers is one of the many reasons why McKesson continues to be a partner of choice for our customers.

Over the past two years, you're well aware we've been working closely with the US government to distribute the COVID-19 vaccine and ancillary kits. As requested by the US government, our contract to serve as the centralized distributor for COVID-19 vaccines was extended through July of 2023. Similarly, the contract for ancillary kits and storage was extended through January of 2023.

We continue to be honored and privileged to be able to leverage our distribution scale and expertise and to continue to support this important public health effort. Britt will comment a little more specifically on the financial impact of these contract extensions, but we continue to look forward to serving the US government for several more months in this capacity.

Building upon the success of the core distribution businesses, we'd like to say we're tackling some of the most complicated problems in healthcare through the expansion of our oncology and our biopharma services ecosystems.

In the first quarter, we were really excited to announce the formation of a joint venture between McKesson's US Oncology Research and HCA Healthcare's Sarah Cannon Research Institute. This transaction marks a really important alliance between these two companies, and we expect it will accelerate our strategic advancement of the oncology ecosystem.

By combining the resources and the expertise of these two organizations, we're creating an expanded clinical research network, and that really means a broader portfolio of clinical trial offerings, expanded patient reach, access to a broader set of data, and more advanced analytics capabilities to better match patients with clinical trials. The new joint venture will really also aim at accelerating drug development and increasing availability and access to clinical trials for community oncology providers and patients, including those patients in underserved communities.

This transaction enhances our proposition to biopharma companies and further advances our differentiated offerings across the entire pharmaceutical lifecycle. It is also purposeful. It reinforces our commitment as a company to advance health outcomes for all.

We expect to close the transaction by the end of calendar year 2022, and we look forward to the partnership, the collaboration, and greater outcomes we can bring to the patients we collectively serve.

We're also making meaningful progress on expanding our biopharma services ecosystem. Through years of intentional investment, we've built a suite of innovative biopharma solutions that supports really every phase of the medication lifecycle across nearly all therapeutic categories. We're reinventing how biopharma companies, providers, and payers can connect to each other through technology with the ultimate goal of really helping patients access, afford, and adhere to their medications.

Today, I thought I might share a few examples around our affordability efforts and how these efforts fit into our biopharma ecosystem. A key piece of our innovative medication affordability product suite is our automatic couponing program. This automatic couponing program really applies co-pay offsets or savings for qualified medications right at the point of dispensing. Using our technologies, it's seamlessly integrated into the pharmacy work flow.

We further help patients stay on their trusted brands through multi-channel support options like activity inform messaging about other discounts, real-time support, and educational materials. We also facilitate patient assistance programs, which are a critical financial safety net for millions of patients. We implement and administer comprehensive patient assistant programs through program pharmacies, which enable access to free medication programs to eligible patients treated at hospitals, in community care settings, and sometimes even at home.

Both of these solutions leverage the reach of our technology network, and in fiscal year 2022, our solutions enabled patients to save more than $6 billion on brand and specialty medications. And importantly, we prevented more than 9 million prescriptions from being abandoned. By improving affordability of prescriptions, in many instances these solutions also improve adherence, helping patients stay on the treatment longer, which leads to better health outcomes.

As we look ahead, we continue to be proud of our differentiated assets and capabilities, and we're excited to bring innovative solutions to more partners and patients. Oncology and biopharma services both represent large, complex, and growing markets for McKesson, and we're strategically positioned to continue to enhance value in these areas.

I want to talk a bit about our next priority, which is streamline the portfolio. It's absolutely imperative that we continue to focus our human and our financial capital into the highest growth and highest margin areas of the company, and part of that is a continuous estimate of our portfolio for strategic alignment. This includes the progress we're making towards fully exiting the European region.

We recently entered into an agreement to sell Denmark, and the transaction was closed on July 29, 2022. The pending transaction with the PHOENIX Group is progressing well, and we would characterize it as on track and has an expected close in the second half of our fiscal 2023. Norway really remains the only country that we have not yet announced an agreement to sell.

So now, one year after we announced McKesson's strategic intent to exit the European region, we've entered into agreements to sell or we have complete divestitures of the business operations in 11 of the 12 countries in Europe. So I'm really pleased with the execution of this important initiative. I think the teams have got after it with remarkable speed and efficiency.

I want to wrap up my review of our company's priorities by reaffirming our focus on people and culture. In fact, it's typically the first priority we mention. We believe that talent can truly be differentiating, and we continue to invest in the development of our employees. We provide our employees not only competitive compensation and competitive benefits, but also the resources and support they need to grow into the next generation of leaders for McKesson.

As an organization, we're committed to advancing diversity, equity, and inclusion, and we continue to increase leadership representation for women in North America and people of color in the US. In fact, just recently McKesson was recognized by Forbes as one of the Best Employers for Women, achieving an industry-leading ranking. This is a demonstration of our outstanding progress in promoting equity and diversity in the workplace and really in my view reflects our deep commitment to support all employees at McKesson, all employees at McKesson.

Additionally, for the seventh consecutive year, McKesson was named the Best Place to Work for Disability Inclusion, which includes earning a top ranking score of 100 on the 2022 Disability Equality Index.

I'm proud of the progress that we've made on all our company's priorities, and we can clearly see it helping advance our long term growth.

Before I turn my attention to our first quarter results, I did want to just provide everyone a quick update on the progress of the opioid-related litigations. This past quarter, we reached agreements in principle with the State of Washington and the State of Oklahoma. With the recent developments, we have settled or we have reached agreements to settle the opioid-related claims of all 50 states, the District of Columbia, and all eligible territories. The majority of the payments that we'll fund as part of these settlements will be used on opioid relief programs. We're particularly proud of that, and we'll support a wide variety of strategies in local communities to help fight the opioid crisis.

In July, after a full trial, a federal judge ruled that McKesson along with two other distributors could not be held liable to two West Virginia subdivisions for contributing to the opioid crisis. This ruling is significant, as the court confirmed that McKesson did not cause an oversupply of opioids in these communities.

As we move forward, our role in combating opioid abuse is not over. McKesson will remain part of the solution when it comes to relief across the country and in preventing opioid diversion within the pharmaceutical supply chain.

Let's move on to business performance. I want to start by just providing a few comments on the macroeconomic trends and environment that we're seeing and what the potential impacts are on McKesson's business.

In the past quarter, we have observed positive prescription volumes and positive patient utilization trends. Additionally, as the macroeconomic environment continues to evolve, our business model has remained resilient to the pressures from cost inflation and supply chain disruption. The impact from these macroeconomic factors was immaterial in Q1, and we do not anticipate any incremental impact in addition to what was already contemplated in our fiscal 2023 outlook.

We remain confident in our ability to navigate a dynamic economic environment. We have a diverse set of products and solutions that allow us to follow the market demand and capture evolving opportunities, and we remain committed to supporting our customers and partners by delivering innovative products and solutions and making quality care more accessible and affordable.

Let me quickly summarize the first quarter performance, and then I'm going to turn it over to Britt, who will provide additional financial details.

I want to start with US Pharmaceutical. We delivered solid first quarter performance in core pharmaceutical distribution, led really by our differentiated value proposition and exceptional service to our customers. Throughout the quarter, we saw year-over-year growth in prescription volume with positive trends in both branded and generic drugs. Our distribution expertise is reflected in the breadth of product offerings, delivery accuracy, and reliability of our service.

We also remain focused on expanding the oncology ecosystem to strengthen our already differentiated market position. The advancements not only reflected in financial performance and its increasing contribution to the segment growth, but also demonstrated by the research we published, the insights we generated and the partnerships we formed, all focused on empowering innovation and advancing cancer care. Our oncology business has proven to be resilient throughout the pandemic, and we saw stable demand in patient visit trends within our US Oncology practices.

In Prescription Technology Solutions, we're pleased with the growth momentum in the first quarter driven by access affordability and adherence solutions. The market demand for our products and solutions remain strong, contributing to the organic growth in the core product categories. The strong financial performance also allows us to reinvest into the business and to expand the reach of our biopharma services ecosystem. The continued investment in innovation is critical to the long term growth of the business.

In the Medical-Surgical Solutions segment, we again had strong performance, led by strength in the primary care marketplace. The demand for COVID tests during the quarter was higher than anticipated, but I would also say generally in line with the COVID case counts. We continue to expand the breadth of our products and services to strengthen our leading capabilities in the alternate site market.

And in the International segment, we're progressing well with the divestiture of our European assets. As it relates to our Canadian business, we remain committed to our strategy in the Canadian market, where we have scale and a diverse set of assets. The distribution and retail businesses remain stable and the team is doing great work driving growth through improved sourcing economics and expanding customer relationships.

Let me try to pull everything together. McKesson reported solid first quarter in fiscal 2023. The fundamentals of our business are stable, and I'm excited about the meaningful progress we've made against our company priorities. Our updated outlook for fiscal 2023 aligns with the long term growth targets of the business and demonstrates our commitment to deliver sustainable growth across all segments.

Last, I want to be sure to thank my teammates and the employees of McKesson. I'm proud to lead this amazing team. You're all innovative problem solvers that bring positive change to our customers and partners. It's the dedication and the execution from each and every one of our employees that's driving McKesson forward and ultimately helping advance health outcomes for all.

With that, Britt, why don't you provide some additional color and comments?

Britt Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

Well, thank you, Brian, and good afternoon.

We are pleased to report June quarter financial results that continue to demonstrate our ability to grow our businesses and execute effectively as a diversified healthcare services company. Our fiscal first quarter results are ahead of our expectations, reflecting progress against our strategic priorities, demonstrating the continued strength of our operations.

Let me begin today with a few company updates before reviewing our first quarter results. I want to start with Europe and our ongoing focus to streamline our portfolio.

Over the past few years, we've taken deliberate actions to streamline the business and deploy capital more effectively, ensuring the organization is operationally efficient and delivering solutions that are focused on solving our customers' biggest challenges. This is exemplified by our actions to exit the European region announced in July of 2021.

Since that time, we've divested or entered into agreements to sell business operations in 11 of the 12 countries in which we operate. To date, we've successfully closed the following transactions.

In the fourth quarter of fiscal 2022, we completed the sales of our Austrian business and the remaining share of our German joint venture. In April of 2022, we completed the sale of our UK retail and wholesale operations. And in July of 2022, we completed the sale of our Denmark business. The transaction with the PHOENIX Group to sell operations and other certain assets in several European countries is also proceeding well. We anticipate it will close in the second half of fiscal 2023, subject to regulatory reviews.

We continue to explore strategic alternatives to exit remaining operations in Norway, the only country that we've not yet entered into an agreement to sell.

For fiscal 2023, we anticipate our remaining European operations will contribute adjusted operating profit of approximately $0.85 to $1.15 per diluted share, which includes accretion resulting from the held-for-sale accounting and the transaction with the PHOENIX Group.

As discussed at our December Investor Day, we intend to deploy capital to share repurchases to offset the dilution resulting from the European divestitures.

Exiting operations in Europe allows us to focus on another important strategic priority, expanding our oncology and biopharma services ecosystems, and we took an important step this quarter in our oncology ecosystem. In June, we announced an agreement to form a joint venture combining McKesson's US Oncology Research and HCA Healthcare's Sarah Cannon Research Institute including the acquisition of Genospace, Sarah Cannon's personalized medicine platform.

The combination of these assets complements our existing operations. It aligns to our strategic growth priorities, and it supports our vision to improve care in every setting. The transaction is anticipated to close by the end of calendar year 2022, again subject to regulatory review and approval. We do not anticipate this transaction will have a material impact on our fiscal 2023 adjusted earnings per share outlook.

Next, as Brian mentioned earlier, our contract with the US government to serve as the centralized distributor for COVID-19 vaccines was recently extended through July of 2023, and the contract for the kitting and storage of ancillary supplies was extended through January of 2023. I'll discuss the impact of fiscal 2023 guidance later in my remarks.

Finally, I want to point out one additional item that will impact our fiscal second quarter GAAP-only results. In July of 2022, McKesson exited one of its investments in equity securities with proceeds of $179 million. We will recognize a GAAP-only gain within other income in the second quarter.

Moving now to a review of our first quarter fiscal 2023 results, my comments today will refer to our adjusted results on a year-over-year basis unless I state otherwise.

Consolidated revenues of $67.2 billion increased 7%, reflecting growth in the US Pharmaceutical segment, partially offset by lower revenues in the International segment as a result of the European divestiture process.

Gross profit was $3 billion for the quarter, a decrease of 4%. Excluding the impact of our European business operations and completed divestitures, gross profit increased 9%, a result of organic growth in our Medical-Surgical Solutions segment, increased volume in specialty products in our US Pharmaceutical segment, and growth in the Prescription Technology Solutions segment. Operating expenses decreased by 10% in the quarter due to completed divestitures in the International segment.

As a result, operating profit was $1.1 billion for the quarter, an increase of 4% led by growth in US Pharmaceutical and improved prescription transaction volumes in the Prescription Technology Solutions segment. When excluding the impact related to the distribution of COVID-19-related products and services and gains and losses associated with McKesson Ventures' equity investments, operating profit increased 13% year-over-year.

Interest expense was $45 million in the quarter, a decrease of 8% due a net reduction of debt year-over-year, and the effective tax rate was 18.4% for the quarter.

Wrapping up our consolidated results, first quarter diluted weighted average shares outstanding were 145.9 million, a decrease of 8% year-over-year resulting from share repurchases throughout fiscal 2022 and the first quarter of fiscal 2023. Overall, first quarter adjusted earnings per diluted share was $5.83, an increase of 5% compared to the prior year.

Now onto our first quarter segment results, which can be found on slides 7 through 12.

Starting with US Pharmaceutical. Revenues were $56.9 billion, an increase of 14% year-over-year resulting from increased specialty product volumes led by retail national account customers and market growth, which was partially offset by branded to generic conversions.

Operating profit increased 4% to $711 million led by growth in distribution of specialty products to providers and health systems, generic launches, and improved performance of Ontada, which was partially offset by lower volumes of COVID-19 vaccine distribution.

The contribution from our contract with the US government for COVID-19 vaccine distribution provided a benefit of approximately $0.18 per share in the quarter, which is compared to $0.30 per share in the first quarter of fiscal 2022. Excluding the impact of COVID-19 vaccine distribution, the US Pharmaceutical segment delivered operating profit growth of 9%. Results in the quarter benefited in the timing of generic launches and the improved performance of Ontada.

Operating margins were modestly lower in the quarter, impacted by mix as the growth from health systems in multispecialty providers were partially offset by robust retail national account customer growth, which contributed 7% to the overall 14% year-over-year top line growth.

Next, as Brian noted earlier, our Prescription Technology Solutions segment delivered another strong quarter. Response to our access, affordability, and adherence solutions continue to be strong across biopharma, providers and payers. The scale and expanded suite of offerings continue to deliver for all stakeholders including patients.

Revenues were $1.1 billion, an increase of 21% year-over-year, driven by volume growth from biopharma services, which includes third-party logistics services and increased technology service revenues. Operating profit increased 19% to $165 million, reflecting the continued favorable market acceptance to a growing set of access, affordability, and adherence solutions.

Moving now to Medical-Surgical Solutions, revenues were $2.6 billion, an increase of 3% year-over-year, as growth in the primary care business, partially offset anticipated lower demand and sales for COVID-19 tests, and lower contribution from kitting, storage, and distribution of ancillary supplies for the US government's COVID-19 vaccine program.

Operating profit increased 4% to $268 million, driven by strength across the primary care business. Improved volumes and greater incidence of respiratory illness and the flu contributed to higher testing and patient visits in the primary care business.

The contribution from COVID-19 tests and our contract with the US government for the kitting, storage, and distribution of ancillary supplies provided a total benefit of approximately $0.25 per share in the quarter compared to $0.35 per share in the first quarter of fiscal 2022. Excluding the impact of these COVID related items, the Medical-Surgical Solutions segment delivered operating profit growth of 20%.

Next, let me address our International results. Revenues were $6.5 billion. And operating profit was $138 million, which was a decrease of 19%. On an FX adjusted basis, revenues were $7.1 billion, a decrease of 23%, and operating profit was $152 million, a decrease of 11%. Our first quarter results reflect the impact from the divestitures of McKesson's UK and Austrian businesses.

Moving onto corporate. Our corporate expenses were $145 million, a decrease of 6% year-over-year. In the quarter, we recognized a tax receivable gain related to our previous change healthcare investment and lower opioid-related litigation expenses. We incurred opioid-related litigation expenses of $19 million in the first quarter. We anticipate that the fiscal 2023 opioid-related litigation expenses will be approximately $45 million.

During the quarter, we had net losses of $22 million related to equity investments within the McKesson Ventures' portfolio, which compares to net gains of approximately $7 million in the first quarter of fiscal 2022.

As a reminder, the impacts on our consolidated results can be influenced by the performance of each individual investment quarter-to-quarter, and as a result, McKesson's investments may result in gains or losses, the timing and magnitude of which can vary for each investment. It's difficult to predict when gains or losses on McKesson Ventures' portfolio companies may occur, and therefore our practice has been and will continue to not include McKesson Ventures' portfolio estimates in our guidance.

Let me turn to our cash position, which can be found on slide 13. As a reminder, our cash position, working capital metrics, and resulting free cash flow can be impacted by timing and vary from quarter-to-quarter. We ended the quarter with $2.2 billion in cash and cash equivalents.

During the quarter, we made $100 million of capital expenditures, which includes investments in technology, data, and analytics to support our growth priorities, including our oncology and biopharma services ecosystems. For the quarter, we had negative free cash flow of $1 billion.

We also returned $1.1 billion of cash to shareholders during the June quarter, which included $1 billion of share repurchases and $71 million in dividend payments.

In July, our board of directors approved a 15% increase to our quarterly dividend to $0.54 per share. And the board also approved a new $4 billion share repurchase authorization, which brings the total remaining share repurchase authorization to $6.3 billion. Our fiscal 2023 guidance for share repurchases remains unchanged.

These actions demonstrate the confidence that the board of directors and management have in the execution against our strategic priorities. Our capital deployment principles remain firmly in place. We prioritize growth by investing internally and through M&A. Our focus continues to center on the areas of oncology and biopharma services, including the expansion of access, affordability, and adherence solutions.

Next, we'll continue to return capital to shareholders through a combination of our growing dividend and share repurchases. And the third piece of the framework focuses on a strong balance sheet and financial position, which is underpinned by the maintenance of our investment grade credit rating.

Let me turn to our fiscal 2023 outlook, starting with the consolidated view. I'll walk you through the key items, beginning with additional details of fiscal 2023 consolidated guidance. A full list of these assumptions can be found on slides 15 through 19 in our supplemental slide presentation.

On a reported basis, our fiscal 2023 guidance assumes 3% to 7% revenue growth and flat to 6% operating profit decline compared to fiscal 2022. When excluding the impacts related to the US government's centralized COVID-19 vaccine and kitting distribution programs, COVID-19 tests, and net gains or losses associated with McKesson Ventures' equity investments, we anticipate adjusted operating profit to increase 4% to 10%.

We also anticipate corporate expenses in the range of $550 million to $620 million, which includes the impact of net losses associated with McKesson Ventures' equity investments in the first quarter.

Given the current interest rate environment, we now anticipate interest expense to modestly increase and be in the range of $205 million to $225 million. Our anticipated full year effective tax rate of approximately 18% to 20% remains unchanged.

Based on our first quarter results, our continued solid operating performance in each segment, and the contract extensions with the US government for COVID-19 vaccine distribution and the kitting, storage, and distribution of ancillary supplies, we are increasing our guidance range for fiscal 2023 to $23.95 to $24.65 from the previous range of $22.90 to $23.60. Our fiscal 2023 outlook aligns with the previously communicated long term growth targets, and it demonstrates the commitment to deliver sustainable growth.

Our revised guidance also includes $0.99 to $1.29 of contribution attributable to the following items. $0.35 to $0.45 related to US government's vaccine distribution in our US Pharmaceutical segment, $0.75 to $0.95 related to COVID-19 tests and the kitting, storage, and distribution of ancillary supplies in our Medical-Surgical Solutions segment, and $0.11 of net losses associated with McKesson Ventures' equity investments.

Excluding the impacts of these COVID-19-related items and net gains and losses from McKesson Ventures' equity investments from both fiscal 2023 guidance and fiscal 2022 results, our fiscal 2023 adjusted earnings guidance indicates approximately 10% to 15% growth over the prior year.

Moving now to the segment outlook. In the US Pharmaceutical segment, our outlook reflects the solid operating performance in the first quarter, the efficiency and durability of our core distribution platform, and continued development of our oncology ecosystem. We anticipate reported revenue to increase 11% to 14% and operating profit to decline approximately 1% to 3% growth year-over-year.

Our outlook includes approximately $0.35 to $0.45 related to COVID-19 vaccine distribution, a result of the previously outlined contract extension. When excluding the impact of COVID-19 vaccine distribution for the US government, we anticipate 4% to 6% operating profit growth, which is modestly above the long term growth target.

In the Prescription Technology Solutions segment, we now anticipate revenue growth of 15% to 21% and operating profit growth of 16% to 22%, which reflects increased affordability solution volumes.

In the Medical-Surgical Solutions segment, we anticipate reported revenues to decrease 3% to 7% and operating profit to decrease 5% to 10%. Our outlook includes approximately $0.75 to $0.95 related to COVID-19 tests and the kitting, storage, and distribution of ancillary supplies, for the US government, which incorporates the contract extension of the US government to January of 2023. Excluding the impact of these COVID-19-related items, we anticipate Medical-Surgical operating profit to increase 11% to 17%.

And finally, in the International segment, we continue to anticipate revenues to decline by 34% to 38% and operating profit to decline by 22% to 28%, and this year-over-year decrease includes a loss of operating profit contribution from businesses and transactions we've closed to-date and those we expect to close during fiscal 2023.

Let me conclude our fiscal 2023 outlook with a few comments on cash flow and capital deployment. In fiscal 2023, we continue to anticipate free cash flow of approximately $3.2 billion to $3.6 billion, which is net of property acquisitions and capitalized software expenses.

As a reminder, our working capital metrics and resulting cash flows vary from quarter-to-quarter. Each working capital metric can be impacted by timing, and in fiscal 2023 our cash flows including the progression of these cash flows may be impacted by European divestiture activity.

Our fiscal 2023 outlook incorporates plans to repurchase approximately $3.5 billion of shares. A significant portion of the share buyback assumption is associated with mitigating year-over-year impact of European divestitures.

As a result of the share repurchase activity, we estimate weighted average diluted shares outstanding for fiscal 2023 to be in the range of approximately 142 million to 144 million.

To wrap up, we are pleased with our solid start to the fiscal year. We continue to deliver on our growth strategy as a diversified healthcare services company. Our talented associates continue to deliver exceptional performance. Our first quarter financial performance reflects their dedication and our execution in a dynamic operating environment, and it also represents the resiliency of our portfolio.

Looking ahead, the combination of our solid first quarter financial performance, our growth strategy, and continued execution positions McKesson to deliver sustainable long term performance and shareholder value creation.

With that, let me turn it back to the operator for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from Lisa Gill with JPMorgan.

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Q

Thanks very much. Thanks very much and good afternoon. Thanks, Britt, for all of the color. I just wanted to go back and make sure I just understand just a couple of things.

One, the comment around macroeconomic trends being immaterial. I know last year you had some wage inflation or gave people bonuses. I'm curious as to what you're seeing right now around wages. And then secondly, I want to make sure that I understand how fuel works. Is that just a pass-through? So as we've seen rising oil prices and higher gas prices, is that something that you can just pass along to your customer, and that's why it's immaterial to you?

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

A

Well, so, Lisa, I'll start with the wage component, and you'll recall last year as we tracked the markets, both nationally and locally, we decided midyear to take some wage actions. We mentioned that was probably $0.10 to $0.20 in each of the segments. We brought a perspective into our fiscal 2023 guide, and at this point we still think that our views on the labor markets and the guidance are in sync.

It's something that we'll continue to watch. People are an important part of our value delivery mechanism. It's important that we stay on top of it. But as we look at key metrics like turnover and service out our doors, we're still comfortable that our assumptions for FY 2023 are the initial outlook we provided you for FY 2023 will be relevant.

As it relates to fuel specifically, it's probably a nuanced answer. I think Britt characterized it correctly that it's been immaterial for this fiscal year. In some instances we can contractually pass it through. In other instances we have the ability to set price. And certainly, we take actions for efficiency within the operations to continually offset any expenses like that, that we might have.

Rachel Rodriguez
Investor Relations Contact, McKesson Corp

A

Next question, please.

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

Michael Cherny
Analyst, BofA Securities, Inc.

Q

Good afternoon, and congratulations on a really nice quarter. As I think about the OpEx management in the quarter, it was something that clearly stood out relative to the outperformance. Aside from some of those dynamics on wage investments, what are some of the pushes and pulls you're seeing in the OpEx line relative to last year? And how should we think about the trajectory of OpEx at least in terms as a percent of revenue as what – in terms of what you can both manage as well as what will clearly benefit as you get more leverage from faster growth, some of these incremental revenue upside pull-throughs?

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

A

Hey, Mike, thanks for the question. Let me try to tackle that. I think the biggest piece that we identify for our consolidated operations was the divestitures in Europe, that drove a lot of the operating expense decline year-over-year. And we also have continued to execute against a lot of our cost initiatives that we began three years ago and a lot of the efficiency that we've driven into the organization and continue to be focused on not only efficiencies, but driving automation in the company as well.

Couple other things that I would point out, for sure, is in our corporate line we saw lower opioid litigation expenses as compared to the prior year. Now, we called that out in our guidance at the beginning of the year, but on a year-over-year basis, it was lower in the first quarter, and that's going through our corporate line. But I think overall, it's a lot of the efficiencies that we've driven in the organization, our cost programs that we've been after now for the last three to four years, and the leverage that we're able to get as we continue to drive the corporation forward and gain productivity.

Rachel Rodriguez
Investor Relations Contact, McKesson Corp

A

Next question, please.

Operator: Thank you. Our next question comes from Steven Valiquette with Barclays.

Steven Valiquette
Analyst, Barclays Investment Bank

Q

Yeah. Thanks. Good afternoon, everyone. So if we go back to the Analyst Day back in December, you guys talked about 12% to 14% EPS growth, excluding COVID and some of the European dilution. I'm trying to quantify how that's tracking in fiscal 2023 ex those items. I think on slide 19 – actually slide 15, I apologize. You show the 10% to 15% growth, excluding those items. I'm wondering, is that the closest poxy for how this fiscal year is tracking relative to that 12% to 14% metric that you talked about previously? Thanks.

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

A

Hey, Steven, thanks for the question. So what we tried to do with that slide is give you the progression, excluding some of the things that we're working through here. Obviously, we have COVID test kits and vaccines and so forth. The guidance that we gave you is more on a long term basis and again excluding some of the programs that we have in place and obviously excluding McKesson Ventures, when you look at each of our segments, as I talked about them here today, our segments have actually performed slightly ahead of the long term growth rates that we provided at Investor Day.

One of the things that we're obviously working through here is the divestitures of Europe and the cadence of those divestitures, and obviously what we've talked about from the beginning here is we're going to try to offset that dilution with share repurchases.

But if you look at our operating profit growth, excluding the programs that we have with the US government and COVID test kits and you look at the segments, that is really in line with the long term growth rates that we provided at Investor Day. And on a consolidated basis, the 10% to 15% that we've talked about here today again also aligns with that long term guidance. We feel very good that we're on pace and that we're tracking against what we told you at our Investor Day in December.

Rachel Rodriguez
Investor Relations Contact, McKesson Corp

A

Next question, please.

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

Eric Percher
Analyst, Nephron Research LLC

Q

Thank you. Question relative to the contract extension with the government. And first, are there any changes in the scope of operations for vax and kitting and vax? Would you potentially support Novavax or Pfizer? And I'd be interested in your perspective on normalization of distribution of both vaccines and COVID therapies over time.

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

A

So in terms of the scope of the agreement, really the scope of either agreement has not really changed in terms of the services that we'll provide. We are not going to expand to do Pfizer, but we are committed to do all of the other US government approved including Novavax, as directed by the US government. And our facilities are capable and ready to support that.

And I would just mimic similarly for the kitting side, although it's probably a little more storage than kitting vis-à-vis the early phases of the program, when kitting was quite intensive. And what was the – I'm sorry, Eric, what was your second question?

Eric Percher
Analyst, Nephron Research LLC

Q

Just your thought on the normalization of distribution into all distributors, both for vax and COVID therapies, are you seeing some of that for your channels?

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

A

Yeah. I mean, I think, as it relates to the vaccine, the vaccines themselves, those continue to run through the centralized government model. To be perfectly candid, two-and-a-half years ago, it would have been hard to imagine we'd still be in this scenario as a nation, just thinking of public health and the prevalence of the disease that we still see.

As we've said all along, we're committed to bring our assets and capabilities to help support the public health response in any way we can. We're, I guess, happy, we have the facility and can continue to support the government program, but like most of us probably will not be sad, when there's no longer a need for any of this.

Rachel Rodriguez
Investor Relations Contact, McKesson Corp

A

Next question, please.

Operator: Next will be Ricky Goldwasser with Morgan Stanley.

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

Q

Yeah. Hi. Good afternoon, and congrats on a great quarter. So [indiscernible] (40:05) question on the COVID vaccines. If we think about the step-up in guidance for vaccines and kitting, how much of that [indiscernible] (40:16) already captured in the $0.54 beat in the quarter versus your expectation going forward? So that's question number one.

And then secondly, to follow up somewhat on Eric's question, I think Moderna said today that they expect a commercial market in 2023 for vaccines. So just can you maybe help us frame it? How should we think about it? Would this be on top of the contract that you have with the US government or would that be in lieu of?

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

A

You want to take the guidance question, and I'll take the second part?

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

A

Yeah. Thanks for the question, Ricky. So again, I think if you look at our slide presentation, we've tried to call out here what the big changes are in our guide. Certainly a portion of our first quarter was a result of the increase in both vaccine distribution and the kitting storage and COVID test kits.

COVID test kits, as we told you in our guidance, would be lower than FY 2022. That has certainly been the case, although it was slightly ahead of our own internal expectations. We continue to expect that test kits will be significantly lower than last year. They are a little bit ahead of our expectations.

So in our first quarter, some of the COVID-related items and programs did drive some of the upside, but certainly our operating performance was strong. You can see that from the slide that talks about our guidance increase, that there is a significant portion of the increase that's related to those COVID programs, but there's also a very strong component that's related to our operating performance.

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

A

And then, Ricky, just relative to the distribution of the vaccine itself, I mean, I guess probably best to just stick to the facts. We've extended the US government agreement to July of 2023, so to the extent the US government continues to acquire vaccines and make them available to the public, we will be there, the centralized distributor of those vaccines.

Should another model emerge and a distributor wants to use commercial markets, obviously McKesson continues to have incredible vaccine capabilities in the commercial market as well. We're the leading distributor of the seasonal flu. We support the Vaccines for Children program. We've got great relationships with community providers all over the country, and we would obviously be anxious, ready, and willing to support those commercial efforts as well.

Rachel Rodriguez
Investor Relations Contact, McKesson Corp

A

Next question, please.

Operator: Next is Kevin Caliendo with UBS.

Kevin Caliendo
Analyst, UBS Securities LLC

Q

Thank you. Thanks for taking my questions. If I'm looking at the growth – just looking at revenue growth in the Pharmaceutical segment and the Med-Surg segment, trying to back out the benefit of COVID, just the guidance range, you apparently are growing faster than market. You're raising numbers. Is this a macro thing? Because you're not seeing utilization necessarily at the levels that you're growing at. Are you just in the right markets? Are you taking share? Can you maybe talk about whether it's a competitive dynamic? Is it just that you're in ASCs, and all the utilization's moving there in the Med-Surg side? What's driving your faster-than-market growth in those two segments?

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

A

Yeah. Thanks for the question. Let me parse that out because I think there are some differences between the two segments.

In the Pharmaceutical segment, we did talk about improved utilization year-over-year. I think if you look at IQVIA numbers, you'll see that first quarter versus last year there's approximately 7% growth in prescription transaction volume. So that is significant from what we've seen over the last few years.

I also talked about in my remarks that within our US Pharmaceutical segment, we are seeing faster growth in our retail national account customers. So our largest accounts are growing faster than the market, and that's not something new to this quarter. We've talked about that now for the previous four or five quarters. We have seen faster growth in those retail national account customers.

In our Medical business, we have a very strong primary care business, and we've talked about the strength that we've had across all of the channels and the breadth of products and services. That continues. What we did see in the first quarter is really what I would call an extended flu season. So we talked about higher level of illness and flu sales in the quarter. That was a part of the upside from medical in the first quarter, but overall, it's the primary care business continuing to be quite robust and strong.

Rachel Rodriguez
Investor Relations Contact, McKesson Corp

A

Next question, please.

Operator: Next is Eric Coldwell with Baird.

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

Q

Thanks. Can you hear me? Hello?

Operator: Yes, we can...

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

A

Yes, Eric. We can hear you. Go ahead.

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

Q

Yeah. Sorry. Thank you. Following on to an earlier question about the OpEx, SG&A control, the incredible upside in that number, I guess my follow-on or twist would be versus Street gross margin was I think also materially lower. Those two were offsets. We see this substantial variance in the P&L each and every quarter I think where the Street's just way too high on one number and way too low on the other. They offset, and all is well. But I was hoping to get maybe a little more color on what in your mind, if you could think about where the Street was, why would gross margin be perhaps lower than consensus expectations, to a lesser extent than OpEx was upside. But what would be the major gross margin factors or things we should be considering moving forward?

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

A

Well, thanks for the question, Eric. I don't really want to try to project what's in the Street models, but I will call out a couple things that I did talk about in my remarks that I think could be a part of the disconnect at least for the quarter.

The cadence of our European divestiture activity could be a big part of that. We closed our UK retail and wholesale operations in April of 2022. And so when you look at the UK business and the Austrian businesses being divested, that drove a significant delta in gross profit and in operating expenses. In gross profit, if you exclude the European divestitures, our gross profit actually increased 9%. And that was in my initial remarks.

The other thing that I would just go back to a prior comment. In our US Pharmaceutical segment, we are seeing faster growth from our retail national account customers. And those customers, as we've talked about in prior quarters, have lower margins for us than the rest of our book, as you would expect that to have. So again, our retail national account customers growing a little bit faster than the rest of the book, that has a mix impact. But I think the big delta in this quarter is really the timing and the cadence of these European divestitures.

Rachel Rodriguez
Investor Relations Contact, McKesson Corp

A

Okay. Next question, please.

Operator: Next will be Charles Rhyee with Cowen.

Charles Rhyee
Analyst, Cowen & Co. LLC

Q

Yeah. Thanks for taking the question. Wanted to ask about the Prescription Technology Solutions. I recall the comments about demand is strong, and you continue to make investments. And I guess looking at the guidance though, looks like the revenue growth though is a little bit down. I might have missed it, but can you just mention what's happening there? Obviously, it looks like the op income guidance is up though. Just – if you could just maybe clarify that a little bit?

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

A

Yeah, I'm happy to do that. We're very pleased with the performance in the segment. Brian talked about some of our solutions. Our affordability solutions growth has been quite strong. When you look at the revenue and the margin guidance versus our first quarter, that is purely a result of mix. And so we would expect that our mix would be better as the year goes on and that has a slight impact on the top line for certain products.

So that is a function of mix, but overall we're very pleased to be able to raise the guidance of profitability within that segment. And that kind of fits with what we've been focused on, which is these higher growth, higher margin opportunities.

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

A

Yeah, I think the key is – the margin profile of the products and the services themselves is very stable, if not improving, but the mix is a pure mix effect. And 3PL tends to be a high revenue, relatively low margin component of this business.

Rachel Rodriguez
Investor Relations Contact, McKesson Corp

A

Okay. We have time for one more question, please.

Operator: Certainly. And that question will come from Brian Tanquilut with Jefferies.

Brian Tanquilut
Analyst, Jefferies LLC

Q

Hey, good afternoon, guys. And congrats on the quarter. Brian, just since you touched on the Sarah Cannon partnership, just curious if you can maybe walk us through how you're thinking about how that's going to drive growth and how strategically it fits going forward and maybe the opportunities to expand that relationship with Sarah Cannon, given they're one of the largest cancer groups in the country.

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

A

Yeah. Sure. We're really excited about this. There were two parts to the acquisition. The first is the JV partnership with HCA, which brings Sarah Cannon and you saw organizations together in the first instance. I'd say they're both really very community provider-facing organizations, both involved in the clinical research.

We think that community oncology and bringing the community practices more prominently into clinical trials and the development of new medications is going to be important for overall health outcomes. So we see tremendous complementarity across the brands, across the teams, and really across the areas we've each historically invested in. So we're really excited, and we're excited to be partnered with HCA in this initiative.

And the second component of that was the acquisition of an asset called Genospace. Really think about that as a complementary data and analytics complement to our other capabilities like Ontada, but this is going to help us do trial matching and recruiting, support clinical decision, support, and really just become another component of this oncology ecosystem that we talk about.

So we're really excited about this. We're obviously still in the phase of waiting for a regulatory approvals and pending close, but we're really excited about this and as another important step in building out our community-based oncology ecosystem.

Brian S. Tyler

Chief Executive Officer & Director, McKesson Corp.

Okay. Rachel, that was it. Well, look, let me again say thank you to everybody for taking time to join our call. Really appreciate the thoughtful questions. I want to thank [ph] Justin (52:04) for helping facilitate the call.

I'd just wrap by reiterating, we had a really solid first quarter. Total company revenue and adjusted earnings per diluted share were ahead of our expectations that we laid out in May. I remain confident. I know Britt shares my confidence in our resilient business model and our ability to deliver sustainable growth and generate attractive shareholder returns in FQ 2023 and beyond.

I want to end again by thanking Team McKesson for their unwavering focus and commitment to our vision, to our strategy and to each other. The support of a strong and dedicated team is the powerful driving force that helps McKesson transform itself into a diversified healthcare services company and make a meaningful difference for all the patients we serve. Thanks again. I hope you all have a terrific evening.

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