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McKesson Corp. (MCK)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to McKesson's second 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 call over to Rachel Rodriguez, VP of Investor Relations. Please go ahead.

Rachel Rodriguez

Vice President-Investor Relations, McKesson Corp.

Thank you, operator. Good afternoon and welcome everyone to McKesson's second 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'll 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 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 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.

With that, let me turn it over to Brian.

Brian Scott Tyler

Chief Executive Officer & Director, McKesson Corp.

Thank you, Rachel, and good afternoon, everybody. We appreciate you joining us on our call today. We're very pleased to report another solid quarter in fiscal 2024 with adjusted results above expectations, demonstrating our ability to consistently execute against company priorities and create sustained value for our shareholders.

In the second quarter, revenues increased 10% to $77.2 billion. Adjusted earnings per diluted share were $6.23. When excluding certain items, adjusted earnings per diluted share increased 14% from the prior year.

Our performance through the first half of the fiscal year combined with the continued momentum in advancing our company strategies gives us the confidence to raise our guidance for fiscal 2024 adjusted earnings per diluted share. Our previous guidance range of $26.55 to $27.35 has been updated to a range of $26.80 to $27.40.

Team McKesson continues to deliver on our mission of improving care in every setting. As a diversified healthcare services company, we're making important progress in strengthening our portfolio of differentiated assets and bringing more value to our customers and their patients.

Before I turn my attention to our company priorities and the second quarter results, I want to briefly discuss Rite Aid's recent bankruptcy proceedings. We have been supplying Rite Aid with the majority of their pharmaceutical products for more than 20 years.

As they navigate through their reorganization process, we are working closely with them to provide continued delivery of products. We're closely monitoring developments. But as Britt will describe in his remarks, we anticipate that Rite Aid's bankruptcy filing will not materially impact fiscal 2024 adjusted earnings per diluted share.

Now let me move on to our company priorities, and I want to start by recognizing our people, including the diverse, dedicated, and talented team we've built here at McKesson. Investing in people and culture is foundational to our strategy, and we offer many engagement programs and initiatives to empower our employees and allow them to express new ideas to contribute their unique perspectives and to care for each other.

We firmly believe that we achieve our full potential when our culture is diverse, inclusive, and focused on best talent. Our efforts fostering a culture of belonging are well-recognized. Recently, we were honored to be named by Forbes as one of America's Best Employers for Women. And for the eighth consecutive year, we were named as one of the Best Places to Work for Disability Inclusion, earning a top ranking score of 100.

We appreciate all the hard work and dedication from Team McKesson, and we recognize the importance of helping, respecting, and caring for each other. On October 27, we celebrated our annual Wellness Day called Your Day, Your Way. This is the third year that we've celebrated this tradition and shown appreciation for our employees by providing them with an additional day off work to prioritize their personal health and well-being.

Let's take a minute to review the performance of the distribution business and the progress we've made driving sustainable core growth. In the second quarter, we saw strong performance in the US Pharmaceutical segment. Over the past 10 quarters, the segment has consistently delivered double-digit revenue increases, demonstrating our ability to serve and grow with our customers.

In the second quarter, we continued to observe solid prescription volume trends, particularly in the category of GLP-1 medications, which contributed to revenue growth in the quarter. And over the past three years, we were honored to support the US government as the centralized distributor of COVID-19 vaccines. Our team demonstrated incredible agility and dedication in standing up a fit-for-purpose operation distribute the vaccines across the country.

This past September, we started transitioning the COVID-19 vaccine distribution to commercial channels. We're working closely with the manufacturers to bring vaccines to patients in an efficient and timely manner. As one of the largest distributors of flu vaccines in the country, we have scaled channel reach and deep expertise in working with vaccine products. And I'm pleased to say that through October 20, we have distributed nearly 8 million COVID-19 vaccines through our commercial channels.

In the Medical-Surgical segment, we continued to support our customers' evolving needs with a diversified portfolio of products and broad experience in Medical-Surgical and related supplies. As a reminder, while we serve many alternate site providers, the biggest channel within the segment is primary care, including physician offices. We closely track market data, and during the second quarter we observed general market moderations in primary care foot traffic.

We also saw a year-over-year decline in instances of respiratory illness and flu, which contributed to lower illness testing and patient visits in the primary care business. These dynamics impacted the segment results in the second quarter and our full-year fiscal 2024 outlook. However, we remain confident in the fundamentals of the business and the strength of our scaled assets within the Medical-Surgical segment.

Moving on to the next company priority of expanding our oncology and biopharma platforms. Since the beginning of this calendar year, we've added four new practices and welcomed hundreds of new providers to the US oncology network. The team is working hard to ensure that the new practices are leveraging the resources of the network, including best practices, coordinated resources, technology, and infrastructure.

As an important element of the integration, all of the new practices will be operating on the same Electronic Health Record or EHR system we call iKnowMed. Designed in close collaboration with oncologists, iKnowMed serves as an important link between the US oncology network and Ontada, our data and insights business. Powered by the innovative technology from Ontada, iKnowMed creates powerful insights and provides comprehensive point-of-care treatment decision support to providers.

More than 2,600 providers across the country use iKnowMed as their EHR, and we are pleased to see iKnowMed being honored as a top-ranked medical oncology EHR in the 2023 Best in KLAS report. In addition to technology solutions like iKnowMed, Ontada continues to advance its mission of transforming the fight against cancer. Recently, the US Food and Drug Administration awarded Ontada a contract to advance the use of real-world data in the US community oncology setting, which is a good opportunity to identify insights that will inform care and clinical research.

Moving on to the biopharma services platform. Through strategic acquisitions and investments, we've built a set of highly differentiated assets within the Prescription Technology Solutions segment. The combination of these assets creates a powerful and scaled network that includes multiple touch points throughout the patient treatment journey.

We are connected to approximately 900,000 providers, enabling solutions that help move barriers to access prescription medications. We're also connected to over 50,000 pharmacies, helping patients afford their prescriptions through solutions like cash co-pay and digital coupons right at the pharmacy counter.

In the second quarter, we were pleased with the strong performance in the segment with double-digit growth in both revenue and adjusted operating profit, driven by growth in access solutions, including increased volumes in prior authorizations for GLP-1 medications. The year-over-year comparison was also partially impacted by lower prior-year results, which, as we called out in Q2 of our fiscal 2023, included higher operating expenses resulting from the timing of increased head count to support customer annual verification activities.

One of the areas where we saw significant growth in the past two quarters is our access solutions, including prior authorizations for brands like GLP-1 medications. For selected prescription drugs, patients are required to obtain approval from their health plan, which sometimes can be very manual and cumbersome.

What we offer is an automated technology solution that is embedded within the provider's workflow. Our technology solution introduces efficiency to the process. More than 40% of our prior authorizations are approved instantly and approximately 65% are approved within one hour.

We continue to add new features and functionalities to improve the user experience. The latest feature introduced allows providers to share prior authorization outcomes directly with their patients when a health plan makes a determination. Through improvements like this, we help remove barriers and provide greater patient visibility to the prior authorization process. Solutions like prior authorizations are great examples of the success of our business strategy. It's also a reflection of our efforts to improve medication access and, ultimately, advance health outcomes for all.

As an impact-driven organization, we're deeply committed to advancing our strategy and contributing to positive changes in the communities where we live and work. This past quarter, we celebrated our Community Impact Days, which is McKesson's largest annual company-wide employee volunteer event.

Thousands of McKesson employees participated in various community impact projects that align with this year's theme, cancer awareness, prevention, and support. This year marked the 25th anniversary of the event. And we will continue honoring this tradition and we'll work to find more ways to enhance the health of those who live in our communities.

So, let me pull everything together. McKesson delivered a solid second quarter. Thanks to the contribution and dedication of over 50,000 McKesson employees, we continue to execute against our company priorities with focus and excellence. Leveraging our differentiated services and solutions, we're well positioned to continue to improve care in every setting. Looking ahead, we're confident in our ability to drive continued growth and strategic advancement in fiscal 2024 and beyond.

And with that, I'll turn it over to Britt for additional comments.

Britt J. Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

Thank you, Brian. We're pleased with our second quarter results, which reflect another quarter of solid performance, driven by operational execution and meaningful growth in our US Pharmaceutical and Prescription Technology Solutions segments.

Before I turn to our consolidated results, I want to highlight one item that impacted our second quarter GAAP-only results. We recorded a pre-tax GAAP provision for bad debts of $210 million, or $155 million after tax, within the US Pharmaceutical segment for uncollected trade accounts receivable related to Rite Aid's bankruptcy.

We anticipate recording an additional provision for bad debts of $511 million in the third quarter of fiscal 2024 for trade accounts receivable that McKesson recognized from sales to Rite Aid in October 2023 prior to its bankruptcy petition.

We continue to provide distribution services to Rite Aid post their bankruptcy filing, providing the same efficiency and operational excellence as we have for over 20 years. We're operating pursuant to an interim agreement for distribution services, which is pending final court approval, includes reduced credit terms of seven days and certain other items as Rite Aid continues to reorganize.

We are closely monitoring developments, and we anticipate this customer event will not have a material impact on our fiscal 2024 adjusted earnings per diluted share results, our liquidity position, and ongoing business operations.

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

Our focus and execution against our company priorities position us to generate consistent, solid financial results while continuing to evolve and grow our diversified portfolio through focused strategic investments in oncology and biopharma services.

As a result of our operating performance and outlook for the remainder of the fiscal year, we are increasing and narrowing our full-year outlook for fiscal 2024 adjusted earnings per diluted share to a range of $26.80 to $27.40.

Moving to our consolidated results, revenues increased 10% to $77.2 billion, led by growth in the US Pharmaceutical segment, resulting from increased prescription volumes, including higher volumes from retail national account customers, specialty products, and GLP-1 medications, partially offset by lower revenues in the International segment resulting from fiscal 2023 divestitures of certain test and European businesses. Excluding the impact of our European business operations and completed divestitures, revenue increased 15%.

Gross profit was $3 billion for the quarter, a decrease of 1%. And when excluding the impact of our European business operations and completed divestitures, second quarter gross profit increased 8%, primarily a result of growth in the US Pharmaceutical and Prescription Technology Solutions segments.

Operating expenses decreased 2% in the quarter. And when excluding the impact of our European business operations, including completed divestitures, operating expenses increased 9% year over year, which included approximately 2% from costs related to the second half fiscal 2023 acquisitions of our Rx Saving Solutions and the joint venture with Sarah Cannon Research Institute.

Second quarter operating profit increased 1% to $1.2 billion, again primarily driven by growth in our US Pharmaceutical and Prescription Technology Solutions segments. This was partially offset by slower growth in our Medical-Surgical Solutions segment, including lower illness season testing and the completed divestitures of our European business operations within the International segment. When excluding the impact of COVID-19-related items in fiscal 2023 and losses associated with McKesson Ventures equity investments in fiscal 2023 and 2024, operating profit increased 12% in the quarter.

Moving below the line, the effective tax rate was 23.5%, which included recognition of a net discrete tax expense of $12 million. Second quarter diluted weighted average shares outstanding was 134.8 million, a decrease of 6% year over year. Consolidated second quarter earnings per diluted share were $6.23, which represents an increase of 3% over the prior year. Excluding COVID-19-related items during the second quarter of fiscal 2023 and losses within our McKesson Ventures portfolio in fiscal 2023 and 2024, second quarter earnings per diluted share was up 14% over the prior year.

Turning to our second quarter segment results, which can be found on slides 7 through 11 and starting in US Pharmaceutical, the US Pharmaceutical segment delivered continued momentum and strong operating profit growth. Our ability to drive sustainable growth in this segment reflects a few factors: the efficiency of our scaled distribution operations; the investments that we're making to unlock new capabilities that will further expand and strengthen our value proposition for our customers and partners; a balanced approach to managing a broad portfolio of pharmaceutical products, inclusive of our ClarusONE generic sourcing operations, bolstering our competitive position and enabling a minimal approach to customer demand, new product launches, and market movements; and continued investment in expansion in our broad oncology platform.

We are pleased with the growth momentum across our oncology assets, from provider solutions in the US oncology network, data and insights through Ontada, and expanded clinical trial capabilities through our Sarah Cannon Research Institute joint venture. These assets contributed to revenue and operating profit results in the quarter which exceeded our expectations.

Second quarter revenues were $69.8 billion, an increase of 16% year over year. Revenue growth reflects an increase in prescription volumes, including higher volumes from retail national account customers, specialty products, and GLP-1 medications. These increases were partially offset by branded-to-generic conversions. The growth of GLP-1 medications provided a revenue tailwind in the quarter. As a reminder, we generally recognize lower margin rates for the distribution of GLP-1 medications in the US Pharmaceutical segment.

In our Prescription Technology Solutions segment, the growth of GLP-1 medications, like other new brand launches, has led to increased demand for our access solutions, such as prior authorization services. Second quarter US Pharmaceutical operating profit increased 8% to $815 million, driven by growth in the distribution of specialty products and increased contributions from our generic programs. When excluding the impact of COVID-19 vaccine distribution in the second quarter of fiscal 2023, the US Pharmaceutical segment delivered operating profit growth of 15% year over year.

Moving to Prescription Technology Solutions, the strong results in the second quarter demonstrate the success of our product portfolio and the partnerships with biopharma manufacturers that we've developed over the years. The strength of our differentiated capabilities and partnerships position in testing captured demand driven by strong prescription utilization trends, including the growth of GLP-1 medications.

For the second quarter, revenues increased 12% year over year to $1.1 billion, and operating profit increased 48% to $209 million. Second quarter results reflected increased prescription transaction volumes, which drove higher demand for our access solutions, primarily related to prior authorization services and growth in our third-party logistics business. The year-over-year growth also included higher operating expenses in the second quarter of fiscal 2023, which resulted from the timing of increased head count to support customer annual verification activities.

In Medical-Surgical Solutions, revenues were $2.8 billion in the quarter, which was flat to the prior year, resulting from anticipated lower sales of COVID-19 tests and lower contribution from kitting, storage, and distribution of ancillary supplies for the US government's COVID-19 vaccine program. The anticipated lower COVID-19-related revenues were partially offset by growth in the extended care business and increased distribution of pharmaceuticals in the primary care business.

Operating profit was $254 million, a decrease of 17%, driven by anticipated lower contributions from kitting, storage, and distribution of ancillary supplies for the US government's COVID-19 vaccine program and lower sales of COVID-19 tests. When excluding the impact of COVID-19-related items in the second quarter of fiscal 2023, the segment delivered operating profit growth of 5%, driven by increased volumes of nutritional supplements in the extended care business.

Based on IQVIA and other market indications, the second quarter exhibited moderating primary care market volumes. The Medical-Surgical Solutions second quarter growth rate reflects these market indications, which was partially related to a slower start to the illness season, including illness season testing, when compared to the prior year.

Next, let me address our international results. Revenues in the second quarter were $3.5 billion, a decrease of 44% year over year. And operating profit was $89 million, a decrease of 35%. Second quarter results reflect the year-over-year effects of the completed divestitures within our European business.

Wrapping up our segment review, corporate expenses were $159 million in the quarter, an increase of 10% year over year. During the quarter, we had losses of $10 million or $0.06 per share related to equity investments within the McKesson Ventures portfolio compared to losses of approximately $3 million in the second quarter of fiscal 2023.

As a reminder, McKesson Ventures portfolio holds equity investments in several growth stage digital health and services companies. We're pleased with the insights and results that we are obtaining through this portfolio. The impacts on consolidated financials 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.

Turning now to cash flows and capital deployment, which can be found on slide 12. We ended the quarter with $2.5 billion in cash and cash equivalents. We delivered free cash flow of $825 million in the second quarter and $4.3 billion for the trailing 12 months. Our cash balance and free cash flow in the second quarter included payments totaling $529 million associated with settlement agreements for opioid-related claims. As a reminder, our cash position, working capital metrics, and resulting cash flows can each be impacted by time, which includes the day of the week that the quarter ends on and, therefore, can vary from quarter to quarter.

During the first six months of the fiscal year, we made $264 million of capital expenditures, which included investments in new and existing distribution centers as well as investments in technology, data and analytics to support our growth priorities. Year to date, we returned $1.7 billion of cash to shareholders, which included $1.5 billion of share repurchases and $149 million in dividend payments.

Now, let me discuss our updated 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. The guidance I'm providing today relates to fiscal 2024. And a full list of our assumptions can be found on slides 13 through 17 in our supplemental slide presentation.

Let me start with the outlook for our segments. For the full year, we now anticipate US Pharmaceutical revenues to increase 13% to 15% and operating profit to increase 6% to 8% year over year. Excluding the impact of COVID-19 vaccine distribution in fiscal 2023, we anticipate operating profit to increase 11% to 14%. This updated segment outlook incorporates the strong second quarter performance as well as further growth in our generic sourcing programs and specialty distribution, including our differentiated Plasma and Biologics business.

Our full-year outlook assumes that volumes related to GLP-1 medications will remain elevated compared to the prior year and may vary quarter to quarter. We anticipate the consolidated GLP-1 medication revenue and operating profit growth compared to prior year will slow in our fiscal fourth quarter, reflecting the inflection in volumes for these medications in the fourth quarter of fiscal 2023. We anticipate GLP-1 medications will continue to be a revenue tailwind for US Pharmaceutical. However, distribution of these medications has a lower distribution margin rate profile and represents a headwind to prior-year results.

In the Prescription Technology Solutions segment, we anticipate revenue growth of 7% to 13%. We have increased our operating profit growth outlook to 18% to 22%, reflecting strong momentum in our access solutions and strong first half performance.

We may continue to see quarter-to-quarter variability in this segment, driven by prescription and transaction volumes, the timing, 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 remains well positioned across all alternate site channels, with unmatched scale, product assortment and capabilities. In the Medical-Surgical Solutions segment, we anticipate revenues to be approximately a 2% decline to 2% growth and operating profit to decrease 12% to 16%.

For the full year, we anticipate volumes of COVID-19 tests to continue to decline compared to fiscal 2023. And the impact from COVID-19-related items will remain immaterial to fiscal 2024 results. Excluding the impact of COVID-19-related items from fiscal 2023 results, we anticipate operating profit to increase 5% to 7% year over year.

Our outlook incorporates the second quarter results, which I discussed earlier. We anticipate the general market moderations in primary care foot traffic, in part driven by a modest illness season, may persist through the remainder of fiscal 2024. Additionally, first half fiscal 2023 results benefited from an extended illness season, which did not repeat in fiscal 2024.

Our outlook includes continued investments in our scaled distribution network, adding state-of-the-art automation and regulatory capabilities to serve the breadth of our customer base. These distribution network investments support the breadth of our non-acute customers and broader cold chain distribution, for example, COVID vaccines for physician offices. We also anticipate further investments in data and analytics to expand the channel reach for our medical supplies, pharmaceuticals, and private brand product portfolio.

Finally, in the International segment, we anticipate revenues to decline by 30% to 34% and operating profit to decline by 23% to 29%. This year-over-year decrease includes a loss of operating profit contribution from European businesses and transactions that we closed during fiscal 2023. In the Corporate segment, we anticipate expenses to be in the range of $600 million to $660 million, which include losses associated with McKesson Ventures equity investments recorded in the first half of the year and the elevated technology spend to support the growth of our businesses.

Moving below the line, we anticipate the full-year effective tax rate to be approximately 18% to 19%. The timing of discrete tax items is difficult to predict, and therefore we typically do not provide quarterly effective tax rate guidance. However, our outlook includes recognition of a discrete tax benefit in our fiscal third quarter. As a result, we anticipate the third quarter tax rate to be lower as compared to the fourth quarter.

And finally, we now anticipate income attributable to non-controlling interests to be in the range of $155 million to $175 million, reflecting ClarusONE's generic sourcing success.

Turning to cash flow and capital deployment, we anticipate free cash flow of approximately $3.7 billion to $4.1 billion. Our outlook incorporates plans to repurchase approximately $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.

In summary, as a result of solid performance in the second quarter of fiscal 2024 combined with our outlook for the remainder of the fiscal year, we are increasing and narrowing our earnings per diluted share outlook for fiscal 2024 to a new range of $26.80 to $27.40. We anticipate operating profit will be flat to 4% decline compared to the prior year. When excluding certain items, we anticipate operating profit to increase by 6% to 10% year-over-year.

As a reminder, certain items include the following: net gains and losses associated with McKesson Ventures equity investments in fiscal 2023 and 2024; a $0.65 benefit related to the early termination of the tax receivable agreement with Change Healthcare in fiscal 2023; and $1.90 related to COVID-19-related items in our US

Pharmaceutical and Medical-Surgical segments in fiscal 2023. We anticipate the impact of COVID-19-related items will be immaterial to fiscal 2024 when comparing fiscal 2023.

The increase to our outlook for adjusted earnings per earnings per diluted share indicates earnings per diluted share growth of 14% to 17% when excluding these certain items. When further excluding the contribution from the runoff of our European operations, earnings per diluted share growth is indicated at 18% to 20% for the full year.

We also anticipate the fiscal third quarter to be stronger than the fiscal fourth quarter based on the development of prescription transactions, patient visits, internal investments, and the recognition of a discrete tax benefit in the third quarter.

In closing, we are pleased with our strong first half performance. The momentum across the business, including growth in our oncology and biopharma services platforms, positions us to deliver for our customers and our partners and to create sustainable shareholder value.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question will come from Eric Percher with Nephron Research. Please go ahead.

Eric Percher
Analyst, Nephron Research LLC

Q

Thank you. I'd like to focus on RxTS. And specifically, Britt, you mentioned that the guidance reflects a strong Q2, but it sounded like there's a range of outcomes for the second half. Can you provide some context on whether revenue upside that you've seen this year on delivering on prior authorization for GLP-1s has been tied to manufacturer programs versus the volume of scripts being written?

And would we be wrong to assume somewhat conservative or some conservatism here on how second half develops? And last, I'll ask, are there particular indicators such as denial rates or new starts that you look for as you're modeling this business?

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

A

Eric, thanks for that question. I'll start, and then certainly, I'll let Brian add on to that. You really touched on a lot of the factors that we look at when we think about this segment. As I mentioned, we've seen continued stable and strong utilization trends. And that certainly drives transactions, which our services benefit from. Effectively, we've seen continued growth in GLP-1 medications, as an example. And our services, primarily prior authorization, support those programs. So we've seen growth from that aspect.

As I mentioned in my remarks, there are a number of things that can create some variability and certainly can drive – decided from a revenue and operating profit perspective, and you touched on a few of those. As I mentioned, prescription utilization is one of those, certainly the timing and pace and the trajectory of drug launches, the GLP-1 category being one of those drug launch categories. And certainly the timing of certain other programs like the annual verification programs that we do for our customers in the fourth quarter.

So we've seen good stable utilization trends. We've seen new drug launches like categories like GLP-1 medications that utilize the successful prior authorization programs that we have. And we've certainly seen revenue and operating profit trend in a similar manner to that.

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

Next question, please?

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

Lisa C. Gill
Analyst, JPMorgan Securities LLC
Q

Thanks very much. Britt, I've got to stick on this area. Just really want to understand, if I take the numbers that you talked about and the updated guidance for the second half of the year, it looks like the margin in Prescription Technology Solutions will come down pretty dramatically versus what we saw in the first half of the year.

The growth rate will come down. So is this conservatism? Is there incremental programs and expenses that you have? Is it any changes in the program? I'm just trying to understand how to think about this business on kind of a normalized basis and again, how would we think about first half versus second half?

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

Yeah. A couple things, this is a business that is – one, I think you need to look at on a full-year basis for items such as our annual verification programs. As an example, it's a very different set of programs that we provide, has different revenue and margin profiles.

The second piece to that is we've talked about in the past our 3PL business, which has a different margin profile from the rest of the business. And that business tends to have some variability from quarter to quarter. It has a good revenue profile, and certainly comes at a lower margin that we've talked about in the past.

The other thing that I would talk about is I mentioned earlier in my remarks, is that GLP-1s are flattening out year over year as we get to the fourth quarter because that's what we anticipate. We saw a significant inflection in GLP-1 medication volumes in the fourth quarter of last year. Certainly, we've seen elevated levels of GLP-1 medication volumes through this year.

But as you kind of get to a year-over-year, begin to lap that fourth quarter inflection point, that's certainly going to be another factor for the year-over-year and the second half component. So I think there's a lot of things going on here, but if you look at the business on an annual basis, I think you'll see very good consistent revenue and operating profit growth.

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

The only thing I would add to that, Britt, is that if you look at the growth and the trajectory the segment has had historically, we continue to also reinvest in product extensions, new product enhancements, new products overall. We're excited about this segment. We're excited about the assets that we have, and we want to make sure we continue to invest into this segment to protect future growth as well. And all those investments are reflected in our FY 2024 outlook.

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

Next question, please?

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

Charles Rhyee
Analyst, TD Cowen
Q

Yeah. Thanks for taking the question. I'd like to ask about the Rite Aid on the reserves. I know you kind of reached a settlement with Rite Aid for ongoing supply of pharmaceuticals for Rite Aid as they reorganize. The reserves that you've taken, can you talk a little bit about how you're going to approach collections on that? And how should we think about that in terms of the way you reserve for it and the way we should think about the cash flows?

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

Sure, I appreciate the question. Let me just go back to some of my earlier comments because I think that these are good questions. First of all, we continue to provide distribution services to Rite Aid, as we have for over 20 years, and we're proud to be a distributor for Rite Aid and their customers.

We did record a provision in the third quarter for those sales that we consider to be uncollected trade accounts receivable as of September 30. That's the $210 million that I referenced. We anticipate an additional provision that will be recorded in our third quarter, so those sales up until they're back to their bankruptcy filing, and that's the $511 million.

We have an interim agreement in place that is still pending final court approval, and that interim agreement has different credit terms. They have shorter credit terms of seven days. There are other aspects to the interim agreement. But the key thing for this call and for this group is that those credit terms are on seven-day terms, which are different than what we had in the previous agreement.

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

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. Britt, just a quick question for me as I think about your operating expense line, pretty good levels of improvement there, especially on the margin side. How should we be thinking about the sustainability of operating expenses and potential gains going forward? Thanks.

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

A

Thanks for the question, Brian, but I'm not sure what you're referring to when you use the word gains. As we think about our operating expenses, we have great operating expense discipline. And the efficiency of our operations allows us to drive operating margin leverage. We've been able to do that for a long period of time.

The success that we've seen in many of our segments really has allowed us to continue to reinvest back into the business. Brian just mentioned what we've been doing at Rx Savings Solutions or should I say, RxTS, where we've been reinvesting to drive additional programs and capabilities for our customers. But as I mentioned in my comments, we've also been investing in distribution network capabilities, additional automation and regulatory capabilities that are going to benefit not only our operations, but our customers.

We're also investing in data and analytics. We think that's going to be important to drive efficiency of our operations and the capabilities for our customers. So you should expect to see us continue to deliver operating margin leverage, but to continue to invest against our programs, our capabilities on behalf of those efficiencies and our customers.

Rachel Rodriguez
Vice President-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

Hi. This is Eric. Was that me? I heard a beep here.

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

A

That's you.

Rachel Rodriguez
Vice President-Investor Relations, McKesson Corp.

A

Yeah.

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

A

Hey, Eric.

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

Q

Good, okay. Thanks. Hi, guys. I wanted to hit on the Med-Surg segment, specifically primary care. I think your comments on slow start low ramp in the illness season is, I think, well understood. We've seen that elsewhere. I'm curious what else you might have seen in the quarter that could lend some color on the lower primary care volumes.

I've heard heavy travel season from some companies. I've heard others talk about vacation schedules, just the timing of the calendar, if you will. But I'm curious if you have any more details or thoughts you could add on the primary care trend. And if you could, could you quantify the rate of growth change that you saw during the September quarter? Thank you.

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

Yes. Thank you, Eric. And we've heard many of those same themes and trends. I mean clearly, a big one is last year, in this call, we would have been talking about the so-called triple-demic and the RSV and flu and COVID kind of all hitting at the same time. And I think – so we're clearly lapping an abnormally high year. And then I think you fast forward to the trends we're seeing this year, they're probably lower than what we would have expected at the beginning of the outset.

The data that we've looked at, the IQVIA data you can reference does show the foot traffic is down. It does also show telemedicine visits are down. We sort of don't think structurally the need to consume healthcare services in this country has gone down. And so that's why Britt provided the context he did for our guidance through the remainder of the year.

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

And, Eric, I would just also point out that we are extremely well positioned across all alternate sites of care and the confidence that we have in that position to service our customers. We're continuing to make investments, and I talked about some of the investments that we are making not only in distribution capabilities in the network, but also in data and analytics to help support our customers and the product portfolio that we provide to them. So we have a lot of confidence in the position and the capabilities that we have, and the investments that we're making are a reflection of that.

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

And we do think macro trends support the continued migration of care into these alternate sites or these more community-based settings, so we're well positioned.

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

Next question, please?

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

Kevin Caliendo Q
Analyst, UBS Securities LLC

Hi, thanks for taking my question. The Pharma segment growth continues to be really impressive. And I'm guessing it's more than just the typical fundamentals of pharma distribution with generic pricing or generic mix and the like. Can you talk about how the mix is evolving? Maybe is it some of your oncology businesses, some of the clinics you purchased recently that are contributing? How is that mix changing currently to drive this sort of outsized EBIT growth that you're seeing?

Britt J. Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

A

Thanks for the question. Certainly, we have a broad portfolio, and it's much broader than it was a few years ago. And the investments that we've made in oncology are certainly adding to that, but the efficiency that we have and the scale that we have with retail national accounts and our ability to providing service specialty are really driving a lot of this, in particular, as you think about stable utilization rates. I also talked about the success that we're seeing at ClarusONE and with our generic programs, and we saw good contribution from generics during the quarter.

Our oncology business continues to grow. We've added four practices in seven geographies and over 200 providers in the last 12 months. And that's certainly going to be additive to the overall oncology platform. But what we're seeing is just a stable utilization growth in prescription volume, our ability to be efficient for our customers to continue to provide good generic programs. So that's driving the majority of the growth that we're seeing at this point.

Rachel Rodriguez

Vice President-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

Hi, thanks for taking the question. I want to go back to the Medical segment and the cadence for the remainder of the year. If I just look at guidance, it implies around a 4% increase in both revenue and AOI from the first half to the second half, so flat margins. You mentioned a less severe flu season and some investments you're making in distribution and data analytics. How should we be thinking about the cadence of AOI for the next two quarters, particularly as we think about some of those larger investments you're making?

Britt J. Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

A

Yes, it's a great question, Dan. I think for modeling purposes, I would guide you to model something very similar in terms of growth rates to the second quarter.

Rachel Rodriguez

Vice President-Investor Relations, McKesson Corp.

A

Next question please?

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

Allen Lutz

Analyst, BofA Securities, Inc.

Q

Good afternoon and thanks for taking the questions, one for Brian. You mentioned the strength of ClarusONE. Given the recent customer bankruptcy you mentioned, are you assuming any volume lost for ClarusONE over time?

And then one for Britt. Within the RxTS segment, you guys did a large restructuring in March. Have those OpEx savings completely flowed through the model at this point, or should we expect more over time? Thanks.

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

A

Let me start with your question on ClarusONE. We obviously have a scaled sourcing engine and partnership with Walmart. We believe we've got leading scale and volume and a very mature team that has been through multiple sourcing cycles. And so we're very confident in our position there. And as the pharma business in general grows, the volumes that flow through the Clarus sourcing engine also grow. So we continue to have a lot of confidence in ClarusONE and their ability to perform for the business. Britt, do you want to take the second?

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

A

Yes, I'll take the second one, Brian. As it relates to your question on the restructuring, we did incur certain charges in the fourth quarter of our fiscal 2023. We also incurred additional restructuring charges in the first half of fiscal 2024. And so we're still in the process of finalizing the programs and the savings that we have are contemplated within our guidance. So the fact that we started this program in fiscal fourth quarter of 2023, continue the program, really taking charges and organizing and integrating through the first half of 2024, we certainly haven't seen all of the benefits from those programs to this point in time.

Rachel Rodriguez
Vice President-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

Great, thanks for taking the question, two questions here. I guess, are you seeing the generic or easing generic deflation environment? Has that been a material driver for you? Just to follow up on the generic side.

And then on M&A, and you outlined the share repurchases, but how are you thinking about the acquisition pipeline from here? Where is the focus? What does the M&A pipeline look like? Thanks.

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

A

Britt, do you want to take the first part?

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

A

Sure, Brian. Thanks for the question, Erin. As it relates to generics, our focus continues to be on a strong sourcing program combined with discipline on the sell side. We've been operating in a competitive but stable environment now for a number of years really. And we're really not seeing any difference in the second quarter from what we've seen in the previous several quarters before that.

We're able to procure generics very competitively on behalf of our customers, and we focus on stability of supply at the same time. So from a generics perspective, our programs are running very well. We feel very well positioned to continue to procure at a low cost and stable supply for our customers, and the environment is conducive to us being able do that.

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

A

And I think the second part of the question was on M&A. Clearly, one of our top priorities for capital deployment is to support the growth and the differentiated capabilities we have in our segments to continue to extend that growth. And so we are and continue to be active on the M&A front. Now we have a very structured and disciplined way we approach that. First is it's got to be aligned to our stated strategy and particularly our growth pillars. And so if you look at recent activities like Rx Savings Solutions or Sarah Cannon joint venture, obviously both very, very tied to our stated growth priorities.

And then the second step of that process is to layer over a lens of financial discipline. We have many uses for capital, some internal investment and efficiencies and technologies and tools. Obviously, we have share repurchase hurdles that we can meet. So we bring a lot of financial discipline to the acquisition process to ensure that we're getting good returns for shareholders as we deploy that capital. So if it's on strategy and has the appropriate financial return, we're very interested and we continue to develop our business development funnels.

Rachel Rodriguez
Vice President-Investor Relations, McKesson Corp.

A

Next question please.

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

Elizabeth Anderson
Analyst, Evercore Group LLC

Q

Hi, guys. Thanks so much for the question. I had two questions. One, on the RxTS business, are you seeing any sort of spillover benefit from GLP-1s? I'm thinking like either an organization that doesn't use you that does use you because they've heard about this with the GLP-1s or sort of a cross-selling across your group of services within this segment.

And then secondarily, on the medical side, one of your competitors on the outpatient side has seen some ordering impact because of sort of website and sort of a cyber-attack. Has that provided any kind of material change in customer ordering within that segment in the last couple of weeks? Thank you very much.

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

A

So the first – I think your first question was as it relates to RxTS and just opening new avenues. I would just remind you, RxTS is connected to 900,000 providers today and 50,000-plus pharmacies today. So we've had a long established relationship with them. And I think we've been well known for quite a long time in that arena. So I don't think you'd be seeing anything material there.

And then your second question was as it relates to a competitor ordering challenges. I'm not really not going to get into issues a competitor might have. I don't think we've – we've spent a little bit of time talking about the trends that we saw in the Medical-Surgical business and reviewed those trends, and I think those stand for themselves.

Rachel Rodriguez
Vice President-Investor Relations, McKesson Corp.

A

And we have time for one more question, please.

Operator: Certainly. That question will come from George Hill with Deutsche Bank. Please go ahead.

George Hill
Analyst, Deutsche Bank Securities, Inc.

Q

Hey, guys. I appreciate you sneaking me in. I'll say, Brian and Britt, the oncology business has really been a standout over the last several years. I was wondering if there's a chance that you guys might give us any kind of sense of the scope or scale of the business inside the US drug segment with any type of number around it. And, Britt, as a quick follow-up, I guess given the ongoing agreement with Rite Aid, can you tell...

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

A

It looks like he dropped off.

Operator: Mr. Hill, please proceed. I think we lost him.

George Hill
Analyst, Deutsche Bank Securities, Inc.

Q

Can you hear me?

Operator: Yes, go ahead.

George Hill
Analyst, Deutsche Bank Securities, Inc.

Q

I'm sorry, Britt and Brian, I don't know what happened there. Just the growth of the oncology business has been pretty impressive over the last couple years. I was just wondering if you would kind of provide any color to kind of give us some sense of the scope of the scale that business inside the US distribution segment. Any color would be helpful.

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

A

When we talk about our oncology business, we talk about it as an ecosystem, everything from distribution to GPO services, to iKnowMed EMR, to the community, to Ontada, to the SCRI joint venture. So there's a lot of components that go into that. I think what we have provided in terms of a sense of scale and scope is 2,400-plus providers operating in 27 states, seeing roughly 15-plus percent of all cancer patients in the community setting. So I hope that helps you get an order of magnitude.

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

Okay. Is that our last question? Great, thank you, everybody, for the questions, for your interest in McKesson, and certainly for joining our call today. Thank you, operator, for helping facilitate the call. I want to conclude by just reiterating McKesson delivered solid second quarter results. We saw continued momentum across the business, and we're confident in our ability to deliver sustained long-term growth.

As a diversified healthcare services company, we've made significant progress advancing our company priorities. And lastly and importantly, I want to make sure that I thank the McKesson team for all their contributions. It's incredibly humbling and proud to be able to lead this talented and dedicated team. Thanks again, everybody. I hope you all have a terrific evening.

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