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McKesson Corp. (MCK)

Q1 2025 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to McKesson's First Quarter Fiscal 2025 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 of Investor Relations, McKesson Corp.

Thank you, operator. Good afternoon, and welcome, everyone, to McKesson's first quarter fiscal 2025 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 into a question-and-answer session.

Today's discussions will include forward-looking statements such as forecast 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 Report and other 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.

With that, let me turn it over to Brian.

Brian Scott Tyler

Chief Executive Officer & Director, McKesson Corp.

Thank you, Rachel, and I'll extend my good afternoon to everyone as well. Thank you for joining our call today.

Earlier today, we reported first quarter company revenues of \$79.3 billion, reflecting 6% growth year-over-year. Adjusted earnings per diluted share increased 8% to \$7.88, above our original expectations.

As a result of our performance in the first quarter, we are raising our guidance for full year adjusted earnings per diluted share from \$31.25 to \$32.05 to a new range of \$31.75 to \$32.55.

The continued business growth and strong cash flow generation allow us to deliver on our commitment to our shareholders. We're also pleased to announce that our board of directors approved a 15% increase to our quarterly dividend and additional share repurchase authorization up to \$4 billion. This brings the total share repurchase authorization to approximately \$10 billion as of July 2024.

Underpinning the financial performance is our continued execution on our company priorities. It was nearly five years ago when we centered our strategy around four company priorities and embarked on the journey of transforming into a diversified healthcare services company.

We've been consistently executing against these strategies, driving enhanced value to our customers and delivering sustained financial growth across our operating segments. Of course, transformation and execution is a lot of hard work, takes the efforts of the full team and the path to sustainable growth is not always perfectly linear.

During the first quarter, we saw solid operating performance led by our pharmaceutical distribution business in the US and Canada. Meanwhile, we experienced some headwinds in other parts of the business. In Medical-Surgical, growth in the primary care channels was really slower than we anticipated, resulting in year-over-year decline for the first quarter.

In Prescription Technology Solutions, adjusted operating profit was unchanged from the prior year, driven by growth in affordability solutions, offset by lower contributions due to the mix of the services within our access programs and higher expenses to support future growth. We remain committed to our long-term growth targets. We have strong conviction in our strategy and confidence in the strength of our differentiated capabilities across the enterprise.

Looking ahead to the remainder of fiscal 2025, our focus remains on our company priorities and advancing our role as a diversified healthcare services company. We are investing in the business, especially where we can leverage technology to enhance product offerings and improve operational efficiencies. We've made great strides in these areas, and I'll plan to share a few examples before I hand it over to Britt.

Let me start, though, with our focus on people and culture. We firmly believe that people are the foundation for everything we do here at McKesson, as we strive to become the best place to work in healthcare. Recently, we

were named one of America's Best Employers for Diversity by Forbes, recognizing our dedicated efforts to fostering inclusion caring and belonging in the workplace.

We also take a very thoughtful and strategic approach to attracting and retaining talent across the company, and this, of course, includes our board of directors. In June, our board of directors welcomed Deborah – Dr. Deborah Dunsire as a new independent Director, serving on the Compensation and Talent Committee as well as the Finance Committee.

She brings decades of experience in biopharmaceuticals and in oncology specifically. She is a highly respected healthcare industry leader as the former CEO of multiple biopharmaceutical companies. We are grateful for the unique experience that Dr. Dunsire brings to our board as she joins us on this exciting journey of growth and innovation.

Moving on to our next priority of driving sustainable core growth in our distribution business. During the first quarter, we saw solid growth in US Pharmaceutical Segment. Adjusted operating profit grew 6%, driven by growth in specialty pharmaceuticals and strong results in our Oncology platform, which includes The US Oncology Network, Ontada, Provider Solutions and the Sarah Cannon Research Institute joint venture, which we often refer to as SCRI. The results demonstrated the diversity and breadth of our oncology assets.

Also in the Pharmaceutical segment, one of the achievements I really want to highlight is the successful onboarding of a large distribution customer this past July. This is a significant endeavor that requires close coordination across many, many parts of the organization. I'm deeply grateful for the dedication and the commitment of the teams at McKesson. They work hard to ensure an efficient and smooth transition for our customer and most importantly, for their patients. This is an example of the terrific execution McKesson is known for.

Moving on to the International segment. We saw growth in the quarter above expectations, primarily driven by the performance of our Canadian business, which includes pharmaceutical distribution, retail pharmacies and technology-enabled capabilities. We're pleased to see organic growth in the business supported by the stable trends in pharmaceutical volumes.

Throughout the quarter, the team also identified opportunities to apply technology and artificial intelligence in areas like inventory control and supply chain management. We're still at the early stages of application, but the opportunities ahead of us are exciting.

Let's turn to the Medical Surgical segment. Market environment over the last several years, which obviously included the COVID-19 era, has been pretty dynamic and introduced volatility. But generally, it was very favorable for our medical business.

As market conditions continue to normalize, we've seen some general market weakness in the primary care channel, which impacted our first quarter. We're taking actions to drive operational efficiencies and increase cost optimization efforts. These efforts will enhance our core distribution capabilities, while continuing to invest in efficiencies to better serve our customers, partners and patients.

Despite a weaker than expected start to the year, we remain confident in our assets and unique positions in the alternate site markets and our ability to drive long-term growth.

Moving on to our two strategic pillars of oncology and biopharma services, we are steadily executing our strategy to grow our oncology platform and improve patients' cancer care experiences. Building upon the foundational distribution services, we have built extensive capabilities spanning a patient's journey in cancer treatment. We're driving strong momentum across the oncology platform, demonstrating our differentiated value propositions and unique positions in this space.

During the first quarter, we aligned all the oncology-related assets and teams, including The US Oncology Network, Ontada, Provider Solutions and SCRI into one organization to further align our oncology platform. We view this as a natural step, as we accelerate our go-to-market strategies across our oncology capabilities. It will also allow us to better execute on our oncology strategy and deliver a connected and seamless customer experience across this diversified portfolio.

One of the foundational assets in the oncology platform is The US Oncology Network. In the past year, the network saw significant growth as reflected in the addition of new practices, the growth in physician numbers and steady increases in patient visits as both patients and providers continue to recognize the value of the network.

In the last fiscal year, we welcomed four practices to The US Oncology Network, expanding our geographic footprint and increasing access to lower-cost oncology care, and we're pleased to see the momentum continuing.

We announced earlier today, we welcome the Tennessee Cancer Specialists to the network, bringing the total number of providers in the network to now exceed 2,600.

In addition to practice management, we also support the community practices through the Sarah Cannon Research Institute joint venture, a fully integrated oncology research organization aimed at expanding clinical research and increasing access to clinical trials.

SCRI's research network brings together more than 1,300 physicians who are actively enrolling patients into clinical trials at more than 250 locations, in 24 states across the United States.

In the past year, practices in The US Oncology Network participated in over 200 clinical trials through SCRI. And earlier this year, SCRI announced a collaboration with AstraZeneca that will introduce modern solutions to accelerate clinical trial delivery time lines, reduce site burdens and enhance patient enrollment.

Let's move now to biopharma services, our second strategic growth pillar, which focuses on improving medication access, affordability and adherence through a scaled and connected network.

During the quarter, adjusted operating profit in the Prescription Technology Solutions segment was unchanged year-over-year. Growth in our technology services products, particularly within the affordability solutions, was offset by lower contributions due to the mix of services within our access programs and higher expenses to support future growth.

Leveraging our differentiated physician pharmacy and patient networks and our transaction scale, we believe we are strategically well positioned to continue to deliver value to biopharma.

In the first quarter, our affordability programs have saved patients nearly \$2.2 billion in out-of-pocket costs. In addition, we continue to offer a variety of services and capabilities that help patients get the medicine they need to live healthier lives. Many of our products achieve this by integrating automation and technology into the existing processes.

We support more than 650 biopharma brands, and have a strong footprint in key therapeutic areas, including oncology, neurology, gastroenterology, endocrinology and cardiology. Our provider network is able to reach more than 50% of the specialists in each of these growing therapeutic areas.

To improve the efficiency of our solutions and enhance customer experience as we continue to explore more use cases for technology and AI, one of the more recent examples include the implementation of a chatbot, which leverages AI to answer common user questions about the prior authorization status.

We're also leveraging AI to improve internal forecasting of customer demand, allowing us to better plan for operations and staffing needs. We really think that pairing AI with humans further differentiates our capabilities and will best position our business for the future.

Now let's pull everything together. We're pleased with the continued progress in advancing our company priorities. Despite the somewhat mixed segment results in the quarter, we are confident that we have a clear and robust plan to deliver on our financial commitments. We have a strong business foundation and well-defined strategy and a track record of execution with dedication and excellence. Our differentiated offerings will continue to drive better health outcomes for our customers and their patients.

With that, I'll hand it over to Britt.

Britt J. Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

Thank you, Brian, and good afternoon. As Brian mentioned, McKesson had another solid quarter with earnings per share results that exceeded our expectations, resulting in an increase to our full year guidance. These results reflect the continued growth in our US Pharmaceutical segment, including our leading oncology and specialty capabilities and our Canadian pharmaceutical distribution operations within the International segment.

I'm also pleased that our board of directors approved two actions in July: first, a 15% increase to the quarterly dividend to \$0.71 per share, marking the eighth consecutive year of dividend increases; and second, an additional \$4 billion of share repurchase authorization, bringing the total share repurchase authorization to approximately \$10 billion as of July 2024. These actions demonstrate the confidence that the board and management have in the execution of our strategic priorities as we continue to focus on capital deployment to drive value for our shareholders.

My comments today refer to our adjusted results unless I state otherwise. I'll start with the consolidated results, followed by a review at the segment level and conclude with an update on our outlook.

Consolidated revenues were \$79.3 billion, an increase of 6%, led by growth in the US Pharmaceuticals segment, resulting from increased prescription volumes, including higher volumes from specialty products, retail national account customers and GLP-1 medications.

Gross profit was \$3.1 billion, an increase of 4%, primarily a result of specialty distribution growth within the US Pharmaceutical segment, including our Provider Solutions business and higher distribution volumes in our Canadian business included in the International segment. These were partially offset by lower contributions from the primary care channel in the Medical-Surgical Solutions segment.

Operating expenses increased 7% to \$1.9 billion, principally to support growth in the US Pharmaceutical segment. Year-over-year results were also impacted by increased technology investment across the enterprise and the lapping of prior year integration cost related to the SCRI joint venture and Rx Savings Solutions.

Operating profit was \$1.3 billion, an increase of 12%, driven by \$110 million of pre-tax gains associated with McKesson Ventures equity investments included in corporate expenses compared to pre-tax losses of \$7 million in the first quarter of fiscal 2024.

Year-over-year results benefited from continued growth in the US Pharmaceutical segment, partially offset by lower volumes across the primary care channel in the Medical-Surgical Solutions segment.

Interest expense was \$70 million, an increase over the prior year, resulting from higher average balances of our loan portfolio throughout the quarter and a prior year gain on debt extinguishment of \$9 million.

The effective tax rate for the quarter was 13%, driven by the recognition of net discrete tax benefits of \$125 million in the quarter. As a reminder, we had a net discrete tax benefit of \$147 million in the first quarter of the prior year. As we've discussed previously, we provide annual effective tax rate guidance as the timing and amount of discrete tax items are difficult to predict.

First quarter diluted weighted average shares outstanding was 130.7 million, a decrease of 4%.

Wrapping up our consolidated results, earnings per diluted share increased 8% to \$7.88, ahead of our expectations, driven by pre-tax gains associated with McKesson Ventures equity investments, a lower share count, and operating profit growth in the US Pharmaceutical segment.

Turning to first quarter segment results. It can be found on slides 7 through 11, starting with US Pharmaceutical. US Pharmaceutical segment delivered solid revenue and operating profit growth. Once again, first quarter results demonstrate the continued momentum across all customer segments and our ability to drive sustainable long-term growth.

Revenues were \$71.7 billion, an increase of 7%. Revenue growth reflects positive utilization trends, leading to increased prescription volumes, including higher volumes from specialty products, retail national account customers and GLP-1 medications.

In the quarter, revenues for GLP-1 medications were \$8.8 billion, an increase of approximately \$1.8 billion, or 26% when compared to the prior year. On a sequential basis, revenues for GLP-1 medications increased \$1.3 billion, or 17% as supply constraints moderated in the quarter.

We anticipate continued GLP-1 medication growth year-over-year, however, with variability from quarter-to-quarter. For the quarter, operating profit increased 6% to \$815 million, driven by growth in the distribution of specialty products, providers and health systems.

Within the US Pharmaceutical segment, our comprehensive platform of leading oncology assets continues to grow and deliver value for customers and patients. Our ongoing investments in the oncology platform further differentiate our capabilities.

More than 2,600 providers in The US Oncology Network continued to experience solid growth with same site visits increasing 6% in the quarter. US Oncology Network has further strengthened by a set of

broad capabilities, including Provider Solutions, GPO services, data and insight through Ontada and clinical trial capabilities through our Sarah Cannon Research Institute joint venture, which includes clinical trial matching, an accelerated clinical trial setup.

We remain excited about our leading and differentiated oncology offerings and intend ongoing investment to sustain the growth and progress we're seeing against our strategic priorities.

Moving to Prescription Technology Solutions. Prescription Technology Solutions segment delivered revenues of \$1.2 billion and operating profit of \$223 million, both flat to the prior year. First quarter results reflect growth across our technology services products, including increased demand for our affordability solutions, including growth in eVoucher and ePrescribe.

Revenue included 18% sequential growth in third-party logistics. However, these results were lower than anticipated due to drug product launch delays, which had an approximately 7% impact on segment revenue growth in the quarter.

Operating profit was impacted by lower contributions from our access solutions due to the mix of transactions and services we provide across our access program and higher expenses to support future growth across the business. We remain confident that the segment operating profit will grow at or above the long-term growth target rate on an annual basis.

Turning to Medical-Surgical Solutions. First quarter results in this segment were below our expectations. Revenues were \$2.6 billion, an increase of 1%, and operating profit was \$200 million, a decrease of 15%. These results were driven by higher volumes of specialty pharmaceuticals, offset by lower volumes across the primary care channel, including customer mix and product demand shifts and the lapping of prior year nutritional product strength in the extended care channel.

Next, let me address our International results. Revenues were \$3.7 billion, an increase of 6%, and operating profit was \$102 million, an increase of 13%, driven by higher pharmaceutical distribution volumes in the Canadian business compared to the prior year.

In wrapping up our segment review, corporate expenses were \$35 million in the quarter, which included pre-tax gains of \$110 million, or \$0.62 per share related to equity investments within the McKesson Ventures portfolio compared to pre-tax losses of \$7 million, or \$0.04 per share in the first quarter of fiscal 2024.

As we've previously discussed, McKesson Ventures impact on consolidated financials, can be influenced by the performance of each individual investment quarter-to-quarter, which may result in gains and losses, the timing and magnitude, which can vary for each investment.

Let me turn to cash and capital deployment, which can be found on slide 12. We ended the quarter with \$2.3 billion in cash and cash equivalents. For the first quarter, we had negative free cash flow of \$1.5 billion, which included \$167 million in capital expenditures. In the quarter, free cash flow was impacted by the timing of tax payments and working capital investments to support the onboarding of new customers in the US Pharmaceutical segment.

We returned \$609 million of cash to shareholders, which included \$527 million of share repurchases and \$82 million in dividend payments. As a reminder, our cash position, working capital metrics and the resulting cash

flows can each be impacted by timing, which includes the day of the week that a quarter ends on and, therefore, can vary from quarter-to-quarter.

Now let me discuss our fiscal 2025 outlook. We continue to make progress against our strategic priorities, leveraging our broad capabilities across the enterprise. As a result of our first quarter performance and confidence in the outlook over the balance of the year, we are raising our guidance range for fiscal 2025 adjusted earnings per diluted share to \$31.75 to \$32.55.

Looking ahead to the remainder of fiscal 2025, we remain confident in our differentiated oncology and biopharma services assets and our strategy to advance McKesson as a diversified healthcare services company.

Let me start with our segments. In the first quarter, we experienced strong momentum across our US Pharmaceutical segment, including our broad oncology offering. The breadth of our capabilities and leading portfolio of assets across oncology have led to value creation for our customers, partners and shareholders over the last five years. Our fiscal 2025 outlook for the US Pharmaceutical segment is a continuation of this momentum.

Our outlook also contemplates the impact of the distribution contract with Optum that went into effect in July of 2024. Thanks to dedicated effort from our employees, we delivered a seamless onboarding experience in July.

As we previously outlined, start-up cost associated with this contract implementation were not material to first quarter results. However, we made investments in working capital during the quarter in advance of the contract start date. We are pleased to expand our pharmaceutical distribution relationship with Optum, and this is a testament to our leading distribution and sourcing capabilities, including our strong customer value proposition.

We now anticipate US Pharmaceutical revenues will increase 13% to 16%. When compared to prior guidance, we anticipate lower contribution from branded pharmaceuticals, which includes lower volumes for Humira. And we anticipate operating profit to increase 8% to 10%.

In the Prescription Technology Solutions segment, we anticipate revenues to increase 14% to 18% and operating profit to increase 11% to 15%, a modest decline from the prior guidance. The updated outlook for the segment reflects the lower-than-anticipated first quarter results and the impact of product launch delays.

During the first quarter, demand for our access solutions, including prior authorization volumes related to GLP-1 medications, demonstrated a slower rate of growth compared to the prior year, including the mix of transactions and services across our various access programs and volatility driven in part by product delays and shortages. These results were lower than our expectations in the first quarter.

As we've previously communicated, we remain confident in the long-term growth rate targets on an annual basis. However, we anticipate the growth trajectory in this segment will vary from quarter-to-quarter, driven by several factors that include utilization trends, the timing and trajectory of new product drug launches, the evolution of a product program support requirements as it matures, which could result in the shift to other services or a program termination, product delays and supply shortages, the annual verification program that we provide for our customers that occur in our fiscal fourth quarter and the size and timing of investments to support and expand our product portfolio.

We see solid market demand for our differentiated suite of solutions and services that help improve patients' access, affordability and adherence to medication, as well as help to support biopharma manufacturers, throughout the life cycle of their products.

We continue to build differentiated technology-enabled solutions that can seamlessly be used in the workflow of payers, providers and pharmacies. We remain confident that our market-leading assets, depth of services and capabilities and continued investment in innovation position us for growth in line or modestly above our long-range targets.

Moving to Medical-Surgical Solutions, we anticipate revenues to increase 3% to 7% and operating profit to be at the low-end of the initial guidance range of 6% to 8%. Over the last few years, including the period covering COVID, the Medical-Surgical environment has been dynamic and experienced volatility across the customers and products within the primary care channel and sites of care.

McKesson's unparalleled breadth of services and capabilities led to strong performance. As market conditions have normalized, we've noted instances of general market weakness in the primary care channel. This led to lower sales and operating profit contributions in the first quarter. Our updated full year outlook reflects the results from the first quarter and the trends we are seeing in the market. And we anticipate that these trends will continue through the second quarter.

As Brian noted in his remarks, in response to the market conditions today, we are announcing a series of initiatives within the Medical-Surgical Solutions segment to drive operational efficiencies and increase cost optimization efforts. In addition to delivering improved operating performance, these actions will result in great alignment across the organization, while continuing to invest to better serve our customers, partners and patients.

We estimate total charges between \$100 million and \$150 million, consisting primarily of employee severance and other employee-related costs, facility and other exit-related costs, as well as long-lived asset impairments. This restructuring program is anticipated to be substantially complete by the end of the first half of fiscal 2026.

These initiatives will lead to improved margins, a streamlined infrastructure and operating leverage. We anticipate the benefits from this program will begin in the second half of this fiscal year. We are well positioned with leading assets and capabilities across all the alternate sites of care, and we remain confident in our ability to continue delivering long-term growth.

Finally, in the International segment, we anticipate revenues to increase 4% to 8% and operating profit to increase 8% to 12%. We are pleased with the first quarter performance in our Canadian business and anticipate continued growth in fiscal 2025.

We also remain committed to exit Norway, as part of the completion of our European exit. As a reminder, Norway remains the only operating country in Europe that we have not yet entered into an agreement to sell. Contributions related to operations in Norway are included in the fiscal 2025 outlook for the segment.

In the Corporate segment, we anticipate expenses to be in the range of \$495 million to \$555 million, which incorporates the impact of \$110 million of pre-tax gains related to equity investments within the McKesson Ventures portfolio in the first quarter as well as increased technology spend.

We're pleased with the development and contributions from our enterprise technology organization, including the pace of our technology investments, focused on supporting growth, innovation and efficiency. Our investments in AI will continue to focus on improving the customer experience.

We continue to evaluate the enterprise technology operating model approach to effectively support the development of our strategy and needs of the organization, our customers and partners. We anticipate an increased level of investment in the technology operating model to accelerate the organization and improve business continuity, compliance and operating efficiency.

Wrapping up our outlook. We anticipate interest expense to be approximately \$245 million to \$265 million, reflecting the impact from increased average balances on the company's loan portfolio and higher interest rates throughout the first quarter and our outlook for the remainder of fiscal 2025.

We anticipate income attributable to noncontrolling interest to be in the range of \$175 million to \$185 million, reflecting the success of ClarusONE's generic sourcing operations. And we anticipate the full year effective tax rate will be in the range of approximately 17% to 19%, reflecting the positive discrete tax items recognized in the first quarter. As a reminder, the timing and amount of discrete tax items are difficult to predict, and therefore, we do not provide quarterly effective tax rate guidance.

Turning to cash flow and capital deployment. We anticipate free cash flow of approximately \$4.8 billion to \$5.2 billion. Our working capital metrics and resulting free cash flow will vary from quarter-to-quarter impacted by timing, including the day of the week that marks the close of quarter.

Our guidance reflects plans to repurchase approximately \$2.8 billion of shares in fiscal 2025. As a result of the share repurchase activity, we estimate weighted average diluted shares outstanding to be in the range of approximately 128 million to 130 million.

We will continue to execute our disciplined capital allocation strategy, creating value for our shareholders. This discipline has led to a return on invested capital approaching 28%.

Wrapping up fiscal 2025 guidance. We anticipate revenue growth of 13% to 15% and operating profit growth of 10% to 15% as compared to the prior year. Fiscal 2025, we anticipate earnings per diluted share of \$31.75 to \$32.55, which represents growth of 16% to 19% as compared to fiscal 2024.

Our guidance assumes that the first half of the fiscal year will deliver less contribution than previously anticipated, with the second half delivering approximately 53% of the full year earnings.

In closing, our fiscal 2025 outlook incorporates continued momentum across the business. We remain confident in our leading positions in growth pillars across oncology and biopharma services platforms. We are confident the actions we are taking now will sustain the growth we have delivered over the past several years.

We have a strong and stable financial foundation, which positions us to execute on our capital allocation strategy and we remain positioned to deliver for our customers and our partners and to create sustainable shareholder value.

With that, we can 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 jump right into RxTS. And Brian, can I ask you to help us understand the mix of services within access. I think you talked about mix between access and 3PL, but it sounds like there was a mix of services in access that is different. And then, Britt, relative to the GLP-1 mix, is this in part the value of new scripts versus annual re-ups? Or are you seeing any manufacture pushback on price as volume expands or any impact from the advent of these direct manufacturer programs, have those been factors?

Brian Scott Tyler

Chief Executive Officer & Director, McKesson Corp.

A

Thanks, Eric. Thanks for the question. So I think the first part of your question was relative to mix within the access portfolio. And here, I would just say these programs – this isn't a single program offering. Each program can have nuance to it, can be based off different sorts of transactions and interactions with the patients. We can get paid differently. It's really a manufacturer program.

So they have a hand in how they want to design and what metrics they want to track and then that translates to the transactions that we can build for. This quarter the mix of those services shifted on us in a way that was unanticipated at the beginning of the year.

Britt J. Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

A

As it relates to GLP-1s, Eric, I don't think we're seeing anything that we haven't seen over the past few quarters. I think maybe I'd just go back and talk about and just maybe reemphasize some of the things that go on in this particular segment. And I think specifically, as you think about our access and affordability programs, clearly, utilization is the foundation building block and utilization has been stable and growing over the last several quarters.

But a couple things that I would point out. Clearly, the timing and trajectory of new product drug launches is an impact. And I referenced in my opening comments that we had product delays in our 3PL business. We also had product delays that relate to our access programs. Icodec is a good example of a product that we have a program in place for. And that program has been delayed and that has an impact on our prior authorization programs throughout the rest of the year.

And if you think about product evolution, so there's also the maturity of products over time. Prior authorization programs, depending on the particular drug and the needs of the biopharma manufacturer, they will vary in terms of the length of that particular product. We had a drug Trulicity that was a prior authorization program for nine years, and the manufacturer determined to shift the funds for that particular program to other programs within RxTS. Nine years is a long time for a prior authorization service.

So it's not unusual that we will see either a funding shift to other programs or in some cases, just terminate. So you have that kind of variability that goes through the segment. It's not necessarily transaction or pricing variations that are driving that variability. But it's certainly the launch timing and trajectory as well as the types of services and programs and the drugs within those particular buckets.

Rachel Rodriguez

Vice President of Investor Relations, McKesson Corp.

A

Next question please.

Operator: And next will be Stephen Baxter with Wells Fargo. Please go ahead.

Stephen Baxter

Analyst, Wells Fargo Securities LLC

Q

Yeah. Hi. Thank you. I just wanted to ask two quick ones on the US Pharma segment. The profit growth there at 6%. Just hoping you could talk a little bit about the factors that are going to drive it up into the 8% to 10% guidance range for the year in a bit greater detail?

And then if we were to look at the revenue revision, I guess, if you were to exclude GLP-1s in Humira, is there any sense you can give us whether the decline in your revenue outlook would be the same or different or maybe there wouldn't be a decline of. Thank you.

Brian Scott Tyler

Chief Executive Officer & Director, McKesson Corp.

A

Well, maybe I'll take those in reverse order. In the case of the lower contribution from branded pharmaceuticals, specifically Humira, that impact is the difference between our current guidance, the guidance that we had previously, there's no really other change to the revenue profile within the segment. As it relates to the first quarter, the performance that we had in the first quarter was in line with our expectations.

I would remind you that that's also in line with the long-term growth rate guidance that we've provided previously. Again, it's being driven by a lot of the same factors that we've seen over the last several quarters, growth in specialty, growth within our oncology business. And as we think about the rest of the year, we anticipate that we'll have continued growth in those areas, continued strength in our generics program and the 8% to 10% guide for the full year, again, is unchanged from our prior guidance. So we feel good about the position that we have, the customer set that we're serving as well as the continued growth in a key strategic area for us, which is our oncology platform.

Rachel Rodriguez

Vice President of Investor Relations, McKesson Corp.

A

Next question, please.

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

Lisa C. Gill

Analyst, JPMorgan Securities LLC

Q

Thanks very much. Britt, just as a follow-up to that. When you talk about the branded Humira, is it that the price is coming down because of the biosimilar? Or it's just circumventing your channel altogether? That's just really not a question, just a follow-up.

And then my real question is just if you can help – you or Brian can help us to understand what's happening in the Med-Surg business. You talked about product demand mix in primary care and shifts there. You talk about the fact that you're putting in new cost cutting, et cetera, on that. But what's really shifting and changing in that market? Thanks.

Britt J. Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

A

Thank you, Lisa, for the question. Let me start with your first question. This is simply a formulary change that a customer made to shift from brand to the biosimilar. And so that's the impact that's happening to the revenues, is that formulary change to the biosimilar. I'll start on Medical. And as we talked about, we're coming off of a pretty dynamic period of years in the Medical segment.

One of things that we're seeing is just to give you one example is, as we've come through this COVID period, there is a significant less demand for COVID-type products, such as COVID test kits and testing in general. And what we have seen is as we've normalized – begun to normalize in the environment, we've come out of this COVID period, that demand for those test kits and other types of testing related to COVID simply has not come back. It's just soft. We see good – continued good growth within most of our segments, but there are particular product segments such as testing and test kits and other related COVID services that have remained soft.

Rachel Rodriguez

Vice President of Investor Relations, McKesson Corp.

A

Next question please.

Operator: The next will be Michael Cherny with Leerink Partners. Please go ahead.

Michael Cherny

Analyst, Leerink Partners LLC

Q

Good afternoon and thanks for taking the question. Maybe to follow-up on Lisa's relative to Med-Surg. As you think about the activities you're taking to improve profitability where specifically within the organization, customer area, are you focused on those activities? And I guess, with the primary care softness, can you just give us a little bit more color on what's been going well in Med-Surg? And what you think is going to keep trend, continue to accelerate trend as part of the guidance into the back half of the year?

Brian Scott Tyler

Chief Executive Officer & Director, McKesson Corp.

A

Yeah. Well, I would just remind everybody, we've got a very extensive alternate site business that plays in multiple channels, primary care, extended care, surgery center, clinic settings, et cetera. And we have on top of that broad product offering of core, obviously, commodity, medical products, equipment, pharmaceuticals, specialty pharmaceutical.

We have been seeing some good growth in the pharmaceutical and specialty pharmaceuticals that creates some margin mix challenges for us. But it's a really well-scaled business. I think outstanding customer service and reputation with customers and diversified across the channels.

Now as Britt described I think quite well, we've been having patient mobility. We called it a onetime demand utilization in the channel. And we've just seen it soften over the course of our first quarter. Could be lots of contributing factors to that, right? It could be impact to the economy and inflation on patients and postponing care, could be staffing challenges in healthcare, which I think are quite well known.

The reality for us is to just deal with what we see in the marketplace and make sure that we respond in the right way. So stepping back, aligning our go-to-market strategies, aligning our operations, thinking about the way we go-to-market with these mix of products. And as you would expect, we're taking essentially all of those actions, and that was the program that Britt referred to.

Britt J. Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

A

And I think maybe just to add on to that, as we think about, as Brian mentioned, as we see these trends, we want to meet the customer where they're at and meet the demands for that are changing within this marketplace or that we see changing in this marketplace. And so we have an opportunity, as we always have to drive sustainable efficiency through our cost structure. Align our organization and align our organization to the customers to drive more velocity efficiency as well as aligning our infrastructure, our real estate portfolio, reengineer the real estate portfolio to also meet these demands.

So we just want to be responsive to that. We think that these are the right actions to do that, and we are comfortable that they're going to drive significant benefits into the organization beginning in the second half of the year.

Rachel Rodriguez

Vice President of Investor Relations, McKesson Corp.

A

Next question please.

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

Allen Lutz

Analyst, BofA Securities, Inc.

Q

Good afternoon. Thanks for taking the questions. Another one for Britt. I wanted to follow up on HUMIRA. It looked like gross profit at the enterprise level was a few percentage points below the Street. Can you talk about how gross profit came in relative to your internal expectations? And did the formulary change with Humira impact your gross profit at all? Thanks.

Britt J. Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

A

Yeah, thanks for that question. As I think about it, the primary driver would be the growth rate and trajectory for GLP-1s. And we talked about in the last few quarters that we anticipated that GLP-1s would continue to grow year-over-year, but we had seen a moderation in that growth. As I mentioned in my comments that what we saw in the first quarter is we actually saw a sequential growth in GLP-1. It was a little bit higher than we had anticipated. I think gross profit generally was pretty much in line with what we anticipated, but there was a little higher growth in GLP-1 distribution transactions than we had anticipated. As I mentioned, we had sequential growth quarter-to-quarter. That's the primary driver.

Rachel Rodriguez

Vice President of Investor Relations, McKesson Corp.

A

Next question please.

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

Stephanie July Davis

Analyst, Barclays PLC

Q

Hey, guys. Thank so much for taking my question. I was just hoping to dig in, again, to some of the product launch delays in Prescription Tech. I get that is based across both [ph] retail (00:46:31) and access. But given it's still early in the year, what gives you confidence that this is a full year pushout? Is there any chance that it ends up flowing back in the back half of the year or any conservatism baked into that? Or is it a bit more predictable?

Britt J. Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

A

Yeah. So we have moderated our full year guidance slightly. So you see that the guidance is down about 1% at the midpoint. We have a broad portfolio of services beyond prior authorizations. We support specialty drugs through hub and reimbursement programs. We have affordability programs. So it is a very broad portfolio of services. The access programs like prior authorization clearly are an important part of that.

But again, we have a broad set. We also have an annual verification program in our fourth fiscal quarter that has been very successful over the last few years. So as we step back and look at all of the services and programs that we have, we believe that taking our guide down at the midpoint moderately is the appropriate thing to do at this time, reflective of a slower start to the year than we had anticipated.

Rachel Rodriguez

Vice President of Investor Relations, McKesson Corp.

A

Next question, please.

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

Daniel Grosslight

Analyst, Citigroup Global Markets, Inc.

Q

Hi. Thanks for taking the question. You guys mentioned this a couple times now that GLP-1 growth this quarter was better than expected. And it does seem that supply constraints are abating a bit. I'm just curious, as GLP-1s become more widely available and the channel becomes more important to the manufacturers i.e., keeping it out of the mail channel. I'm wondering if there's any opportunity in the near-term for you to improve buy-side economics there and capture a little more of kind of the operating profit benefit from GLPs?

Brian Scott Tyler

Chief Executive Officer & Director, McKesson Corp.

A

Well, we have seen really in the last several weeks, I would say, improvement in the supply situation. Obviously, as it relates to our financial relationships with the manufacturers, I mean, we always strive to get fair value for the services that we lend and support, getting these cold chain products to market and get to the patients and quite proud of the service and the service level that we do provide in that regard.

We are always in ongoing dialogue, a lot of it around access, availability, what we can do to support the manufacturers and these drugs, which really would have tremendous patient impact and impact on people's lives. So we are continually in discussion, some of those discussions around the core distribution, others will be about additional services like we provide through our Technology Solutions business to support them. But it's all about access and getting access to patients to get uptake in the products.

Rachel Rodriguez

Vice President of Investor Relations, McKesson Corp.

A

Next question, please.

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

Elizabeth Anderson

Analyst, Evercore ISI

Q

Hi, Sorry. I was on mute. Hi, guys. Thanks for the question. I was wondering if you could comment on sort of the changing mix you've talked about in market and what impact that has on ClarusONE? And how you guys think about the contribution from ClarusONE and kind of the new services and things that it can bring as the market continues to evolve from a mix perspective with biosimilars and oncology in that? Thank you.

Britt J. Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

A

Thanks for the question. We're really pleased with the performance of ClarusONE now for several years. The partnership that we have with some key customers of ours, the partnership that we have with really hundreds of suppliers on the buy side, we think that ClarusONE positions us well not only for competitive low cost for our customers, but also they focus really heavily on the availability of supply. And we think the ClarusONE will continue to partner well as we bring on new partners in our distribution business.

We believe that they'll continue to partner well on the manufacturer side. And as I mentioned in my comments, part of the full year guide around non-controlling interest is reflective of the strength in ClarusONE. So we're really pleased with how ClarusONE positions us across all generic products. We think that could be opportunity to expand those services, but we're really focused on serving our customers with their generic needs from an availability of supply and a low-cost perspective.

Rachel Rodriguez

Vice President of Investor Relations, McKesson Corp.

A

Next question please.

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

Brian Tanquilut

Analyst, Jefferies LLC

Q

Hey, good afternoon. Britt, maybe just on RxTS, I'm looking at your guidance adjustment, right? And the decline in operating profit is notably lower than the revenue change. So suggesting that there's better margin in what is in the business left. So just curious what those margin dynamics are that we need to be thinking about, the that impact of the delta in the guidance?

Britt J. Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

A

Yeah. Thanks for the question, Brian. As I've talked about before, if you look at the revenue composition of this particular segment, more than 50% of the revenue comes from our 3PL business, which is less than 10% of the operating profit contribution. So we anticipate that our other programs around access and affordability and some of our adherence solutions, which have higher margins for us, will drive a lot of that improvement over the second half of the year. Again, the 3PL business, although it has grown sequentially, we do anticipate that it will grow year-over-year. The impact that it has on our operating profit is not material.

Rachel Rodriguez

Vice President of Investor Relations, McKesson Corp.

A

We have time for one more question, please.

Operator: Certainly, that question will come from Erin Wright with Morgan Stanley. Please go ahead.

Erin Wilson Wright

Analyst, Morgan Stanley & Co. LLC

Q

Thanks for taking my question. So I want to switch gears a little bit to US oncology and in sort of the specialty offering the news around the Tennessee Cancer Specialists today, what that adds for you and what your appetite for similar deals are going forward? And just your effort also that you talked about to consolidate the specialty offering as well and have this cohesive offering. I guess, will you be breaking out more for us in terms of the disclosure on that front, as that becomes a bigger part of the growth algorithm for you? Thanks.

Brian Scott Tyler

Chief Executive Officer & Director, McKesson Corp.

A

Great, great question. I appreciate it very much. We've been very pleased with the growth of the US oncology Network over the last several years. As we mentioned, we're now in over 600 sites, 31 states, 2,600 providers. And really, it's been multiple years of steady growth. And we continue to think that the network has tremendous attraction to community-based oncology providers.

We look to add to that network through either acquisition of practices, through managed agreements with them, where we find a practice that has relevant scale in the geography, and we think you can practice clinical oncology consistent with the quality standards we have in the USON network. So we can acquire a practice, we can attract physicians to existing practices, but I think we've consistently demonstrated over the last year, that's a key part of our growth strategy.

Now when we've talked for several years about the ecosystem or the complementarity between our various oncology assets, not just the network, it's the Ontada data insights business that we started four years ago. It's the joint venture with Sarah Cannon that we entered into a couple of years ago. It's the iKnowMed EMR system that we have. And I think as we've just seen these begin to mature, we saw the opportunity to more naturally bring them together under coordinated leadership to just sort of accelerate this ecosystem or this network effect across the businesses. And I'm very excited about this move. I think it brings more clarity. I think it's going to bring more speed, it's going to bring more focus. So when we think about where we invest in this company. We want to deploy capital against our strategic priorities and expanding the network is certainly one of those and will continue to be one.

Brian Scott Tyler

Chief Executive Officer & Director, McKesson Corp.

Okay. Well, look, thank you, everyone, again, for joining the call. Thank you for the excellent questions. I want to thank Cynthia, our operator, for facilitating the call.

Look, McKesson's reported first quarter adjusted earnings per diluted share, which exceeded our expectations. We are very focused on executing against our strategy and our company priorities, which enable us to navigate through a dynamic environment with confidence.

Looking ahead, we're confident in the strength of our underlying businesses, the differentiation of our assets and where they sit in the market in terms of positioning.

I cannot end this call without thanking the 51,000-plus McKesson employees for their dedication and contribution to advancing our mission. So to team McKesson, thank you very much.

Okay. I hope everyone has a terrific evening. Thanks again for joining the call.

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

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