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McKesson Corp. (MCK)

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to McKesson's First Quarter Earnings Call. Today's conference is being recorded. At this time, I'd like to turn the call over to Holly Weiss. Please go ahead.

Holly Weiss

Senior Vice President, Investor Relations, McKesson Corp.

Thank you, Elisa. Good morning and welcome everyone to McKesson's First Quarter fiscal 2021 earnings call. Today, I'm joined by Brian Tyler, our Chief Executive Officer; and Britt Vitalone, our Chief Financial Officer. Brian will lead off, followed by Britt, and then we will move to a question-and-answer session.

Today's discussion will include forward-looking statements, such as forecast about McKesson's operations and future results. Please refer to the cautionary statements in today's press release and our slide presentation, and to the Risk Factors section of our periodic SEC filings for additional information concerning risk factors that could cause our actual results to materially differ from those in our forward-looking statements.

During this call, we will discuss non-GAAP financial measures. Additional information about our non-GAAP financial measures, including a reconciliation of those measures to GAAP results, is included in today's press release and presentation slides, which are available on our website at investor.mckesson.com.

With that, let me turn it over to Brian.

Brian S. Tyler

Chief Executive Officer & Director, McKesson Corp.

Thank you, Holly, and good morning everybody. Thank you for being with us on this morning's call. I hope that you, your families and your communities are staying healthy and safe. On our fourth quarter call in May, I discussed that we were entering the new fiscal year with macro uncertainties and volatility in healthcare consumption patterns as a result of the COVID-19 pandemic. And our first quarter results clearly reflect the effects of these dynamics.

Today we're reporting results for one of the most complicated quarters in our company's history. Our first quarter adjusted results while materially down against prior year due to the pandemic, finished significantly above our original expectations. We reported first quarter total company revenues of $55.7 billion and adjusted earnings per diluted share of $2.77. Both ahead of our original expectations. Through April and May, trends in the business aligned closely with our original expectations. However, we saw volumes across the business improved significantly over the back half of June, resulting in a strong close to the quarter.

Based on our first quarter results, and the current shape of the recovery versus our original expectations, we're raising our fiscal 2021 adjusted earnings per diluted share guidance range to

$14.70 to $15.50 per diluted share. This is up from our previous range of $13.95 to $14.75 per diluted share. Despite the uncertainty brought on by the pandemic, our focus is on executing against what is within our control. And that execution really underpinned our strong finish to the quarter, as customer demand began to improve from the troughs we experienced in April and May. From the beginning, our top priority has been to navigate the challenges and the fluidity of the situation brought on by the pandemic by focusing first on protecting the health and safety of our teams, so that we could continue to meet the needs of our customers and keep the healthcare supply chain operating at a high level.

We've committed to increase safety measures for our employees and have maintained an unwavering commitment to our customers and our communities. In May, I talked about the essential role McKesson plays in the fight against the COVID-19 pandemic, and the need to partner closely with manufacturers, and various government entities, so that we can react quickly, as demand patterns shift with the spread of the COVID-19 virus. One such area that has evolved is the demand for personal protective equipment or PPE, as frontline workers and our customers work to help treat and keep patients safe. We've worked with supplier partners federal, state and local governments to get higher volumes of PPEs to areas of critical needs.

Our partnership with Walmart to produce and deliver medical gowns in the US has continued to increase total gown supply, with over 30 million gowns shipped to the US since April. We're also continuing to invest in our communities. Our foundation made contributions to over a dozen food banks in some of the nation's most vulnerable areas. These investments translate into more than 6 million meals for individuals who would otherwise go hungry.

Before I expand on our first quarter results, I want to provide just a brief update on the macro environment and the trends we've seen over the past 75 days since we reported our fourth quarter fiscal 2020 results and issued our fiscal 2021 outlook.

COVID-19 has continued to progress and persist here in the US in ways we couldn't have predicted when we initially provided our outlook for fiscal 2021. Several states, including Texas, where I am today, are experiencing significantly higher numbers of cases, while others -- other parts of the country and frankly, the world are in very different and various forms of recovery. This variability makes predicting an aggregate timeline for the recovery challenging.

As we detailed on our fourth quarter call, we expected the most severe impacts to our business in the fiscal first quarter. And as a reminder, our original outlook assumed the pandemic would have the most material impact on our businesses with physician and specialty provider and oncology exposure. We expected a gradual stabilization beginning in our fiscal second quarter and ramping over the remainder of the fiscal year as doctors offices reopen and patients return to their treatments. Through April and May, our results were largely in line with our original expectations, with volumes across the enterprise materially down versus the prior year and well below pre-COVID levels.

What we experienced in June, however, was an earlier than expected pace of recovery, particularly in the last weeks of the quarter, resulting in demand acceleration and higher volumes versus our original expectations. These impacts were the most pronounced in the primary care business within our medical segment. Primary care patient visits showed encouraging signs of improvement in June as patients return to their doctors following the relaxation of shelter-at-home guidelines.

Now turning to the business. I'll summarize the first quarter, and then I'll turn the call over to Britt to elaborate. U.S. Pharmaceutical and Specialty Solutions exceeded our original expectations in the quarter, underpinned by strong execution and improving volume trends in the business in the back half of June. Market stability, our disciplined approach to pricing and a growing specialty market continue to be foundations for us to build upon.

We're very pleased to have recently renewed our distribution agreement with [ph] The Buyers Alliance (00:07:25) sometimes refer to as TBA, and doing so while maintaining our disciplined approach to the market. I would remind you, TBA is a group consisting of several health systems, retail national accounts and small and medium chain pharmacies.

We're always looking for how we can best serve our customers and help them grow their business. This was evidenced by the growth in our specialty provider business in the midst of this pandemic driven in small part by improved adoption of biosimilars in the quarter. While our specialty business recovered more quickly than we had assumed following the initial downturns in demand, we have certainly had to adapt to meet the needs of patients. At the onset of the pandemic, the US oncology network developed a rollout plan for telemedicine. And within four weeks, 80% of our network physicians were able to initiate telemedicine follow-up visits and new consultations with their patients.

To-date, more than 120,000 telemedicine visits have taken place with over 1,250 providers. Our improved outlook for fiscal 2021 in the segment reflects the positive trends we saw in the quarter across the portfolio versus our original expectations. Let me make a few comments on Europe. While each of the 13 countries we operate in, have had different responses and recoveries during the pandemic, we're encouraged by the segment's results in the first quarter.

We also continue to take actions to better position the business for future growth, as evidenced by our ongoing efforts to evaluate our footprint and cost structure in our largest market, the UK. In the UK market, I'd remind you that our owned retail pharmacies are very health care-focused, with up to 90% of our mix coming from pharmaceutical volumes. While lower foot traffic through our pharmacies was a headwind in the quarter, our downside was limited due to our relatively small exposure to the front shop categories.

A good example of how we're evolving this business is our 2019 acquisition of a company called Echo, now operating as Echo by LloydsPharmacy. This is an online prescription fulfillment business in the UK. It was a timely acquisition for us, particularly given the impacts of the pandemic. To meet customer demands in uncertain times, our investment in our digital health care strategy in the UK has helped position the business to benefit from movement of patients to home and to omnichannel services.

Let me move on to Medical. As I discussed earlier, in June, we experienced a sharp increase in demand across our primary care sites. This directly correlates to the reopening of physician offices and resumption of performing elective procedures as patients started to feel more comfortable returning to their doctors and health care providers.

In addition, to a stabilization in primary care volumes as the quarter closed, our leading position in our lab business also puts us in a good place to respond to customer and patient needs during the pandemic. We have a strong history in this channel. And as customers need solutions for COVID-19 and as our manufacturer partners develop and launch testing solutions, we remain a partner of choice and a leader across alternate site – settings of care. The trends we witnessed in June, combined with our improved outlook for the business over the remainder of this fiscal year, give us confidence in our significantly improved outlook for the segment.

Turning to Other, which now primarily consists of Canada and McKesson Prescription Technology Solutions following the separation of our investment in Change Healthcare in fiscal 2020. We're encouraged by the trends we saw in Canada to end the quarter as volumes began to approach pre-COVID levels in our distribution and retail businesses.

Within the retail setting, our focus remains on building an enhanced customer experience through investments in people and reconfigured pharmacy formats. This has helped to strengthen our fundamentals and the role that community pharmacy plays in the Canadian health care system, which is especially important in times like these. Our own Canadian pharmacies are continuing to evolve and will soon offer e-commerce and e-prescribing platforms, creating additional options for Canadian consumers, who want both a physical and digital shopping experience.

Within MRxTS, we're making progress with our investments to create technology offerings that resonate with our retail and biopharma customers. Since launching in September of 2019, Access for More Patients, a product we call AMP, has helped automate access to therapies for complex and chronic diseases, reducing the time to therapy by 18 days on average, and we're continuing to expand the brand taking advantage of this offering.

The collaboration between our RxCrossroads and CoverMymeds businesses to develop AMP is a good example of how our business evolves to meet the needs of our customers. As part of our ongoing evolution, on July 1, we announced the resegmentation of our businesses effective in the second quarter of this fiscal year. We believe that this new organization structure better positions McKesson to focus and execute against our growth strategies and to meet the changing needs of our customers.

With this resegmentation, two new segments have been established: International and Prescription Technology Solutions. Kevin Kettler has assumed responsibility for the new International segment, which combines McKesson Europe and our Canadian business. Nathan Mott will lead the new Prescription Technology Solutions segment, which has been expanded to include the RxCrossroads business, formerly reported as part of McKesson Life Sciences within our U.S. Pharmaceutical and Specialty Solutions segment.

In the quarter, we also appointed Tom Rodgers as Executive Vice President and Chief Strategy and Business Development Officer. Tom brings more than 25 years of experience working in both emerging companies and large health care environments.

In summary, we certainly faced unprecedented headwinds to begin fiscal 2021, but we're encouraged by the signs of recovery across our businesses as we exit our first quarter. We still believe the first quarter will be the trough of the recovery curve with the most material impacts in the business. We are pleased our first quarter results exceeded our expectations, reflecting great execution by our teams. The path to recovery over the remainder of our fiscal year is unlikely to be linear, and we will continue to closely monitor the progression of COVID-19 through our communities and its implications for our business.

The pandemic has reinforced the need for us to be agile in response to both customer demand and the ways in which patients choose to consume health care. One theme through the pandemic has been changed, and I believe McKesson is well positioned to respond to change as the macro environment around us continues to evolve, McKesson will continue to evolve.

I believe we have exited the quarter in a much stronger position than we entered it, stable fundamentals across the business, paired with focused execution against our strategic growth initiatives, give me confidence that McKesson will adapt to the near-term uncertainties and ultimately be positioned to thrive long term. Thank you very much for your time.

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

Britt J. Vitalone

Executive Vice President & Chief Financial Officer, McKesson Corp.

Thank you, Brian, and good morning, everyone. My comments today will relate to our existing segment structure. As Brian discussed in his opening comments, effective the second quarter of fiscal 2021, we'll begin to report our financial results in four reportable segments; U.S. Pharmaceutical, International, Medical-Surgical Solutions and Prescription Technology Solutions. We will issue a recast of financials in the new segment structure, ahead of our second quarter earnings call to assist with the modeling under the new structure.

Our June quarter was a testament to McKesson's ability to execute during challenging times. Our results speak to the dedication of our people, the resilience of our business, and the important leadership role that McKesson plays in the health care supply chain. This morning, I'll provide commentary on our first quarter results, and I'll provide an update on the key assumptions that underpin our outlook for the balance of fiscal 2021. Throughout my comments this morning, I'll provide an update of the recent trends we are observing and the implications to our fiscal 2021 results.

As expected, our first quarter was severely impacted by the global pandemic, as lockdown and social distancing requirements placed unique pressures on our customers and patients. We navigated the quarter with a combination of discipline and focus to what we continue to believe will be peak levels of global lockdown and restrictions. In the first quarter, we finished ahead of the expectations that we laid out in May on our fourth quarter fiscal 2020 earnings call. Those expectations included our assumption that patient visits in the physician, specialty provider and oncology segments and pharmacy interactions in our US, Canadian and European markets would bottom out and gradually improve beginning with our second quarter.

Through April and May, the relative shape of the recovery curve was in line with this original guidance framework. However, as we progressed through June, we began to see an acceleration of demand as volumes across our businesses recovered at an earlier pace than our original outlook had contemplated. This increase in demand largely tracked the easing of restrictions in openings of markets across the world. Prescription transactions, patient interactions and elective procedures began to recover sooner than we had anticipated and had favorable volume impacts that were most pronounced in the Medical Surgical and Specialty businesses.

Let me turn now to our first quarter results. A summary of our first quarter results and updated guidance assumptions can be found in our first quarter earnings slide presentation which is posted on the Investors section of our website. Before I provide more details on our first quarter adjusted results, I want to point out one item that impacted our GAAP-only results in the quarter. During the first quarter, we recorded an after-tax gain of $97 million for insurance proceeds received in connection with the settlement of the shareholder derivative action related to McKesson's controlled substances monitoring program.

Now let's transition to a discussion of our adjusted earnings results for the first quarter, starting with our consolidated results on slide 4. First quarter consolidated revenues of $55.7 billion were flat compared to the prior year. Market growth and higher retail national account volumes within the U.S. Pharmaceutical and Specialty Solutions segment were offset by lower prescription volumes in primary care patient visits, primarily a result of the negative impact from COVID-19. Although flat to prior year, this result exceeded our original expectations for the quarter.

First quarter adjusted gross profit was down 4% year-over-year as lower prescription transaction volumes and mix were a result of the pandemic. First quarter adjusted operating expenses decreased 2% year-over-year driven by cost mitigation efforts in response to the headwinds presented by the COVID-19 pandemic. These were partially offset by increased investments in the business. Adjusted operating profit was $707 million for the quarter, a decrease of 24% as compared to the prior year. When excluding the results of Change Healthcare from the prior year, adjusted operating profit was down approximately 14%, again, ahead of our expectations. Interest expense was $60 million in the quarter, an increase of 7% compared to the prior year.

Our adjusted tax rate was 22.3% for the quarter. We continue to assume a full year adjusted tax rate of approximately 18% to 20%, which may vary from quarter-to-quarter and includes anticipated discrete tax items that we expect to realize during the course of the year. We anticipate recording a favorable tax discrete item in our fiscal second quarter, which would result in a second quarter adjusted tax rate of approximately 5% to 10%.

I would remind you that this could vary as a result of the mix of our worldwide earnings. First quarter adjusted earnings per diluted share was $2.77, down 16% in the quarter compared to the prior year primarily driven by the negative impact of the COVID-19 pandemic across the business and the lapping of prior year contribution from the company's investment in Change Healthcare. These items were partially offset by a lower share count compared to the prior year.

In wrapping up our consolidated results, our first quarter diluted weighted average shares were 163 million, a decrease of 14% year-over-year driven by the successful exit of our investment in Change Healthcare, which lowered our shares outstanding by approximately 15.4 million shares and due to prior year share repurchases.

Next, I'll review our segment results, which can be found on slides 5 through 7, and I'll start with U.S. Pharmaceutical and Specialty Solutions. Revenues were $45.1 billion for the quarter, which were up 2% driven by market growth and higher retail national account volumes. This was partially offset by branded generic conversions and the negative impact of COVID-19 on prescription transaction volumes.

Prescription transaction volumes were uneven in April and May, improved throughout the quarter and were above our expectations in June. Oncology visits were approximately 70% of pre-pandemic levels in April, however, improved to over 95% in June. And telemedicine visits in our oncology practices now account for up to 15% of all visits.

First quarter adjusted operating profit decreased 2% to $589 million, driven by lower volumes as a results of the pandemic and strategic investments, including our oncology portfolio. Partially offset by growth in the provider solutions business. The segment adjusted operating margin for the first quarter was 131 basis points, a decrease of 5 basis points.

Next, I'll talk about European Pharmaceutical Solutions, where revenues were $6.2 billion for the quarter, a decrease of 7% year-over-year. On an FX-adjusted basis, revenues decreased 4% driven by the negative impact of the pandemic on the pharmaceutical distribution and retail pharmacy businesses, partially offset by two extra sell days in the period compared to the prior year. First quarter adjusted operating profit was flat year-over-year at $35 million.

On an FX-adjusted basis, adjusted operating profit increased 3% to $36 million driven by lower operating expense and two additional sell days in the period when compared to the prior year, partially offset by lower volumes due to the pandemic. The segment adjusted operating margin for the first quarter was 56 basis points an increase of four basis points.

I'd like to spend a minute on the actions taken in the UK, which Brian discussed earlier. The first quarter was a very difficult quarter and the COVID pandemic has had a greater impact in our UK operations than the rest of our European operations. Our teams have adapted to a changing operating environment in the wake of COVID-19.

We saw increased demand prior to the lockdown, but material reductions after the stay-at-home orders were imposed. Volumes have remained steady, however, below pre-pandemic levels.

In our UK business, we identified an opportunity to accelerate our transition to digital. Our investment in Echo and our digital capabilities led to strong growth in our online business, and we moved quickly to increase capacity. Revenues from our Echo business grew over 300% from pre-pandemic levels and continue on a strong growth trajectory.

Our investment in digital health care strategy in the UK positions us to benefit from the movement of patients to a digital environment. However, given the severity of the COVID impact and the uncertain outlook, we are accelerating actions in our UK business.

During the quarter, we announced restructuring actions in the UK to adapt to the difficult and evolving operating environment in the wake of COVID and to continue to better position the business for future profitability. As a result, we took incremental charges in the quarter, which include further rationalization of our footprint in UK along with additional cost optimization efforts.

Moving now to Medical-Surgical Solutions. We're encouraged to see improved patient mobility and procedures starting to return versus what we saw at the onset of the pandemic. For example, according to IQVIA, April in person primary care visits were down nearly 70% and that improved to approximately 10% to 15% declines as of late June.

Revenues were $1.8 billion for the quarter, which were down 5% driven by the pandemic's impact on volume in our primary care business, partially offset by growth in the extended care business. First quarter revenues include increased volumes of personal protective equipment.

First quarter adjusted operating profit decreased 22% to $124 million, driven by lower demand in the primary care business, in part due to temporary closures of physician offices across the US, as a result of shelter-in-place guidelines. Segment adjusted operating margin for the first quarter was 689 basis points, a decrease of 147 basis points driven primarily by customer and product mix.

And finishing our business review with Other. Revenues were $2.6 billion for the quarter, a decrease of 13% year-over-year. On an FX-adjusted basis, revenues decreased 10% driven by lower volumes in the Canadian business, which includes both the exit of an unprofitable customer at the onset of the fiscal year and the negative impact of the pandemic. First quarter adjusted operating profit was $137 million, down 50% on both the reported and FX-adjusted basis driven primarily by the lapping of the prior year contribution of $108 million from the company's investment in Change Healthcare, along with the negative impact of the pandemic on the businesses within other. Excluding the prior year contribution from Change, Other was down approximately 18% year-over-year.

And moving to Corporate. McKesson recorded $178 million in adjusted corporate expenses in the quarter, an increase of 30% year-over-year, which was primarily driven by the lapping of a prior year onetime gain from investment activities and an increase in opioid litigation costs compared to the prior year. Excluding the prior year onetime benefit, corporate expenses increased to approximately 10% year-over-year. For the first quarter, we reported net opioid-related litigation expenses of $43 million.

Now on to cash, which can be found on slide 10. And we ended the quarter with a cash balance of $2.9 billion. During the quarter, we had negative free cash flow of $1.2 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 a quarter. The dynamics of the current operating environment resulting from the effects of COVID-19 has introduced further volatility in our cash flow.

However, improving volumes and strong working capital fundamentals give us confidence we will continue to generate solid free cash flow. Investment in growth opportunities remains a key priority for McKesson. And during the quarter, we made $117 million of capital expenditures. We continue to focus on internal investments in areas such as technology and our strategic growth initiatives.

We returned cash to our shareholders through the payment of $74 million in dividend. We have $1.5 billion remaining on our share repurchase authorization. We continue to expect weighted shares outstanding in the range of 161 million to 163 million. We also continue to anticipate free cash flow in the range of $2.3 to $2.7 billion for fiscal 2021.

Let me transition now and talk about our outlook for the balance of fiscal 2021. We continue to believe we are well positioned in the markets we compete with a clear strategy and a differentiated set of assets and capabilities. We remain confident in our long-term prospects, which are rooted in the important role we play in the health care supply chain.

In May, we outlined two-key macro assumptions, which I am reiterating today. First, we do not assume a second wave of COVID-19, which would lead to shelter at home and economic lockdowns. And second, we do not assume any systemic customer insolvency events.

Similar to my comments in May, I'd reiterate that one certainty is that events will occur in the coming days and weeks that could cause these underlying assumptions to change from what we know today. As you think about our outlook, I'd highlight the strong relationship of our performance with two-key factors. First, the macroeconomic environment and the intersection of prescription volumes and patient behavior; and second, our ability to continue to execute our strategy with a disciplined approach to invest and position ourselves for growth in the areas of specialty, oncology and biopharma services. This remains a dynamic environment. And while the situation has undoubtedly improved, the reality remains that the virus is not completely under control, with many areas seeing increased positive cases and hospitalizations.

The impact of the pandemic is highly fluid and likely to continue evolving over the coming weeks and months. We continue to expect the trajectory of the recovery to correlate closely to the level of mobility of patients, prescription transaction volumes and the demand for health care interactions with primary care physicians, oncologists and elective procedure levels.

We continue to believe the first quarter will be the most severely impacted, and we expect to see sequential revenue and adjusted operating profit improvement over the balance of the fiscal year. However, we do not believe the recovery in our business will be linear. Based on what we have observed in the past 75 days, we believe that a full recovery may take longer than originally contemplated. However, we continue to expect growth in the second half of the year as compared to the prior year.

Let me provide a few details of our outlook. As a result of earlier recovery in volumes versus original expectations, we now anticipate consolidated revenues to increase on the high end of the previously provided range of 2% to 4% growth for fiscal 2021.

We now expect the consolidated adjusted operating profit will decline between 1% and 4% for the full year, when you exclude the results of Change Healthcare from the prior year. And this is up from our original guidance, the decline between 5% and 8%. And as I mentioned earlier, we anticipate enterprise adjusted operating profit to grow sequentially throughout fiscal 2021 and continue to expect growth in the second half of the fiscal year on a year-over-year basis.

Let me talk a little bit about the segments. Given the earlier than anticipated recovery of the Provider Solutions business in the quarter and improved outlook for fiscal 2021, we now expect U.S. Pharmaceutical and Specialty Solutions full year segment adjusted operating profit to be in the range of down 2% to up 2% compared to prior year. In the second half of our fiscal year, we continue to expect adjusted operating profit of flat to 3% growth compared to the prior year.

In Europe, our first quarter segment results were above expectations, driven by increased cost mitigation activities in response to the pandemic. As a result of this first quarter performance and modest improvement in the aggregate recovery timeline across Europe, we now expect European segment revenues to be in the range of down 3% to up 1% compared to prior year. Additionally, we now expect segment adjusted operating profit to decline between 4% and 9% for fiscal 2021. The operating environment remains challenging in many markets. Due to the earlier recovery and the flattening of the recovery curve, we now expect second half adjusted operating profit to decline between 4% and 6% in Europe.

Turning to our Medical-Surgical segment. As discussed in my opening remarks, we began to see volume improvements in the primary care business in the month of June. As a result of the pace of the recovery within primary care in the segment, and higher volumes within extended care, we are updating our outlook for the segment. We now expect fiscal 2021 segment revenue to increase between 8% and 12%, and segment adjusted operating profit in the range of down 3% to an increase of 3%. We continue to expect growth in the second half of the fiscal year compared to the prior year and now project to be between 10% and 15%.

Turning to Other. As a result of the return to more normalized volumes in the Canadian business in the back half of June, we now anticipate segment revenues to decline between 5% and 10% for fiscal 2021. Excluding the impact of Change Healthcare, we continue to expect greater than 10% growth in the second half of the fiscal year when compared to the prior year.

Within our Corporate segment for fiscal 2021, we now anticipate that opioid-related costs will approximately be $160 million. Based on higher opioid-related costs and increased investment in the business, including technology, versus our original outlook, we now anticipate corporate expenses to be in the range of $690 million to $740 million.

We have a solid balance sheet, healthy cash generation and financial flexibility, which underpins our investment-grade credit rating. These dynamics form the foundation for a balanced approach to capital deployment. Investing in growth areas aligned to our strategy and returning cash to our shareholders. Based on our solid first quarter results, our view of the macro environment and our updated outlook on transaction volumes across the business, we are raising the full year fiscal 2021 adjusted earnings per share outlook to a range of $14.70 to $15.50 per diluted share from our previous outlook of $13.95 to $14.75 per diluted share.

In closing, we're pleased with the results of our fiscal first quarter, and we're proud of how we responded to a dynamic environment, supporting our customers despite the uncertainties that were brought on by this pandemic. Our disciplined execution delivered solid results. Combined with our strong balance sheet and financial position, we're well positioned to deliver growth in the second half of the year as compared to the prior year. The external environment continues to present many unknowns, but our businesses have continued to be resilient, with strong execution and stable fundamentals.

With that, I'll turn the call over to the operator for your questions. In the interest of time, I'd ask that you limit yourself to just one question to allow others an opportunity to participate. Turn over to the operator.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And our first question will come from Eric Coldwell with Robert W. Baird.

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

Q

Thanks very much. Congrats on navigating the tough environment. The question is pretty simple. It's on PPE. I'm curious if you can give us a sense on how much PPE demand helped the growth or offset the challenges in Medical-Surgical. And then longer term, do you see opportunities in PPE that expand beyond your core customer base, other industries that might be in need of these products and whether you have an interest in addressing that as well. Thanks.

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

A

Thank you, Eric. I mean, the – it probably goes without saying the demand for PPE is up significantly, whether you're talking about core health care markets or schools or workplaces, we certainly see that increased demand for PPE. And that reflects – that does reflect in the medical group's results for the quarter.

Our priority internally has been and continues to be to make sure we support the frontline caregivers and that we get the necessary PPE to them. And quite honestly, some of these customer segments historically didn't have a lot of demand for some of the products like N95 mask, it just wasn't necessary in the way they ran their businesses, that's obviously changed.

And so we're working hard to source. Our sourcing teams are very active with various partners, manufacturers around the world really to continue to make sure we can meet the needs of those health care customers. And we would not be looking to expand into industrial or other lines until we felt confident we could meet the core needs of the health care – our health care customers today.

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

A

Eric, I guess what I would add to that. You probably noticed that in addition to the strong volumes we saw in primary care in June, PPE contributed to that, and that was part of the reason why we increased our revenue guide for the year. If you recall, our original guidance for the Medical segment was revenue to be down 3% to 8% year-over-year. We've now upped that to 8% to 12% growth and PPE was a part of that in addition to the strong primary care volumes that we saw at the back half of June.

Holly Weiss
Senior Vice President, Investor Relations, McKesson Corp.

A

Next question.

Operator: And next will be Charles Rhyee with Cowen & Company.

Charles Rhyee
Analyst, Cowen & Co. LLC

Q

Yes. Thanks for taking the question. You guys noted a strong recovery in June. Maybe you can give us a sense on how July has looked then? And has volumes remained at the June levels? Or are you continuing to see a further acceleration, particularly as we've seen more surges here in states like Texas, California and Florida, because it sounds like you're saying you're not assuming a second wave. So is it kind of the assumption that unlike the beginning of the pandemic where everything kind of shut down, you're assuming that these states largely stay open which kind of changes how volume should be affected? Thanks.

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

A

Thank you, Charles. Certainly, April was a very soft month. I think we signaled that when we talked about our guidance for the year. April and may more or less tracked to the assumptions that we had laid out as we saw the recovery progressing. That held up early part of June, and then it really accelerated, and it's pretty correlated to, if you look at the timing of when states kind of relax their restrictions on movement and local economy, markets got opened back up and people got back to the business of health care. And we saw those volumes strengthened for us really through the conclusion of our June quarter. June ended right prior to 4th of July holiday. So there's always nuances around timing of events like that.

I think as we think about going forward, you're exactly right. We are not -- we have not built this plan around a presumption of a second lockdown, so to speak. We think economies will continue to stay open. I do think if you reflect on what's happened in Texas and Florida and Arizona and what's occurring now in other states as those states start to bend their curves downward, that's where we get to this idea. I think the word we use was linear. We don't think it's going to be steady progression. I mean based on states and cities and municipalities and how the virus accelerates or decelerates, we'll see some variability. But we are not anticipating a return to shelter in place, like we saw in the March timeframe.

Holly Weiss
Senior Vice President, Investor Relations, McKesson Corp.

A

Next question.

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

Michael Cherny
Analyst, BofA Securities, Inc.

Q

Good morning and congratulations on the strong results. I want to dive in a little bit to the pharma segment. You had a comment in your release about the strength in national accounts, you talked about that going forward. Can you maybe bifurcate a little bit in terms of the pacing of recovery you're seeing, the differences you're seeing broadly between those national accounts versus some of the independent pharmacies that you've traditionally served and how those should dovetail going forward given the various different pacings of openings across the country?

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

A

Sure. I would say as a general characterization, the pacing has been pretty consistent retail national account versus independent. Meaning the macro trend of when we saw volume soften in April, start to recover in May, continue to bounce back in June. I think those trend lines are largely consistent. A national chain probably has a little less exposure, to a particular state or community that might be experiencing a better or worse, COVID progression. So obviously, there's some almost built-in risk mitigation from being a national chain.

But by and large, I think the independents have held up pretty well. We have – we stay obviously in close contact with them. We see many of, for example, our Health Marts, participating in some of the testing. And I think people reflect now more than ever, the important role of community care and pharmacists as a point of community care in the recovery. So I don't think there's anything I would draw other than that.

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

Yeah. I think it goes without saying that national accounts just based on their size, have a greater proportion of the segment. And I don't think you should take that as one part of the segment grew faster than the other, [indiscernible] (00:44:28) just given the proportion that national accounts makeup within that segment, they had a bigger impact.

Holly Weiss
Senior Vice President, Investor Relations, McKesson Corp.
A

Next question?

Operator: And next will be Steven Valiquette with Barclays.

Steven Valiquette
Analyst, Barclays Capital, Inc.
Q

Great. Thanks. Good morning. Brian and Britt, thanks for taking the question. I guess, if you go back about three months ago, there was a lot of chatter in the US prescription marketplace, about mail order, Rx, taking share from retail Rx. I guess, I'm curious, just based on reorder patterns that you might be seeing as the June quarter progressed and into July, are there any notable trends for your own book of business, just on the strength of reorders in the mail order channel versus retail channel? Thanks.

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

Thank you for the question, Steven. I mean, we obviously [ph] when (00:45:18) early in the lockdown period and payers and health plans started relaxing some of their, or changing some of their policies, there was an uptick in mail order. If you actually look at the trend lines for mail order and retail, though, after that sort of initial -- just take that initial period out, they actually are tracking pretty consistently. So we don't -- there one week, you can get a swing, one way or the other. But if you looked over a period of a couple of months, they're actually tracking, I would say, in kind of in locksteps. So I don't see anything systemic, in terms of the way the market is going to change because of this.

Holly Weiss
Senior Vice President, Investor Relations, McKesson Corp.
A

Next question.

Operator: The next will be from Eric Percher with Nephron Research.

Eric Percher
Analyst, Nephron Research LLC

Q

Thank you. A question on the specialty business, I think you mentioned 70% volumes at one point in oncology. Certainly, the volumes don't look or your U.S. Pharma volumes don't look, like you saw that type of impact. Is it safe to assume that, that was visits and that administration has remained much more stable? And then any commentary on the non-oncology would be appreciated.

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

A

Eric, let me start, and then Brian can add. Just to clarify, my comments were really related to visits. And so what we saw at the beginning of the quarter right after the pandemic is that, visits ticked down to about that 70% level. And we saw pretty steady growth throughout the quarter to roughly the 95%, at the end of the quarter that I referenced. And we also saw an increase in telemedicine visits, which I think helped the practices from an efficiency standpoint as well. So a comment, just to clarify, was really based on visits.

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

A

The [ph] only (00:47:24) thing I would add to that is, obviously, we had a lot of tremendous insight into oncology. We're in a lot of other specialties. And it's one of the, I guess, nuances to the environment we're in right now is that each specialty, just like each of our market segments has got a bit of their own recovery curve and timing just kind of dependent on what's the nature of the disease, what's the nature of the therapies, what's the interaction with physicians, what's the applicability of telehealth versus not. So we really watch this by each of the various disease states.

Holly Weiss
Senior Vice President, Investor Relations, McKesson Corp.

A

Next question.

Operator: Next will be Glen Santangelo with Guggenheim.

Glen Santangelo
Analyst, Guggenheim Securities LLC

Q

Yes, hi. Thanks for taking my questions. I just had two quick financial ones. Britt, you raised the adjusted EPS number by $0.75 at the midpoint. I just want to be clear that this doesn't include any of the gain from the insurance proceeds or the one-time benefit that sounds like it's coming in 2Q?

And then secondly, you raised operating profit and your EPS outlook, but could you maybe discuss the impact on cash flows because, obviously, we had the negative timing thing in 1Q, you maintained the free cash flow guidance for the year despite raising the operating profit, and it seems like you have no repo in the guidance. So I just want to make sure I have all those pieces clear. Thanks.

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

A

Sure, and thanks for the questions. Let me try to unpack those for you. As it relates to the guide, first, as it relates to the insurance proceeds, as I mentioned, those are GAAP only. So those are not included in our adjusted earnings. As it relates to the comments that I made around tax, I would just refer you that our full year expectation on the tax rate is still within 18% to 20%. What I was trying to do is to give a little bit more visibility into the timing that we expect to see throughout the year.

So I think -- and as you think about cash flow, it's early. It's first quarter of the year. We're trending as we had assumed or roughly as we assumed in the first quarter. Our cash flow, as I mentioned in my comments, has historically varied from quarter-to-quarter, but I think the COVID environment places additional volatility on that. And so – as we think about this throughout the rest of the year, as we get more visibility into patterns and working capital demand, we'll certainly provide updates as appropriate. But I wouldn't read anything into that. It's early for – to give a full year update on the cash flow guide.

Holly Weiss
Senior Vice President, Investor Relations, McKesson Corp.

A

Next question.

Operator: Next will be Stephen Baxter with Wolfe Research.

Stephen Baxter
Analyst, Wolfe Research LLC

Q

Hi. Good morning. Thanks for the question. I was hoping you could touch on trends within the generics market a little bit. As we entered this COVID period, there are some concerns around API and potential drug shortages. So I guess, what, if anything, did you end up seeing on that front? And then kind of in line with that, it looked to us at least the generic depletion trends moderated a bit in the quarter, is that consistent with McKesson's experience and then if so, do you have a view on what's driving that moderation and how sustainable it is? Thanks.

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

A

So I'll start, and let Britt add on if he'd like. I mean, I think that generic market has continued to perform in a way, consistent with the past several quarters. As you know, we focus more on the spread, the difference between the sell price and the acquisition price and we don't tend to comment on generic deflation too much, but I would continue to characterize that market as stable and is consistent with what we've seen over past quarters.

I think it's -- I think the disruptions to generic supply from COVID had been well-managed and quite minimal and may not even be attributable to COVID per se. We do have a dedicated and focused team that we stood up at the outset of this pandemic to work closely with suppliers, not just existing suppliers, but other suppliers around the globe to forecast and track our views of inventory and inventory availability. But I would say, thus far, through certainly our first quarter, the supply situation has been well managed.

Holly Weiss
Senior Vice President, Investor Relations, McKesson Corp.

A

Next question.

Operator: Next will be Lisa Gill with JPMorgan.

Lisa C. Gill

Analyst, JPMorgan Securities LLC

Q

Thanks very much. Good morning. I just wanted to go back to a comment, Brett, that you made around the macro economic environment. I'm just curious, what do you currently have built into your expectations? I know that there's been some concern around layoffs [indiscernible] (00:52:18) staying permanent. But yet, as we look at membership across the managed care companies coming in a little bit better than the expectations, I'm just curious, as to what your thoughts are, obviously, going into the guidance. And then as we think about that macro environment and go back to the last financial downturn, if I remember correctly, when we think about pharmaceutical utilization it was pretty inelastic, right, had a little bit of an impact, but not very material. So I just – I want to better understand what's in the guidance?

Britt J. Vitalone

Executive Vice President & Chief Financial Officer, McKesson Corp.

A

Sure. Good morning, Lisa, thanks for that question. I'll just refer you back to some comments that I made on the May call. And we track unemployment levels very closely. We track the solvency of our customers very closely, work very closely with them to make sure that they have all the resources that they need. What I said in May, would still hold. We expect that the peak unemployment levels will be in the second calendar quarter.

We still expect that to be the case. Obviously, unemployment has been stubborn for the last 18, 19 weeks, but we do believe that it will peak in this second calendar quarter. And so I think to your second question, I think you're right. I think we do believe that prescription transaction volumes will be not as affected as the overall economy will be. And that's given us the confidence to really raise our revenue guide within that segment for the full year.

Holly Weiss

Senior Vice President, Investor Relations, McKesson Corp.

A

Next question.

Operator: Next will be Ricky Goldwasser with Morgan Stanley.

Ricky R. Goldwasser

Analyst, Morgan Stanley & Co. LLC

Q

Yeah. Hi. Good morning. So distribution of COVID vaccine captured headlines last week and we've been getting questions from investors on what could the distribution infrastructure looks like. Just wondering, how do you envision distribution of COVID vaccine when available in the market? Where would it be administered? And what role would McKesson have?

Brian S. Tyler

Chief Executive Officer & Director, McKesson Corp.

A

Thank you, Ricky. It's early days, I think, to forecast, a, when the vaccine will be available, which manufacturer, it might be available from and what the best method of distribution for that vaccine will be. You're as aware as I am, there's over 100 vaccines, close to 150 in development. There's probably 10 to 20 at the front end of that funnel. We continue to work closely and are in discussions with all of those – all of the manufacturers around these vaccines.

Our company has a great capability in this area. We administer the vaccines for children's program today. We obviously have large channels in the medical business and in the pharmaceutical business that support community providers who administer these vaccines, and in over a decade ago, when our nation was dealing with H1N1, we continue – it's a proud moment in McKesson's history the role we were able to play in managing that vaccine solution.

So I think we have terrific capabilities. We're in active dialogue with everybody. Our first and foremost goal will be to do whatever we can do to help accelerate getting a vaccine to market. That's the most important thing we can do and what we're focused on right now.

Holly Weiss
Senior Vice President, Investor Relations, McKesson Corp.

A

Next question?

Operator: Next will be Robert Jones with Goldman Sachs.

Robert P. Jones
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks for the questions. I guess maybe just to follow-on to that. There seems to be a view that flu vaccines will be much higher utilized this year than in a normal year. So just curious how you're thinking about that and what's factored into guidance?

And then -- and Brian, you made a comment during the prepared remarks around lab testing, and the opportunity that McKesson is playing in just the COVID testing process. I was curious also there, if you could maybe just expand a little bit about how big that opportunity is and what's factored into the guidance? Thanks.

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

A

Sure. Thanks, Robert. So on start, I guess, just a few comments on flu. I mean, flu is a component of our Medical business. I wouldn't overemphasize the role of flu vaccine there. Every flu season tends to be its own season, depending on the severity of the strand, depending on the effectiveness of the vaccination. So we've lived through lots of different kinds of flu seasons, strong ones and weak ones. And I think our best thinking at this point is this it would be a typical or average flu season.

Now it's still quite early to make that call with any specific insight into how flu may interact with COVID and patient perception. So it's something we'll continue to monitor and watch. And then relative to the comments about lab, I mean we – by virtue of our position in the alternate care markets and supporting nursing homes and supporting physician offices, we just have great reach into the community. And so as the need for this testing moves into the community-based setting, we're well-positioned to take advantage of that.

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

A

Maybe just to build on Brian's comment. The flu vaccine itself within our Medical business is a component of pharmaceutical distribution within that segment. And it's not – the vaccine itself is not material to the segment. And as Brian mentioned, we've thought about this as more of a typical flu season that we've seen over the last several years. Now if it's a little bit greater than it has been in prior years, again, the vaccine distribution itself is not material to the segment.

Holly Weiss
Senior Vice President, Investor Relations, McKesson Corp.

A

Operator, we have time for one more question.

Operator: Certainly, that question will come from George Hill with Deutsche Bank.

George Hill
Analyst, Deutsche Bank Securities, Inc.

Q

Hey, good morning guys, and thanks for squeezing me in. I guess nobody's asked the opioid question. I was little surprised to see opioid litigation expenses up year-over-year. I guess, just do you guys feel like any progress has been made on the opioid litigation front over the last quarter? And kind of any update in that process would be helpful. Thank you.

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

A

Thanks, George. I'll take this one. And I really don't have any, kind of, material update. We do continue to be engaged in discussions with attorneys, generals and others. We do remain hopeful that broad resolution can be achieved. We think it's important that if there's a path to accelerate relief efforts for people and the communities impacted that we find a way to take that path.

You can imagine the amount of focus on COVID-19 over the past quarter, but we do continue the dialogue, we do continue to be optimistic that a broad resolution could be reached, and we do continue to prepare our defense in the event that it can't be. And that's about all I can add to that.

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

Well, thank you, everyone for your questions, and thank you for joining us on the call. Elisa, thank you for helping us facilitate this call. I want to conclude my remarks today, by just thanking all the frontline workers across the world, who are tirelessly, day in and day out working to keep us healthy and safe. And I certainly want to recognize the outstanding performance of our 80,000 employees, especially their commitment to helping their communities and to helping each other in this time of need. We wish you and your families, good health and wellness. I look forward to the day, we can be together. Thank you all.

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