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MANAGEMENT DISCUSSION SECTION

Holly Weiss

Senior Vice President-Investor Relations, Corporate FP&A, M&A Finance, McKesson Corp.

Good morning, and welcome, everyone, to McKesson's Third 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 Scott Tyler

Chief Executive Officer & Director, McKesson Corp.

Thank you, Holly, and good morning, everybody. I appreciate you joining us on our call today.

Before I get to our third quarter results, I'd like to update you on the status of discussions related to a framework proposed by a group of attorneys general for a broad resolution of opioid-related claims. In the third quarter, we made an accrual of approximately $8.1 billion, reflecting the amount we would expect to pay over a period of 18 years for opioid-related claims of governmental entities, with more than 90% intended to remediate the opioid crisis. We continue to be in ongoing advanced discussions with state attorneys general and counsel for plaintiffs; and based on the substantial progress we have made toward a settlement, we determined it was appropriate to accrue for this liability. Although we're prepared to defend ourselves vigorously, we remain hopeful that a broad resolution can be achieved, which would accelerate relief efforts for the people and communities impacted by this public health crisis.

Now let's get to the results. We're pleased to report third quarter total company revenues of $62.6 billion and an adjusted earnings per diluted share of $4.60, which is ahead of the prior year and the revised expectations we laid out in November. The third quarter was yet another example of the often unpredictable and dynamic nature of the recovery from the effects of the pandemic. While heightened demand persisted for products like COVID-19 tests and PPE, medical visits and prescription volume trends did show some signs of softness in the quarter.

Despite those macro trends, we're pleased to have grown adjusted operating profit across each of our segments, and our third quarter results reflect the important role McKesson plays in the response to the COVID-19 pandemic in the US and abroad. Our fundamentals remain strong and we continue to see success across the differentiated assets in our broad portfolio.

Today we are raising and narrowing our fiscal 2021 adjusted earnings per diluted share guidance range to $16.95 to $17.25 per diluted share. This is up from our previous range of $16 to $16.50 per diluted share. This update reflects our solid performance in the quarter and improved outlook across the businesses, including the anticipated contribution from our work distributing COVID-19 vaccines and assembling and distributing ancillary supply kits.

Before turning to the business, I do want to expand on the work being done across McKesson in support of the COVID-19 vaccination efforts in the US. In August of last year, the CDC selected McKesson to ramp up and distribute future COVID-19 vaccines in the US, expanding our 14-year partnership. The CDC exercises existing option within our Vaccines for Children contract, making McKesson the centralized distributor of COVID-19 vaccines and ancillary supplies needed to administer vaccines, similar to the role we played in the H1N1 pandemic over 10 years ago.

Our team immediately got to work. Standing up the infrastructure needed the support and initiative of this scale, we quickly established new fit-for-purpose distribution centers, separate from our normal business operations so that when vaccines became available for distribution, McKesson would be ready to execute our part. We've added four new distribution centers that are highly specialized and capable of frozen and refrigerated cold chain COVID-19 vaccine distribution. And given our work also includes the assembly and storage of ancillary supplies, several more DCs were brought online to support this additional work. In total we've added over 3.3 million square feet of dedicated space to support this initiative.

A little over a month ago, on December 18, Moderna's COVID-19 vaccine became the second COVID-19 vaccine granted emergency use authorization by the FDA. And given this vaccine is within the scope of our contract with the CDC, McKesson began distributing this vaccine within 48 hours of its authorization. Through January, McKesson has successfully distributed over 25 million doses of the COVID-19 vaccine to sites around the country. From a distribution perspective, we remain on target to meet the US Government's plans to distribute hundreds of millions of refrigerated and frozen vaccines. We are currently distributing vaccines from only two of the four DCs built for this program.

I'd like to remind you that in this operation, McKesson is operating as a third-party logistics provider on behalf of the US Government, which is similar to our role during H1N1. The US Government administers this program allocating vaccines to states, pharmacy chains, federal agencies, et cetera, and takes orders for the participating provider site. Ultimately, the US Government makes all allocation decisions and decides what product is distributed to what site and in what quantities. The orders are submitted to McKesson and when the orders are received we pick, pack and ship orders typically within one business day of receiving the order. We are using the depth and breadth of our experience to manage the safe distribution of hundreds of millions of doses of vaccines to the entire country. We believe this distribution approach is the safest and fastest way to get COVID-19 vaccines into the arms of Americans across our country.

This is a complex distribution program with several partners collaborating from end to end and McKesson takes extensive measures to maintain the safety and efficacy of the vaccine supply chain. Our goal is that every shipment be received at the administration site in a timely manner and within the specified guidelines established by the manufacturer. As I've discussed, our work as a centralized distributor is now underway. So, earnings from the COVID-19 vaccine distribution program are factored into our improved outlook for fiscal 2021.

McKesson has also been hard at work preparing and distributing the ancillary kits needed to administer all of the COVID-19 vaccines, including for the Pfizer ultra-frozen vaccine, even though Pfizer's vaccine itself is not distributed by McKesson. Each week we are producing enough kits to support 10 million to 15 million doses and to-date we have assembled enough kits to support over 250 million doses. It's our great privilege to have been selected to serve the US Government for these roles and we've been engaged with the new administration's transition team and stand ready to fulfill our commitments in the ongoing battle against COVID-19.

Now, let's get to the business. I'll summarize the third quarter and then turn it over to Britt to provide more details. Let me start with U.S. Pharmaceutical. Prescription volume trends in the third quarter were again reflective of the non-linear trajectory of the recovery. After seeing stability in the market trends in the second quarter, we saw some volume declines in our third quarter as it progressed, driven in part by a light cold and flu season versus the prior year. Despite some softness in volume trends within the quarter, we continue to see stability in brand and generic pricing. Through the third quarter and into January, branded price inflation has tracked in line with our original expectation. For generics, we continue to be disciplined in our approach to pricing in the market. On the buy side through the scale and strength of our sourcing operation with ClarusONE, we've leveraged our relationship with a diverse set of manufacturers to [ph] maintain (00:08:39) stable levels of supply at low costs for our customers throughout the pandemic. Strong pricing discipline and effective sourcing continue to allow us to earn spread in the business.

While total prescription volume trends fluctuated in the quarter, specialty volumes and particularly oncology have been more resilient throughout the pandemic. Our provider solutions and US oncology businesses have performed well year-to-date and are key areas of investment as we look to further differentiate our capabilities in oncology. In the quarter, The US Oncology Network continued to expand its reach in some local communities by welcoming two new practices, further strengthening the availability of advanced cancer care across the communities we serve. US oncology also reached a major milestone in its journey to provide high quality value-based care by enrolling its 100,000th patient in the Centers for Medicare and Medicaid Innovation Oncology Care model.

Lastly, our Health Mart franchises are expanding the role they play in the fight against the pandemic. Health Mart pharmacies have performed more than 400,000 COVID-19 test collections through a partnership with eTrueNorth and the HHS. Many of our Health Mart franchise pharmacies are also preparing to serve as COVID-19 vaccine administration sites in local communities when the CDC moves into the next phase of the rollout.

Let's transition to our International segment. Our businesses in Europe and Canada are continuing to play their part in the pandemic response; and as essential businesses, our pharmacies remain open. Through our owned and banner stores abroad, we're working with local governments to accelerate COVID-19 testing efforts. Our digital offerings like well.ca in Canada and Echo by LloydsPharmacy continue to grow quickly and expand their service offerings to meet the needs of patients. Also, as a reminder, on November 1, we completed the creation of a joint venture with Walgreens Boots Alliance, combining our German wholesale businesses. While it is still early days, we are excited about these teams coming together and the progress they are making.

Let's turn to Medical. When we gave initial guidance for fiscal 2021, our alternate site customers were facing significant headwinds with providers and surgery centers seeing sharp declines in office visits due to shelter-in-place guidelines. These dynamics were clearly reflected in our first quarter results, which were significantly down versus prior year. The pandemic continues to affect the needs of our customers in this market and how they operate today looks very different than it did nine months ago.

As our customers reopen and address COVID-19, the core business has recovered and returned to growth. With one of the largest and most tenured sales forces in the industry, our primary and extended care teams work hard every day to ensure that our customers have the products and services they need to provide patient care, whether it's COVID-19 tests, PPE or pharmaceuticals.

Investments we've made into our lab business over the last few years have given us additional expertise and reach around lab testing solutions. So, as COVID testing emerged, we have been well-positioned to expand our existing partnerships and quickly drive these products into the community provider channels.

We strategically built this business to succeed at moments like this. We are the leader in distribution to the alternate site setting and offer a broad set of products and solutions to over 250,000 customers. The broad capabilities of this business position us well to quickly take advantage of new opportunities as they emerge and as customer demand evolve. I continue to be impressed at how our Medical business has responded to the rapid change in fiscal 2021.

Turning now to Prescription Technology Solutions. We saw solid growth in the quarter, underpinned by the expansion of our brand support programs for our biopharma partners. We invest in innovation in this segment, and our results reflect positive contributions from our prior authorization solutions and newer products like Access for More Patients, also known as AMP. AMP service offering is continuing to be recognized in the market, both by our biopharma customers and the industry. AMP recently signed on a full product portfolio for a top pharmaceutical company and was recognized as one of 2020's most innovative products in the healthcare and medical category according to Best in the Biz Awards, an honor voted on by top reporters and editors in North America.

Taking a step back to reflect, it was over two years ago that we redefined our strategy, identifying the areas of oncology and biopharma services as key differentiators and areas of investment. We also set out to make the business simpler and more efficient, kicking off a comprehensive review of the company's operating and cost structure. Since then, we have been methodical in our actions as we work to build a connected ecosystem of assets across the enterprise, with the ultimate goal of creating innovative solutions that improve patient care delivery and drive incremental profit growth for the company.

Through internal investments in M&A, we've built a powerful and scaled specialty business with deep oncology expertise. Today, we are the number one distributor in community oncology. And The US Oncology Network is the nation's largest network of its kind, with 1,400 independent physicians.

Most recently, we launched Ontada, an internally developed technology and insights business dedicated to transforming the fight against cancer. Ontada builds off our existing capabilities and combines real-world data and research with the leading suite of technologies to help deliver innovative solutions that improve patient outcomes. Shortly after the launch of Ontada, Amgen and McKesson announced a strategic agreement to advance cancer care and improve outcomes by accelerating the development and access to life-changing medicine.

Last quarter, I talked about the evolution of our Prescription Technology Solutions assets into the exciting business it is today. This business is a powerful biopharma commercial services business that enables over $5 billion in annual prescription savings for patients through innovation and next-generation patient access and adherence solutions. The strategic investments I've discussed have been powered in part by the successful efforts to streamline the business. We've centralized many back office functions in North America and Europe and have become smarter as an organization about how we spend and invest.

We also continue to evaluate the portfolio and position the business for success. Last year, we successfully exited our position in Change Healthcare and most recently we created the joint venture in Germany with WBA. Further, we re-segmented the business to better align us around our strategies and increased focus and speed throughout the organization. But underpinning everything we do is our continued focus on growing the core business where fundamentals continue to be stable and execution has improved. Success in the core enables strong cash flow generation, which we can use to reinvest back into the business and return to our shareholders.

While the pandemic has brought an unprecedented level of uncertainty, it has not paused our strategic priorities, and we will continue to invest to differentiate and innovate our service offerings to our customers. This has served us well throughout the pandemic as we responded to near-term demands from our customers, but it also positions the business to succeed in the long term.

As we look forward to our fiscal 2022, I'd like to walk through some of the things we're thinking about. First and foremost, the COVID-19 pandemic continues to present many unknowns. The trajectory of the virus can change quickly, accelerating in some communities and decelerating in others. The recovery from the pandemic is likely to continue to be non-linear into fiscal 2022. But McKesson will continue to be part of the recovery, serving our customers and partners every step of the way.

Secondly, our work distributing COVID-19 vaccines and ancillary supplies will ultimately be influenced by the number of vaccines that come to market, the percentage of the population that chooses to get vaccinated, the effectiveness of each vaccine and the duration of the centralized distribution model. These same dynamics are likely to have an impact on the levels of demand we see for products like COVID tests and PPE in fiscal 2022.

And as I mentioned earlier, we have a new administration in Washington and our teams have been working closely with the new administration's transition team and now emerging team to ensure that the proposed reforms support solutions to improve cost, quality and access.

I'll reiterate that we continue to see stability in the core and strength in the underlying fundamentals of the business heading into fiscal 2022. We will continue to make strategic investments in the areas of oncology and biopharma services.

So, in summary, through nine months, each quarter of the current fiscal year has proven to be different one to the next, and the results we're sharing today reflect McKesson's ability to rise to the challenge and meet the evolving demands of our customers and partners. The pandemic has not put our strategy on hold, but HAS challenged us to continue to think differently and react more quickly against the dynamic macroeconomic backdrop.

Before I close, I also want to touch on our commitment to our local and global communities. We're dedicated to doing our part to eliminate bias and promote equality, and we are proud to have been recently recognized as one of the Best Places to Work for LGBTQ Equality by the Human Rights Campaign for the eighth consecutive year. And we recently recruited Dr. Kelvin Baggett to the newly created role of Chief Impact Officer reporting to me where he will be responsible for advancing our strategy and execution related to diversity, equity and inclusion, ESG and McKesson's overall social impact. We're excited to have Kelvin on the team.

In the end, it all comes back to our people. The passion and the focus of our 80,000 plus employees are what makes McKesson special. And without them, the work we are doing to combat the COVID-19 pandemic would not be possible. My greatest thanks to them all.

Thank you for your time. And with that, I'll turn it over to Britt.

Britt J. Vitalone

Executive Vice President & Chief Financial Officer, McKesson Corp.

Well, thank you, Brian, and good morning, everyone. I'm pleased to speak to you about another solid quarter for McKesson. Against a dynamic and challenging macroeconomic backdrop, we continued to respond to the evolving demand brought on by the pandemic, leveraging the breadth and scale of our distribution and services capabilities.

The underlying core business continues to be fundamentally sound. And we've built solid revenue, operating profit and cash flow momentum over the past several quarters, which continued in the December quarter. Our solid broad-based third quarter results reflect this momentum.

Our demonstrated delivery of consistent and stable organic growth, combined with the execution of the vaccine and kitting programs with the US Government, are enabling us to further increase fiscal year 2021 guidance. As we mentioned during our first and second quarter earnings calls, we expected the non-linear recovery from the effects of the pandemic to persist for the remainder of our fiscal year and likely into our fiscal 2022. We saw this uneven recovery play out in Q3.

COVID-19 cases and hospitalizations reached their highest levels. This led to some softening in recovery trends during the quarter. Prescription volumes were softer than the prior quarter. And primary care patient visits and elective procedures continued to remain below pre-COVID levels. Despite these challenges, in Q3, all segments delivered year-over-year adjusted operating profit growth. And year-to-date, adjusted earnings per diluted share grew 14% compared to the prior year.

In the third quarter, we recognized a benefit from our work with the US Government for assembling and distributing ancillary supply kits needed to administer COVID-19 vaccine. And while not material to the quarter, we also began distributing the Moderna COVID-19 vaccine in late December.

Volumes for COVID-related testing and personal protective equipment, or PPE, continued to remain high in our Medical segment while the impacts of social distancing measures have resulted in a soft cold and flu season. According to IQVIA, the US adult flu diagnoses were down approximately 10% compared to the prior year, which resulted in lower generic flu scripts. And similar to last quarter, in the third quarter, we recognized unplanned gains on equity investments within our McKesson Ventures portfolio.

Now on to our third quarter results which can be found in the Investors section of our website. And let me start by pointing out two items that impacted our GAAP-only results in the quarter. Based on the substantial progress toward a settlement of our ongoing opioid-related claims, it is concluded that a broad settlement of opioid claims by governmental entities is now probable. It can be reasonably estimated. And as a result, we reported a pre-tax charge of $8.1 billion, $6.7 billion after-tax. Secondly, we recorded a pre-tax long-lived asset impairment charge of $115 million primarily related to McKesson's retail pharmacy businesses in Canada and Europe.

Let's move now to a discussion of our adjusted earnings results for the third quarter, starting with our consolidated results on slide 4. Consolidated revenues of $62.6 billion were up 6% compared to the prior year, primarily due to market growth, higher specialty volumes in our U.S. Pharmaceutical segment and COVID-related volumes in our Medical business, including COVID tests and PPE. This was partially offset by branded to generic conversions and the contribution of our German wholesale business to a joint venture with Walgreens Boots Alliance.

Adjusted gross profit increased 7% year-over-year driven by growth in the Medical-Surgical segment, which once again benefited from the contribution of near-term opportunities, including distribution of COVID-19 tests and our work assembling ancillary supply kit for COVID-19 vaccine.

Adjusted operating expenses increased 2% year-over-year, led by higher operating expenses to support growth in strategic investments across the business, partially offset by the contribution of our German wholesale business to the joint venture with Walgreens Boots Alliance and a reduction in operating expenses due to the impact of COVID-19.

Adjusted operating profit was $1.1 billion for the quarter, an increase of 11% compared to the prior year. When excluding the $51 million contributed by Change Healthcare in the prior year, which was previously recorded in Other, adjusted operating profit grew 18%, exceeding our expectations.

Interest expense was $55 million in the quarter, a decline of 14% compared to the prior year, which was driven by lower commercial paper balances and the retirement of approximately $1 billion of debt. We now expect fiscal 2021 interest expense in the range of $210 million to $230 million. Our adjusted tax rate was 21.6% for the quarter and we continue to assume a full year adjusted tax rate of approximately 18% to 20%.

Third quarter adjusted earnings per diluted share was $4.60, which was up 21% in the quarter compared to the prior year, driven by a lower share count and growth in the Medical-Surgical Solutions segment. These items were partially offset by a higher tax rate and the lapping of the prior year contribution from the company's investment in Change Healthcare. Third quarter adjusted earnings per diluted share also includes net pre-tax gains of approximately $30 million or $0.14 per diluted share, which is associated with McKesson Ventures' equity investment.

Wrapping up our consolidated results, third quarter diluted weighted average shares were 161 million, a decrease of 10% year-over-year, driven by the successful tax-free exit of our investment in Change Healthcare at the end of fiscal 2020, which lowered our shares outstanding by approximately [ph] 15-point million (00:25:33) shares and in addition to share repurchase activity in the current and prior year. We now expect diluted weighted shares outstanding for fiscal 2021 to be approximately 162 million.

And next I'll review our third quarter segment results, which can be found on slides 5 through 9, starting with U.S. Pharmaceutical, where revenues were $49.5 billion, up 7%, driven by market growth and higher specialty volumes, partially offset by branded to generic conversions. Adjusted operating profit increased 2% to $656 million, driven by growth in specialty, partially offset by higher operating expenses in support of our strategic growth initiatives, including Ontada. These investments accounted for an approximate 2% headwind to year-over-year segment growth. Our segment results were also negatively impacted by the light cold and flu season.

Given the timing of FDA approval of Moderna's COVID-19 vaccine in December, earnings related to the vaccines distribution were immaterial in the third quarter. I'll provide more detail on our outlook related to COVID-19 vaccine distribution later in my remarks.

And for the third quarter, branded price activity trended in line with our expectations. Additionally, based on manufacturer price actions taken in January, we are maintaining our full year fiscal 2021 assumption of branded price increases to be in the mid-single-digit percent range.

Next, International. Revenues were $9.3 billion, a decrease of 6% year-over-year. On an FX-adjusted basis, revenues decreased 10%, primarily driven by the contribution of our German wholesale business to the newly formed joint venture with Walgreens Boots Alliance, which was effective as of November 1, 2020.

The segment also had lower volumes in the Canadian pharmaceutical distribution business, largely due to the exit of an unprofitable customer at the beginning of the fiscal year. Excluding the impact from the divestiture of our

German wholesale business, segment revenue increased 4% year-over-year and was flat on an FX-adjusted basis.

Adjusted operating profit increased 9% year-over-year to $158 million. On an FX-adjusted basis, adjusted operating profit increased 3% to $150 million, primarily driven by two additional sell days in the European business compared to the prior year.

Now moving on to Medical-Surgical Solutions. Our Medical-Surgical segment continues to be impacted by the COVID-19 pandemic. We experienced strong demand for COVID-19 tests throughout the quarter and often unpredictable and uneven levels of demand related to PPE. We're also pleased to have delivered solid growth in the core business, despite patient mobility trailing pre-COVID levels. Our customers have been resilient throughout the pandemic. And we're supporting providers and their patients with the breadth of our primary and extended care capabilities, such as lab solutions, private brands and patient home delivery.

Similar to the U.S. Pharmaceutical segment, Q3 results were also impacted by the light cold and flu season, and we expect this to continue throughout the remainder of our fiscal year. Revenues were $3.1 billion in the quarter, up 43%, primarily driven by demand for COVID-19 tests in the primary and extended care businesses.

As we discussed on the second quarter call, our Medical-Surgical business built supply quickly to meet demands from our customers for COVID-19 tests and elevated levels of demand for PPE. This elevated and uneven demand is reflected again in our third quarter results, as COVID-19 cases and hospitalizations reached their highest levels, impacting patient mobility and elective procedures, which were down 15% to 20% at times in the quarter according to IQVIA.

Throughout the pandemic, and as always, our focus has been meeting the needs of our customers and their patients, providing access to the supplies including PPE that they need to continue to treat patients. Early on, we procured these products in a highly volatile market, with unpredictable supply and demand levels due to the impacts of the pandemic. Due to these dynamics, some PPE and related items experienced inventory charges. In our third quarter, we recorded $35 million of charges related to these products.

For the quarter, adjusted operating profit increased 52% to $279 million, driven by demand for COVID-19 tests and the contribution from the kitting and distribution of ancillary supplies for COVID-19 vaccines, partially offset by the inventory charges on certain PPE-related products. Excluding the impact of incremental PPE and COVID-19 tests, adjusted operating profit in the segment is up 29% year-over-year in the third quarter.

Next, Prescription Technology Solutions. Revenues were $777 million, an increase of 9%, driven by new and higher volumes of existing brand support programs. Adjusted operating profit increased 27% to $131 million, driven by organic growth in the business. While we continue to invest in the expansion of our technology offerings for our biopharma customers, we are starting to recognize the benefits of these investments, such as our investment in AMP, which Brian discussed earlier.

Moving on to corporate, McKesson recorded $158 million in adjusted corporate expenses in the quarter, a decrease of 6% year-over-year, driven by gains of approximately $30 million on equity investments within our McKesson Ventures portfolio. This was partially offset by an increase in employee expenses as well as lower interest income. This quarter, we had fair value adjustments related to several of our portfolio companies within McKesson Ventures.

As I mentioned on our second quarter call, it's difficult to predict when gains or losses on our venture portfolio companies may occur and, therefore, our practice has been and will continue to be not include ventures portfolio impacts in our guidance. And finally, we reported opioid-related litigation expenses of $34 million in the quarter and for fiscal 2021 we anticipate that opioid-related costs will be approximately $160 million.

Turning now to cash which can be found on slide 11. We ended the quarter with a cash balance of $3.6 billion. And for the first nine months of the fiscal year, we generated free cash flow of $745 million. Our working capital metrics and resulting free cash flow vary from quarter-to-quarter, impacted by timing, including the day of the week that marks the close of a quarter.

In fiscal 2021, our cash flow dynamics have also been impacted by changing levels of customer demand. In Q3, we again saw higher levels of inventory, resulting primarily from increased quantities of COVID tests and PPE. As we work to meet the evolving needs of our customers and ramp up our work with the U.S. Government, we may experience additional working capital volatility.

Year-to-date, we made $427 million of capital expenditures, includes internal investments to support our COVID-19 vaccine and kitting efforts and technology, data and analytics investments to support our strategic initiatives of oncology and biopharma services. For the first nine months of the fiscal year, we returned $709 million of cash to our shareholders through $500 million of share repurchases and the payment of $209 million in dividends.

Let me now turn to our outlook for the balance of fiscal 2021. The COVID-19 virus and effects of the pandemic continue to impact our communities in different ways. The sharp declines across our businesses in the first quarter, followed by a more positive trajectory through our second quarter indicated signs of stabilization. However, the third quarter was another good example of the non-linear shape of the recovery that we've been talking about all year, as increased case counts and hospitalizations led to a softening of the trends in the third quarter.

Two important assumptions have underpinned our guidance throughout fiscal 2021 and we're reiterating those today. First, we do not assume a new wave of COVID-19 which would lead to shelter-at-home and economic lockdown, which would preclude patient mobility and consumption of health care services. And second, we do not assume any systemic customer insolvency event.

I'd also like to reiterate that we believe that the recovery will take longer than initially anticipated and will not be in a straight line as the impacts of the pandemic will persist into our fiscal 2022. Further, we do expect that there will continue to be significant volatility in the demand and ultimate volume levels for COVID-19 test kits and PPE. Through our third quarter, we've seen elevated levels of these product categories. However, we do expect these dynamic volumes will moderate.

Also, given there is now an approved COVID-19 vaccine that is within the scope of McKesson's contract, our guidance now takes into account earnings related to COVID-19 vaccine distribution, in accordance with the distribution schedule provided to McKesson by the CDC.

As a result of our solid third quarter performance and outlook for the remainder of the year, which now includes estimated earnings tied to the distribution of COVID-19 vaccines, we are increasing and narrowing our adjusted earnings guidance range to $16.95 to $17.25 from our previous range of $16 to $16.50. We continue to anticipate consolidated revenues to increase between 2% to 4% for fiscal 2021. And we now expect the consolidated adjusted operating profit will grow 7% to 9% for the full year, excluding the results of Change Healthcare from the prior year, which is up from our prior guidance of an increase between 2% and 6%.

Now moving to the segments. In our U.S. Pharmaceutical segment, we continue to expect revenue growth of 3% to 6% and now expect adjusted operating profit to grow 2% to 5% compared to the prior year. We've included in our guidance a net benefit to fiscal 2021 adjusted earnings per diluted share of approximately $0.25 to $0.35 related to our role as the centralized distributor for COVID-19 vaccine. This range is dependent on a number of factors, which includes final vaccine distribution volumes and product mix as directed by the CDC.

I would also remind you of our continued commitment to invest in and extend our leading position in oncology, where we are making incremental investments in the second half of fiscal 2021, which equates to a headwind of approximately $0.05 to $0.10 of adjusted EPS for fiscal 2021. In our International segment, we now expect a revenue decline of 5% to 9% year-over-year and segment adjusted operating profit to be 1% to 3% growth.

Let me now turn to Medical-Surgical. The shifting pattern and recovery path of COVID-19 remains a pivotable variable within the Medical-Surgical supply market. As I referenced earlier, throughout the third quarter, we continued to see elevated levels of demand for COVID-19 test kits and PPE. We expect to see shift in volumes, which we anticipate will moderate. We expect these sales to be a near-term opportunity in the segment, and elevated levels of demand are factored into our guidance for the remainder of our fiscal year.

During the quarter, we expanded our contract with HHS for the assembly and storage of COVID-19 ancillary supply kit and also contracted with Pfizer to distribute ancillary kits directed to administration sites on their behalf. Due to this expanded scope, we now expect a benefit of approximately $0.20 to $0.30 in FY 2021 related to the kitting and distribution of ancillary supplies for the COVID-19 vaccine. Therefore, we now expect fiscal 2021 Medical-Surgical segment revenue to increase between 27% and 32%. And as a result of our improved third quarter performance and outlook, including the increase in our expected contribution from the kitting and distribution of ancillary vaccine supply, we now expect adjusted operating profit will grow in the range of 29% to 37%.

In our Prescription Technology Solutions segment, we expect revenue to grow 5% to 8% and now expect adjusted operating profit to be approximately flat to the prior year. And finally, we now expect corporate expenses in the range of $645 million to $685 million.

Let me wrap up our outlook with capital deployment. We continue to expect free cash flow of approximately $2.3 billion to $2.7 billion. As a reminder, we historically have generated the majority of our cash in the fourth quarter of our fiscal year. This strong cash flow generation provides the financial flexibility to execute a balanced capital allocation approach, investing in our strategies of oncology and biopharma services, positioning our business for long-term growth, while remaining committed to return capital to shareholders through our dividend and share repurchases. Our investment-grade credit rating remains a priority and underpins our financial flexibility.

In Q3, we utilized a portion of our free cash flow to retire approximately $1 billion of debt, and we issued a $500 million bond at attractive market rate. These actions, which were in line with our stated intent to modestly delever, further strengthened our balance sheet and our financial position.

In closing, we're pleased with the results of our fiscal third quarter and we feel confident in our updated outlook for the remainder of the fiscal year. I'm proud of our focus and execution across the business despite a challenging macroeconomic backdrop. Investing in the strategies we've outlined remains a priority, as we drive further differentiation in our positions in oncology and biopharma services, as evidenced by our continued investment in Ontada. As a proud partner of the US Government in the COVID-19 vaccine effort, we look forward to continuing our role in the pandemic response, working to get vaccines and ancillary supplies into the communities that need them.

And with that, Holly, let me turn the call back over to you for Q&A.

Holly Weiss
Senior Vice President-Investor Relations, Corporate FP&A, M&A Finance, McKesson Corp.

Thanks, Britt. We will now take questions. In the interest of time, I ask that you limit yourself to just one question to allow others an opportunity to participate. Operator, please go ahead.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question will come from the line of Michael Cherny with Bank of America. Your line is open.

Michael Cherny Q
Analyst, BofA Securities, Inc.

Good morning. Thanks for all the color and congratulations on the strong results. I want to dive in a little, if I can, to the pharma segment profit. Given the moving pieces you had in the investments in that segments, also with obviously the offset of the COVID vaccine, can you just give us in terms of how you think about the implications for 4Q growth and also with all the market dynamics in place, how the trajectory should progress on the core pharma side and packing out the puts and takes in terms of directionally or conceptually on the volume side versus some of the strategic investments versus the COVID benefits that you'll be seeing in that segment?

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

Sure. Let me start and Britt can add any color. I mean, we're very pleased with the results from our core Pharmaceutical business. I think we see that kind of step back from COVID impacts, we'd say market fundamentals are consistent with where we thought they would be in the beginning of the year, brand price inflation in line with the dynamics that we see in the generics marketplace, both in terms of our go-to-market strategies and our sourcing capabilities, we're pleased to see where they're at.

I mean, we're continuing to invest in this segment. And that investment particularly in the area of oncology comes at the expense of a little bit of what could be operating profit growth, but we think that that's very important investment to make for the long-term positioning and the long-term growth of the segment. So I think, in general, everybody recognizes that cold and cough and flu season was a little bit lighter than what we would historically have seen, probably the result of the social responsibility, social distancing, mask wearing measures. But overall, we're very pleased with the progress of this segment.

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

Yeah. Mike, maybe what I would just add is I think part of the trends that we talked about the softening trends in Q3 really I think as we go into Q4, a lot of that will depend on how the pandemic continue to persist, but despite that, we continue to grow in the quarter. So, our business, despite the kind of lumpiness in the overall environment, continues to grow and we feel confident in that growth. As Brian mentioned, we continue to invest.

And as I talked about, we invested about 2% of headwind year-over-year in Ontada. So I think as this continues to persist, as our vaccine distribution begins to take hold, we feel comfortable that the business is stable and is showing good – the fundamentals of it are strong and the growth is still there. And again, that allows us to continue to make investments for further growth going forward.

Holly Weiss
Senior Vice President-Investor Relations, Corporate FP&A, M&A Finance, McKesson Corp.

A

Operator, next question, please?

Operator: And the next will be Lisa Gill with JPMorgan.

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Q

Thanks very much. Good morning. So, Britt, I know I asked this a couple of weeks ago at my conference, and that's around the actual profitability per dose on the vaccine. So now that that you've given us some numbers, you talked about 25 million doses being on target, not a lot of impact in the third quarter. You talked about the $0.25 to $0.35. How do I think about that on a per dose basis? Number one.

And then number two, there's been some news articles talking about your two chief competitors saying, hey, we'll help out with the vaccine distribution as well. What would that potentially do as far as the amount of volume that McKesson would potentially get given your current contract?

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

A

Good morning, Lisa. Thank you for that question. Let me start and I think Brian will probably want to tackle on some of your later questions. Just to clarify. What Brian talked about in his remarks was 25 million doses through January. And as I talked about, the amount that was in our quarter was immaterial to our results. We don't get into a per dose conversation. What we have guided here is based on the distribution volumes that we've been provided by the CDC and we expect that that will deliver $0.25 to $0.35 of contribution in our fourth quarter.

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

A

Yeah, let me – and to the second point, Lisa, it's like a lot of people have offered their help and support of the vaccine distribution program and we appreciate everyone's desire to help facilitate the nation getting itself vaccinated. In our view, we think the centralized distribution model that we have is the safest and the fastest way to get these COVID vaccines into the arms of people. We have built capacity to ramp up to provide hundreds of millions of doses. And we think it's the fastest, safest way. And by that, I mean it's the least time from the time an order is delivered to that vaccine arriving at a provider site. It's the least handoffs and handling and chances for temperature excursions or lost product or damaged product. So, in essence, it's going to allow us to get the maximum amount of doses out of what is produced and available from the manufacturers in the fastest time.

Now, to the extent we can find ways to be faster, we're open for any idea. Make no mistake. Our goal is to get this product to into patients' arms as quickly as we can so that we can get this country vaccinated and back to a more normal environment.

Holly Weiss
Senior Vice President-Investor Relations, Corporate FP&A, M&A Finance, McKesson Corp.

A

Operator, next question?

Operator: And next will be Eric Coldwell from Baird.

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

Q

Thanks very much and good morning. And sorry, toggling several calls this morning. I want to just follow up on one thing here quickly. If you addressed it, I apologize. I know you've talked about the 25 million doses mostly in the month of January so far. I guess, a couple of questions around that. First off, are you able to provide your expectations for total doses in fiscal 4Q specifically, so the next two months, how much that might ramp.

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

A

The guidance we provided ties to the schedule we have been provided by the CDC. And just like every other major customer we have, we don't comment on their plans and business strategies. So, we're not able to talk about that, but the guidance we provided ties to the schedule we've been provided by the CDC.

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

Q

Okay. Fair enough. And then just my follow-up on that was the kitting opportunity. Obviously, you've assembled a tremendous number of kits to-date. You're making 10 to 15 million a month or a week. I'm just curious, does the kitting opportunity extend into fiscal 2022. Are you so advanced on what you've assembled to-date that that opportunity really ends in fiscal 2021 even if the vaccines obviously extend into fiscal 2022?

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

A

Yeah. Eric, thank you for the question. Obviously, as we think about the kitting opportunity, we produced kits in advance of the vaccine. So, we talked about that on our Q2 call. I think it's a little early to tell how far this will actually play out. We would expect that some kitting would continue on beyond our fiscal year. But it's hard to say at this point how to value that. So, we feel good about increasing the guidance range for the kits that we expect to produce this year. I think that you could expect to see some kitting into next year. I guess, it will all really depend on the distribution schedule that we get from the CDC and what the volumes are this year.

Holly Weiss
Senior Vice President-Investor Relations, Corporate FP&A, M&A Finance, McKesson Corp.

A

Operator, next question?

Operator: And next will be Robert Jones with Goldman Sachs.

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

Q

Great. Thanks for the question. I guess, maybe just to shift gears over to Med-Surg, EBIT there was particularly strong in the quarter. And, Britt, I know you shared what the increased contribution you're viewing from kitting and other ancillary COVID-related supplies. But I am just wondering even taking that out, it was a particularly strong result, just given where that business has been and I know utilization hasn't exactly been even or strong in this environment. So I was hoping maybe you could just talk a little bit about what's driving the growth kind of ex the vaccine kitting related items that you quantified.

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

A

Yeah. Good morning. Thank you for that question. You're right, our core business did continue to be very solid into the quarter. And I tried to call out a little bit for you in my remarks what our growth was excluding COVID tests and PPE. So that gives you some sense that we did continue to see solid momentum into our quarter.

I talked about a few of the items and certainly Brian can elaborate on as well, but if you think about our business, it is across all settings of alternate site. As we've talked about in prior calls, our product breath is very large, private brand, lab solutions, certainly the depth of capabilities that we have in extended care, patient home delivery. It's a very broad set of solutions, capabilities and customer set that we address, and we've seen that really continue to grow in a very stable way over the last several quarters now.

Holly Weiss
Senior Vice President-Investor Relations, Corporate FP&A, M&A Finance, McKesson Corp.

A

Operator, next question?

Operator: And next will be Charles Rhyee with Cowen.

Charles Rhyee
Analyst, Cowen & Co. LLC

Q

Yeah. Good morning. Thanks for taking the question. Just two quick ones. Britt, maybe just to clarify. You talked about the $0.20 to $0.30 from kitting. I think last call you talked about $0.15 to $0.20. So, is this an incremental $0.20 to $0.30 or is it really – are we talking about just kind of a bump of $0.05 to $0.10? And then secondly, in the international drug retail business, you obviously took an impairment charge here. Was there any benefit? I think one of your peers talked about receiving some funding from NHS. Just wanted to see if that was something that you guys were also benefiting from. Thanks.

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

A

Yeah. Good morning. Thanks for the question. Let me take the first one quickly. The $0.20 to $0.30 is not incremental, it's $0.20 to $0.30 from $0.15 to $0.20. So, we did increase it from the last by that $0.05 to $0.10. In terms of the International question, the NHS funding that you referenced here was fairly immaterial to our quarter.

Holly Weiss
Senior Vice President-Investor Relations, Corporate FP&A, M&A Finance, McKesson Corp.

A

Operator, next question?

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

Eric Percher
Analyst, Nephron Research LLC

Q

Thank you. So, in Medical, I think a lot of questions on kitting, vaccine. Am I wrong to expect that this is really testing-driven strength? And we look at the testing numbers, they seem to have doubled or tripled from quarter to quarter to quarter. So, is that really the primary driver? And is the supply there continuing to expand in ways that will enable you to continue facilitating that?

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

A

Eric, thank you for the question. I would say it's really both things. I mean, I think the PPE demand has remained elevated and strong. That's certainly contributing. And there's no question that as COVID test kits emerged on the scene – remember, when we provided our guide at the beginning of this year, there wasn't such a thing as a COVID test.

So, as the scientific community, the lab community began to develop these tests, whether molecular, antigen, antibody, because of our existing business in the lab, we were really well-positioned to help get those to market quickly and swiftly. And we have certainly benefited from the strong demand for COVID test kits.

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

A

And Eric, maybe I'll just add on. I did try to call out in my comments here that, while this has been elevated and we've seen sort of an uneven supply and demand throughout the year, we do expect that this will moderate and we expect the elevated demands to remain through our fiscal year, but we do expect that at some point in FY 2022 these elevated levels of demand will moderate.

Holly Weiss
Senior Vice President-Investor Relations, Corporate FP&A, M&A Finance, McKesson Corp.

A

Operator, next question?

Operator: And next will be Jailendra Singh with Credit Suisse.

Jailendra Singh
Analyst, Credit Suisse Securities (USA) LLC

Q

Yes. Thank you. A quick clarification on vaccine. Does the vaccine EPS contribution take into account additional vaccines receiving approval for use in the US? And then my main question, I want to better understand the $100 million increase to the company's CapEx guidance. Is that all related to building out more infrastructure for COVID vaccine distribution beyond fiscal 2021? Any color there will be helpful.

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

A

Yeah. I'll just start with the guide for the vaccine. It is tied to the schedule that the CDC has provided us, which would be largely consistent with what you read in the public statements.

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

A

And I'll take the CapEx one. We did increase our guide on CapEx. Part of that is to support the vaccine and kitting programs. But a larger part of that is really continuing to invest in our strategies, technology, data and analytics to support those strategies. So I would say that a portion of that is to support the infrastructure, but a larger portion of that is really to support ongoing growth initiatives.

Holly Weiss
Senior Vice President-Investor Relations, Corporate FP&A, M&A Finance, McKesson Corp.

A

Operator, next question?

Operator: And next will be Glen Santangelo with Guggenheim Securities.

Glen Santangelo
Analyst, Guggenheim Securities LLC

Q

Yes. Thanks for taking my question. Hey, Brian, I appreciate there's probably not much you can say with respect to the opioid settlement at this point. But if we assume for a second that it does come to fruition, as you outlined, I wanted to ask about the potential impact on the future capital deployment algorithm. And to that, if we look at the after-tax settlement over 18 years, maybe netting that against some of the legal costs that go away, it looks like it could consume roughly 10% to 15% of your free cash flow. And so I'm trying to reconcile the future capital deployment versus maintaining the investment-grade rating on the balance sheet. Thanks.

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

A

Thanks, Glen. Well, you mentioned a couple of things that I'll come back to you in my answer. One is we are very focused on maintaining our investment-grade credit rating. We think we have a business that generates good cash flow. We have a strong balance sheet. We've had time to contemplate this. So I think, philosophically, our approach to capital deployment will not change. It will be a balance. We look to make internal investments that we think support growth in the business. We look to make growth investments in M&A where we can find targets that are aligned to our strategy and offer a financial return that makes sense vis-à-vis other ways we can deploy capital, like buying back shares or paying a dividend. So I don't think our philosophy changes at all. And I think we feel very comfortable that we have a strong balance sheet.

Holly Weiss
Senior Vice President-Investor Relations, Corporate FP&A, M&A Finance, McKesson Corp.

A

Operator, next question?

Operator: And next will be Ricky Goldwasser with Morgan Stanley.

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

Q

Yeah. Hi. Good morning. So, taking everything that you said on the vaccine, and I understand that you're basing it on the guidelines. The CDC guidelines are for about $100 million. So just wanted to confirm that that's what we should think about as we think about what's included in your guidance. But if we take that and we extrapolate sort of what you are guiding for the fourth quarter, we're getting to sort of an average benefit of about [ph] $1 (00:58:22) in 2022. So while I know that it's early to talk about 2022, [ph] you usually (00:58:28) guide in May, but maybe you can – but clearly, vaccine is going to be a nice tailwind. So, maybe you can just offer us some color on what tailwinds and headwinds should we just be considering as we think about 2022?

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

A

Well, let me talk about your opening comments on the vaccine itself and then maybe Britt can give us a few headwinds and tailwinds. First, just to reiterate, our guidance is based on the schedule that the CDC has provided to McKesson. We've been working to that schedule from day one, and that is what we base our forward guide on, and we can't really comment on that. So I just want to make that clear. And then, Britt, I don't know if you want to start down our list of puts and takes.

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

A

Yeah. Thank you for the question, Ricky. I mean, I'd really start with what I think are some strengths and some tailwinds in the business, and we've talked about these really over the last several quarters now. We've had good momentum for several quarters now where we're seeing organic growth, and Q3 is a good example of that where each of our operating segments grew over the prior year. We would expect that the fundamentals of our business will continue to be solid and sound. And we're starting to see some benefits from the investments that we're making. Brian talked about AMP. And clearly, we've talked about the investments we're making in Ontada.

So, the strategies and the investments in oncology and biopharma services, I would expect, will continue to be strengths of ours. Obviously, the breadth of our Medical business, as we talked about earlier, the breadth of our customers, the breadth of services and capabilities across private brand and lab will continue to be strong for us. So I think, as you look across our operating segments, we have a lot of good momentum and strength. We have a very strong balance sheet. As Brian just mentioned, we've seen consistent cash flow.

From a headwinds perspective, I think it will really be how long does the pandemic persist and the unevenness and unpredictability of that. I think that will be the thing that we will be challenged with. But as you've seen from our results this year, we've been able to manage through that quite well and take on some near-term opportunities at the same time.

Holly Weiss
Senior Vice President-Investor Relations, Corporate FP&A, M&A Finance, McKesson Corp.

A

Operator, we have time for one more question, please.

Operator: Certainly. That question comes from Steven Valiquette with Barclays.

Steve J. Valiquette
Analyst, Barclays Capital, Inc.

Q

When we think about the $0.25 to $0.35 EPS related to COVID vaccine distribution, the additional $0.20 to $0.30 from the kits and supplies, is the 100% of this combined EPS being derived in the US? Just want to confirm that. Can you remind us about the potential for McKesson to capture international economics on either the COVID vaccines or kits in Canada or Europe and where that stands either for the remainder of fiscal 2021 or maybe a greater opportunity in your fiscal 2022? Thanks.

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

A

I'll start. Great question. Let me just clarify, for the kitting component of this, the $0.20 to $0.30 is not incremental to last quarter. It's $0.20 to $0.30 from $0.15 to $0.20. What we've talked about here both for the vaccine contribution and the kitting and supply contribution are US. contributions. And I'll let Brian maybe talk a little bit about our International.

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

A

Yeah. Look, our international countries and companies are engaged with local governments either through our distribution capabilities, our retail pharmacy capabilities to help the response of those countries to the pandemic. They I would say as a general characterization are probably from a timeline trailing the US a little bit, but we are heavily involved in those discussions, but nothing that would be material to our financials at this point.

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

Okay. Thank you, everyone, for your questions, and thank you, Zen, for facilitating this call. I want to conclude my remarks today by once again recognizing and thanking all the frontline healthcare workers across the world who are working day in and day out to keep us safe and also acknowledge the great work from our biopharma scientific community to have us at this hopeful moment as it relates to vaccinations.

Our company's top priority is the vaccination program. And we look forward to continuing to work with the US Government to successfully distribute COVID-19 vaccines and stand ready to support the distribution of additional vaccines as they come to market. I want to thank the entire McKesson team for their continued commitment and hard work during this challenging time. We wish you all and your families good health and wellness. Thanks again for joining us today.

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