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McKesson Corp. (MCK)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to McKesson's Q2 Earnings Call. This conference is being recorded.

At this time, I'd like to turn over the call to Ms. Holly Weiss. Please, go ahead.

Holly Weiss

Senior Vice President, Investor Relations, McKesson Corp.

Thank you, Raul. Good morning, and welcome, everyone, to McKesson's Second 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 joining us on [audio gap] (01:25) in the United States. Today is obviously an important day, a day, which every citizen can vote, should have the opportunity to exercise this civic right.

Regardless of who's in the White House, we look forward to working with the administration and the new Congress to ensure a strong and safe economic recovery, while keeping the healthcare supply chain running and continuing to deliver for our customers on the frontlines of this pandemic.

Today, we reported second quarter total company revenues of $60.8 billion and adjusted earnings per diluted share of $4.80, both ahead of prior year and our revised expectations we laid out in August. I'd like to thank the people who make up team McKesson for their resilience, their dedication, their flexibility and ability to manage through change.

The first half of fiscal 2021 has certainly played out differently than the original expectations we provided to you in May. You'll recall that based on the positive signs of recovery at the end of our first quarter, we raised our guidance for fiscal 2021.

In our second quarter, we again saw volumes increase compared to the low points early in the first quarter. While patient mobility and prescription volume showed improvement and stability, the recovery continues to be nonlinear is the word we've adopted. And our second quarter results are a good example of the unpredictability of the pace and the trajectory of the recovery.

In addition, the pandemic has caused customer needs to evolve, and we've pivoted quickly to meet the incremental demands and needs. Investments in the business and customer relationships, particularly in our medical business, have positioned us well to serve our customers during this unprecedented time.

New demand for product categories, such as COVID-19 tests, and elevated demand for PPE have contributed meaningfully to our results year-to-date. While short-term upside, we do not anticipate the elevated levels of demand for these products in the long term.

Our results year-to-date are underpinned by three dynamics. First and foremost, the shape and pace of the recovery has been different than we had originally contemplated in May. Following a sharp recovery to the end of the first quarter, we continue to see modest improvement in the second quarter, but with signs the recovery will not fully happen in our fiscal 2021, most likely extending well into the calendar year 2021. And given current COVID-19 infection rate volatility, we expect a non-linear recovery.

Second, the fundamentals in the business remain solid and our execution has continued to improve. Lastly, discrete one-time gains in the second quarter and short-term opportunities present near-term upside for the fiscal year.

As a result of our performance in the quarter and our improved outlook across the business, we are raising and narrowing our fiscal 2021 adjusted earnings per diluted share guidance range to $16 to $16.50 per diluted share. This is up from our previous range of $14.70 to $15.50 per diluted share.

Since the onset of the pandemic, McKesson has partnered with government agencies at the federal state and local level, along with other industry leaders, to help find solutions to the most complex and pressing issues the crisis presented. This critical work once again speaks to the important role we play in the healthcare supply chain and to the depth of McKesson's expertise in sourcing, picking, packing and distributing supplies to sites of care across the US. Our role in the supply chain was highlighted in the quarter through expanded partnerships with the US government, specifically supporting Operation Warp Speed.

Similar to our role in the 2009 to 2010 period, the H1N1 pandemic, the Centers for Disease Control and Prevention engaged us to expand our existing partnership under the Vaccines for Children Program to support the US government's Operation Warp Speed team as a centralized distributor of future COVID-19 vaccines and ancillary supplies needed to administer those vaccines. McKesson's role in the H1N1 response was a proud moment in our history over 10 years ago, and we're very honored to serve in a similar capacity as we help support the fight against the COVID-19 pandemic.

I do want to take a moment to just clarify the scope of McKesson's involvement in Operation Warp Speed. We will be the centralized distributor for refrigerated and frozen vaccine types once approved by the FDA. Ultra-frozen vaccines, which are those requiring temperatures of minus 60 degrees Celsius or colder are not within the scope of McKesson's contract with the CDC.

In the centralized model, the US government directs McKesson on the distribution of the vaccines and related supplies to point-of-care sites across the country. McKesson will make no allocation or prioritization decisions, and we will not have any influence on which vaccine is shipped to which location. While it's still early in the process and a vaccine has not yet been approved for distribution, our role in Operation Warp Speed has been and will continue to be our company's top priority since we were selected by the CDC in August.

We've been working to scale up the infrastructure necessary to be ready to distribute approved vaccines as soon as they are available. Given the uncertainty around the timing and volume of vaccines that may become available, future earnings tied to the distribution of COVID-19 vaccines as a centralized distributor for the US government are not reflected in our current outlook. McKesson was also selected by the US government to manage the assembly and distribution of the ancillary supplies needed to administer the future COVID-19 vaccines.

We're partnering with the Department of Health and Human Services, or HHS, to help equip healthcare professionals with the supplies they need to safely and efficiently administer COVID-19 vaccines once they're available. Supplies like syringes, alcohol, prep pads, face shields and more will be selected and grouped together as directed by the HHS for future distribution to point-of-care settings across the country. We quickly ramped up our capacity outfitting and staffing four distribution center locations for assembling and storing the ancillary kits to be used in the administration of the COVID-19 vaccines once approved. Each kit contains enough supplies to be used for the administration of 100-plus vaccines.

Our teams have been hard at work assembling these kits as part of the preparation needed for when a vaccine's approved. Given the scope of our work with the HHS is well-defined and that the work has begun, the economics from this contract are factored into our improved outlook for fiscal 2021.

We are honored and proud to serve the US government in this dual role, and we believe it will help streamline delivery to frontline and provide the most expeditious access possible to the COVID-19 vaccines.

Before I elaborate on our second quarter results, I wanted to provide just a brief update on our board of directors. In mid-October, our board of directors welcomed Linda Mantia as a new Independent Director. Linda most recently served as the Senior Vice President and Chief Operating Officer for Manulife Financial Corporation, where she played a critical role in defining Manulife's corporate strategy and oversaw its innovation portfolio. She brings over 25 years of experience managing extensive financial services, operations and digital technology. Linda's appointment demonstrates our continuing commitment to refresh and diversify the experience, backgrounds and perspectives on our board.

Now let's get into the business. I'll remind you that this is our first quarter reporting in the new segment structure we announced back in July. I'll summarize the second quarter, and then I'll turn it over to Britt to provide more details.

U.S. Pharmaceutical's results in the quarter exceeded our expectations and reflect improved script and patient mobility trends versus the levels we experienced in the first quarter. Specialty volumes, particularly oncology, have continued to be resilient throughout the pandemic. Oncology patient visits, inclusive of telehealth visits, returned to pre-COVID levels in the quarter, and our provider solutions and US oncology business continue to grow and are well-positioned as innovative specialty products and biosimilars come to market.

Our US oncology research team recently celebrated a significant milestone. We have now been part of the trial process for 100 FDA-approved cancer therapies. This achievement is a result of the hard work and the dedication to research for more than 165 research locations, conducting and participating in over 1,600 clinical trials for cancer therapy.

Our Health Mart franchises continue to play a vital role in community healthcare, as they roll out COVID-19 testing efforts and expand immunization capabilities ahead of this year's influenza season.

Transitioning to our International segment, as part of our segment realignment, we brought together our strong presence in non-US-based drug distribution and retail operations in Canada and Europe. Together, these businesses are positioned to further leverage the company's global footprint to drive value across key differentiators like the company's owned retail pharmacy assets.

I remind you, as part of the reorganization in August, we named Rebecca McKillican, as the Chief Executive Officer for McKesson Canada. She succeeded Dominic Pilla, who retired in August. I'm encouraged by the performance of our International business as we found ways to meet the changing customer demands and contain our costs.

We continue to invest in the digitization of healthcare in both Canada and Europe. We've invested in new state-of-the-art distribution centers to support digital growth in our e-commerce platforms. In Canada, our Well.ca business was recognized for the second year in a row as a leader in digital customer experience. And in Europe, our Echo by LloydsPharmacy platform in the UK remains the UK's fastest-growing pharmacy.

I'm pleased to announce that on November 1, we completed the creation of a joint venture with Walgreens Boots Alliance to combine our pharmaceutical wholesale businesses in Germany. As a reminder, WBA owns a 70% controlling equity interest in the joint venture, and McKesson holds the remaining 30% ownership interest. We have a continuous process in place to look at, review and evaluate our portfolio and our strategy. Sometimes, the outcome is we find assets that we're not the natural owner of, or as was the case in this transaction, we believe that combining our German wholesale businesses with that of WBA is the right decision to secure the long-term success of both businesses. The combined businesses will strengthen the ability to compete and deliver high customer satisfaction through evolving our customer value proposition and delivering on operational excellence.

Let me move to Medical. Demand continued to improve across the business in the quarter, as physician offices reopened across the US. The pandemic has also created new demand for products like COVID-19 tests and an unprecedented level of demand for PPE across the segment, both of which we view as near-term drivers of growth in the segment.

We're proud to have a leading position in the distribution of lab equipment and solutions in the provider space. Over the past several years, we've developed relationships with many lab partners and helped position our providers with the tools they need to deliver better patient outcomes. Our investments in our lab business and in our private brand portfolio continue to position us to serve our customers' evolving needs, particularly in times like these.

Also, to meet this incremental demand, we've worked quickly to strengthen our sourcing partnerships around the globe. We've built our inventory across several product categories to be ready for incremental and often unpredictable levels of demand from our customers. Improved patient mobility and a continuation of near-term opportunities for McKesson to meet our customers' evolving demands contribute to the revised outlook for the segment.

Turning to Prescription Technology Solutions, we'll refer to as RxTS for shorthand, which brings together our Relayhealth Pharmacy, our CoverMyMeds and our RxCrossroads businesses. I want to just spend a minute here on the evolution of these businesses into the reportable segment it is today.

Over time, we have acquired capabilities that together create a broad set of commercial services businesses. RelayHealth is an asset that's been in the McKesson family dating back to 2006. This business processes over 19 billion transactions a year and connects us to over 50,000 US pharmacies, giving us access to the workflow of the vast majority of pharmacies in the US, with the goal of delivering value-added services directly into this pharmacy workflow.

In 2017, we acquired CoverMyMeds, whose mission is to help patients get access to the appropriate drugs for their care by automating and accelerating the prescription approval process known as electronic prior authorization, an otherwise very manual and very time-consuming process. This business gave us access to the workflow of over 700,000 providers by automating the insurance approval process for drug coverage.

And most recently, in 2018, we acquired RxCrossroads, a business that expanded our services and solutions for our biopharma partners and gave us disease-state expertise, specifically focused on specialty therapies. Bringing these businesses together under one leadership team allows us to have a more cohesive strategy and a highly coordinated go-to-market effort. Together, these businesses help to connect pharmacies, providers, payers and biopharma for next-generation patient access and adherence solutions.

Last quarter, I talked about one of these solutions that we've continued to invest in, a product we call Access for More Patients, or AMP, and how we've been able to reduce the average time to therapy by 18 days. Just one year ago, we had one brand on the platform. Today, we have several brands live and a good growing pipeline.

Expanding our brand support programs for our biopharma partners helped to offset the impact of lower prescription volume trends, specifically new prescriptions in the quarter. As an important part of our strategy, we are continuing to invest in these businesses so that we can provide innovative solutions for biopharma, and these investment dollars are reflected in our results in the segment year-to-date.

Summarizing at the enterprise level, while we expected challenges in the quarter, we significantly exceeded our expectations, and it is, in large part, due to the execution of our 80,000 employees. Our teams move quickly and decisively to react to evolving customer needs and our expanded government partnerships. I continue to just be so impressed by our teammates, particularly those on the frontlines, for their unwavering focus and dedication during this incredibly challenging time.

And as part of our appreciation, we again made special payments to our frontline employees, recognizing their courage and their service to our company, our customers and frontline caregivers over these past several months.

I mentioned how the second quarter was a good example of the nonlinearity of the recovery as our results far exceeded our original and even revised expectations. While we're encouraged by the positive trajectory of the recovery, we continue to believe a full recovery back to pre-COVID levels will take longer than we originally contemplated and is unlikely to occur within our fiscal year.

We continue to expect in the second half of the year as compared to the prior year, driven by an improved market, near-term demand from our customers and our current work in the US government assembling the ancillary kits to go along with future COVID vaccines once approved.

While some of the tailwinds I mentioned are expected to be near term, we believe we have made the investments necessary to position us as a partner of choice for our customers and manufacturers throughout this time.

On our first quarter call, I talked about the biggest theme through the pandemic would be change, and that I thought McKesson was well-positioned to respond and react to that change. And I believe the second quarter was a clear example of how McKesson shines when faced with challenges and new opportunities. Despite an evolving market landscape, we've remained focused on executing against our priorities, which now proudly includes playing an even larger role in the fight against the COVID-19 pandemic, leveraging our deep expertise as we partner with the US government on future COVID-19 vaccine efforts.

I'm so proud of the execution I've seen across the business in the first half of fiscal 2021 and the dedication of our employees remains unmatched in my view. Thank you for your time this morning.

And with that, let me hand it over to Britt to elaborate.

Britt J. Vitalone

Executive Vice President & Chief Financial Officer, McKesson Corp.

Thank you, Brian; and good morning, everyone. We're pleased with our adjusted operating profit and adjusted earnings per share results in the second quarter. We delivered growth over our prior-year results and exceeded the expectations that we laid out on our Q1 earnings call, despite an extremely volatile and challenging macroenvironment. We couldn't be more proud of the way our teams have executed and continue to deliver and innovate through this unprecedented period of uncertainty.

We delivered solid core performance across our businesses in the quarter, including new product volumes and elevated demand in our Medical-Surgical segment. This new volume includes an increase in the sales of COVID-19 tests and increased volumes in personal protective equipment, as we continue to respond to the needs of our customers during the pandemic. We also recognized gains on equity investments within our McKesson Ventures portfolio, and I'll provide further detail on this.

As a reminder, in our first quarter, we were impacted across our businesses by economic lockdowns and social distancing, which led to decreased healthcare utilization across the geographies that we operate in. However, in June, we began to see an acceleration of demand as volumes recovered earlier than we originally anticipated.

As I mentioned during our Q1 earnings call, we expected a nonlinear recovery from the effects of the pandemic over the remainder of our fiscal year, and we saw the nonlinear course of recovery continue to play out in our second quarter results. Prescription volumes recovered from their lowest levels earlier in our fiscal year, although not back to pre-COVID levels, and primary patient visits continued to improve at a rate faster than we had anticipated.

As Brian mentioned, in the second quarter, we observed increased volumes for COVID-related products, particularly COVID tests as we stocked up to meet demands for additional testing and supplies, including personal protective equipment. We continue to respond to the dynamic and fluid environment, and we're pleased with our execution throughout the first half of our fiscal year.

This morning, I'll provide commentary on our second quarter results and an update on the key assumptions that support our outlook for the remainder of fiscal 2021, and my comments today will relate to our new segment structure.

Let's turn now to our second quarter results, a summary of which, including updated guidance can be found in the Investors section of our website. And I'll start by pointing out two items that impacted our GAAP-only results in the quarter.

First, within U.S. Pharmaceutical, we recorded a pre-tax charge of $50 million for an estimated liability related to the New York State Opioid Stewardship Act or OSA. The charge is the estimated share of the New York OSA surcharge for calendar years 2017 and 2018.

As a reminder, we recorded an accrual in the first and second quarter of fiscal 2019 for the estimated portion of the annual assessment under the OSA. The OSA was later ruled unconstitutional, and the accrual was reversed in the third quarter of our fiscal 2019. That ruling was reversed in September of 2020. And therefore, we took a charge in our fiscal second quarter.

Secondly, within our International segment, we recorded a goodwill impairment charge of $69 million, which was associated with the segment realignment.

Now to a discussion of our adjusted earnings results for the second quarter, starting with our consolidated results on slide 4. Consolidated revenues of $60.8 billion were up 6% compared to the prior year, primarily due to market growth and higher volumes from retail national account customers in our U.S. Pharmaceutical segment. Adjusted gross profit increased 4% year-over-year, driven by growth in our Medical-Surgical segment, which saw increased demand for COVID-19 tests and higher volumes from customers in the U.S. Pharmaceutical segment.

Adjusted operating expenses increased 5% year-over-year, led by increased technology spend, which was partially offset by reduction in operating expenses due to the impact of COVID-19.

Adjusted operating profit was $953 million for the quarter, an increase of 3% compared to the prior year. When excluding the $39 million contributed by Change Healthcare in the prior year, which was previously recorded in Other, adjusted operating profit grew 8%, which was ahead of our expectations.

Interest expense was $50 million in the quarter, a decline of 22% compared to the prior year due to lower commercial paper balances and we now expect interest expense in fiscal 2021 to be between $220 million and $240 million.

Our adjusted tax rate was 7.2% for the quarter, in the range that we indicated on our first quarter earnings call in August. During the quarter, we realized discrete tax benefits of approximately $129 million and we continue to assume a full-year adjusted tax rate of approximately 18% to 20%.

Second quarter adjusted earnings per diluted share was $4.80, which was up 33% in the quarter compared to the prior year, driven by a lower share count, a lower tax rate, and operating performance, led by the growth in the Medical-Surgical Solutions segment. These items were partially offset by the lapping of the prior-year contribution from the company's investment in Change Healthcare.

Second quarter adjusted earnings per diluted share also includes net pre-tax gains of approximately $49 million or $0.22 per diluted share associated with McKesson Ventures' equity investments.

Wrapping up our consolidated results, second quarter diluted weighted average shares were 163 million, a decrease of 11% year-over-year, which was driven by the successful exit of our investment in Change Healthcare, lowering our shares outstanding by approximately 15.4 million shares and due to prior-year share repurchases.

Next, I'll review our second quarter segment results, which can be found on slides 5 through 9. As a reminder, effective with the second quarter of fiscal 2021, McKesson revised its segment reporting structure. We now report results in four reportable segments, which include U.S. Pharmaceutical, International, Medical-Surgical Solutions, and Prescription Technology Solutions or RxTS.

And I'll start with U.S. Pharmaceutical, where revenues were $48.1 billion, up 5%, driven by market growth and higher retail national account volumes, partially offset by brand to generic conversions.

In our specialty businesses, particularly in our US oncology network, we saw patient visits approach pre-COVID levels. Adjusted operating profit increased 3% to $658 million, driven by growth in specialty, partially offset by higher operating expenses in support of our strategic growth initiatives. And the segment adjusted operating margin for the second quarter was 137 basis points, which was a decrease of 3 basis points.

Next, on to International, where revenues were $9. 5 billion, an increase of 2% year-over-year. On an FX-adjusted basis, revenues decreased 1%, primarily driven by lower volumes in the Canadian pharmaceutical distribution business, which was largely due to the exit of an unprofitable customer at the beginning of the fiscal year. This was partially offset by higher volumes in the European pharmaceutical distribution and retail pharmacy businesses.

Adjusted operating profit increased 20% year-over-year to $116 million. On an FX-adjusted basis, adjusted operating profit increased 19% to $115 million, driven by lower European operating expenses, including continued cost reduction initiatives and cost mitigation efforts in response to COVID-19. The segment adjusted operating margin for the second quarter was 122 basis points, which was an increase of 18 basis points.

As Brian mentioned in his remarks, yesterday, we announced the completed contribution of our German wholesale business to a newly formed joint venture with Walgreens Boots Alliance. WBA now holds a 70% controlling equity interest in the JV, and McKesson holds the remaining 30%. Going forward, McKesson will no longer consolidate the operating results of its German wholesale business. We'll recognize the 30% share of the JV earnings and losses in other income within our International segment.

Moving on to Medical-Surgical Solutions. We continue to see to see trends improve during the quarter. According to an October IQVIA report, primary care patient visits reached approximately 91% of the pre-COVID baseline. Our Medical-Surgical business continues to play a vital role in the COVID-19 pandemic, ramping up to meet customer demand with our delivery of COVID-19 tests and personal protective equipment.

Revenues were $2.5 billion in the quarter, up 23%, driven by higher volumes of COVID-19 tests and personal protective equipment in both our primary care and extended care businesses. Adjusted operating profit increased 27% to $210 million, driven by demand for COVID-19 tests, early flu season volumes and contributions from the extended care business. And the segment adjusted operating margin was 829 basis points, an increase of 22 basis points.

Next, Prescription Technology Solutions. Revenues were $668 million, an increase of 7%, driven by new brand support programs, which were partially offset by the impact of lower prescription volume trends. Adjusted operating profit decreased 10% to $104 million, which was driven by higher operating expense investment to support the company's biopharma service growth initiative.

For the past several quarters, we've outlined our strategic investment into the products and services within RxTS, resulting in higher operating expenses to support future growth. We expect to continue to invest in the expansion of our technology offerings for our retail and biopharma customers to support the future operating profit growth of this segment. The segment adjusted operating margin for the second quarter was 15.57%, down from 18.37% in the prior year.

And moving on to corporate. McKesson recorded $135 million in adjusted corporate expenses in the quarter, an increase of 2% year-over-year, primarily driven by increased technology costs and lower interest income. This increase was largely offset by net gains of approximately $49 million on equity investments within our McKesson Ventures portfolio.

Our McKesson Ventures portfolio holds equity investments in several growth stage, digital health and services companies, and we're pleased with the portfolio results and the insights obtained. While mark-to-market valuations in this quarter resulted in gains from three of our investments, the impacts to our consolidated financials can be influenced by the performance of each individual investment quarter-to-quarter.

As a result, McKesson's investments may result in gains or losses, the timing and magnitude of which can vary for each investment. It's difficult to predict when gains or losses on our venture portfolio companies may occur, and therefore, our practice has been and will continue to not include ventures portfolio activity in our guidance.

And finally, we reported opioid-related litigation expenses of $41 million in the quarter. And for fiscal 2021, we continue to anticipate that opioid-related legal 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 $3.1 billion. For the first half of fiscal 2021, we had negative free cash flow of $306 million. Our working capital metrics and resulting free cash flow vary from quarter to quarter and are impacted by timing, including the day of the week that marks the close of a quarter.

Looking at the cash flow dynamics, we saw higher levels of inventory this quarter, primarily resulting from the increased quantities of COVID testing and personal protective equipment and our participation in Operation Warp Speed. As we prepare for continued larger quantities of personal protective equipment and Operation Warp Speed activity, we may experience additional working capital volatility.

Year-to-date, we made $265 million of capital expenditures, led by internal investments in areas such as technology and continued investment in our strategic growth initiatives. We also made investments in data and analytics capabilities across the enterprise. For the first six months of the fiscal year, we returned $388 million of cash to our shareholders through $248 million of share repurchases and the payment of $140 million in dividends. We have $1.3 billion remaining on our share repurchase authorization, and we continue to expect diluted weighted shares outstanding in the range of 161 million to 163 million.

Let me now turn to our outlook for the balance of fiscal 2021. As we've seen over the past several months, the trajectory of the COVID virus can change quickly as evidenced by recent increases in case numbers in many parts of North America and Europe.

On our Q4 FY 2020 and Q1 earnings calls, we outlined two assumptions that underlie our guidance for fiscal 2021 that we are reiterating today. First, we do not assume a new wave of COVID-19, which would lead to shelter-at-home and economic lockdowns, which would preclude patient mobility and consumption of healthcare services. And second, we do not assume any systemic customer insolvency events. We continue to believe that the recovery will take longer than initially anticipated and it will not be linear as the full impact of the pandemic is likely to persist beyond the fiscal year.

The nonlinear nature of the recovery continued in our second quarter. As a result of our second quarter performance and outlook for the remainder of the year, including near-term opportunities related to COVID-19 demand, we're increasing our adjusted earnings guidance range to $16 to $16.50 from our previous range of $14.70 to $15.50.

While our guidance does not take into account any revenues or earnings related to future COVID-19 vaccine distribution, it does include volumes from our kitting program in our Medical-Surgical segment, which I'll provide more details on shortly. We anticipate consolidated revenues to increase 2% to 4% for fiscal 2021, and we now expect the consolidated adjusted operating profit will grow 2% to 6% for the full year when excluding the results of Change Healthcare from the prior year, an increase from our prior guidance of a decline between 1% and 4%. We continue to anticipate enterprise adjusted operating profit to grow sequentially throughout fiscal 2021. And now on to the segments.

In our U.S. Pharmaceutical segment, we expect revenue growth of 3% to 6% and segment adjusted operating profit to grow 1% to 4% compared to the prior year. This takes into account improved volumes, particularly in our specialty businesses. In our International segment, we expect a revenue decline of 5% to 10% year-over-year, and segment adjusted operating profit to be flat to 4% growth, driven by the performance in our European business.

Let me now provide some details on our Medical-Surgical segment. As discussed in my opening remarks, throughout the quarter, we saw increasing volumes of COVID-19 tests. We expect these sales to be a near-term opportunity in the segment, and it's factored into our guidance for the remainder of fiscal 2021.

We've also seen increased volumes of personal protective equipment. This category remains vital as we support our customers during the pandemic. We expect that volumes will continue to fluctuate through the balance of the year. As the largest seasonal flu vaccine distributor in the US, we continue to prepare for the influenza season, which is particularly important this year due to the impacts of COVID-19 on the nation's healthcare system. While it's too early to predict how the flu season will progress, we're actively preparing to meet the needs of our customers.

As Brian mentioned in his remarks, we're also partnering with HHS on preparing and storing ancillary kits to be used in the administration of a future COVID-19 vaccine. We've included in our guidance a net benefit to adjusted earnings per diluted share of approximately $0.15 to $0.20 in the second half of our fiscal year related to our partnership with HHS. As a result, we now expect fiscal 2021 Medical-Surgical segment revenue to increase between 20% and 25%, and segment adjusted operating profit to grow in the range of 8% to 18%.

In our Prescription Technology Solutions segment, we expect segment revenue to grow 5% to 10%, and segment adjusted operating profit in the range of down 5% to flat. We expect improvement in this segment over the second half of the fiscal year as we continue to realize the benefits of our strategic investments.

As this is our first quarter reporting Prescription Technology Solutions segment, I want to provide some background on the drivers within this segment. Brian discussed in his remarks how this segment brings together our RelayHealth Pharmacy, CoverMyMeds and RxCrossroads businesses. Volumes in our RelayHealth and CoverMyMeds businesses are driven by pharmaceutical transactions, including prior authorizations. Volumes in these businesses are also driven by adding drug brands to the existing platforms and services that we offer to our biopharma and pharmacy partners.

Moving on to corporate. We now expect corporate expenses in the range of $625 million to $675 million. Our corporate guidance takes into account increased technology investments and the impact of our second quarter equity investment gains in our McKesson Ventures portfolio as previously discussed.

Let me wrap up our outlook by turning to cash flow. 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 consistent cash flow generation provides the financial flexibility to continue investing in our strategic initiatives, which position our business for long-term growth.

Our investment-grade credit rating remains a priority and underpins our financial flexibility. We have two bonds totaling approximately $1 billion, which matured during the second half of our fiscal year. We intend to utilize a portion of our free cash flow to modestly delever by up to $500 million, further strengthening our balance sheet and financial position. And we remain committed to returning capital to shareholders through a modest dividend and through share buybacks.

In closing, we're pleased with the results of our fiscal second quarter, and we're confident in our updated outlook for the remainder of the fiscal year. Our focus and execution should drive another full year of operating profit growth despite a challenging and competitive environment. We will continue to invest in high-growth, high-margin markets and strategic areas that will further leverage our differentiated positions in oncology and biopharma services. We're proud of our expanding partnerships as we work on the COVID-19 vaccine effort and continue to be an important part of the pandemic response to maintain supply chain stability.

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

Holly Weiss

Senior Vice President, Investor Relations, McKesson Corp.

Thank you. We will now take questions. In the interest of time, please limit yourself to just one question to allow others an opportunity to participate. Operator?

Brian S. Tyler

Chief Executive Officer & Director, McKesson Corp.

Operator, can we go to questions, please?

QUESTION AND ANSWER SECTION

Thank you. [Operator Instructions] Our first question will come from Eric Percher from Nephron Research. Your line is now open.

Eric Percher
Analyst, Nephron Research LLC

Q

Thank you. Your role enabling the vaccination distribution is of great interest. Brian, can you help us understand what's required operationally? It sounds like you're developing some new DCs as well as using some of the existing infrastructure.

And then, Britt, can you help us understand the financial flows from a government contract of this type? Does some of the initial government investment flow through the P&L? And should we think of this as paid for preparation? Or is it really tied to the amount of volume that ultimately moves through?

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

A

Well, good morning, Eric. Thank you for the question. We're fortunate to have had the H1N1 experience about a decade ago and provided a bit of a roadmap or a playbook for us to execute. Based on the volumes that we've been given and projections, we have quickly been engaged in standing up some new facilities, both for the vaccine distribution and for the kitting and frankly for just some storage. That is all in-flight on plan tracking. But, yes, it will be – it's a big effort to stand up several new facilities and onboard a lot of new employees, but something that we've successfully done in the past.

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

A

Eric, let me address your second question. There's a couple of different elements to this program. As we've talked about previously, we were reimbursed for some of the costs to set up these new facilities. We will also, when a vaccine is approved and we begin distribution, we'll recognize a fair value for the services that we perform similar to a third-party logistics provider. That's on the vaccine side. Obviously, that hasn't started yet as the – there's not been a vaccine that's been approved. On the kitting side, it'll be very similar to how we prepare kits that we did in H1N1, as we prepare kits and produce those kits, we'll recognize revenue as those kits are prepared and produced.

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

A

Next question, operator?

Operator: And next will be Robert Jones from Goldman Sachs. Your line is now open.

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

Q

Great. Thanks for the question. I guess maybe just to stick with COVID, but looking at the Med-Surg segment, it appeared that EBIT in the quarter came in, I don't know, somewhere roughly around $50 million higher than what was implied relative to the back half guidance you guys had given previously.

Just wanted to see if you could share or help us understand what drove the performance as it relates to the increase in COVID-19 test that you mentioned and then the increased demand for PPE. Just trying to really get some context around just what the contribution has looked like in that segment from COVID tests and PPE would be helpful.

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

A

Sure. Thanks for the question. I'll start. Certainly, as the year has progressed, we've seen some momentum in the segment. What we talked about in both of our comments and what we've seen through our second quarter is that COVID-19 tests and personal protective equipment have increased in volume throughout the quarter. So they're a key driver for that. I also touched on early vaccine – flu vaccine sales.

So too early to call the flu season, but we did see earlier flu vaccine sales than we had anticipated, a little bit stronger than we had anticipated in the quarter. And we're seeing really strong underlying performance as flu vaccine sales start to pick up, as COVID-19 test kits pick up, that really helps the core business. It drives more primary care visits. It drives more supplies within our core business.

So I think all of those things really play together. But, certainly, COVID-19 tests in personal protective equipment are key drivers in the quarter and key drivers for our full year raise.

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

A

Next question, operator?

Operator: Next will be Stephen Baxter from Wolfe Research. Sir, your line is now open.

Stephen Baxter
Analyst, Wolfe Research LLC

Q

Hi, thanks. Wanted to ask about the trajectory and the seasonality of the Prescription Technology business. It seems like the full year guidance implies a pretty big step-up in EBIT relative to what you just posted for Q2. So I was hoping you could talk a little bit about the factors driving this increase, whether there's anything to do with some of the timing of investment spend that you've cited in the release?

And then just in general, what's the right way to think about seasonality in this business? Trying to understand what we should be thinking about future periods using the second half of fiscal 2021 as a baseline or if there's other consideration that we should be keeping on mind? Thanks.

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

A

Yeah, appreciate that question. I'll start and then Brian can certainly elaborate. We have been making investments into this business. We think that this is a business where innovation can happen. And so we've been increasing our investments over the last year or so, and we'll continue to do that.

Certainly, one of the things that we've noticed here is that lower prescription volume trends versus the prior year, particularly new prescriptions or new branded prescriptions, has had an impact on that business from a top line perspective.

We do expect that the second half of the year, we'll see some very strong growth. And typically, in this business, you can expect that the fourth quarter is a little bit stronger seasonally than the other three quarters. So I think it's a few things. It's been the lower prescription volume trends year-over-year. It's investments that we've continued to make in the business to drive new brand programs and innovation. And then we expect that the back half of the year will be stronger. And typically, seasonally, Q4 is a little bit stronger than the other three quarters of the year.

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

A

And not much to add to that other than we do think as we bring these businesses together and look at the connectivity we have into providers and pharmacies, we look at the automation, experience and tools we have and the expertise in various disease states. We think this is a growing part of the market, and there we have opportunities to invest internally in innovation that will deliver superior returns over time, and we continue and are committed to making those investments.

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

A

Next question?

Operator: And next will be Kevin Caliendo from UBS. Your line is now open.

Kevin Caliendo
Analyst, UBS Securities LLC

Q

Thanks. And thanks for taking my call. Just a PPE question, you're saying demand has gone up. Your inventory levels have gone up. I guess, I'd like to understand the dynamics around the pricing of PPE and how that affects your revenues and/or profit. PPE prices seem to be stabilizing or maybe coming down a little bit. And also, we're hearing there's a shortage of nitrile gloves. Can you just talk a little bit how pricing dynamics change your profit in the PPE segment?

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

A

Yeah, sure. Maybe I'll just make a couple of general comments. We certainly have seen higher demand for these products over the course of the year. That demand continued through the second quarter, more in the COVID-19 test kits in the second quarter, but PPE has been heavy demand as well.

Look, we have very good and solid relationships from a logistics perspective with many different suppliers. We believe that that allows us to source competitively. And clearly, the market is – it's a competitive market on the sell side. But, again, we've seen some stability in the pricing in the first half of the year, but it's a volatile market.

There's a lot of – the demand is changing as the year goes on, and our sourcing will adjust to that. And so what we're really trying to call out here is that we've seen a lot of demand in the first half of the year. It's been kind of volatile, and we would expect that we'll see good demand in the second half of the year, but certainly not in a straight line, but we feel that the relationships that we have with our suppliers put us in a good position to meet the customer demand.

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

Next question?

Operator: And next will be Lisa Gill with JPMorgan. Your line is now open.

Lisa C. Gill
Analyst, JPMorgan Securities LLC
Q

Good morning and thanks for taking my question. Brian, just going back to your comments around specialty and the resilience on the oncology side. If I start to think about biosimilars coming to the market, especially in the oncology area; one, can you talk about if there were any benefit from biosimilars in the quarter? And then, secondly, if you or Britt can help us to understand the margin differential and the opportunity around biosimilars as we think about the strength in your specialty business?

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

Sure. Well, we've got a very strong provider base for specialty products, and that's our – what we call sometimes our non-affiliated or non-US oncology and/or US oncology. The oncology business in particular, I think, has been pretty resilient.

Probably visits even at the trough period were relatively stronger than many of the other specialties. And what we're seeing now is that combined, the physical patient visits with the telehealth activities, we're seeing volumes really get back almost to pre-COVID levels.

And we have a tremendous footprint in that business. We have a broad set of scaled assets. And one of the things that we're – I think we will be able to do and are doing and will continue to expand over time is take advantage of not just biosimilars, but other new specialty products that launch into that space.

So you know our conviction in the community provider settings and how – what important role we think it plays in the healthcare landscape, and we continue to invest and expand our offerings to position us to take advantage of those opportunities.

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

And, Lisa, maybe just to touch on your – the last part. We've seen that biosimilars have grown this year. We've seen more biosimilars launch into the space, particularly in the specialty provider in oncology. We think that biosimilars are a win-win-win. They're lower cost opportunities for patients. They provide economics for physicians and they certainly provide better economics for us.

So we like that biosimilars are continuing to develop. They're not very material yet, but they do continue to grow. And certainly, they provide better cost for the patient, the physician and better margin opportunity for McKesson.

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

A

Next question?

Operator: And next will be Jailendra Singh from Credit Suisse. Your line is now open.

Jailendra Singh
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi, thanks, everyone. Quickly a couple of clarification on the second half versus first half outlook. Your Medical-Surgical segment revenues, of course, it now includes the benefit from vaccine distribution in second half. But can you give us any flavor around what is the second half outlook on Med-Surg business on apples-to-apples basis compared with 9% growth you had in first half? And same thing on International segment. What is driving that high-single to low-double-digit decline for second half outlook versus down 3% in the first half?

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

A

Thank you for the question, and I'll let Britt respond to it. But just to clarify, the Medical business really is not the vaccine distribution, but it's the kitting operation or the production of and storage of the kits that will support the administration of the vaccine.

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

A

Right. Thanks, Brian. And so what we are seeing in our second half is a continuation of some of the momentum that we saw in the first half. We expect that COVID-19 tests will continue to be a big portion of the business in the second half of the year. Our core business continues to have very strong momentum.

And then as Brian just clarified, we did put in guidance the kitting portion of the contract. That will drive some top line as well as the $0.15 to $0.20 of adjusted earnings that I called out. So what we have in our Medical-Surgical business is a very broad-based business that we've talked about many times across primary care, extended care, and we continue to grow there. And the opportunities that we have now through our relationships with lab suppliers and others is just providing additional momentum in the business.

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

A

Next question?

Operator: And next will be Michael Cherny from Bank of America. Your line is now open.

Michael Cherny
Analyst, BofA Securities, Inc.

Q

Good morning and thanks for taking the question. I want to dive in a little bit on the U.S. Pharma side, and particularly thinking about how the pacing of growth this quarter could influence or impact the growth in the back half of the year. You noted some of the higher volumes from retail national accounts. This is despite what appears to be market-wide softness and what you even called to in terms of the pacing of recovery.

So heading into the second half of the year, outside of specialty, which I know you already addressed, what are the key drivers to support U.S. Pharma revenue growth in particular? And how should we think about how those should drop down to the bottom line and incremental margins?

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

A

Yeah. I'll start, and certainly, Brian can elaborate. I think what we're seeing in our U.S. Pharmaceutical business, just to be clear, it's our traditional US wholesale business to independents, to retail national accounts in the health systems. We're seeing pretty good stability in that business.

Now we're seeing quarter-to-quarter stable position, stable growth. You add to that the position that we have in our specialty provider businesses, the opportunities that we're seeing in oncology. And what you're seeing is a business now that is growing at a stable 2% to 4% that we've seen over the last several quarters. So I don't think there's anything specific. I think it's just the good execution, the stability of our customers and the stability of the environment that's really allowing us to continue to perform.

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

A

Yeah. I think that the brand market has been relatively stable. The generic market has been relatively stable. And we've been very focused on cost and efficiency initiatives in this business to help underpin that.

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

A

Next question?

Operator: And next will be George Hill from Deutsche Bank. Your line is now open.

George Hill
Analyst, Deutsche Bank Securities, Inc.

Q

Hey, good morning, Britt and Brian. And thanks for taking the question. I was just wondering if you guys would quantify or detail both from an office procedure perspective and maybe from an Rx volumes perspective, what percent of baseline you guys expect to achieve in the back half of the year as it relates to volumes? I know in the press release, it says you're still not expecting a return to baseline, but would love to know what percentage you guys are thinking you're getting back to?

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

A

Yeah. Great question. And always a little bit risky to prognosticate in the current environment. Even given the way we've seen the disease progress in Europe and the US in the last several weeks shows the volatility that's still out there in the marketplace. You'll recall, we – early in the year, when we gave our first guidance, we assumed Q1 was going to be the trough, that Q2 would get sequentially better, Q3 would get better and by Q4, we would be back to what we call pre-COVID levels.

If you think about the way the year has unfolded, we had really high volatility in the first quarter, month-to-month, even week-to-week, the swings were pretty challenging. I think we saw that begin to stabilize a little bit as we got midway through Q2, and the trend lines started to look like they were leveling out a little bit. And so that's what gives us the pause or the revised view, I guess, that we won't get back to full pre-COVID elective procedures, physician office visits and scripts by Q4, but the recovery is likely to extend well into the calendar 2021. And so that's our current view, and that's what we've worked into our guidance.

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

Next question?

Operator: And next will be Steven Valiquette from Barclays. Your line is open.

Steven James Valiquette
Analyst, Barclays Capital, Inc.
Q

Great. Thanks. Good morning, everybody. So you touched on this for the US just a minute ago. But I guess, I'm curious to hear about the Rx volume progression throughout the quarter for Europe. Maybe any early color around trends in October as well, just given that some of the regions in Europe seem to be going back into lockdown mode. Thanks.

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

Yeah. We track these trends in Europe very closely. And frankly, what you see is it's really not a Europe trend. It's a country-by-country trend depending on how the COVID virus itself progresses and how local governments react with their social policy, close down, lock down, and things of that nature. So it really is very different.

We saw France, for example, tended to be ahead of the UK in the way it experienced these waves. But the general theme has been pretty consistent that we had the trough in the Q1 period, and we had slow strengthening. We're very proud of the way our teams have operated there. Our pharmacies are open, they're servicing their communities. They've adopted all the new safety protocols and standards to enable them to provide that continuity of care. But I'd say, at a macro level, while there is definitely difference between countries and the way country governments react, it's generally the same.

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

Next question?

Operator: And next will be Ricky Goldwasser from Morgan Stanley. Your line is open.

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

Yes, hi. Good morning. I have a quick follow-up question on the COVID vaccine benefit. If we think qualitatively about the relative contribution from kitting versus vaccine, how should we think about these two? Is vaccine contributions in general qualitatively tend to be higher than the kitting or vice versa?

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

Yeah. Thanks for the...

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

Q

I'm thinking about the broader potential opportunity.

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

A

Yeah, thanks for the question, Ricky. Look, we've only quantified our relationship on the kitting side, that's really all that we can quantify at this point. We don't have a vaccine approved, so it's too early for us to really provide you any guidance on that. And I wouldn't try to relate the two. They're very different programs.

I would say, though, that the kitting program does provide us the opportunity to continue to expand our relationship with the government and others. We certainly have all the capabilities, and that's why we were selected to be able to continue to expand our capabilities and services. So we're focused right now on the programs that are in flight. But certainly, there are opportunities for us beyond that.

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

A

Next question?

Operator: And next will be Glen Santangelo from Guggenheim Investment (sic) [Guggenheim Securities] (01:00:42). Your line is open.

Glen Santangelo
Analyst, Guggenheim Securities LLC

Q

Yeah. Thanks for taking my question. Brian, I just wanted to follow up and maybe pivot towards the opioid litigation status. It's been a while since we heard anything on this front. And in the press release, you seem to suggest that you're going to reserve some money for settling with the State of New York potentially. I was just curious, has COVID really slowed the process here? It felt like we were making much greater progress in the beginning of the year, tracking towards the settlement. Now it feels like there's some inertia in the process. And I was just curious if you can maybe give us an update on any signposts that we should look out from this point?

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

A

Hey Glen, just before Brian jumps in there, I just want to clear up. The New York charge that we took was related to the surcharge that was enacted in 2017 and 2018. And so what we're doing here is just picking up the accrual for the reversal of that court litigation suit back in 2019. So it's not related to the larger opioid settlement at all.

Glen Santangelo
Analyst, Guggenheim Securities LLC

Q

Okay.

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

A

Yes, great. I was going to make that point. So as regards to the larger discussions, I think it's fair to say there was a few-month period there where the nations and the AGs and the distributors' focus was on responding to a pandemic. But we're now in the eighth month of this. And just like all of us have had to find ways to return to normal business, we continue to be engaged with the AGs.

We continue to believe we're making progress in the discussions. We continue to be hopeful we'll reach a broad resolution because we think that that's the best way to accelerate relief for people and communities that have been impacted by various health crises at this point. So we remain very focused and hopeful.

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

A

Operator, we have time for one more question.

Operator: Certainly. And that question will come from Elizabeth Anderson from Evercore. Your line is open.

Elizabeth Anderson
Analyst, Evercore ISI

Q

Hi guys, thanks for the question. I was wondering if you could provide a little bit more in terms of details on AMP. Just in terms of like how you see the trajectory of that growing, the types of drugs and potentially also how you guys posit the value proposition to customers and sort of, if you could comment anything on margins there, that would be helpful. Thanks.

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

A

So relative to AMP, I really think about this as – there are existing models out there to do access and adherence. But really, frankly, haven't really innovated too much in a long time. And the opportunity we see here is to bring really the disease state expertise, the expertise we have over two decades supporting these access adherence-like programs.

But then leveraging the technologies that we have in a relay or a CoverMyMeds to essentially automate and make that process more efficient, get patients started on their therapies quicker, help them adhere to them longer, so that ultimately, they get better health outcomes.

And so it's really the combination of these things that's kind of redesigning the access and adherence model, and we've been very pleased with our early partnerships and the development of this. We've been very quick to take it from concept into market, and it's been quite encouraging and nice to see the number of brands on that program grow and the pipeline continue to expand.

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

Okay. Well, I'd like to apologize for running a few minutes late. We wanted to be – provide as much insight as we could on the call. I want to thank everybody for your great questions, and thanks, Raul, for helping facilitate this call.

I'm going to conclude my remarks today by once again thanking all of the frontline workers across the world, who are working day in and day out to keep us healthy and keep us safe. And I want to recognize the great work of the McKesson team, all 80,000 of them, for their persistence, for their commitment, for their energy and resiliency during this time. They really are playing a vital part in keeping our communities healthy as well. So I wish you all a very good day. I hope you voted. If you haven't, please do.

And with that, we'll talk to you next quarter.

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