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McKesson Corp. (MCK)

Q4 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to McKesson's fourth quarter fiscal 2024 earnings conference call. Please be advised that today's conference is being recorded.

At this time, I would like to turn the call over to Rachel Rodriguez, VP of Investor Relations. Please go ahead.

Rachel Rodriguez

Vice President of Investor Relations, McKesson Corp.

Thank you, operator. Good afternoon and welcome, everyone, to McKesson's fourth quarter fiscal 2024 earnings call. Today, I'm joined by Brian Tyler, our Chief Executive Officer, and Britt Vitalone, our Chief Financial Officer. Brian will lead off, followed by Britt, and then we will move to a question-and-answer session.

Today's discussion will include forward-looking statements such as forecasts about McKesson's operations and future results. Please refer to the cautionary statements in today's earnings release and presentation slides available at our website at investor.mckesson.com and to the Risk Factors section of our most recent annual and periodic SEC filings for additional information concerning risk factors that could cause our actual results to materially differ from those in our forward-looking statements.

Information about non-GAAP financial measures that we will discuss during this webcast, including reconciliation of those measures to GAAP results, can be found in today's earnings release and presentations slides. The presentation slides also include a summary of our results for the quarter and guidance assumptions.

With that, let me turn it over to Brian.

Brian Scott Tyler

Chief Executive Officer & Director, McKesson Corp.

Thank you, Rachel, and good afternoon, everyone. Thanks for joining our call this afternoon.

Today, we reported our fiscal fourth quarter results, marking the close to a strong fiscal 2024. I want to thank our 51,000 McKesson employees for their terrific efforts over the course of this year, as together we drove the business and achieved significant progress in advancing our mission and our strategies.

In fiscal 2024, consolidated revenue grew 12% to $309 billion and adjusted earnings per diluted share increased by 6% to $27.44, both exceeding the expectations we set out at the beginning of the fiscal year.

We're pleased with the growth across the enterprise, supported by our differentiated portfolio of assets, our innovative solutions, and our deep commitment to quality and operational excellence. We're particularly excited about the opportunities within our strategic growth pillars of oncology and biopharma services. During the year, we saw a record expansion in the US oncology network and strong market demand for our access, affordability, and adherence solutions.

I'm going to start my remarks today with a review of our company priorities, and then I'm going to hand it over to Britt, who will take us through more details on the financial performance and our outlook for fiscal 2025. What you will take away from both of us today is our confidence in the strength of the underlying businesses, our commitment to continue carrying out the strategy, and the momentum into the next year.

The first company priority I want to touch on is our focus on people and culture. Over the past few years, we've made continued progress in transforming McKesson into a diversified healthcare services company. That requires us to embrace new ideas and lead at the forefront of innovation. We're honored to be recognized as one of America's Most Innovative Companies by Fortune. We'll continue to strengthen our innovative culture, which is essential to our growth strategy overall.

Recently, we were also named as one of America's Greatest Workplaces for Women by Newsweek and a Top Women Employer by DiversityComm Media. I am pleased to see our company-wide efforts continue to be recognized externally. I'm also really quite impressed by the commitment and leadership exhibited by so many McKesson employees and the initiatives they take on to support each other and to create an open and collaborative culture.

Moving on to our two strategic pillars of oncology and biopharma services, these are both pivotal assets that unlock tremendous value and bring significant benefits to our customers and stakeholders. Over the years, we've been building out our portfolio of assets around oncology, spanning from the distribution of related therapies to practice management, to oncology data insights and other value-added services.

We're very pleased with the meaningful expansion in our oncology assets, as reflected in the growth of the US oncology network. We welcomed four practices to the network in the fiscal year, including Regional Cancer Care Associates, Cancer Center of Kansas, Nashville Oncology Associates, and SCRI Oncology Partners. The addition of these new practices expands our geographic footprint and allows us to provide our services to a broader set of providers and importantly to the patients they serve.

As of April, the network has grown to approximately 2,600 providers at 600 sites of care across 31 states. We grew the provider network through a combination of newly affiliated practices and the recruitment of new providers to existing practices. We saw organic growth in providers at more than 75% of the practices. With this extensive reach within the community oncology setting, the US oncology network now treats over 1.4 million patients each year.

In addition to practice management, we also provide clinical trial services to these community-based practices. In 2022, we expanded our clinical trial capabilities through the formation of a joint venture that now operates under the name of Sarah Cannon Research Institute, or sometimes referred to as SCRI.

In the past year, practices in the US oncology network participated in over 200 clinical trials through SCRI, enrolling more than 3,100 patients in treatment studies across various disease states. And in February, SCRI announced a collaboration with AstraZeneca to enhance the delivery of oncology clinical trials. Working together, the two parties will implement modern solutions to accelerate clinical trial delivery timelines, reduced site burden, and enhance trial enrollment within our scaled provider network.

In addition to oncology, our other differentiated growth priority is our biopharma services platform. Our portfolio of connected solutions provides unique value propositions to biopharma companies and helps them improve medication access, affordability, and adherence.

In fiscal 2024, we saw strong growth in the Prescription Technology segment, delivering 23% growth in adjusted operating profit. More importantly, in the past year, our differentiated solutions helped patients save more than

$8.8 billion on brand and specialty medications. We helped to prevent approximately 10.7 million prescriptions from being abandoned due to affordability challenges, and we helped patients access their medicine more than 94 million times.

The biopharma services platform was built through years of strategic investments. It includes targeted acquisitions that accelerated our growth strategy, and internal investments that drove innovation and enhanced capabilities. One of the first assets we acquired was RelayHealth, and it's foundational to the network and services we offer today. For those who aren't familiar with this business, it helps adjudicate prescription claims and enable the efficient delivery of prescription drugs. It's now connected to over 50,000 pharmacies and processes billions of transactions annually. The connectivity to the pharmacies provides us insights into the patient's journey, and it helps us develop additional solutions, programs like co-pay assist programs and digital coupons. We want to provide our customers not just a claims switch solution, but a robust platform that connects key stakeholders, delivers access and affordability solutions, and ultimately improves the patient's experience and outcomes.

Let's move on now to our next priority of driving sustainable core growth. We have scaled and durable assets in both pharmaceutical and medical surgical distribution, and we continue to deliver sustainable growth in these core businesses.

In fiscal 2024, US Pharmaceuticals delivered solid results with 16% increases in revenue and a 7% increase in adjusted operating profit, which I'll remind you is at the high end of our long-term target for this segment.

To support the business growth and the evolving needs of our customers, we continue to invest in our infrastructure, ensuring that the distribution assets are technologically equipped to maximize capacity and efficiency. And while we're still in the early stages of investing in capabilities of artificial intelligence, we've already developed tools and algorithms that apply AI in the supply chain. This is enabling us to move products more quickly and nimbly throughout our distribution centers, generating cost savings and continuing to improve our service levels. We'll continue to make these targeted and strategic investments that support the sustainable growth of our business.

Our core distribution business is also complemented by a growing portfolio of services and solutions around specialty and oncology, which adds to our differentiated market position and supports our unique value proposition to our customers.

And today, we're excited to talk about our strategic relationship with Optum. We started servicing a portion of Optum's business last year, and we're pleased to get the opportunity to expand the scope of our services starting July of 2024. We believe this relationship is a strong testament to our differentiated capabilities and services across pharmaceutical distribution, sourcing, and oncology. We look forward to the opportunity to serve and grow with all of our customers, including now Optum.

As we assess investment opportunities and we allocate resources across the enterprise, we strive to ensure that our decisions align with our strategic priorities and with our mission of improving healthcare in every setting. We want to become not only a diversified healthcare services company, but also a company that enables positive change in our communities and drives impact.

In April, we launched a new initiative aimed at advancing HealthEquity for at-risk populations in underserved communities. We have a long history of working with pharmacies and providers in the community setting. Now, we want to leverage our business resources and expertise to support their growth and enable better access to healthcare in many of these communities. With this project, we look to identify and address pharmacy deserts where residents face significant challenges in accessing essential pharmacy services.

We chose Avondale, Ohio as our pilot activation site. We helped facilitate an expedited path to an independent pharmacy ownership in the local community, and we opened the pharmacy this past December. I had the opportunity to be there personally and experience the joy of those who live in that community appreciating something that most of us take for granted, a pharmacy near our house. We look forward to making a lasting difference in more communities like Avondale in the future.

We also support and fund many charitable works through the McKesson Foundation. This past year marked an important milestone for the foundation as it celebrated its 80th anniversary. During the last year alone, it funded nearly 50 organizations through its grant-making program and dispersed approximately $9 million, one-third of which supported direct patient care and assistance. We're also pleased to see continued increase in employee participation in these impactful initiatives. In fiscal 2024, McKesson employees put in over 44,000 volunteer hours with charities across the US and Canada. I'm truly proud of what we have achieved as a team to support the communities and to live our purpose of advancing health outcomes for all.

Now let me pull that all together. McKesson delivered performance above our initial expectations in fiscal 2024, underpinned by continued momentum across the businesses. We finished the year with a growing portfolio of oncology and biopharma services solutions and an expanded core distribution business and a stronger culture that unites us all.

As we look ahead to our fiscal 2025, we're excited about the opportunities to grow our differentiated assets and capabilities. We remain deeply committed to our strategies and priorities, and we're confident in our ability to drive sustainable business growth and generate attractive shareholder return. Team McKesson is more focused and more agile as we enter this new fiscal year with strength and confidence.

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

Britt J. Vitalone

Chief Financial Officer & Executive Vice President, McKesson Corp.

Great. Thank you, Brian, and good afternoon, everyone.

Fiscal 2024 marks another year of strong execution and financial performance. We entered fiscal 2025 with the momentum to deliver growth and create value for our customers, partners, and shareholders. Today, I'll discuss our fourth quarter and full-year fiscal 2024 results. Then I'll provide an overview of our fiscal 2025 outlook. My comments today will refer to our adjusted results unless I state otherwise.

We're exiting fiscal 2024 with solid performance, delivering earnings per diluted share of $6.18 in the fourth quarter and $27.44 for the full year. Our fourth quarter results were in line with our expectations and with the earnings per diluted share guidance range that we provided on our third quarter earnings call, demonstrating our ability to consistently execute against company priorities and create long-term sustainable value for our shareholders.

For the full year, when excluding fiscal 2023 contributions from COVID-related programs and McKesson Ventures, adjusted operating profit grew 9% and adjusted EPS increased 17%. These results are above our long-range targets and reflect the strength of our products, services, and operating execution.

Let me start with a review of the fiscal fourth quarter. Revenues increased 11% to $76.4 billion, led by growth in the US Pharmaceutical segment, resulting from increased prescription volumes, including higher volumes from specialty products, retail national account customers, and GLP-1 medications. Gross profit was $3.3 billion, an increase of 7%, primarily a result of specialty distribution growth within the US Pharmaceutical segment, including our leading plasma and biologics business.

Operating expenses increased 11% to $2.1 billion, driven by higher costs to support growth across the businesses. During the quarter, we recorded a reserve for environmental matters of $0.09 per share for increased remediation costs related to McKesson's former chemical business, which we disposed of several years ago. The environmental reserve was recorded in our corporate segment.

Operating profit was $1.3 billion, which was flat to the prior year, driven by growth in the US Pharmaceutical segment, offset by increased corporate expenses, which included the previously outlined environmental reserve. Year-over-year results were also impacted by anticipated lower contributions from US government COVID-19 programs in both the US Pharmaceutical and Medical Surgical Solutions segments when compared to the prior year. When adjusting for the COVID-19 programs and a modest McKesson Ventures loss in fiscal 2023, adjusted operating profit increased 4% in the quarter.

Moving below the line, interest expense was $75 million, an increase of 7%, driven by higher short-term borrowings of commercial paper compared to the prior year. The higher short-term borrowings resulted from lower average cash balances, in part due to the impact from the Change Healthcare outage.

The effective tax rate for the quarter was 28.1%, which is in line with our previous guidance and driven by a discrete tax item. Fourth quarter diluted weighted average shares outstanding was 131.6 million, a decrease of 5% year over year.

Wrapping up our consolidated results, earnings per diluted share was $6.18, again, in line with the implied earnings per diluted share that we provided on our third quarter earnings call. While this represents a decrease of 14% compared to the prior year, fourth quarter results were principally driven by a higher tax rate and lower COVID-19 program contributions in fiscal 2024, partially offset by a lower share count and growth in the US Pharmaceutical segment.

Turning now to our fourth quarter segment results, which can be found on slides 7 through 11 and starting with US Pharmaceutical. Revenues were $68.8 billion, an increase of 12%, driven by increased prescription volumes, including higher volumes from specialty products, retail national account customers, and GLP-1 medications.

As we have previously guided, GLP-1 medications continued to show growth year over year. But despite this increase, the rate of growth continues to moderate. In the quarter, GLP-1 revenues were $7.5 billion, an increase of approximately $1.5 billion or 24% compared to fiscal 2023. However, GLP-1 revenues were flat on a sequential basis.

For the quarter, operating profit increased 5% to $901 million, driven by growth in the distribution of specialty products to providers and health systems and increased contributions from our generics program. The breadth of capabilities and assets continued to deliver robust value to our stakeholders.

In our Prescription Technology Solutions segment, revenues were $1.2 billion, which were flat to the prior year. Lower contributions from the third-party logistics business were offset by growth across our technology services products and primarily our access solutions.

Within this segment, CoverMyMeds continues to deliver value for our partners by increasing connectivity between pharmacies, providers, payers, and biopharma manufacturers through next-generation access, affordability, and adherence solutions that are automated and integrated into provider workflows.

Results in the fourth quarter reflect organic growth across our access solutions, including prior authorization services, as we extended existing partnerships with biopharma manufacturers. In addition to the strength of our access solutions, year-over-year performance was also supported by higher volumes across our affordability solutions.

Operating profit decreased 3% to $212 million, driven by higher costs and investments to sustain the momentum and growth across the biopharma services platform. This included incremental infrastructure investments and costs to deliver increasing levels of ROI for our customers. Operating profit was also impacted by lower third-party logistics performance in the quarter as compared to the prior year.

Turning to Medical Surgical Solutions, revenues were $2.8 billion, an increase of 6%. And operating profit was $248 million, which was flat versus the prior year. Fourth quarter results reflect growth in the primary care and extended care businesses, including higher volumes of illness season testing, partially offset by lower contributions from the kitting storage and distribution of ancillary supplies for the US government's COVID-19 program compared to the prior year. As a reminder, each illness season is unique depending on the onset and severity of various respiratory illnesses during that particular year.

Next, let me address our international results. Revenues were $3.5 billion, an increase of 6%. And operating profit was $94 million, an increase of 18%. These strong results were driven by higher pharmaceutical distribution volumes in the Canadian business compared to the prior year.

Wrapping up our segment review, corporate expenses were $193 million in the quarter, an increase of 30%, driven by the previously discussed environmental reserve and higher technology infrastructure and compliance spend.

Let me now turn to cash and capital deployment, which can be found on slide 12. We ended the quarter with $4.6 billion in cash and cash equivalents. For the fiscal year, we generated $3.6 billion in free cash flow, including $687 million of capital expenditures, which included new and existing distribution centers as well as investments in technology, data, and analytics to support our growth priorities.

During the quarter, several of our customers were impacted by the Change Healthcare outage, delaying billing functions and claims payments. This outage created a timing impact on McKesson's cash flows. However, the impact was less severe than we had previously indicated.

We continue to focus on capital deployment to drive value for our stakeholders. In fiscal 2024, we returned $3.3 billion of cash to shareholders. We returned $3 billion through share repurchases at an average price per share of approximately $436, including $678 million of share repurchases in the fiscal fourth quarter.

Additionally, we paid dividends of $314 million for the full year. When combining share repurchases with dividends paid, we returned approximately 92% of free cash flow to shareholders in fiscal 2024.

Since the beginning of fiscal 2019, we have returned $16.2 billion of cash to shareholders through share repurchases and dividends. Of this amount, approximately $14.5 billion has been returned through share repurchases, reducing our total average shares outstanding by nearly 36%.

The strength of our balance sheet and strong credit metrics, supported by our strong operating performance and disciplined and balanced financial policy, was recognized in the quarter by the recent Moody's credit rating upgrade to A3 from Baa1. We are now A-rated by two of the three major credit rating agencies.

Our strong balance sheet and consistently robust cash flow generation, along with disciplined capital allocation, continues to provide us with the financial flexibility to invest in our growth initiatives, pursue strategic opportunities, and return capital to shareholders, all while maintaining a durable capital structure.

Now let me discuss our fiscal 2025 outlook. The breadth of our capabilities and leading portfolio of assets across oncology and biopharma services have led to value creation for our customers, partners, and shareholders over the last five years. Our fiscal 2025 outlook is a continuation of this momentum.

Let me start with our segments. We anticipate US Pharmaceutical revenues to increase 16% to 19% and operating profit to increase 8% to 10%, propelled by sustainable momentum in the core distribution business and growth across our oncology platform. We continue to make investments in the core distribution network to deliver more efficiency and value for our stakeholders.

The strength of our value proposition was highlighted by the recent agreement to build on our existing pharmaceutical distribution partnership with Optum. This five-year contract begins on July 1, 2024. The fiscal 2025 segment outlook incorporates stable, growing prescription utilization trends, bolstered by further growth in our generic sourcing programs and specialty distribution, including our leading plasma and biologics business.

We anticipate further growth from our differentiated oncology platform through the breadth of our assets, US oncology network, Ontada, and the Sarah Cannon Research Institute joint venture. As Brian mentioned, as of April 2024, the US oncology network has grown to approximately 2,600 providers in 31 states, and we're pleased with the advancements we've made with Ontada and Sarah Cannon Research Institute supporting our mission to advance cancer care. We are pleased with the growth we're seeing in the US Pharmaceutical segment as our assets and capabilities and core distribution and the oncology platform continue to accelerate growth.

In the Prescription Technology Solutions segment, we anticipate revenues to increase 18% to 22% and operating profit to increase 12% to 16%. This outlook reflects organic growth across our solutions and services as we expand and extend partnerships with biopharma manufacturers and increase the number of brands utilizing our access, affordability, and adherence programs. Throughout fiscal 2024, we continued to see increased demand for our access and affordability solutions, particularly those related to GLP-1 medications. As a reminder, McKesson's prior authorization products serve the majority of the brands through GLP-1 medications. Our products continue to generate value for our partners. Looking ahead to fiscal 2025, we anticipate that this demand will remain elevated, yet lessen as the rate of increase will be slower than prior years for GLP-1 medications.

The Medical Surgical business remains well positioned to leverage the breadth and depth of its services and assets across all alternate sites of care, including growth in the primary care business and our comprehensive private label portfolio. We anticipate Medical Surgical Solutions revenues to increase 4% to 8% and operating profit to increase 6% to 8%.

Within the primary care market, we anticipate continued growth in Lab Solutions and Specialty Pharmaceuticals. Our scale, sourcing, and distribution footprint has propelled expansion and growth of our private label portfolio, providing superior value for our customers while maintaining sound economics for McKesson.

In fiscal 2025, we're making investments in this segment to support the recent acquisition of Compile, a healthcare data platform that captures and aggregates data to provide insights and analytics for biopharma. We believe there's an initial use case across the breadth of the Medical Surgical Solutions segment. The Medical Surgical Solutions segment has broad relationships with providers and extensive data sets, leading to opportunities to develop incremental value creation opportunities.

Longer term, there are increased opportunities to integrate the capabilities and commercial applications across our oncology and biopharma services platforms. These investments will deliver meaningful returns to the segment and to the enterprise.

In fiscal 2025, we anticipate that these investments will account for an approximate 2% operating profit headwind in the Medical segment as compared to the prior year.

Finally, the International segment, we anticipate revenues to increase 4% to 8% and operating profit increase 6% to 10% year over year. Our diversified set of assets within our Canadian business, including the scaled distribution business, continues to support growth in the international segment. We continue to make investments in our Canadian technology footprint to create a more custom and integrated supply chain for specialty drugs.

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

In the Corporate segment, we anticipate expenses to be in the range of $580 million to $640 million, which includes increased technology spend to support the growth of our businesses and infrastructure and compliance investments. We will also continue to invest in data and analytics, including the acceleration of several investments in artificial intelligence. We are leveraging AI to increase the efficiency across our operations and increase automation and productivity for our customers.

Our investments in AI and other advanced technologies play an important role in improving customer service and provider productivity. We continue to build these tools across the value chain to increase speed and success rates.

One example where we're implementing AI is in our oncology platform. The iKnowMed EHR contains structured data that can often be sparsely entered for patients' longitudinal records. Instead, unstructured data, such as uploaded documents and provider-authored notes, are used to capture details on patients' disease condition and response to treatment as well as many core clinical factors.

To have complete longitudinal patient records for real-world research, core variables are required to be extracted from the unstructured data into a well-organized database. Natural language process is the only scalable solution to achieve more than 100 million documents in iKnowMed today and growing at the rate of 1 million documents per week.

The application of AI reduces clinicians' exhaustive burden in finding related documents for care and reimbursement workflows, ultimately leading to practice efficiencies and better patient care. This is just one example of many where we're using AI to power insights and deliver clinical and financial value to our stakeholders.

We've been pleased with our progress to date as we work to develop and implement various AI technologies, and we remain committed to increased investment to further extend our leadership positions and deliver value to our partners and stakeholders.

Now moving below the line, we anticipate interest expense to be approximately $220 million to $240 million, and income attributable to non-controlling interests to be in the range of $140 million to $160 million. We anticipate the full-year effective tax rate will be in the range of approximately 18% to 20%. And as a reminder, the timing and amount of discrete tax items are difficult to predict, and therefore, we do not provide quarterly effective tax rate guidance.

Turning now to cash flow and capital deployment, we anticipate free cash flow of approximately $4.8 billion to $5.2 billion. Our working capital metrics and resultant free cash flow will vary from quarter to quarter and are impacted by timing, including the day of the week that marks the close of a quarter.

Our guidance reflects plans to repurchase approximately $2.8 billion of shares in fiscal 2025. As a result of this share repurchase activity, we estimate weighted average diluted shares outstanding to be in the range of approximately 128 million to 130 million. The strength of our balance sheet and operating cash flows provides the financial flexibility to incrementally invest both organically and inorganically for growth as well as return capital to our shareholders.

Wrapping up fiscal 2025 guidance, we anticipate revenue growth of 15% to 17% and operating profit growth of 9% to 14% as compared to the prior year. For fiscal 2025, we anticipate earnings per diluted share of $31.25 to $32.05, which represents growth of 14% to 17% as compared to fiscal 2024. We expect earnings per share will be more heavily weighted towards the second half of the fiscal year. We also anticipate the first quarter to have the lowest contribution. As a reminder, we had a lower effective tax rate in the first quarter of fiscal 2024 due to a discrete tax item.

In summary, we see strength and stability in the underlying fundamentals across our businesses. Our sustained financial performance over the past several years has been bolstered by the strength of our financial position and the consistent operating execution, leading to compelling value creation for our customers, partners, and shareholders. We're pleased with the strong fiscal 2024 performance. And the fiscal 2025 outlook reflects our continued confidence in the operating profit growth momentum across all segments of the business, supplemented by the strength of our balance sheet and strong financial position. McKesson is well positioned to deliver strong results as we successfully execute against our strategic and financial framework to drive long-term sustainable growth for all stakeholders.

With that, we can move to Q&A

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question will come from Kevin Caliendo with UBS. Please go ahead.

Kevin Caliendo
Analyst, UBS Securities LLC

Q

Great, thanks for taking my question. I appreciate all the color on the guidance. I just want to delve into a little bit of the pharma growth increase. How much of that is related to Optum? And were there any costs – onboarding costs associated with bringing a contract like that on board, meaning did it dilute the impact this year?

And then as a quick follow-up, I noticed you didn't mention Optum as being part of the MedSurg guidance. There is some belief that that was also a potential contract win for you or an incremental contract win for you there. Is that not true, or is there just no impact this year?

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

A

Thanks for the question, Kevin. I'll start. Maybe I'll go in reverse order. Our win of the Optum contract, and we're certainly pleased to extend and expand our partnership, as Brian mentioned, is pharmaceutical-related only. As we think about next year, Optum is included in our guide. As you know, we do not specifically talk about customer contract details, and so we have not provided specific contributions for Optum, and we don't intend to do that going forward. This is a recent contract win. We have not incurred any costs yet related to that transition. We do expect that there will be some costs in the transition, but not material and certainly included in our guidance.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.

A

Next question, please.

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

Allen Lutz
Analyst, BofA Securities, Inc.

Q

Good afternoon and thanks for taking the questions. One for Britt, I want to ask about the prior authorization business and RxTS. We've heard that employer coverage for GLP-1s doubled year over year, so the amount of employees that have coverage of GLP-1s is now twice as high as it was in 2023. So even though the amount of GLP-1s that you're dispensing is lower, we would have still expected that prior authorization activity in that business would have benefited pretty significantly in calendar 1Q. Did any of the GLP-1 related prior authorizations get pushed out of calendar 1Q? Was there any impact from change? And can you just speak to the growth rate of that business more broadly? Thanks.

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

A

Yeah, thanks for the question. I'll start, and certainly Brian could add to this. I think when we've talked about this segment in the past, there are many different things that go through this segment, one of those being our 3PL business. Our 3PL business, as we talked about in the past, is slightly more than half of the revenue. And as I mentioned in my comments, the 3PL performance was lower than the prior year for various customer and contract considerations.

We're certainly pleased with what we're seeing in our prior authorization business. We continue to see growth in that business. We continue to see growth in our fiscal fourth quarter as well. We did make a number of investments, as I talked about, and we also made some investments for future years to continue our growth and continue the value that we're providing to our customers.

So underlying all of that, we had a very strong year. The business grew on the bottom line 23% year over year, so there's great momentum there. Prior authorization business as part of our access solutions did have growth in the first quarter. But as I mentioned, we had slower 3PL performance and we continue to make some investments into the business for future growth.

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

A

As it relates to payer and frankly employer behavior as it relates to the coverage of these drugs, I think you've got to probably bifurcate it into diabetes, which is a more mature indication, weight loss, which is kind of emerging tracking follow-on conditions that it may or may not be applicable to. So I think it's in the early days of employers and payers figuring out how to handle this, and across that spectrum, it can be quite different.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.

A

Next question, please.

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

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Q

Thanks very much. I just want to go back to the Pharmaceutical operating profit for 2025. If I go back and I look at kind of your long term out, like you talked about 5% to 7% growth. You're now talking about 8% to 10%. One, I know you don't want to talk about specific customers, but is this tied to the new customer win, or is there something else that's propelling that?

And then as I think about Optum, your comments were that you started a relationship last year. You've increased the scope of services. You're now doing sourcing, distribution, oncology. Can you maybe just help us understand, one, in winning that business; and secondly, how we look at Optum versus maybe some of your other clients and any incremental opportunities you see with Optum going forward?

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

A

Thank you, Lisa. I appreciate the question. Look, we're obviously really excited to get the privilege and the opportunity to expand our relationship with Optum. And I think it's a testament to the differentiated services and solutions, the breadth of our diversified healthcare service offerings. Optum itself is a big complicated entity with lots of services and lots of solutions, so we're really happy to have the opportunity.

I do think it's a reflection on the investments that we've made over the past several years and the efficiency of our core operations, our commitment to continuing to make those investments, not just in efficiency, but in innovations and thinking about how we use our tools to solve different problems. This is very much today a distribution agreement. We'll be servicing Optum home delivery to Optum infusion, OptumCare, the specialty pharmacy. So it's very broad in that regard. But I do think it's a reflection of past investments that we've made, not just in distribution, but in the portfolio of capabilities that we offer.

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

A

Lisa, maybe I'll answer your question. Maybe I would just start with just a little bit of a foundation building here. If you think about the US Pharma segment over the last four years, the adjusted operating profit has grown at a compound annual growth rate of about 6%, so really right in the middle of the long-term targets that we provided. They're long-term targets for a reason. It's what we expect as a sustainable growth rate for the segment. We're certainly pleased with the growth that we saw in FY 2024. If you exclude the impact of COVID-related programs in FY 2023, the segment grew 12%. So we certainly have a lot of momentum in that business as we enter into FY 2025. As Brian mentioned, we're certainly pleased with the opportunity to serve Optum as well.

So this is a business that we've been making a lot of investments in. It's a business that we have some expertise that we're continuing to add to in terms of our sourcing capabilities, providing value back to our customers. And we have a lot of momentum in this segment. And so I think the growth rate that we've outlined here for 2025 is a continuation of the momentum that we've seen now over the last several years.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.

A

Next question, please.

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

Michael Cherny
Analyst, Leerink Partners LLC

Q

Good afternoon. Thanks for taking the question and congratulations on a really nice guide. As we think forward, both for 2025 and beyond, I want to ask a little bit about the oncology side of your assets and maybe wrap it into the secondary question, but you continue to scale stuff like USO and Ontada alongside, obviously, everything inside the Pharma Services segment. As you think about the totality of the assets and the ability to build off of that platform, how does that dovetail with your ability also to utilize your ever-growing free cash flow to continue to drive inorganic growth on top of organic? And within that portfolio of, again, broad-based oncology assets, what are the best areas you have to continue to expand beyond where you already are?

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

A

Thank you. Michael, I appreciate that. We talked about many times our capital allocation strategy, and our first priority in that strategy is to invest to grow the business either through internal development and investments in innovation or inorganic opportunities.

Certainly, when we look at inorganic opportunities or M&A, we like that to be very, very tightly aligned to our articulated strategy with the associated proper financial returns, of course. And so oncology is one of those growth areas and one of those growth priorities. And being a pretty significant player in the oncology space in general and the leading player in the community oncology space, we're very familiar with a lot of, I would call, emerging tools, technologies, and companies out there. And anywhere that we can find an asset that's aligned to our strategy in community oncology that we think is additive to either the footprint that we have in US oncology or our leading EMR or our adds capability to our data insight business or accelerates clinical trials would be very much a sweet spot for us.

Britt actually referenced in his comments some internal stuff we're doing around AI. And we have made some small acquisitions in the past that bring us capabilities in this area that are helping us improve our interface with patients, our efficiency in serving those patients, and improving the practice quality or the lifestyle basically of our oncologists, the practices part of US Oncology. And we think that's part of the overall formula that's been really supporting and enabling, quite frankly, the record growth that we had last year.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.

A

Next question, please.

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

Charles Rhyee
Analyst, TD Cowen

Q

Thanks for taking the question. I wanted to circle back to RxTS, obviously, looking at a really positive outlook. But thinking about the preliminary fiscal 2025 guide you kind of gave for this segment last quarter, the final guide actually is a little bit better here. Any sort of comments on what is driving sort of the increased optimism here? Is it solely just as we're thinking about maybe GLP-1s? Or maybe can you talk about sort of any kind of gains at RelayHealth as it relates to the Change Healthcare outage? Any comments there would be helpful. Thanks.

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

A

Thanks for the question. I'll start. So the AOP growth guide that we provided you for FY 2025 is really right in the range of what we've seen for growth over the last four years, maybe just slightly below. We had 16% compound annual growth rate in this business on operating profit since FY 2020. And so the growth rate that we've provided you this year is really kind of right in line with that. And we intend to continue to make investments in this business as we go forward to develop additional solutions and capabilities for our customers.

So we expect that our technology solutions and services will continue to grow as they have over the last few years. The value that we're providing for our partners is continuing to resonate, and we see stable prescription growth. It's really underpinning a lot of the programs and solutions that we have. And the growth rate that we expect for next year is really in line with what we've been able to deliver over the last several. And we'll continue to, as Brian talked about, we'll use our free cash flow to invest in our growth opportunities as we go forward.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.

A

Next question, please.

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

Eric Percher
Analyst, Nephron Research LLC
Q

Thank you, a question related to competitive intensity, and specifically contract movement we've seen. I think with Optum, there was a real concern that the contract could even be outsourced or element of specialty could be outsourced. And yet here it comes to you, and we've also seen CVS outsourcing scale to you.

So my question would be, do you believe that you've developed a scale advantage and mail on specialty that is unique relative to other distributors, and/or how important is the specialty footprint in driving the value that has led to these significant gains?

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

Thanks, Eric. Look, I'm not going to comment much on the competitive set. But I can say we have made some pretty significant investments in the business to modernize our distribution infrastructure. Think about cold chain, how you handle cold chain efficiently, have a highly compliant distribution network. We certainly have scale.

And in this business, I've been in this business 28 years, and scale does tend to help. But I really come back to the fact that we've made the investments in core distribution excellence. We clearly understand this piece of the market quite well. and that we think of ourselves as a solution-oriented value-added kind of partner and try to paint a broad picture of not just what we could do if we had a relationship but how we could grow that relationship through time using an array of the capabilities represented within McKesson.

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

Eric, I would just add to that. If you think about the strategy that we've executed on over the last several years, we've been very disciplined and focused and really growing our capabilities in oncology and pharma services, including the investments that Brian spoke of in terms of our distribution network.

So the breadth of capabilities that we have today is more significant than it was a few years ago. And the value that we're able to provide now through the investments that we've made through some of the other acquisitions that we've made in like oncology as an example, we believe that that value is what is attractive and the breadth of capabilities that we have as well.

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

Next question, please.

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

Stephanie July Davis
Analyst, Barclays PLC
Q

Hey, guys, thank you for taking my questions and congrats on the guidance. I was hoping to get a little bit more color about the nature of the biopharma investments you're making in the prescription transaction business. Just kind of nature of it, whether they're more of a recurring expense, like head count compared to more near-term pockets of them like platform development, and anything you can give us on that?

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

Yes. So I'll start, and if Britt wants to add anything he can. I mean we have a pretty differentiated set of assets in this business, scaled – multiple scaled networks is what we call them, which includes connectivity into provider workflow, and we very much fundamentally think part of our job is to continue to innovate off of those to both enhance the value and the return our products provide to biopharma and to continue to solve new problems for them.

So we have historically always invested in this business. And when we see an opportunity ahead of us, we are not afraid to increase that investment to run at that because we think these differentiated assets allow us to solve problems in unique ways. Most of this investment has been in technology, and that's probably about all I would say.

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

Next question, please.

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

Elizabeth Anderson
Analyst, Evercore ISI
Q

Hi, guys. Thanks so much for the question and congrats on a nice guide. I was intrigued by your comments about the MedSurg segment and sort of how you're thinking about data and the use of assets with the new acquisition you just made. It seems like a little bit of a shift into more sort of additional value-added services in that segment. Could you give a little bit more color on that and sort of how you see that evolving over the next couple of years?

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

Sure. I mean in many ways, we thought of Compile as a foundational data investment for us. And we like the business by itself, but we also thought, given some of the other data sets, transaction sets that reside in the company, we could augment and add and accelerate that.

We chose the first use case in the medical business, where we have extensive, hundreds of thousands of relationships with providers and data that complement their already strong provider data service offering. So we think we can both augment that and unlock unique value because of the footprint and reach in MedSurg. And so we're making an investment into that thesis.

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

Next question, please.

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

Daniel Grosslight
Analyst, Citigroup Global Markets, Inc.
Q

Hey, guys. Thanks for taking my question. I want to go back to the question that Charles asked on RxTS. But really on the top line, you're seeing a material acceleration in growth next year while, as you mentioned, the adjusted operating income is kind of in line with where you've been historically. So that does imply a bit of a degradation in margin. So I was hoping you could put a finer point on the growth acceleration on the top line and margin compression you're seeing. Is that mix shift to lower margin businesses? Is that the increased investments you're making? Any color there would be great. Thanks.

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

Thanks for that question. I can answer that. The growth that we're seeing next year on the top line is more accelerated growth in our 3PL business. As we've talked about before, the 3PL business generally represents a little more than half of the revenue in the segment, but less than 10% of the adjusted operating profit. And so as we expect to win some additional business next year and see some of our customers continue to grow, that revenue will be faster rate than we've seen in prior years.

And given the mix that that represents in the segments driving faster top line again, at a lower margin rate on the bottom line from that particular business, 3PL business. So the underlying technology businesses are continuing to grow in a consistent manner, and we're really pleased with the growth that we're seeing there. But what you're seeing is a mix impact in FY 2025 from the 3PL business.

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

Next question, please.

Operator: And next will be Erin Wright with Morgan Stanley. Please go ahead.

Erin Wilson Wright
Analyst, Morgan Stanley & Co. LLC
Q

Great, thanks. I wanted to get a little bit of color on what you're seeing and what's embedded in your guidance in terms of the pricing environment on the US pharma business and what assumptions you're making in terms of generic pricing trends and environment that you're seeing as well as kind of on the branded side. I know that's less of a swing factor for you, but how is that playing out relative to your expectations here?

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

Sure, happy to answer that question. As we think about the pricing environment for branded products, it is going to be – our anticipation is it would be very consistent with what we've seen in the past several years, so stable and competitive branded price environment. And in the generic space, again, we look to drive value for our customers through our sourcing operations and looking to drive the lowest cost at the highest availability supply. And we believe that in our outlook for FY 2025, we expect to see a competitive and stable environment in the generic space as well.

So we don't see a lot of changes in the environment for both branded and generics pricing in our outlook versus FY 2024. And we anticipate that we can continue to drive good value in the generic space for our customers.

Rachel Rodriguez
Vice President of Investor Relations, McKesson Corp.

A

I think we have time for probably one more question.

Operator: Certainly. That question will come from Stephen Baxter with Wells Fargo. Please go ahead.

Stephen Baxter
Analyst, Wells Fargo Securities LLC

Q

Hey, thanks for the question. Much of the guidance, I wanted to ask one on the quarter. Just on the pharma revenue growth rate, was wondering if you could help us think about any impact you might have seen from insulin list price changes in the quarter. It sounds like that was probably a headwind to your revenue growth rate? And any contribution from commercial COVID vaccines in the quarter that we should be mindful of? Thanks.

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

A

Yes, nothing really specific to call out there, Stephen. And as it relates to COVID vaccines, as I mentioned, we are lapping the COVID programs that we had last year and from a commercial vaccine perspective, lower contribution that we saw in the third quarter, really a non-material amount of contribution to our fourth quarter results.

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

Well, thanks again, everyone, for joining our call this evening. We appreciate your ongoing interest and support of McKesson. I want to thank you, operator, for facilitating the call.

McKesson reported solid performance in fiscal 2024. I'm really pleased with the momentum across the segments and the continued commitment to our company's priorities.

Looking ahead to 2025, I remain confident in our ability to consistently execute against our strategies, which will support and sustain growth in the long term. We're excited about the opportunity to grow with our customers, to drive innovation through our differentiated portfolio of services and solutions. But most importantly, it's in service of our mission to advance – improve healthcare in every setting

So I appreciate everyone's time. I hope you have a terrific evening.

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