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# McKesson Corp. (MCK)

Q1 2022 Earnings Call

# **CORPORATE PARTICIPANTS**

# **Holly Weiss**

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

### **Brian Scott Tyler**

Chief Executive Officer & Director, McKesson Corp.

### **Britt Vitalone**

Chief Financial Officer & Executive Vice President, McKesson Corp.

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Welcome to the McKesson's Q1 Earnings Call. Today's conference is being recorded. At this time, I would like to turn the call over to Holly Weiss. Please go ahead.

# **Holly Weiss**

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

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

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

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

With that, let me turn it over to Brian.

# **Brian Scott Tyler**

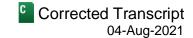
Chief Executive Officer & Director, McKesson Corp.

Thank you, Holly, and good afternoon, everybody. Thank you for joining us on our first quarter call today. We are pleased to be reporting a strong start to our fiscal 2022, which reflects continued operating momentum across our businesses despite the fact that our markets are still recovering from the impacts of COVID-19. We're also making significant progress against our strategic priorities and our commitment to do what's in the best interest of you, our shareholders.

Before we get to our first quarter results, I want to provide an update on the progress made towards a broad resolution of governmental opioid-related claims. On July 21, we announced that McKesson, along with two other distributors, negotiated a comprehensive proposed settlement agreement, which, if all conditions are satisfied, would result in a settlement of a substantial majority of opioid lawsuits filed by state and local governmental entities. If this broad resolution – if this broad agreement becomes effective, the agreement reached between the distributors and the state of New York and its participating subdivisions to settle opioid-related claims will become part of this broader settlement agreement.

Under the negotiated proposed settlement agreement and subject to final state, territorial and political subdivision participation, McKesson will pay up to \$7.9 billion over a period of 18 years. Over the next several months, we will monitor participation of the eligible governmental entities to determine if participation levels are sufficient to proceed. This is an important development, and I am pleased with the progress we've made after years of negotiations.

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If we're able to reach a final settlement, it would provide immediate relief to thousands of communities across the United States that have been impacted by this public health crisis. While we strongly dispute the allegations made in these lawsuits, we believe that bringing resolution to these outstanding claims is in the best interest of those impacted by this crisis. We also believe resolution is in the best interest of our shareholders, and will allow us to further focus on the business and our role in protecting the safety and the integrity of the pharmaceutical supply chain.

We remain committed to doing our part to fight against the opioid epidemic through efforts to continuously enhance our anti-diversion programs and to advocate for reform at the state and national level. If the settlement cannot be finalized or plaintiffs instead choose to pursue their claims in court, we are prepared to litigate against those claims, and we remain confident in our defenses.

We also recently announced that we entered into an agreement to sell several of our McKesson Europe businesses to the PHOENIX Group, who we believe is the right and natural successor to McKesson and the ideal leader of these European businesses going forward. The agreement includes our McKesson Europe businesses in France, Italy, Ireland, Portugal, Belgium and Slovenia as well as our German AG headquarters in Stuttgart, our shared service center in Lithuania, our German wound care business and our equity stake in our joint venture in the Netherlands. This transaction is expected to close in fiscal 2023, subject to customary closing conditions, including the receipt of required regulatory approvals.

Our remaining European businesses in the UK, Norway, Austria and Denmark were not included in this transaction and will continue to be operated by McKesson. However, we are exploring strategic alternatives for these remaining businesses as we align future investments to our growth strategies outside of Europe. We believe fully exiting Europe is another step towards becoming a more streamlined and efficient organization.

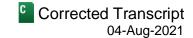
Let me turn now to our performance in the quarter. We are continuing to see the operating momentum we discussed on our fourth quarter fiscal 2021 earnings call. Today, we're reporting adjusted earnings per diluted share of \$5.56, ahead of our original expectations, resulting from the strength across our businesses and our roles in the COVID-19 response efforts across the geographies in which we operate.

Our US and international distribution businesses are playing an integral role in the pandemic response and our operational excellence and capabilities continue to be highlighted through our evolving partnership with the US government's COVID-19 vaccine distribution efforts. Through July, our US pharmaceutical business has successfully distributed over 185 million Moderna and J&J COVID-19 vaccines to administration sites across the United States, and our medical business has now assembled enough kits to support the administration of more than 785 million doses for all vaccine types.

Also in the quarter, the US government asked McKesson to support their mission of sending millions of COVID-19 vaccines to countries in need all around the globe. We are picking and packing Moderna and Johnson & Johnson COVID-19 vaccines into temperature-controlled coolers and preparing these vaccines for pickup by international partners, all at the direction of the US government.

McKesson is not managing the actual shipments of vaccines to other countries. Through July, we successfully prepared over 65 million COVID-19 vaccines for shipment abroad. We are humbled and honored to serve the US government in this expanded role.

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Our roles in Europe and Canada are also continuing to evolve, and we're partnering with local governments to distribute and administer COVID-19 vaccines there as well. Through July, we've distributed over 45 million vaccines to administration sites in select markets across these geographies.

Based on our first quarter results, our evolving roles in the COVID-19 response efforts and our confidence in our outlook for the remainder of our fiscal 2022, we are raising our adjusted earnings per diluted share guidance to \$19.80 to \$20.40 from a previous range of \$18.85 to \$19.45.

As I mentioned in my opening remarks, we're making significant progress against our strategic priorities. We're simplifying the portfolio and increasing our focus on areas where we have deep expertise and that are central to our long-term growth strategy. Our progress to-date is underpinned by execution against our top company priorities.

The first is a focus on the people and the culture. The second is our commitment to strengthen the core pharmaceutical and medical supply chain businesses. The third, our intentional efforts to simplify and streamline the business. And finally, to continue to invest to advance our differentiated oncology and biopharma services ecosystems.

Let me now touch briefly on the progress we're making across each of these priorities. First and foremost, we're prioritizing our people and advancing our company's culture as we strive to be recognized as an impact-driven organization and the best place to work in healthcare. We've been hard at work to transform and energize our company's culture. Our ICARE and ILEAD values serve as the foundation as we work toward our common goal, advancing health outcomes for all.

As an organization, we're committed to advancing diversity, equity and inclusion. For the sixth consecutive year, McKesson was named a Best Place to Work for Disability Inclusion. McKesson earned a top-ranking score of 100 on the 2021 Disability Equality Index.

In addition, we marked progress in diverse representation in the US with female executive representation up 3% over the prior year and a 6% gain over the prior year in executive representation for persons of color. Our second company priority is to strengthen our core distribution businesses where we have market-leading scale and capabilities across North America. Success in the core enables strong cash flow generation, which we in turn use to reinvest in the business and to return capital to our shareholders.

In addition to our work to help our customers and government partners in their pandemic response efforts, our pharmaceutical and medical surgical distribution businesses are continuing to improve and the recovery from the effects of the COVID-19 pandemic has been in line with our expectations.

Elective procedures and primary care visits had improved throughout our first quarter and prescription volume trends are showing signs of improvement as well. Also positive are the trends we've seen across specialty and oncology patient visits, which were at or above pre-COVID baselines in the first quarter. And distribution volumes to our specialty provider customers continue to drive and support our growth.

In our Canadian distribution business, our operational excellence and scale was recently recognized through a new partnership with one of Canada's largest retailers as a primary distribution customer. This is a testament to the strength of our supply chain in Canada. The renewed focus on growing the core has been enabled by our commitment to streamline the business over the past several years, efforts that go beyond our recent announcement to exit the European region, which I commented on in my opening remarks.

Over the past several years, we've committed to transforming our operating model. We've centralized back-office functions across North America and Europe to further rationalize costs through a reduction of our own retail pharmacy footprint and a commitment to lower spend across the organization. Throughout our enterprise, there's an initiative we call Spend Smart, which helped us achieve our three-year cost reduction target of \$400 million to \$500 million of annual cost savings by the end of our fiscal 2021.

Over time, we've identified businesses that are not central to McKesson's current strategic priorities or direction, as was the case in our exit of our position in Change Healthcare and the creation of a German wholesale joint venture with Walgreens Boots Alliance. We will continually review our portfolio to ensure tight and focused alignment to our strategy.

All this work has enabled us to focus our time and investments on our strategic growth pillars, where we're working to build connected ecosystems in the growth areas of oncology and biopharma services, which serve to advance our already differentiated positions. We continue to be confident in the long-term outlook of businesses that operate in these high-growth markets.

Starting with oncology, an ecosystem that McKesson has strategically built over a period of nearly 15 years, beginning with our acquisition of Oncology Therapeutics Network all the way back in 2007, which added, at that time, core specialty distribution capabilities. 10 years ago, we deepened the breadth and the depth of our offering with the acquisition of US Oncology Network, which gave us practice management, site management for research and the iKnowMed EHR, which is one of the foundational pieces of Ontada.

Fast-forward to today and we're now supporting over 14,000 specialty physicians through distribution and GPO services. We're also the leading distributor in community oncology space and have over 1,400 physicians in the US Oncology Network spread over approximately 600 sites of care in the US.

As innovative specialty therapies come to market, our leading position in oncology distribution enables us to grow our connected oncology ecosystem in parallel. As we grow our non-affiliated and our US oncology provider basis, we accelerate the growth of our oncology assets, such as GPO services, practice management, site management for clinical research, specialty pharmacy and our value proposition for Ontada, where we're providing real-world insight to both manufacturers and providers.

Although in its infancy, Ontada's value is being recognized through expanded partnerships with manufacturers such as Amgen and its leading role in a large-scale real-world research study known as MYLUNG, which aims to improve treatments and outcomes for non-small cell lung cancer.

New therapies coming to market can also provide additional challenges for patients, providers and our biopharma partners. Our Prescription Technology Solutions business invests in innovation and aims to provide access, adherence and affordability solutions for over 500 brands across nearly every therapeutic area. Our connectivity to over 50,000 pharmacies, 750,000 providers and 75% of EHRs in the US helps enable over \$5 billion of prescription savings for patients each year.

Prescription Technology Solutions ended fiscal 2021 with solid momentum. In the first quarter of fiscal 2022, we saw organic growth in the business and encouraging signs that patient engagement levels and prescription volume trends are continuing to improve. Our market-leading technology offerings are helping patients get access to therapies they need more quickly and efficiently and stay on those therapies longer to get better health outcomes.

In closing, we believe that we've made significant strides against our strategic priorities of strengthening the core, simplifying the business and investing in our growth areas of oncology and biopharma services. Announcing the proposed opioid settlement agreement is an important development. In addition, our strategic intent to exit the European region positions us to become a more focused and agile company. We believe both are in the best interest of our employees, in the best interest of our customers and in the best interest of our shareholders.

While it's early in the fiscal year and the pandemic continues to present unknowns, I'm confident in the fundamentals of the business and believe we are positioned well for long-term growth. And we'll look to build upon this momentum over the remainder of our fiscal 2022. Thank you for your time.

And with that, I'll turn it over to you, Britt, for a few additional comments.

#### **Britt Vitalone**

Chief Financial Officer & Executive Vice President, McKesson Corp.

Thank you, Brian, and good afternoon, everyone. I'm pleased to speak with you today about our strong first quarter results, which reflect the importance of the products and services McKesson delivers, the execution and momentum across our business, which includes supporting the US government's COVID-19 domestic and international vaccine and kitting efforts, and the recovery of prescription volumes and patient visits impacted by the COVID pandemic in the prior year.

I'll begin my remarks today by sharing an update on our European businesses, followed by our first quarter results, and I'll close with an update for our fiscal 2022 outlook. The summary of our first quarter results and updated guidance assumptions can be found in our earnings slide presentation, which is posted on the Investors section of our website.

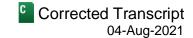
In early July, we announced an agreement to sell our European businesses in France, Italy, Ireland, Portugal, Belgium and Slovenia to the PHOENIX Group. This transaction includes our German AG headquarters in Stuttgart and our European shared service center in Lithuania. The purchase price for the transaction is approximately US\$1.5 billion. The ultimate proceeds from this transaction are subject to certain adjustments under the agreement. Therefore, the proceeds may differ from the purchase price.

The assets involved in this transaction contributed approximately \$12 billion in revenue and \$75 million in adjusted operating profit in fiscal 2021. We've determined that this transaction shall not qualify for discontinued operations. The net assets included in the transaction we've classified as held for sale. The held-for-sale accounting is effective at the start of our second quarter of this fiscal year.

We will re-measure the net assets to the lower carrying amount or fair value, less cost to sell, and we estimate that this will result in a GAAP-only charge of between \$500 million to \$700 million in our second quarter of fiscal 2022. Due to held-for-sale accounting treatment, we'll discontinue recording depreciation and amortization on the assets involved in the transaction.

As a result of the held-for-sale accounting, we would guide to approximately \$0.26 adjusted earnings accretion in fiscal 2022. This will be included in our updated outlook, and I'll outline those later in my remarks. McKesson will operate these businesses and record revenue and income until the transaction is closed, which is expected to occur in fiscal 2023. We're committed to exploring strategic alternatives for our remaining European businesses, and we'll provide details on the plans for the remaining businesses as they become available.

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Exiting Europe at this time is the right course of action for McKesson and our shareholders, and it will sharpen the focus on our growth strategies of oncology and biopharma services as we develop and grow a connected ecosystem.

Let me now turn to our first quarter results. Before I provide more details on our first quarter adjusted results, I want to point out two items that impacted our GAAP-only results in the quarter. First, during the June quarter, we committed to donate certain personal protective equipment and related products to charitable organizations to assist in COVID-19 recovery efforts. In the quarter, we recorded \$155 million of pre-tax inventory charges within our Medical Surgical Solutions segment for inventory, which we no longer intend to sell and will instead direct to previously-mentioned charitable organizations.

And secondly, on our May 6 earnings call, we outlined an initiative to rationalize office space in North America to increase efficiencies and support increased employee flexibility. These actions will result in the realization of annual operating expense savings of approximately \$60 million to \$80 million when fully implemented. Our guidance does not assume a material benefit in fiscal 2022. In the June quarter, we reported approximately \$95 million of charges associated with this initiative.

Moving now to our adjusted results for the first quarter, beginning with our consolidated results, which can be found on slide 7. First quarter adjusted earnings per diluted share was \$5.56, an increase of 101% compared to the prior year. This result was driven by the recovery of prescription volumes and primary care patient visits from the COVID-19 pandemic, as we lapped the most significant pandemic impacts from lockdowns in Q1 of fiscal 2021. It also included a lower tax rate and the contribution from COVID-19 vaccine distribution and kitting programs with the US government,

Consolidated revenues of \$62.7 billion increased 13% from the prior year, driven by growth in the US Pharmaceutical segment, largely due to higher volumes from retail national account customers and price increases on branded and specialty pharmaceuticals, which is partially offset by branded to generic conversions.

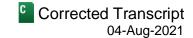
Adjusted gross profit was \$3.1 billion for the quarter, up 19% compared to the prior year. Adjusted operating expenses in the quarter increased 6% year-over-year, led by higher operating expenses to support growth in our core businesses and strategic investments, partially offset by the contribution of our German wholesale business to the joint venture with Walgreens Boots Alliance.

Adjusted operating profit was \$1.1 billion for the quarter, an increase of 55% compared to the prior year, which reflects double-digit growth in each segment. Interest expense was \$49 million in the quarter, a decline of 18% compared to the prior year, driven by the retirement of approximately \$1 billion of long-term debt in fiscal 2021. Our adjusted tax rate was 11.3% for the quarter due to discrete tax items that were recorded during the quarter.

Our full year adjusted effective tax rate guidance of 18% to 19% remains unchanged. And our first quarter diluted weighted average shares were 158 million, a decrease of 3% year-over-year driven by \$1 billion of shares repurchased in the first quarter.

Moving now to our first quarter segment results, which can be found on slides 8 through 12, and I'll start with US Pharmaceutical. Revenues were \$50 billion, an increase of 12%, driven by higher volumes from retail national account customers and price increases on branded and specialty pharmaceuticals, partially offset by branded to generic conversions.

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Adjusted operating profit in the quarter increased 16% to \$682 million, driven by the contribution from COVID-19 vaccine distribution and growth in specialty products distribution to our providers and health care systems, which was partially offset by higher operating costs in support of the company's oncology growth initiative.

Turning to Prescription Technology Solutions, we're very pleased with the strong growth and scale that we're building in this higher-margin segment. The drivers for our Prescription Technology Solutions businesses continue to move in the right direction. First, we're seeing expansion in many of our services businesses as we continue to add more manufacturing partners and programs for our existing solutions such as electronic prior authorization, our access and adherence services and 3PL.

Second, our technology-based platforms, like RelayHealth, support 19 billion clinical and financial transactions annually, from claims routing in the growing discount card market to alerts and edits to make the practice of pharmacy clinically safer and administratively more efficient. And we continue to invest and innovate to build a connected ecosystem of biopharma services, our next-generation access and adherence solution, AMP, is showing accelerated adoption and growth with new brands. This year, AMP is bringing its network-enabled approach to hub services and the support for oncology and specialty drugs covered under the medical benefit.

We also continue to expand our clinical decision support capabilities in provider office workflow across every major EHR. Our technology network spans every touch point in the patient journey, from doctor's office to benefit verification to dispensing pharmacy, which allows us to address barriers in the patient journey by adding unique automation that accelerates time to therapy and lowers patients' out-of-pocket costs.

In the June quarter, revenues were \$881 million, an increase of 34%. And adjusted operating profit increased 62% to \$139 million, driven by higher volumes of technology and service offerings to support biopharma customers, organic growth from access and adherence solutions and recovery of prescription volumes from the COVID-19 pandemic.

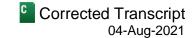
Moving now to Medical-Surgical Solutions, revenues were \$2.5 billion in the quarter, up 40%, driven by improvements in primary care patient visits and increased sales of COVID-19 tests. The contribution from our contract with US government to prepare and distribute ancillary supplies related to the COVID-19 vaccine provided a benefit of approximately \$0.25 in the quarter and were above our original expectations.

For the quarter, adjusted operating profit increased 107% to \$257 million, driven by improvements in primary care patient visits and the contribution from kitting and distribution of ancillary supplies for the US government's COVID-19 vaccine program.

Next, let me speak about International. Revenues in the quarter were \$9.2 billion, an increase of 8% year-over-year. Excluding the impact from the divestiture of our German wholesale business, segment revenue increased 28% year-over-year and was up 14% on an FX-adjusted basis. Revenue was primarily driven by the contribution of our German wholesale business to the joint venture with Walgreens Boots Alliance, which was completed during the third quarter of fiscal 2021, and the recovery of pharmaceutical distribution and retail pharmacy volumes from the COVID-19 pandemic.

First quarter adjusted operating profit increased 133% year-over-year to \$170 million. On an FX-adjusted basis, adjusted operating profit increased 107% to \$151 million, led by the recovery of pharmaceutical distribution and retail pharmacy volumes from the COVID-19 pandemic and distribution of COVID-19 vaccines and test kits in Europe and Canada.

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Moving on to Corporate, for the quarter, adjusted corporate expenses were \$154 million, a decrease of 7% year-over-year, driven by decreased opioid litigation expenses. We reported opioid-related litigation expenses of \$35 million for the first quarter. We continue to estimate fiscal 2022 opioid-related litigation expenses to approximate \$155 million.

I would remind you that while we've negotiated a comprehensive proposed settlement agreement, until we know the scope of participation in proposed settlement, we are not in a position to revise our opioid litigation expenses outlook.

Let me now turn to our cash position, which can be found on slide 14. We ended the quarter with a cash balance of \$2.4 billion. During the quarter, we had negative free cash flow of \$1.8 billion. As a reminder, our working capital metrics and resulting free cash flow vary from quarter-to-quarter and are impacted by timing, including the day and week that marks the close of a given quarter.

We made \$159 million of capital expenditures in the quarter, which includes investments in technology, data and analytics to support our strategic initiatives of oncology and biopharma services. As our business performed at a very high level, we were also able to return \$1.1 billion of cash to our shareholders in the June quarter. This included \$1 billion of share repurchases, pursuant to an accelerated share repurchase program, which resulted in an initial delivery of 4.3 million shares in the quarter.

Additionally, we paid \$69 million in dividends. We have \$1.8 billion remaining on our share repurchase authorization and we're updating our guidance for diluted weighted shares outstanding to range from 154 million to 156 million for fiscal 2022, which incorporates plans to repurchase an additional \$1 billion of stock over the remainder of the fiscal year.

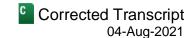
Let me transition and speak to our outlook for the balance of fiscal 2022. For a full list of fiscal 2022 assumptions, please refer to slide 16 through 19 in our supplemental slide presentation. I'll begin by reiterating a couple of key macro-level assumptions that underpin our fiscal 2022 outlook. We expect prescription and patient engagement volumes will demonstrate steady improvement from the levels at the end of our fiscal 2021 through the first half of our fiscal 2022 and returned to pre-COVID levels in the second half of our fiscal 2022.

For fiscal 2022, our updated guidance for adjusted earnings per diluted share is a range of \$19.80 to \$20.40, up from our previous range of \$18.85 to \$19.45, approximately equally split between our first and second half of the fiscal year. Our updated outlook for adjusted earnings per diluted share reflects 15% to 18.5% growth from the prior year and our guidance assumes core growth across all of our segments.

In the US Pharmaceutical segment, we now expect revenue to increase 5% to 8% and adjusted operating profit to deliver 4.5% to 7.5% growth over the prior year. Our US Pharmaceutical segment continues to exhibit stable fundamentals. Our outlook for branded pharmaceutical pricing remains consistent with the prior year for midsingle-digits increases in fiscal 2022. And the generics market remains competitive, yet stable, as volumes have shown signs of recovery.

COVID-19 vaccine contribution contributed approximately \$0.30 in the first quarter of fiscal 2022. We are updating our full year outlook to approximately \$0.45 to \$0.55. The \$0.45 to \$0.55 range reflects anticipated contribution of earnings for the fair value of services performed as the US government's centralized distributor of COVID-19 vaccines, including work preparing vaccines for international missions.

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Our current outlook remains aligned to the volume distribution schedule provided by the CDC and the US government, which excludes booster shots and vaccines for pediatrics, which have not been approved by the FDA. We will continue to invest in our leading and differentiated position in oncology. These investments will represent an approximate \$0.20 headwind in fiscal 2022. Normalizing for the COVID-19 vaccine distribution and our ongoing growth investments, we continue to expect approximately 5% to 8% core adjusted operating profit growth.

In our Prescription Technology Solutions segment, we see revenue growth of 20% to 25% and adjusted operating profit growth of 17% to 22%. This growth reflects the opportunities we see to accelerate service and transaction contributions benefiting from our technology platforms.

Now, transitioning to Medical-Surgical, we continue to partner with the US government under our contract for the kitting and distribution of ancillary supplies and are updating our outlook to \$0.35 to \$0.45 of contribution in this segment related to kitting and distribution. This program's scope and duration is evolving, and our updated assumptions reflects the current outlook provided by the US government.

Our revenue outlook assumes a 3% decline to 3% growth, and adjusted operating profit to deliver 6% to 12% growth over the prior year. We continue to expect year-over-year core adjusted operating profit growth of approximately 10% to 16%.

Finally, in the International segment, our revenue guidance is 1% decline to 4% growth as compared to the prior year. And as a reminder, this reflects the contribution of our German wholesale business to the joint venture with Walgreens Boots Alliance. For adjusted operating profit, our guidance is growth in the segment of 26% to 30% due to the previously mentioned benefit from the discontinuation of depreciation and amortization, which followed the announcement of our agreement to sell certain European assets, our strong performance in the first quarter and the contribution from COVID-19 vaccine distribution in the segment.

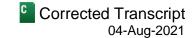
Turning now to the consolidated view, our guidance assumes 4% to 7% revenue growth and 7% to 10% adjusted operating profit growth compared to fiscal 2021. And we continue to expect corporate expenses in the range of \$670 million to \$720 million.

Let me now turn to cash flow and capital deployment. We were pleased to recently announce the completion of a cash-funded upsized tender offer. This successful tender offer resulted in the early retirement of \$922 million of our outstanding debt. Additionally, we announced the early retirement of a €600 million note for a total reduction in debt of approximately \$1.6 billion. These actions occurred during the beginning of our second quarter. It further strengthened our balance sheet and financial position and they are in line with our previously stated intent to modestly delever.

And as a result of these actions, we're updating our interest expense guidance for fiscal 2022 to \$180 million to \$200 million. We're also reiterating our free cash flow guidance from approximately \$3.5 billion to \$3.9 billion, which is net of property acquisitions and capitalized software expenses.

Last quarter, I mentioned that we anticipated a use of cash to purchase shares in McKesson Europe through exercises of a put rate option available to non-controlling shareholders that expired in June of fiscal 2022. The remaining put rate options resulted in payments of approximately \$1 billion in the quarter, which was generally in line with our expectations.

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As a reminder, this is reflected in the financing activities section of our cash flow statement. As a result of this activity, McKesson holds approximately 95% of McKesson Europe's outstanding common shares, and we anticipate income attributable to non-controlling interest in the range of \$175 million to \$195 million in fiscal 2022.

Our commitment to return cash to shareholders through dividend and share repurchases was recently highlighted by our Board's approval of a 12% increase to our quarterly dividend to \$0.47 per share. And our fiscal 2022 guidance continues to include share repurchases of approximately \$2 billion for the full year.

In closing, we're pleased with the strong results of our first quarter. We remain focused on driving growth as we invest against the strategic high-growth opportunities in oncology and biopharma services. This focus, combined with our commitment to further evolve the portfolio, will drive significant value to our customers, shareholders and patients. Our outlook for fiscal 2022 reflects this focus and execution with healthy adjusted operating profit and adjusted earnings per share growth and return of capital to our shareholders.

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

# **Holly Weiss**

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

Thank you, Britt. I'll now turn the call over to the operator for your questions. In the interest of time, I ask that you limit yourself to just one question to allow others an opportunity to participate. Operator?

# QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And we will go first to Brian Tanquilut of Jefferies.

#### **Brian Tanquilut**

Analyst, Jefferies LLC

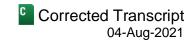
Hey. Good afternoon, guys. Congrats on a very strong quarter. I guess, Britt, as I think about the guidance, it looks like it assumes a lower margin profile. Just curious what you're thinking in terms of any – the puts and takes in the margins as we look forward to the next three quarters?

#### **Britt Vitalone**

Chief Financial Officer & Executive Vice President, McKesson Corp.

Yes, Brian, thanks for that question. I'd remind you that this is our first quarter, and we had a very strong first quarter. We're still in an evolving environment. We're very encouraged by the utilization trends and the improvement that we're seeing. As we think about our US Pharmaceutical business, our growth, as I mentioned in my remarks, was driven in large part by the growth of our largest customers. So, that does impact the mix and it certainly impacted the mix in the first quarter. And in our RxTS business, we have very healthy growth, as I mentioned, across all of our different capabilities. And some of the growth that we're seeing in that business, they're again mix impacted by some of our 3PL growth. We're very encouraged by the growth of our access and adherence solutions, particularly our AMP product. But I think, as you think about this, it is really a reflection of the first quarter. It's a reflection of the continued improvement in utilization and it's a reflection of some mix within some of our segments.

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### Holly Weiss

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

Operator, we can go to the next question.

Operator: And thank you. We will go next to Steven Valiquette of Barclays.

### **Steven Valiquette**

Analyst, Barclays Capital, Inc.

Great. Thanks. Good afternoon, everyone. Thanks for taking the question. I guess if we go back to when McKesson acquired the European assets seven, eight years ago, one of the drivers of the deal was to increase McKesson's generic drug purchasing power. I guess, by announcing the sale to PHOENIX, my sense is you're probably not too worried about any dissynergies related to less generic purchasing power you went [ph] and did (00:38:32) the transaction.

So, I guess, I'm just curious to hear a little more about McKesson's purchasing power today, whether it's ClarusONE or other factors, such that the additional European purchasing power is less critical. And just to make sure we're not missing anything around this too, hopefully, well, I guess, is there any post-deal agreement between McKesson and PHOENIX on generic purchasing collaboration, or was that even explored? Thanks.

### **Brian Scott Tyler**

Chief Executive Officer & Director, McKesson Corp.

Thank you for the questions. Maybe I'll start. I mean if you wind the clock back to almost a decade ago when we expanded into Europe, I think there were multiple elements for the company to strategically go to Europe. One of them – one of many was the opportunity to make sure we stay leading in our generics procurement capabilities and scale. I think over the last years, we continued to invest in that capability. We have a very successful partnership in ClarusONE, and we're very confident that we have not just the scale, but also the procurement expertise, that we have a very contemporary generics procurement operation that will continue to be a leading generic operation after the divestiture of the European assets that we've discussed. So, we're quite confident in the productivity and the yield and results we see from ClarusONE, and we believe that will continue to be the case into the future.

### Holly Weiss

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

We'll go to the next question.

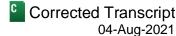
**Operator**: And next, we will go to Michael Cherny of Bank of America.

#### Michael Cherny

Analyst, BofA Securities, Inc.

Good afternoon. Congratulations on the quarter. I just want to dive in, I guess, a little bit more on the pharma distribution outlook. Clearly, the results were strong in the quarter. You're pointing towards higher [ph] reported (00:40:30) growth on a go-forward basis. As you think about the dynamics in the market maybe aside from the ClarusONE question, but what has been the pace and health of recovery of your non-large national chain customers? You called them out as specific contributors to the quarter. Can you give us a sense about how the rest of your book of business, the rest of your customers are handling the potential or, hopefully, recovery in utilization across their platforms and where that factors in, in terms of your outlook for rest of the year?

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# **Brian Scott Tyler**

Chief Executive Officer & Director, McKesson Corp.

Sure, Michael. I'll start with a couple of comments. So, first off, we are pleased at the trajectory of the recovery that we have seen. And it's been more or less in alignment with the expectations we set out at the beginning of the year. And I think it's not just isolated to a particular segment. I think if you look at the market overall, we continue to see, really through the first quarter, steady progression along the trend line that we signaled we thought would be the case.

So, we continue to be encouraged by that. We continue to think that we will reach a full recovery, meaning pre-COVID levels in the second half of our fiscal year. Obviously, we track the trends regularly. If we saw something that would cause us to deviate from that, we would be sure to share it with you. But right at this point in time, the recovery has been more or less in line with how we thought. We're very pleased about that, and we expect that we will get to the full recovery in the second half of this fiscal year.

### **Britt Vitalone**

Chief Financial Officer & Executive Vice President, McKesson Corp.

Yeah, maybe I would just add that I think the balance of our customers and the channels that we serve, and what we're seeing in those various channels is reflected in the guidance that we gave you, 5% to 8% operating profit growth. So, all of the channels are recovering, and they're recovering, as Brian mentioned, in line with our expectations. And they're all contributing to that overall core operating profit growth.

#### **Holly Weiss**

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

We'll move to the next question.

**Operator**: And we will go next to Lisa Gill of JPMorgan.

#### Lisa C. Gill

Analyst, JPMorgan Securities LLC

Thank you. And let me add my congratulations as well. Brian and Britt, I just want to understand biosimilars. So, you talked just now about operating profit. How much of an impact are biosimilars having? And then, as we think about the comments, Brian, that you made both around oncology and bio services, how do we think about that going forward, especially on the oncology side? What type of investments are you making? How important are biosimilars? Is this program – are you going to make acquisitions? How do we think about that?

#### **Brian Scott Tyler**

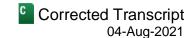
Chief Executive Officer & Director, McKesson Corp.

Thank you. Thank you for the question, Lisa. I'll maybe start with biosimilars and then round into the oncology question. I mean, biosimilars, we think we are very well positioned given our strength in the specialty business and including the oncology elements of that. It still, from our perspective, is fairly early days. There is just under a dozen in the marketplace today. We think the pipeline does look good. And that given the assets we have in oncology and biopharma and our footprint in the specialty space, we will benefit from that. And we have seen a growing impact of biosimilars over the last several quarters.

As it relates to oncology, we use the word ecosystem, and that's really just to try to introduce this notion that there are many assets that McKesson has that relate to our oncology businesses, whether it's distribution, specialty



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distribution, GPOs, health economic outcome, research. The latest addition to that portfolio of assets is the data and insights business that we call Ontada.

And when we think of the oncology ecosystem, we think of these as all kind of self-reinforcing and adding momentum to each other. We add providers that add scale to GPO, that adds more customers and data to Ontada. As Ontada matures, as partnerships expand, we get more insights. We funnel that back to providers which makes us a more attractive solution provider to them. So, that's really how we're thinking about it. Each into themselves is a good business we think. But together, we think there's real differentiation and strength.

#### **Britt Vitalone**

Chief Financial Officer & Executive Vice President, McKesson Corp.

And, Lisa, I'd just add on that we're really pleased that the development of biosimilars are really adding to the operating profit growth in the segment. It's growing over time. We think that it will continue to grow. And the channel matters, where we have more services to provide. As Brian mentioned, GPO services is a good example of that.

Certainly, it's more profitable for us and we'll see higher adoption rates. The adoption rates continue to build. And that, I think, is reflective of the growing operating profit contribution that we're seeing from biosimilars. But we do think, longer term, there is a larger opportunity.

**Holly Weiss** 

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

Operator, next question.

**Operator**: Next will be Eric Percher of Nephron Research.

**Eric Percher** 

Analyst, Nephron Research LLC

Thank you. The international D&A dynamics are interesting. Thank you for that detail. Maybe a two-parter, Britt. One is when we think about the remaining European business, can you provide us some sense of scale? I think the last time we got a Celesio number without Canada was around \$230 million of op profit. And then, on the D&A, could the same circumstances exist for the remaining EU business, should you get to a sale?

### **Brian Scott Tyler**

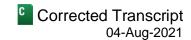
Chief Executive Officer & Director, McKesson Corp.

Yeah. Great questions, Eric, and thank you for those questions. I mean we're not going to break out the international business into its piece parts. We just don't think that that's something that we're ready to do at this point in time. And I would just say that every transaction that could happen in the future, we will evaluate that based on the facts of the transaction. For this particular transaction, we deemed that these assets would be in a held-for-sale perspective. But I can't really comment on what future transactions might look like. It's difficult to know how those transactions may or may not come together and what the specific details would be.

Next question, operator.

**Operator**: And next will be Charles Rhyee of Cowen.

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# **Charles Rhyee**

Analyst, Cowen and Company

Yeah. Thanks for taking the question. Just wanted to, Britt, just talk about the guidance here for the remainder of the year. Obviously, a large outsized performance in the quarter, at least relative to what I think consensus was expecting. Maybe if you could talk about how this came in at least relative to what you were expecting coming into this quarter. And as we think about the rest of the year, if I look at the pieces, it seems like we're getting a benefit from the D&A, also a tax benefit. Is that really the big drivers here relative to your expectations coming in? And maybe any kind of thoughts around that as we think about the remainder of the year relative to how you guys were – your plan came in. Thanks.

### **Brian Scott Tyler**

Chief Executive Officer & Director, McKesson Corp.

Yeah. Thank you for that question. Maybe I'll just start with, as you look at some of our macro assumptions, we talked about these in May that we assume that we would continue to see growing patient activity and prescription volumes. We saw that. We saw that in the first quarter. And so, that was in line with our expectations. We see that continuing to build and continuing to improve. And so, just from a very macro utilization perspective, we're seeing the improvement that we expected to see. We're seeing it on the trajectory that we expected to see. And so, we're very encouraged by that.

Our businesses, each of our segments had very strong performance. And so, we're very encouraged by that. It is our first quarter. Certainly, utilization will continue to evolve over the rest of the year. But we're very encouraged by that. The strong operating performance, the utilization that we're seeing, the patient activity that we're seeing, we expect that will continue, along the lines that we thought it would.

Certainly, the vaccine distribution and kitting program continues to evolve and it was a little bit higher than we had anticipated and we've increased the guide for that. Generally speaking, utilization is strong. It's in line with what our expectations were and we expect that will continue through the remainder of the year.

And you had asked a question on tax. The one thing that I would remind you on tax is we don't guide tax by quarter. We guide you on an annual basis. We did not change our guidance for the full year effective tax rate. And I think if you look over the last few years, the annual guidance around the tax rate that we've given has pretty much been in line with the original guide.

#### Holly Weiss

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

Next question.

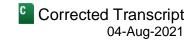
Operator: And we'll go to Kevin Caliendo of UBS.

### **Kevin Caliendo**

Analyst, UBS Securities LLC

Thanks for taking my call. So, I want to ask the guidance question a little bit differently, because it is unusual for McKesson to sort of raise guidance for all the segments right after the first quarter. And I'm wondering if it's just something about the way – if it's COVID-related or not. But I mean, to raise your revenue expectations for all of your segments versus what you guided to just a couple months ago, is there anything else specific? I mean, was it just conservatism on your part? Because we can't just point to script growth or patient volume, there's got to be

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some sort of larger macro thing happening here that's driving this. And I know you kind of addressed it, but maybe talk specifically about the conservatism, or when you went into the year, what were the overhangs that possibly lifted that are allowing you to do this across the board?

#### **Britt Vitalone**

Chief Financial Officer & Executive Vice President, McKesson Corp.

Well, let me start. I appreciate the question, and let me phrase it a little bit differently. We don't provide conservative guidances. We provide guidances based on what we see in our markets and what we're seeing within our businesses. I would remind you that when we gave you our guidance, one of the things that we talked about is that the markets that we operate in had not fully recovered. And so, we're coming off a year of one of the most dynamic environments that we've ever operated in. And when we provided that guidance, we're very clear that our markets had not fully recovered. We expected that they would. But certainly, it was going to evolve over time.

Our businesses continue to operate at a very high level. And I think you saw that in the performance this quarter. We're very encouraged by the utilization trends that we see. We're very encouraged by the performance that each of the businesses has shown. And we're seeing really good reaction and response to a lot of the products that we have, specifically in the RxTS business, as an example. So, I think what you're seeing is an environment that is continuing to recover, not necessarily on an even basis over the last year and a half, and a business that is performing very well in those situations.

#### **Holly Weiss**

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

Next question.

**Operator:** And next will be Ricky Goldwasser of Morgan Stanley.

#### Ricky R. Goldwasser

Analyst, Morgan Stanley & Co. LLC

Yeah. Hi. Good afternoon. I want to go back to kind of especially Ontada. You talked, Brian, about sort of [ph] contactor (00:52:08) relationship and sort of that cycle between providers and biopharma, et cetera. So, for Ontada, are payers customers as well? And is that sort of kind of like – and if not, is that sort of a growth opportunity that you're looking at? Just kind of like interested in kind of like opportunities to grow that oncology business beyond just the pipeline of drugs.

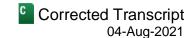
### **Brian Scott Tyler**

Chief Executive Officer & Director, McKesson Corp.

Thank you, Ricky. I think there is lots of interest in data and insights and understanding patients and provider behavior as it relates to these oncolytics. Our primary focus in Ontada is really to leverage the data, the working relationships and the scale of our physician relationships to generate insights that help the development, the discovery and, ultimately, the launch and adoption of oncology products.

And likewise, to take the early lessons we get in the research and the development and launch planning around these products, to ensure that providers are most able to react, adopt and get great patient outcomes from that. So, we see it as a very virtuous cycle, really anchored in provider and in the biopharma companies. But there may be several other interested parties in the data, insights that we can generate, and that's something that we'd certainly consider as the business matures.

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#### **Holly Weiss**

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

Operator, we have time for one more question.

Operator: Certainly. That question will come from Jailendra Singh of Credit Suisse.

#### Adam Heussner

Analyst, Credit Suisse Securities (USA) LLC

Hi. This is Adam on for Jailendra today. Thanks for taking the question. Just wanted to follow-up on the assumption of a return to pre-COVID utilization in the second half of your fiscal year. One of your competitors, this morning, think it is – they saw a return to pre-COVID prescription utilization in the June quarter. So, I mean, is the difference in comments just a function of customer or channel mix or, I guess, the way pre-COVID is being measured? Or what else should we be thinking about when attempting to bridge those comments? Thanks.

#### **Britt Vitalone**

Chief Financial Officer & Executive Vice President, McKesson Corp.

Thank you for your question. I'll give you one example in our medical business, as an example. What we saw in the June quarter was that primary care patient visits improved from the fourth quarter back to about 95% of pre-COVID levels. So, continuing to see the improvement, but not back at pre-COVID levels. So when we speak about utilization, we are seeing pre-COVID levels for oncology and for specialty, but we're not seeing that quite yet for primary care patients, as an example, continuing to improve on the trajectory that we laid out in our earnings call and that we had expected. But that's one example for our business that is perhaps a little bit different.

# **Brian Scott Tyler**

Chief Executive Officer & Director, McKesson Corp.

Great. Well, thank you, everyone. Thank you for your insightful questions. Thank you for joining on this call. And thank you, Jenny, for helping facilitate the call. McKesson is off to a very strong start in our fiscal 2022. I'm incredibly excited not just about the recovery of the markets, but frankly, the execution by our teams, which is generating this performance in the business.

So, I want to be sure to thank our more than 75,000 employees for their commitment to be together, to be a team, to focus on doing good for our company, for our customers and for the health care industry. As a global leader in health care, we are committed to doing our part to serve our employees, our customers, our partners and our communities as they continue the pandemic response efforts.

So in closing, I just want to wish you all and your family's good health and wellness. Have a great evening. Thank you.

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

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