Q3 FY15 Cardinal Health, Inc. Earnings Conference Call

April 30, 2015 8:30AM Eastern

Operator: Please stand by. We're about to begin.

Good day and welcome to the Cardinal Health Third Quarter Fiscal 2015 Earnings Conference Call. Today's conference is being recorded. At this time I'd like to turn the call over to Sally Curley. Please go ahead.

Sally Curley: Thank you, Jennifer. Welcome to our Third Quarter Fiscal 2015 Earnings call today. We'll be making forward looking statements and matters addressed in these statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected or implied.

Please refer to the SEC filings and the Forward-looking statement slide at the beginning of the presentation found on the Investor page of our website for a description of risks and uncertainties. In addition, we'll reference non-GAAP financial measures. Information about these measures and reconciliations to GAAP is included at the end of the slides.

I'd also like to remind you of a few upcoming investment conferences and events. We will be webcasting our presentations at the Bank of America Merrill Lynch 2015 Healthcare Conference on May 13 at 8:00 a.m. local time in Las Vegas and at the Goldman Sachs 36th Annual Global Healthcare Conference on June 10 at 10:00 a.m. local time in Rancho Palos Verdes, California.

Today's press release and details for any webcasted events are or will be posted on the IR section of our website at cardinalhealth.com. So please make sure to visit this site often for updated information. We hope to see many of you in an upcoming event.

Now I'd like to turn the call over to our Chairman and CEO, George Barrett. George.

George Barrett: Thanks Sally. Good morning everyone and thanks to all of you for joining us on our third quarter call. I'm pleased to report another strong period of results with third quarter revenues of $25.4 billion, an increase of 18%. Third quarter non-GAAP diluted EPS was $1.19, up 18% from last year.

Based on the strength of our performance year-to-date, we're increasingly confident that we'll finish our fiscal 2015 in the upper half of our full year non-GAAP EPS guidance range of $4.28 to $4.38. This is an extraordinary time in healthcare and our organization is doing an outstanding job of serving today's needs while at the same time leveraging our experience to address the demands of a system in transition.

Our people have done this through a disciplined focus on execution while using our capabilities and insights to anticipate change and commit to providing solutions to emerging health care challenges. With this as backdrop, since we last reported earnings we've made some important moves in areas of strategic focus. On March 2, we announced our plan to acquire the Cordis cardiology business from Johnson and Johnson.

And earlier this month we completed the acquisition of the specialty distribution business of Metro Medical, expanding our presence and reach in Specialty business. I'll come back to each of these important initiatives in my segment remarks, first our Pharmaceutical segment.

Our Pharmaceutical segment had a very strong third quarter with revenue of $22.6 billion, an increase of 20% compared to the prior year third quarter - and our Pharmaceutical segment profit was up 25%. The Pharmaceutical segment continues to operate with great efficiency, attention to detail and strong strategic positioning.

Red Oak Sourcing, our joint venture with CVS Health, continues to operate extremely well. We can now report that suppliers representing nearly 100% of the total generic spend have transitioned into the venture. At a time of great change, it's not just the scale which brings value to our customers, but also the combined knowledge of our two experienced organizations.

Our Specialty Solutions business continues to achieve extremely high growth rates. Earlier this month, we closed the acquisition of the specialty distribution business of Metro Medical, the largest privately owned specialty distributor in the U.S. This move strengthens our presence in the therapeutic areas of Rheumatology, Nephrology and Oncology, expands our scale and positions us to provide more cost-effective services to our customers.

For clarity, we expect to exceed the $5 billion Specialty revenue figure for fiscal 2015, which we highlighted in our last earnings call even without the contribution of the Metro Medical specialty business.

As you know, over the last few months we've seen some important developments in the world of biosimilars. As we've said to you before, it's very difficult to make categorical predictions on the evolution of this new subset of products. We continue to believe that each product will have its own characteristics driven by many factors, including regulatory interchangeability, the disease which the drug addresses, the need for patient support, the location and mode of delivery and of course the competitive response. We feel well positioned to participate in each of these opportunities as they emerge and the acquisition of Metro Medical expands our reach.

Turning to our Medical segment, we reported revenues for the quarter of $2.8 billion, an increase of 4% versus the prior year. Our segment profit was down 8% in an operating environment largely similar to that which we've outlined in prior quarters. I'd like to take a few minutes to address this and give some perspective on the Medical segment's performance, positioning and role in Cardinal Health's growth plans.

This is commentary I'd more typically provide at year end, but as our Medical numbers in the last few quarters have lagged below our high standards, I wanted to address it directly now. We take great pride in being "best in class" in the distribution of traditional branded med/surg products, but market forces have put pressure on prices in this legacy line of business. This is not new.

Over recent years, we've been purposefully building a range of new products and services that are strategically aligned with healthcare trends are highly valuable to our customers, expand margins and build on our base in traditional distribution.

Why has this been a more difficult year for our Medical segment? Simply put, price erosion in that legacy branded med/surg distribution business combined with the challenges in the Canadian market, have been more pronounced in this past year. And while we've seen uplift from the newer services and products, the uplift has not been large enough to offset those factors.

How have we been responding to this? We are relentlessly driving cost efficiency, while at the same time continuing to reposition our Medical segment portfolio to ensure we're bringing to market the products and services that meet the future needs of our customers in a rapidly environment. I'd like to highlight a few of these moves.

We've expanded our consumable product line to position us to drive more Cardinal Health medical products and through more channels. Our move to acquire Cordis significantly enhances our scale, product line and capabilities in cardiology - building on our acquisition of AccessClosure and aligning with our overall strategy around physician preference items.

Together, they complement our moves in orthopedics and wound management to bring standardization and efficiency to medical devices - a major pain point for our IDN customers and a meaningful driver of profit growth in the coming years. More about Cordis in a few moments.

Cardinal Health at Home, formerly AssuraMed, continues to grow significantly in excess of market growth. We have unique capabilities in the fulfillment and the complex administration of serving patients in the home. Our colleagues at Cardinal Health at Home interact with these patients every day, are extremely well trained and totally committed to supporting the needs of these patients. We did complete one small home-health tuck-in acquisition during the quarter. We continue to see great potential as more care is delivered in the home.

Our strategic partnership with Henry Schein is off to a good start. While still new, we're now able to bring the Schein physician practice capability to our IDN customers. We're beginning to ship products to Schein facilities and plans are to have the integration substantially completed during the June quarter. I had the opportunity in recent weeks to address the combined teams at Schein's National Sales Meeting and it was clear that the group is extremely optimistic about the opportunities in front of them.

To be clear, these strategic initiatives are not a departure from our traditional distribution. Rather, they draw upon our expertise, our considerable channel strength and the Cardinal Health name to bring the additional products and services that our customers and patients need to thrive in this dynamic healthcare environment.

What do we see going forward in our Medical segment? We don't expect major changes in the environment over the next few quarters and we could see a bit of choppiness. But as we look forward and into the back half of FY16, we would expect to see the new and growing business lines in the Medical segment, and increased utilization, giving us a more sustainable uplift.

Coming back to the Cordis acquisition which we announced on March 2, we're making excellent progress in our work to move towards closing. Leadership teams and organizational design have been defined in all key markets and recently we received early termination of the Hart-Scott-Rodino waiting period, the first of a series of steps to close.

Finally, China continues its track record of double-digit growth. We continue to see great opportunities in this expansive market. It's very clear that the growth of the healthcare market in China will continue to outpace general economic growth driven by demographics, lifestyle changes, and strong government prioritization.

Overall, Cardinal Health is performing at a high level generating strong cash flow and showing consistent growth. The repositioning of our portfolio over the last half-decade has been driven by a clear perspective on how we see healthcare evolving. Most of our customers across multiple channels are experiencing new dynamics as both public and private sector forces push them to deliver care more cost-effectively, in a more coordinated fashion, into emerging sites of care, and in such a way as to bring the patient more into the equation.

Our ability to offer a broad and integrated set of solutions across the continuum of care and to continue to innovate around our customer base has enabled new opportunities for growth, and at the same time helped us to absorb the bumps that can occur in a system going through rapid change. I think it's an indicator of the overall

strength of our portfolio that even through these transitions, we expect to deliver non-GAAP Operating Earnings growth for this full fiscal year in the mid-teens.

There is no other healthcare company that has quite the range of tools we can bring to the market and do so at a time when comprehensive solutions are the need of the day. Put another way, we can address a larger percentage of virtually any customer's overall business than any other company in healthcare. And with that, I'll turn the call over to Mike.

Mike Kaufmann: Thanks George and thanks to everyone joining us on the call today to hear about our strong third quarter results. My comments will walk through our third quarter consolidated financial performance as well as expectations for the quarter ahead as we close out our 2015 fiscal year.

You can refer to the slide presentation posted on our website as a guide to this discussion. Third quarter non-GAAP earnings per share grew 18% to $1.19. Total company revenues were $25.4 billion which was also an increase of more than 18%. Total company gross margin dollars were up more than 12% versus the same quarter in the prior year.

Consolidated SG&A increased 9% versus the prior year with the largest driver being acquisitions. Next, non-GAAP Operating Earnings in the quarter were $656.7 million, which is a 17% growth versus the prior year.

Moving below the operating line, Net Interest and other expense came in at $32.7 million in the quarter. As a reminder, Q3 of the prior fiscal year included a 6 cent per share after-tax gain related to the sale of our minority equity interests in two investments.

Our non-GAAP effective tax rate in the quarter was 36.5% and our diluted weighted average shares outstanding were about 334 million.

Moving to operating cash flows, we generated $658 million in the quarter. At March close, our cash balance was $3.2 billion with $447 million of this held offshore. We remain committed to our previously stated balanced capital deployment policy of focusing on reinvesting in our business and maintaining our differentiated dividend while pursuing strategic M&A and stock buybacks on an opportunistic basis.

Next, I'll review each Segment's performance. Let's start with the Pharmaceutical segment. Revenues were up 20% year-over-year to $22.6 billion due to growth of existing and new customers across all business lines in the segment. Segment profit was $567 million, an increase of 25% versus the prior year. This was due to strong performance of our generics program, including the net benefit of Red Oak Sourcing, as well as growth from our existing customers and contribution from new customers.

Segment profit margin rate increased by 10 basis points driven by the performance of our generics program which offset the impact of customer price changes and the dilutive impact of sales of branded hepatitis C therapies.

Clearly, the performance of our generics program has been excellent. Enhanced sourcing under Red Oak, customer wins, and growth of existing accounts have all been key drivers. Manufacturer price inflation or deflation, new item launches, penetration of existing accounts and advanced pricing analytics are also factors in determining our program's success. I remain confident we can balance all of these for continued growth in our generics program.

Besides the contribution from generics, our branded drug business continues to go well with strong performance under our fee for service agreements. As has been typical over the past several years, inflation tends to be a larger component in the third quarter versus other quarters. The rate of inflation was essentially the same as the prior year, in the low double digits.

As George mentioned, in our specialty business we closed the acquisition of Metro Medical earlier this month. Let me give you a few details. Metro Medical has various business lines. We acquired their specialty distribution, specialty GPO, specialty Pharmacy and private label medical/surgical disposable products business. The Metro Medical Online and Metro Medical Partners pieces of the business were not included in the acquisition.

This acquisition will provide us the opportunity to expand our specialty distribution scale and deepen our reach into the Rheumatology, Nephrology and Oncology markets. We've been working on this deal for several months and had already contemplated the bottom line impact in our FY15 EPS guidance range. Now, let's move to our Medical segment performance.

Third quarter revenue grew 4% to $2.8 billion, primarily due to the contribution from acquisitions. Segment profit declined by $9.1 million to $101.5 million. This was a result of the decline in the contribution of national brand med/surg distribution and the continued impact of the previously communicated challenges in the business in Canada. These same drivers contributed to a margin rate decline of 50 basis points versus the prior year period.

Let me give you a few other highlights to consider. First, revenues from our Strategic Accounts continue to significantly outpace our remaining book of business. In addition, topline growth from our higher margin wrap-around services is outpacing overall Medical segment revenues.

Our Cardinal Health at Home business has grown at or above market each quarter of this fiscal year. And finally, we're continuing to build out the physician preference item strategy. In this space, our acquisitions of AccessClosure and Innovative Therapies are off to a good start and are performing better than the business case.

Our recent announcement of our intent to acquire Cordis - which we still expect to close before the end of the calendar year - will only accelerate our work in this space. Let me reiterate some key points surrounding this deal.

First, we'll be acquiring Cordis for $1.944 billion in cash or approximately $1.6 billion net of roughly $350 million in cash tax benefits.

Next, we plan to finance the acquisition with debt and cash on hand. Our intent is to issue debt sometime in the next few months and take out the $1 billion bridge financing that we secured as a contingency.

From a non-GAAP EPS perspective, we expect slight dilution in FY16 as a result of three factors that we mentioned at the time of the announcement. First, FY16 will only include a partial year of Cordis earnings. Second, we expect approximately a full year of interest expense, estimated at 7 to 8 cents and third, there will be 13 to 15 cents of unfavorable impact due to an inventory fair value step up.

Then in fiscal 2017, the first full year post close, we expect the transaction to be greater than 20 cents accretive and increasingly accretive thereafter. We still expect operational synergies of at least $100 million annually by the time we exit fiscal 2018.

Before I move to our outlook for the rest of the fiscal year, I'd like to add a few updates on China, which reports into both segments. Our businesses in China continue to perform well. We continued to see strong double-digit revenue growth for the quarter, up 25%. Also during the quarter, we closed on an acquisition of a local distributor in Northeastern China which expands our local direct distribution to 11 cities.

Turning to slide number 6, you'll see our consolidated GAAP results for the quarter. The variance to non-GAAP results was primarily driven by amortization and other acquisition-related costs, which reduced our GAAP results by 15 cents per share.

Looking forward, we're increasingly confident in the upper half of our non-GAAP EPS range of $4.28 to $4.38.

Let me finish with the following updates around our corporate assumptions. We continue to expect our full year non-GAAP tax rate range to be between 36% and 37%. This obviously implies that our fourth quarter rate will be higher, likely between 38% and 41%, based on the timing and outcome of various discussions we are having with tax authorities.

We're expecting capital expenditures to come in at about $330 million; and our full year amortization expectations increased to about $190 million based on the acquisitions we've completed as of March 31. We don't expect the Metro Medical acquisition to add a significant amount to our final number for the year.

In closing, we're pleased with our overall performance in the third quarter, recognizing that we've got some important work to do in Medical to shift the trajectory. We've taken great steps during the past several years to

build a strong foundation for sustainable future growth. That's why, across the enterprise, I expect a solid finish to our fiscal year. With that, let's begin Q&A. Operator, please take our first question.

Operator: Thank you. If you'd like to ask a question press signal by pressing star 1 on your telephone key pad. If you're using a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment. Please limit yourself to one question and one follow up question.

Once again press star 1 to ask a question and we'll pause for just a moment to allow everyone an opportunity to signal for questions. We'll go first to Bob Jones with Goldman Sachs.

Bob Jones: Thanks for the question. As we think about the performance in Medical, George, it seems like volumes have been improving on the inpatient side. You added some accretive margin deals. It sounds like private label is still growing yet the business has struggled.

I know you mentioned Canada being an issue for the balance of the year but I'm just curious if maybe you can give us some insight on when you think this business can really start to turn around.

George Barrett: Good morning, Bob. Thanks for the question. Yes, well, look Canada's definitely been a tough challenge all year and as you said, we tried to be pretty clear about the work that we need to do and are doing in the Medical segment.

I think we just have to get through some short-term choppiness. I mentioned during the call that the traditional, the legacy lines of traditional branded med/surg has been a largely the challenge, and it's really been largely repricing of some accounts.

I think we'll start to see the benefit of all the initiatives that we've described begin to more sustainably feel like uplift as we get in the second half of fiscal 2016, but I actually like our positioning. I think we're doing really good work if you look underneath the numbers over the last three years. For example, we've had very good growth of our private label products and good contribution of margin from it.

So it's really about a shift in the model where the legacy line is becoming a smaller component of the overall mix and those newer products and services are beginning to grow. We've done some really important work there. We've made some big moves this year to strengthen that and feel good about that.

Bob Jones: If I could sneak one in on Specialty I know in the quarter you acquired Metro Medical. Just curious maybe if you could give a little bit more on how that business specifically enhances your Specialty footprint. And then I know broadly, George, you've gotten this question in the past but increasingly it seems like Specialty is obviously a very important channel for the wholesalers. And I'm just curious, how do you feel about your footprint even in light of the Metro Medical deal and are there bigger deals out there that could really give you greater exposure to this important channel?

George Barrett: Yes, let me answer that and I just want to follow up a little bit on the first part of the question again. Metro Medical really just helps us expand our reach. We've been growing at a pretty hefty clip over these last couple of years and I think our scale is now at a point where we really are a meaningful factor in the market. I think that's

important given some of the trends in healthcare and Metro Medical just expands that reach and that footprint so we're excited about it.

Whether or not there are other opportunities out there, we continue to look at every opportunity in our areas of strategic focus. Obviously Specialty is one. Whether or not you find the assets at the right moment at the right price is always the question for us, but this is clearly an area of priority and - so we'll continue to look for opportunities, but we're excited about the Metro Medical.

Again just backing up, I wanted to make sure I highlight this on the Medical side, just as a reminder, that our customers are really becoming much more complex. They're no longer a single line of activity, and so I do think that part of what we've felt strongly about it is that these complex systems need products and services across all of the lines of business. So that's really important at a time where you're seeing the changing incentives which have been completely activity-based over the year, just a different kind of incentive system.

I think the tools that we really bring are going to become increasingly important. I don't want to miss the opportunity to say that related to the first part of the question.

Sally Curley: Operator, next question.

Operator: We'll go next to Ricky Goldwasser with Morgan Stanley.

Ricky Goldwasser: Yes hello, good morning. Question on M&A post Cordis, what is your appetite for M&A? Obviously you did Metro Medical which is on the smaller side, but what leverage are you comfortable going up to? And when you think about the areas you're interested in obviously Specialty is one but maybe if you can rank order them for us?

George Barrett: Good morning Ricky. So again appetite is that we want to grow the business. We want sustainable competitive positioning and we believe there are key areas strategically that are aligned with where care is going and we've been pretty clear about that. It's around generic. It's around Specialty.

It's around every opportunity to improve performance management for large integrated customers. It's the home. Opportunities in China, which is a unique market. So we'll continue to look for those opportunities. Obviously we have a strong balance sheet but again we're going to be very disciplined about the moves we make, when we make them and how we make them to make sure that we can execute. And that's always been a priority for us but we feel well positioned, a strong balance sheet. I don't know if Mike wants to add anything to that.

Mike Kaufmann: Yes Ricky. I think again it's going to depend on whether it's a strategic fit, whether the culture fits for us, the growth trajectory, all those types of things of the acquisition. But from a balance sheet standpoint, we've said that we'd like to keep our debt ratio to 1.5x to 1.75x as a range that we're comfortable in. Could we at times make a decision to go slightly above that for the right type of acquisition and stretch ourselves some? Sure, we'd be open to doing that.

We're always going to want to be concerned about where the debt rating agencies see us and that's an important thing for us to consider in how they view us. And so sometimes the type of acquisition matters when we deal with those folks and remember the last thing too we like to keep about $1 billion to $1.5 billion of cash on hand just for

our everyday working capital and needs because of the fluctuations in the business. So those are some of the things that we try to keep in mind.

Ricky Goldwasser: Okay then, just one quick follow up. Obviously in the prepared remarks you talked about the strong branded inflation. I think it was in the low double-digits. We're hearing strong inflation on generics. Where do you think we are in the pricing cycle in the sustainability of the trend across the portfolio, because we're seeing in both in brand, generic and specialty?

George Barrett: Ricky, I'll start with it but then I'll welcome Mike to join in. Predicting this going forward is always difficult. The branded side, as you've seen, has been on average relatively consistent throughout. But actually inside that average is a lot of different rates, and so it's one of the things that makes it very hard to predict, but in some ways a little easier because you have this moving effect.

On generics, it's such a tough call because as you know it's an enormous product line that we call "generics", and so the number of products that can move the needle can be relatively small and you could talk about 50, 75, 100 products that move the needle. So it's really difficult for us to get a forward looking guidance on what we see.

We've done this in the past and I'd probably just say we're talking about the environment and what are the conditions of the environment. And I'm not sure that those conditions have changed materially from last period, but we have seen some variation. Mike can touch on that.

Mike Kaufmann: Yes I'd agree with George. I think on the branded space it's been pretty consistent over the last several years. That branded inflation rate has stayed in that double-digits, low double-digits area and we've not seen a lot

of fluctuation there. I just wanted to really call out this quarter, remind folks of the seasonality component and why the third quarter tends to be bigger than some of the other quarters.

And again we all know the majority of the fees are earned on the fee-for-service agreement, so inflation on brand is a much lower component of our margins than it used to be in the buy and hold periods. But again in third quarter, it's important so that's really why we called it out.

On generics, it's important, but one of the things we keep trying to emphasize is that in our mind it probably gets a little bit too much attention at times because there are a lot of other levers in our generics program that are going to help us perform over the years. And we really believe confidently that even in a - if generic inflation were to decline, there's a lot of other levers for us around our penetration, around our pricing and analytics capabilities, around the new business that we've won, etc., that we can still compete effectively and perform well.

Sally Curley: Operator next question.

Operator: We'll go next to Eric Percher.

George Barrett: Hello?

Sally Curley: Eric?

Eric Percher: Can you hear me now?

George Barrett: Yes.

Eric Percher: There we go, dead headset. Okay so med/surg, two questions. One would be your comment in the press release on national brand distribution. Is that meant to reflect your commentary on pricing erosion or is there anything else meant by that?

And then also relative to Canada, have we now reached a point where next quarter we'll anniversary some of those initial issues and customer departures or movement in-house? Does that help in the second half?

George Barrett: Yes Eric, good morning. What we're talking about primarily is really pricing on traditional med/surg. It's probably not much more complicated than that, and a lot of that is actually re-pricing some meaningful accounts for us which we're happy to have in the long run important customers - strategic customers. I'm sorry, the second part of your question?

Eric Percher: Within Canada, it feels like it's been about a year since we first saw some of those issues. I know there are a couple of customers that moved in-house. Will we now anniversary that?

George Barrett: So here's what I'd say and I mentioned this earlier. I'd say probably a couple of choppy quarters and then I think we're taking some pretty significant actions in Canada to address some changes in that market, and I think then we'll start to feel a more normalized rate.

Mike Kaufmann: Yes Eric. I'd expect us to still see some pressures in Canada through the end of the calendar year, so it'll still affect us for the first two quarters of FY 16 and then beginning in our Q3 of fiscal '16 we begin to see a more normal and leveling off in the Canadian business.

Sally Curley: Operator next question.

Operator: We'll go next to David Larson with Leerink.

David Larson: Hello. Can you guys talk a bit about biosimilars and what sort of opportunity you're looking at, maybe just touch on the different channels that biosimilars will flow through, if they ship to the member at home where they self-inject, if they ship to the doc office? Are you better positioned in any one of those channels than the other? Thanks.

George Barrett: Good morning, David. I'm not sure I can add that much to what I said in my earlier comments but again I'll highlight them. I think many of you have asked us over the years what have we been anticipating in terms of biosimilars. We always felt that there'd be some uniqueness to each product and as you said, the route of administration, which channel it goes through, whether or not there's substitutability - these are all things that'll influence what kind of services the patient needs.

We actually feel well positioned regardless of route, is what I'd tell you. So as you know, we've got an extremely strong position in hospitals. We've expanded our position at all kinds of clinics. We're very strong in Pharmacy. We've got specialty Pharmacy. So clinics are an area, and now obviously we've got some enhanced strength in the small physician practices.

So I think from our standpoint we've got great reach across therapeutic areas which is very important, and from a channel perspective I think we're in a pretty good position regardless of that route.

Mike Kaufmann: The only thing I'd add to that George is that also from a services standpoint upstream to the manufacturer we feel that we're in as good a position as anybody in the industry to provide any type of services that they might need, whether it be specific cold chain or other type of transportation need, whether it be HUB services, data analytics. We know that we can provide all of those services too. So we really feel that we're in a great position both upstream and downstream on biosimilars.

David Larson: Thanks a lot.

George Barrett: Thank you.

Sally Curley: Next question?

Operator: We'll go next to John Kreger with William Blair.

John Kreger: Hi, thanks very much. George and Mike if you're willing - thinking about some of the puts and takes for next fiscal year, how do you feel about the outlook, realizing it's early compared to some of your longer term growth goals?

George Barrett: John, good morning. It's a little early for us to be saying a lot about fiscal '16. We're finishing our budget process out at year end. We provide guidance but in terms of our long-term goals we still feel good about those. The organization right now has a feel like a lot of momentum actually and I think if you go around Cardinal Health I think you'd see a group that's very energized.

We're very clear about our goals, very disciplined in managing to those and we'll have a little bit of bump in any part of the business, but the overall Cardinal enterprise feels good and on target to achieve the goals that we've set. Go ahead Mike.

Mike Kaufmann: I'd agree with you. We do need to get through the budgeting process this summer. That's really important. Probably the only thing that we really mentioned about next year that I can give you a quick update on, was around the commodities and we did say that for FY16 that they'd be about $10 million to $20 million of benefit from commodities. We've updated that work and we can still continue to believe that that's the right number for next year.

I know that's only one small component that goes into it, but it's the only thing that we've really given you any clarity on.

George Barrett: And the Cordis mechanics.

Mike Kaufmann: And then the Cordis mechanics that I've walked through.

John Kreger: Very helpful thanks, just one quick follow up on Red Oak. As you move into year two it sounds like you pretty much finished your work with supplier re-contracting. What happens next? Is there an opportunity for meaningful growth in year two as well?

Mike Kaufmann: I'm real excited about where we are in Red Oak. I serve on the board of Red Oak and recently had a board meeting and continue to be incredibly impressed with the team. We've again been able to retain all of the key folks from both companies and have decades of generic buying experience there, which again to get though essentially 100% of the spend in this short a period of time has been exciting.

We do expect there to be uplift in FY16. A big piece of that would just be that we'll have a full year of all of the benefits while we were ramping this year. But even on top of that, we do expect to continue to generate value and, as I met with the team, they're constantly looking at different ways to work with the manufacturers to try to create more incremental value for both parties.

Sally Curley: Operator next question.

Operator: We'll go next to Glen Santangelo with Credit Suisse.

Glen Santangelo: Thanks. George, I just want to come back and revisit this Medical segment issue a little bit further. You talked obviously a lot on the call about the pricing pressure within the segment. Is that repricing certain GPO customers that you got hit with, and is there anything else on the horizon that would impact the pricing as we go forward over the next 12 months?

I'm also kind of curious. Can you talk about the overall pricing of the underlying inventory you're selling? Are you seeing price deflation on the products you're selling or is that still somewhat inflationary and is that impacting the profit margins at all either?

George Barrett: I'm going to come back to the second part as I'm not completely sure I understand the question. We'll make sure we do and then Mike will address that. But this is really not a GPO issue, Glen. This is just individual accounts that happen to fall during the period of time where we're signing some long-term agreements.

No single one of them by the way is big enough to call out and necessarily move the needle. It's just a general dynamic. Again, what I wanted to highlight during the call is that this - over many years the traditional -- of what we call branded Med/Surg business -- has gone through this dynamic and so that's really not new. So I don't want to make it sound like there's one big contract that was the key. We just - some repricing in that aspect of the business we felt and I hope that answers that part of it. The second part of the question, Mike, did you get?

Mike Kaufmann: Let me take a stab at it and even if I don't get it right please Glen, just ask again. I agree with George as far as the GPOs. We always work with them but in tandem we work individually with the hospitals. And if you take a look at the product portfolios, I don't think this is really necessarily a deflationary environment on all the items.

You're going to see certain items that they go up and some that will go down but I wouldn't say there's any one trend. Either way that's actually affecting this. This is just our ultimate net price to the customer themselves, not the items driving it.

Glen Santangelo: Okay, maybe if I just ask one follow up. Could you maybe elaborate a little bit more on what the challenge is in the Canadian market because it sounds like it's going to persist for another two to three quarters? I think it'd be helpful for you to just remind us exactly what that issue is.

Mike Kaufmann: Really two things, one is similar to what we just described, some re-pricing of customers. And as we mentioned last time, there were a couple customers that we did lose in Canada that we won't actually anniversary until the end of the calendar year. One of those brought in-house the services they were doing and one switched to a competitor. So that's really what's driving it, is a loss of a couple of larger customers as well as some pricing and retention of some other customers. Those are really two big factors.

George Barrett: The other piece that I mentioned is some shifting of reimbursement dynamics around that market. So that is a component of that pricing aspect.

Mike Kaufmann: And remember those customer losses are not new. Those are the ones I mentioned last quarter that they're out there. Just that it was going to take until the end of the calendar year for us to anniversary them.

Sally Curley: Operator next question?

Operator: We'll go next to Ross Muken with Evercore ISI.

Ross Muken: Good morning. I wanted to just touch base regarding Cordis. So, obviously you haven't closed the deal yet but you do have a very close relationship. Some of you are positioned in hospital partners. You've got some key

thought leaders in the field that you interact with on a regular basis. What's the dialogue been post the announcement, now that you've seen or have been with those individuals and what other sort of things does it spark in your mind as you think about the long term strategic value of the endeavor?

George Barrett: Good morning Ross. Yes, so this is - it's been actually a really interesting period since the announcement. A couple of things happened, many of which we thought can happen which is just a high amount of energy around this. Inside our organization I think the people that are going to be joining us from Cordis are pretty excited about where this falls for us in terms of priority.

We're getting great feedback from our advisory board. I think it was mentioned before, that we've got really world-class advisory boards who are working with us. We started to, as you might imagine, hear from other players in the market who recognize that we might be an interesting partner for them as we expand our commercial capabilities both here and outside the U.S. in these medical products.

So I think what we're seeing is a pretty high level of enthusiasm across the board. Obviously, we've got a lot of work to do to get to the finish line in the closing, but it's been really well received. And I think the one thing that I'd highlight is people are now beginning to realize that it's not just about the product. And so we're talking about a different service offering in terms of being able to bring the medical device and some wrap-around services that help manage inventory, eliminate waste or prevent errors.

These are all part of the strategy in helping in the physician preference areas. So I think what's happening both internally and externally is that our excitement about joining those two components, the service component and the product component, are giving us a pretty good sense of optimism about the future on this.

Ross Mucken: Great thanks George.

George Barrett: You're welcome.

Sally Curley: Operator next question.

Operator: We'll go next to Lisa Gill with JP Morgan.

Lisa Gill: Hello, thank you. I'm just wondering can you give me some color, George, around the size of Metro Medical? Obviously you talked about it being in 2015 numbers, but maybe on a revenue basis how big is this?

George Barrett: Lisa, good morning. Unfortunately I can't provide that information right now. I think what we've - as we come out of our year and we start guiding into next year, I think some of that will become a little bit more apparent but at this point I can't provide more information. I'm sorry.

Lisa Gill: Okay. And then secondly as we think about Red Oak, we think about relationships with manufacturers. There's a lot of talk about continued consolidation of generic manufacturers. Can you talk at all about your expectation, you or Mike around Red Oak and how that'll impact you going forward?

George Barrett: Yes. Let me just start and then Mike can speak more specifically to Red Oak. As you know, consolidation isn't really new to the industry. It's been happening for quite some time. It's something we're used to. It's a

dynamic we understand. And it's one of the reasons that having scale is real important, and it's also what having a knowledge base of each supplier strategy is all about.

That actually matters because those labels we're looking for in a benefit situation those win-win moments. So I think we understand the landscape well and we know the players well. And so consolidation can be a double-edged sword but I think for us, we see the opportunity work more closely with companies. We see that as an opportunity. Mike, I don't want know if you want to add to it more narrowly from the Red Oak perspective.

Mike Kaufmann: Probably the only thing I'd add is, first I guess I'd emphasize I really like where our relationships are with the manufacturers. They value us. They understand the simplicity and the speed of our model and particularly the transparency, and the feedback we're getting from manufacturers around those components has been incredibly positive.

And what that leads to is us being willing to try new things with them. And we're also focused on not only the large manufacturers but also small- and medium-sized ones that have really mentioned that they appreciate that they've been able to be part of the program. And so again consolidation is part of the industry but we like where we're at and we think in certain situations if we needed to - we can work with folks to try to create the right type of competitive environment to get the type of pricing we need.

Sally Curley: Operator next question?

Operator: We'll go next to Steven Valiquette with UBS.

Steven Valiquette: Thanks, good morning George and Mike. Just within the Medical segment I'm curious in relation to the Cordis acquisition. Is your plate going to be pretty full over the next year just on the integration of this fairly large asset or if let's say other medical manufacturing has said they're potentially available for acquisition? Would you have the bandwidth to do additional medical manufacturing M&A deals over the next year? Thanks.

George Barrett: Yes thanks Steve, good morning. Obviously I'm going to answer this with some care. Let me start with the basics. As I mentioned earlier our balance sheet is strong. Our organizational capacity is very significant but we always put a high priority on execution and so we think about when we look at acquisitions it's not just the financial capacity to execute and integrate but the organizational capacity to do that.

So we're very mindful of that. I'd also note though that we have a very broad-based employee population. For example we can have a group of folks that are very deeply dedicated to the integration of one asset and literally another group whose lives are untouched by that.

And so what we're mindful of as we look across at opportunities externally is making sure we're not doubling down on those people who are trying to do execution of one deal. Always mindful of that, but I think we have a pretty talented diverse organization with a lot of capacity but we'll always think about execution.

Steven Valiquette: Okay got it. Okay thanks.

Sally Curley: Okay next question?

Operator: We'll go next to John Ransom with Raymond James.

John Ransom: Hi, just had a question about the independent Pharmacy channel. Are you seeing any more signs of stress in that channel just given some of the fundamentals around generic inflation and reimbursement squeeze? And if so, are you approaching that marketplace differently than you were three or four years ago?

George Barrett: John, let me start. Good morning, first, and then I'm going to turn it Mike. Again we'll probably have two angles on this. We've been doing really well providing value to the independent Pharmacy customers. And so I think the key is recognizing that there are certain market dynamics and market pressures that they deal with. And what we do is focus on how do we relieve those pressures, how do we bring value in that environment.

So I think what's happened is we've become increasingly targeted on how we create value for those kinds of customers in this kind of environment. And our organization's done a really good job in terms of expanding our position there, and growing some share, and I feel good about our position with how we're creating value. Certainly there are pressures out there that they have to deal with. I think we're doing a lot to help them.

Mike Kaufmann: I can think of a couple specific examples. First of all obviously Red Oak and our ability to be competitive for the generic programs in recognizing the need in how we price generics at different life cycles of reimbursement. That's always important to do that. Our PSAO has growing steadily and we've added a lot of members and we've been able to do some unique things with them and get out and market our PSAO and work with our customers to help them on their Star Ratings to make sure that they're the type of customers that the PBMs want to do business with. And we're incredibly excited about those.

And then in other areas in the out front part of the store, we've been expanding our programs and opportunities there to work with the folks, and we really like where we're headed with some of our Cardinal private label line in our opportunity to help them manage inventory both on the out-front and behind the counter. So, we have a lot that we're doing.

I wouldn't say that we're seeing any decline, that we've seen in this. We continue to grow our share in that space and that's how I feel. One thing, if you didn't know what I meant for those on the phone about a PSAO, that's our third-party contracting arm where we work with third-party payers on behalf of our retail independents to get them reimbursements.

John Ransom: And my other question just checking in on your other channel, you sell into a lot to IDNs. What are they asking for from you that they weren't asking for two years ago, and is there any affect yet that you're seeing from the ACA in terms of what capabilities you need?

George Barrett: Yes. It's a really interesting question because I think what they're seeing is - I think many of the big acute care and integrated systems are recognizing that in a world where there's probably some shifting incentives and, we're looking at bundles of care and payment, where there are penalties for re-admission.

They're just beginning to look at each line more holistically. So I think one of the changes that we've seen certainly, it still can be very competitive in each line is that the institution at the enterprise level of the IDN is thinking holistically about how do we compete? How do we thrive in this new environment?

And I think that's why our work across the enterprise is particularly resonating right now because we're really not just able - we're not just talking about lines of business. We're talking about being able to address the huge percentage of their activity and I think we're the only one that can do this in quite that way.

John Ransom: All right, thanks a lot.

George Barrett: You're welcome.

Sally Curley: Operator next question?

Operator: We'll go next to Garen Sarafian with Citigroup.

Garen Sarafian: Good morning everyone. I just had a couple questions on the quarter. So first on the Pharmaceutical segment, could you elaborate a little bit more on the revenue growth of 20%? You called out growth from both new and existing customers so maybe if you could break those two out or give us an idea. And then any other relevant metrics such as volume growth or other inflation, hepatitis C, and so forth.

Mike Kaufmann: I can give you a little color. First of all the hepatitis C component of our growth is still less than 25% of the overall growth. It's an important driver but it's less than 25%. *Existing customers would be the largest component of our growth and then growth of our new customers would be next.** Keep in mind with branded drug inflation being in the low double-digits, that's going to be a huge driver of overall top-line revenue growth

particularly in the market where you haven't seen very large generic launches that would be taking away some top-line volume. So I think those would be the key drivers to help you understand that.

Garen Sarafian: That's useful. And then as a follow up, on the branded side of the business has the non fee-for-service so the buy-and-hold portion of the business remained the same as a percent of the entire business? And what's in it, have the mechanics in the past few quarters, maybe a couple years to alter the profitability of the profile in any meaningful way?

Mike Kaufmann: That's been really steady. Over an annual period it's still averaging about 80% is non-contingent of our branded buy-side piece. And then as I mentioned in the third quarter it's a little bit more slanted towards inflation. But again over a whole year period it's still running 80%.

The agreements continue to be about the same. Often they renew very similar terms and conditions. We continue to tweak them but this is an area that we continue to feel good about.

Garen Sarafian: Got it, great. Thank you.

Sally Curley: Operator next question?

Operator: We'll go next to Robert Willoughby with Bank of America Merrill Lynch.

Robert Willoughby: Hello George or Mike maybe this is more a J&J question, but can you give us any color on the quarter results or hopefully post change of control announcement the wheels don't come off there, and maybe remind us

of your budget plans there and what infrastructure you'd want to put in place internationally to really maximize that opportunity?

George Barrett: Good morning, Bob. Unfortunately the first part to your question is a J&J question and I can't answer for them. Regarding the second, we've been really hard at work on really working across the globe on what that organization is going to look like. I think it all feels like it's going very well.

In the U.S., as you know we have some cardiology assets here so that we've been looking at how we're going to coordinate and integrate those activities, have a very clear game plan. Ex-U.S., I think we've got organizational design under our control. I think we've got the leadership in all key markets looking at key positions.

We want to make sure that we retain some of the great tradition of that existing Cordis, but we want to bring some of that Cardinal approach to it. And so I think what we're - one of the things I mentioned earlier, Bob, that I think is pretty interesting is that as we go outside the U.S. and we talk to the organization, again recognizing that there certain conversations we can't have at this stage as two separate companies, they're particularly interested in our service model and how we can help bring additional efficiency to the medical device side of it. So I think people are beginning to realize that we can bring more than product skill. Again short-term critical issue for us, I talked of execution earlier. We're adopting the Hippocratic Oath -- do no harm. So when the businesses are performing very well and there are many markets where they are one or two in the market, we're going to make sure that we do no harm there and keep the business executing. So I hope that helps to answer.

Robert Willoughby: Maybe just a point to drill down, you're looking at the services side of things obviously, but is there ever an R&D line item that you'll be breaking out with this in other assets that you have in place now requiring a bit more investment on that front?

George Barrett: That's a good question. In terms of how we break it out I can't answer it fully yet. What I can tell you in strategy; this isn't going to be a big research-based business unit inside of us. There'll be development and we do that today by the way. As a medical device company today we're doing "D" as a development all the, but you shouldn't expect us to be a research-based medical device company. That's not really the game plan here.

Robbery Willoughby: Thank you.

Sally Curley: Operator next question.

Operator: We'll go next to Dave Francis with RBC Capital Markets.

Dave Francis: Thanks, good morning. I wanted to go after the Specialty piece from a little bit of a different angle. Looking at the fact that you guys are at a $5 billion revenue level or will be as you exit the year there, is the business now either from a critical mass of revenue perspective or service portfolio perspective now at that place where you think you're big enough to grow the business organically through internal development efforts above the market rate, or do you still need to deploy capital externally to get to the point where you're able to capture additional market share?

George Barrett: Yes, good morning. Actually the answer is we are growing it organically quite rapidly so that's the good news. I think we have the scale. We've got great talent. It's a really innovative group. We've got a pretty good group behind that driving new models for how to create value for our specialty customers and our suppliers.

So I think we're actually getting very strong organic growth and we'd continue to expect to, but, we'll look for opportunities to deploy capital if we see opportunity but we're getting very strong organic growth.

Dave Francis: A quick follow up, looking back at the med/surg business, you guys have been spending a lot of time trying to get the business repurposed, a little more focused on the ambulatory side of the business as well. Can you talk about trends that you're seeing in terms of actual utilization or actual volumes being pushed outside of the inpatient environment that might be starting to pay dividends for you in terms of the investments in the home health and other ambulatory environments?

George Barrett: Yes. I'd say these trends, in terms of care moving relative to ambulatory setting, is probably unambiguous. This is absolutely happening across the board. Getting actual exact numbers on this is difficult because I think our system is not used to tracking this. I don't mean Cardinal's system. I mean those who track this kind of data. But when we talk to IDN customers who look at our data it's pretty clear that more activity is being driven to different sites of care and I think that plays to the strategy.

It helps explain some of the moves that we've made and I think it's really going to be, for us, as we go forward, a tailwind because I think that is a natural byproduct of some of the changes in the incentive system in the industry.

Mike Kaufmann: And we've seen a lot of that with our at home business already with those changes in dynamics and it continues to grow not only significantly but above market itself. So, for example, the ambulatory surgery center business where we continue to have very large share. That's another area we really like.

Sally Curley: Operator next question.

Operator: We'll go next to Charles Rhyee with Cowen & Company

Charles Rhyee: Thanks for putting me in here at the end. Obviously, a lot of discussion on Medical. I guess maybe one last question on the topic but maybe following up on last question here, I think part of, George, when you talked about repurposing the Medical business you also talked about having more extensive dialogue with the C-suite of your hospital customers.

And there was something maybe that the organization wasn't really in deep with previously. Can you talk about where you are in that progress to really explain what Cardinal can do for IDNs in general, maybe where we are at that stage and what inning and how much further can we get do we need to go before we can really drive that? Thanks.

George Barrett: Good morning Charles. That C-suite question that you guys think about what inning are we in and that's always a hard question because the system is going through this change. Let me highlight a couple of things.

Again I'd say our largest customers across healthcare are becoming more complex, more integrated and their needs now cross more products and services than we've seen historically. So we've been at the same time aligning with that and one thing that we did over the last year is to create these strategic account teams.

We always had strength in our selling organization selling lines of business. We'll continue to do that, but I think part of what we've been trying to leverage -- and this is what you're touching on -- is that need for the integrated system for that complex customer to think about a changing world and which are the partners who can help them.

So again as they think about changing from an industry which has been activity-based to one with different incentives it's a pay-for-outcome or fee-for-outcome. I think all the tools that we bring, standardized consumables, private label medical products, services that enable increased sufficiency, helping them navigate across their channels, our physician preference strategy or work in the home, these are all valuable to them. And then you combine this with our Pharmaceutical line and our Specialty and I think we have a unique set of offerings.

We're trying to make sure that we're positioned to address that the most senior levels of the organizations because it's really now about competing in a world that looks in the future a little bit different than historically.

Charles Rhyee: Great. That's all I had. Thanks a lot guys.

Sally Curley: Thanks Charles. Operator, next question?

Operator: We'll take our last question from George Hill with Deutsche Bank.

George Hill: Hello guys. One upping Charles -- thanks for squeezing me at the end. Good morning guys. I just want to touch on something quickly. I thought I heard you say in your prepared comments but I might've gotten the notes wrong, did you say the customer price changes were serving as a headwind in the drug distribution business? And if you did say that, can you put a little more color around what that meant?

George Barrett: It was one of the offsets so we said the positives was a growth in new customers and the net benefits from Red Oak that were offsetting some of the customer price changes. And those wouldn't be anything other

than the normal types of day to day renewals we see with all of our customers. So, there's really nothing new there, no new news. It's just typical. It always tends to be one of our largest headwinds and we're constantly working on the opposite side obviously to more than offset those.

George Hill: Okay fair enough. So just the normal pricing pressure that part of renewals. And then maybe just - as we talked about pricing pressure in the med/surg business, I guess George or Mike how should we think about that pricing pressure impacts what will be the Cordis business, and is that business immune from that pricing pressure or will that see pricing pressure as well?

George Barrett: Well I'm not going to say they are immune from pricing pressure. That is obviously a big statement to make, but I think we've really been talking primarily about something that's a dynamic that's occurring over sometime in what I'm going to call the traditional legacy medical surgical business.

I really wouldn't connect that necessarily in the line of business. This is just a trend that we've seen for some time, and I think what we're seeing with the other lines of business is actually they're drivers in the opposite direction.

George Hill: Great, thanks George.

Sally Curley: Thanks George. Operator do we have any other questions?

Operator: At this time, there are no further questions. I'll turn the call back to George Barrett.

George Barrett: All right. Well thanks for all the questions and for being on this call. We appreciate you doing this. We look forward to getting a chance to talk to you and see many of you in the near future. Thanks again.

Operator: This does conclude today's conference. We thank you for your participation.

*Corrected for accuracy. The speaker actually said, "*New customers would be the largest component of our growth and then growth of our existing customers would be next*."