Q4 FY16 Cardinal Health, Inc. Earnings Conference Call

August 2, 2016 8:00AM Eastern

Operator: Please standby. We're about to begin. Good day and welcome to the Cardinal Health fourth-quarter fiscal year 2016 earnings conference call. Today's conference is being recorded. At this time I'd like to turn the conference over to Ms. Sally Curley. Please go ahead.

Sally Curley: Thank you Ronald and welcome to Cardinal Health's fourth-quarter and fiscal year-end 2016 earnings call.

We have a lot to get through this morning including our fiscal 2017 outlook. We also recognize that most of you have a very full earnings reporting day today, which is why we thought it would be helpful to move our call a little earlier this morning. Because we have limited time on the call, if we don't get to all of your questions, please feel free to reach out to us after the call ends.

Also today, we will be making forward-looking statements. The matters addressed in the 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 will reference non-GAAP financial measures. Information about these measures and reconciliations to GAAP are included at the end of the slides.

In terms of upcoming events, we will be webcasting our presentation at the Morgan Stanley Global Healthcare Conference on September 14th at 9:20 am Eastern in New York.

Today's press release and details for any webcasted events are, or will be, posted on the IR Section of our web site at cardinalhealth.com so please make sure to visit the 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 our fourth-quarter and end of the year call.

Healthcare is at an inflection point. The demands of an aging population, the challenges of public health and continued policy debates around cost, quality and access have significant implications for economies around the globe and families close to home. They require adaptive and meaningful action from our industry.

The simple truth is we are experiencing the most dynamic and rapid change in the history of healthcare. At Cardinal Health, we are acutely aware of the need to adapt, innovate and lead. Our teams worked hard this past year integrating new product teams, building and acquiring additional capabilities and finding more efficient and effective ways to deliver real value, while never losing sight of the ultimate goal, serving patients and their families.

This was also a period in which I participated in the healthcare system in a very personal way. I lost both of my parents in these last 15 months. I had the opportunity to witness the technical skill, the dedication, and the compassion of caregivers, from physicians to hospice workers, as well as the extraordinary power of science. I also had the opportunity to see how complex our system remains. How disconnected the elements of care can be and how difficult it can be for a person to retain their dignity when they need it most.

Healthcare is, at its core, personal. This is what inspires all of us at Cardinal Health to do our work every day. Every priority we set, every strategic move that we make, we know that at the center of all of this is that patient - our mother or father, our sister or brother, our son or daughter, our friend.

As I highlight our Q4 and full-year performance and put the year in context, I will keep those patients at the forefront of our conversation.

Also, as I've done in years past at year end, I'll spend a few minutes providing some commentary on the big picture for our business and our future. And then I will turn it over to Mike who will go into further detail on the financials, our assumptions for the year ahead, and our long term aspirations.

We delivered a solid fourth-quarter, closing out an outstanding fiscal 2016 thanks to the incredible hard work of our integrated teams – from Medical, to Pharma, to Corporate.

First, revenue for the quarter was up 14% versus the prior year to $31 billion. Second, we reported an increase of 5% versus the prior year in non-GAAP operating earnings of $643 million. And third, we delivered an increase of 14% versus the prior year of non-GAAP diluted earnings per share of $1.14.

For the year, we delivered strong, impressive results in fiscal 2016 across the enterprise. Full-year revenues were up 19% versus the prior year to a record $121.5 billion. Non-GAAP operating earnings were up 17% versus the prior year to $2.9 billion, also a record. And non-GAAP earnings per share was up 20% to $5.24.

I cannot say enough about the dedication, teamwork and commitment that our more than 37,000 people demonstrated this year. This record achievement is their milestone.

These results were indeed a true team effort – rooted in our culture of collaboration: both the Pharmaceutical and Medical segments achieved meaningful, measurable growth while strengthening our overall competitive and strategic positioning. That's a result of their disciplined and determined execution, delivering the highest levels of service to our customers, driving operating efficiencies, managing our rock-solid balance sheet, and integrating the operations of important acquisitions.

First, let's look at the strong year our Pharmaceutical segment had. Full-year revenue was up 20% versus fiscal 2015 to $109 billion. And we reported an increase of 19% versus the prior year in segment profit of $2.5 billion.

Jon Giacomin and his team spent this past year deepening their relationships with existing customers while welcoming new ones. They successfully completed the integration of the Harvard Drug team, building on our first rate generics offering.

As for existing customers we grew our retail independent footprint over the course of the Fiscal year, increasing the number of customers we serve. Two weeks ago we hosted a record 9,300 attendees at our annual Retail Business Conference in Chicago, where independent pharmacists shared their unique insights about how they serve their communities… as well as the pressures they face.

As a result of this regular engagement, the Cardinal Health team has its finger on the pulse, driving meaningful relationships with our customers and working directly to help them be more efficient to drive the outcomes their patients deserve. This is how we operate, boots on the ground, understanding our customer's needs.

Throughout our Pharma business, you can see that our world-class supply tools provide patient-driven service offerings and help reduce cost, increase efficiency, and improve quality for providers and the patients they serve.

As an example, the Cardinal Health Pharmacy Network, which includes thousands of locally owned pharmacies as members, provides comprehensive services to monitor and elevate performance, improve adherence, and manage compliance and credentialing. Our pharmacies consistently rank among the highest in customer satisfaction, a testament to the fact that our offerings are helping our customers achieve their quality star ratings.

And of course, our first-rate generics program – strengthened by Red Oak Sourcing, our partnership with CVS Health – continues to be a source of value for our customers, their patients, and our shareholders.

For those who might question whether the entrepreneurial spirit is thriving in America, listening to these business leaders share their experiences about running a small business while working to make their communities stronger, serves as a powerful rebuttal to that narrative.

Specialty solutions also delivered an outstanding fiscal 2016. Building on its proven track record of growth, the business not only met, but exceeded the $8 billion revenue target we shared with you for fiscal 2016. Our specialty solutions group successfully completed the integration of Metro Medical which expands our ability to serve customers in some important therapeutic areas such as Rheumatology, Nephrology, and Oncology, now and well into the future.

We're continuing to add new biopharma tools and services to our portfolio, which positions us for strong, steady growth today and tomorrow. Our work in specialty links directly to the outcomes of major scientific breakthroughs coming from the pharmaceutical and biotech industries.

Our nuclear business has regained its footing. We've moved beyond radio-diagnostics and into radio-pharmaceuticals – exploring the potential for new life-saving treatments for cancer patients.

The way that we are working with Bayer on the Xofigo project, their treatment for prostate cancer, integrating manufacturing to dose compounding, is just one example of the cutting edge work that we're doing in the Nuclear segment.

To conclude on the Pharma segment, while the generics environment presents some near-term challenges for our pharmaceutical distribution business on a comparative basis, we feel extremely good about the way the entire segment has competed in 2016 and positive about our competitive positioning going forward.

Fiscal 2016 was a real tipping point for our Medical segment, producing exceptional results. Full-year revenue for the Medical segment was up 9% versus the prior year to $12.4 billion and we reported an increase of 6% versus FY15 in segment profit of $457 million. These results are a true testament to how we are working seamlessly and successfully with our provider and manufacturer partners as they seek to serve patients more efficiently with less waste, to aid in delivering safer, higher quality care.

Our OptiFreight and 3PL Services and our inventory management tools are delivering real and measurable results to our partners. And the considerable expansion of our Cardinal Health line of consumables drives both standardization and value. In just the last two years we've added over 2,600 products to help providers with greater standardization and to source more cost-effectively.

While healthcare systems continue to wrestle with evolving payment models moving from a fee-for-service model to one that is more value-based, Cardinal Health is providing products and services to help our customers manage these important changes.

Our physician preference item strategy allows us to integrate products and services that help our partners deliver care in a cost-effective and high quality manner for their patients.

Don Casey and his team did a tremendous job closing the Cordis acquisition on time and managing the integration into Cardinal Health with discipline and a focus on the patient. Our global cross-functional teams have been performing at a high level and we hit our integration and performance benchmarks.

To stay on the theme of evolving payment models, we can draw a straight line between these trends and our work in discharge management and post-acute care. Our solutions offered through naviHealth, RightCare, and Curaspan position us to help providers and payors manage the complex processes of discharge. With these tools, we can help direct patients to the optimal site of care, build the linkages to post-acute settings and through our At Home business, supply medical products to patients in their homes, improving their healthcare experience. These are important solutions as the population ages and the health system adapts.

While we are proud of the strong results we delivered in Fiscal 2016, we know that our healthcare system continues to undergo rapid transformation. And, we know what changes are necessary in this new environment.

First, care needs to be more coordinated, more efficient and centered around the patient. Second, a higher priority must be placed on delivering the right care at the right time using the right evidence-based protocols and standards, and in the right setting. Third, a greater focus must be placed on patient outcomes, not activity.

Lastly, and certainly not insignificantly, we are seeing daily the potential for science and technology to change the healthcare experience.

To highlight the significance and pace of change, just last week, CMS released another proposed mandatory bundled payment model for acute myocardial infarction, coronary artery bypass graft, and surgical hip-femur fracture treatment episodes in their Medicare population.

Similar to the now finalized rule around comprehensive joint replacement, acute care hospitals would bear financial risk for an episode of care from inpatient admission to 90 days post discharge.

Our work in physician preference items, where we can focus on an episode of care, across the continuum of care – from device to inventory management to discharge management to patient follow-up, all help providers compete in an environment in which they will increasingly be compensated around that episode of care.

The capabilities resident in naviHealth, RightCare and Curaspan all strengthen our ability to deliver real and measurable value at a time when providers are being asked to bear more risk.

While the initiatives coming out of CMS can create some challenges for providers, we see the goal of rewarding hospitals that work together with physicians and other providers to avoid complications, prevent hospital readmissions, and speed recovery as an important direction for the future of healthcare.

We have participated directly in bundles programs, and will continue to work very closely with providers and payors, as well as CMS, to do our part to best serve patients.

As we position Cardinal Health for the future, we're always looking for new ways to better serve providers and patients, while driving value for our shareholders.

We enter fiscal 2017 well prepared and positioned to weather some short-term challenges, particularly around the generic pharmaceutical environment. At Cardinal Health we are committed to exploring avenues by which we can turn the system's challenges today into breakthroughs and opportunities tomorrow. We are both realistic and optimistic about our industry and its future.

With this as a backdrop, we are providing non-GAAP EPS guidance for FY17 of $5.48 to $5.73, which equates to a growth rate of about 5% to 9%.

Healthcare is ultimately about people. Every technical solution we consider, every innovation in which we invest, and every team that we welcome in the Cardinal Health family are all focused on the same faces – those of the mothers and fathers, the sisters and brothers, the sons and daughters, and friends that we serve as patients. We all have a part to play in the next generation of healthcare and I believe that as long as we are focused on those patients, their families and our communities, we will make the right decisions, the right investments, and the right moves to be successful now and well into the future.

I'd like to thank our customers for their trust, our manufacturer partners for their shared goal of great patient care, our shareholders for their support, and all of our employees for their deep commitment. With that, I will turn the call over to Mike to discuss more of our financials and our outlook for the future.

Mike Kaufmann: Thanks George and thanks to everyone joining us on the call today. George said our team delivered another strong year of earnings growth and cash flow in fiscal '16. And this just highlights the great work of our Pharmaceutical, Medical and Corporate teams to deliver these record results for our customers and shareholders.

Our proven track record of success, combined with our aspirational goals, position us to deliver meaningful, measurable value for our shareholders now and well into the future. We remain committed to a disciplined and balanced approach to capital deployment, including our dependable dividend payout ratio of 30% to 35%. We also continue to aspire to a non-GAAP EPS compound annual growth rate, over any three year period, of 10% to 15%.

So with that additional context, I'd like to go into more detail on our fourth-quarter results, then our full-year highlights, and finally, a preview of our expectations for fiscal 2017, including some of our underlying assumptions. I have a lot to cover, but I'll leave plenty of time to answer all of your questions.

Please note that, with all of my comments, I'll begin with GAAP and then provide the comparable non-GAAP figure. The slide presentation on our website will be a helpful guide throughout this discussion, as it includes our GAAP to non-GAAP reconciliation tables.

Let me start by discussing the strong year-over-year financial performance our team delivered this quarter and year. You can follow along on slides 3 through 12 in our earnings presentation.

For the fourth-quarter of fiscal 2016, GAAP diluted earnings per share from continuing operations grew 16% to $1.02 while non-GAAP EPS grew 14% to $1.14. These results contributed to full-year GAAP and non-GAAP EPS growth of nearly 20% to $4.32 and $5.24, respectively.

Fourth-quarter consolidated revenues grew 14% to $31.4 billion, while full-year revenue grew 19% to a record $121.5 billion. GAAP gross margin dollars grew more than 14% in the fourth-quarter, and gross margin rate increased by 1 basis point, which includes a $51 million LIFO benefit that we recognized in the quarter.

Fiscal '16 GAAP gross margin dollars increased 15%, while gross margin rate decreased 19 basis points primarily from the impact of mix as we on-boarded a new mail order customer in our Pharmaceutical segment. Non-GAAP gross margin dollars increased 11% in the fourth-quarter and 15% versus the prior full-year. Non-GAAP gross margin rate declined in the fourth-quarter and full-year by 15 and 19 basis points, respectively again due primarily to the new customer I just mentioned. SG&A expenses increased in the quarter and year as we anticipated largely as a result of our strategic acquisitions, many of which George spoke about in his comments.

Consolidated GAAP and non-GAAP operating earnings grew 11% and 5%, respectively, in the fourth-quarter and grew 14% and 17%, respectively, for the full fiscal year. As anticipated net interest and other expense increased versus the prior year's fourth-quarter and year primarily due to the debt issued in Q4 of Fiscal '15. The GAAP effective tax rate for the quarter was 41.8%. As expected, our non-GAAP ETR was lower at 37.6%.

As many of you may remember, in Q4FY15 we had an unusually high tax rate because of increased reserves related to certain federal and state tax matters. For FY16, full-year GAAP tax rate was 37.1% and non-GAAP ETR was 36%. Our fourth-quarter and full-year diluted weighted-average shares outstanding were 327 and 330 million respectively.

During the fourth-quarter, we pulled forward $350 million worth of share repurchases. This brought our fiscal 2016 share repurchases to about $650 million, which combined with our differentiated dividend payouts, totals $1.2 billion in cash returned to shareholders. In addition, we repurchased another $250 million of shares in July, which leaves us with $793 million remaining on our board authorized share repurchase program.

Moving on to consolidated cash flows, we generated approximately $640 million in operating cash flow during the quarter. This brought the fiscal '16 cash from operations to a record $3 billion, a result of strong contributions from both segments. We also deployed $465 million in capital expenditures, primarily in order to refresh our existing infrastructure and support new acquisitions.

Overall, we ended June 30th with a strong balance sheet, with cash and liquid investments of approximately $2.6 billion of which $475 million were held internationally. Outstanding working capital management by our teams resulted in this strong year-end cash position, and average net working capital days improved by more than a day.

Now let's move to the Pharmaceutical segment performance for the fourth-quarter and Fiscal year. You can refer to slides 6 and 10.

Pharma segment revenue in the fourth-quarter grew 14% to $28.2 billion, driven by growth from existing and net new pharmaceutical distribution customers and, to a lesser extent, performance from our Specialty business. For the year, we drove growth in existing and net new pharmaceutical distribution customers, acquisitions and Specialty by 20% to a record $109 billion. In fact, as George mentioned, the Specialty team far exceeded the revenue goal we set in Fiscal '16 of $8 billion.

Segment profit for the fourth-quarter increased 1% to $542 million primarily due to the contributions from acquisitions, offset by the loss of Safeway. In addition, positive contributions from existing and net new pharmaceutical distribution customers, which includes our generics program, were offset by reduced contribution from a specific branded manufacturer agreement. For the year, segment profit increased 19% to $2.5 billion due to growth from existing and net new pharma distribution customers, which includes our generics program, as well as contributions from our strategic acquisitions. This was partially offset by the typical customer re-pricings and to a lesser extent, reduced contribution from the specific branded manufacturer agreement mentioned earlier.

Speaking of acquisitions, we've not only met, but exceeded the goals that we set for our acquisitions of the Harvard Drug Group and Metro Medical, which is a testament to the hard work of these dedicated teams. We've now lapped both acquisitions.

Segment profit rate declined by 24 basis points for the quarter and 2 basis points for the year. This was largely due to changes in product and customer mix. Performance under our generics program, which includes the Red Oak Sourcing venture, helped to positively offset some of the full-year decline.

All in all, despite a challenging environment in Q4 with the expiration of the Safeway contract and a tougher product pricing environment, we demonstrated that we have the team and talent to still deliver outstanding performance for the year.

Let's move to slides 7 and 11 that cover the Medical segment, which had an excellent fourth-quarter. Revenue for the quarter grew more than 12% to $3.2 billion, primarily due to acquisitions and, to a lesser extent, Cardinal Health Brand products. For the year, revenue grew 9% to a record $12.4 billion, driven by contributions from acquisitions and sales growth from existing businesses.

Fourth-quarter segment profit grew more than 19% to $122 million due to acquisitions and growth in Cardinal Health Brand products. Full-year segment profit increased 6% to $457 million due to contributions from Cardinal Health Brand products as well as the net contributions from acquisitions. This increase was partially offset by changes in the Canadian market which affected the first half of fiscal '16, and which we've mentioned on prior calls.

Medical segment profit rate expanded by 22 basis points in the fourth-quarter driven by Cardinal Health Brand products, including Cordis, but declined by 12 basis points for the year, again related to the first-half pressures in Canada.

Knowing you'll have some questions on Cordis, I'd like to provide more details on our progress. Our integration team has worked hard this year, and all day one countries are stood up and providing solutions that drive efficiency, standardization and improved patient outcomes. In fact, the Cordis team has already demonstrated measurable growth in certain geographic regions, such as Europe, which hasn't seen that type of growth in a number of years. We continue to work on closing and standing up day two countries.

As I mentioned last quarter, we expected variability in the margin rate between quarters as we are still working through a few intricate mechanics related to the transition service and manufacturing agreements that we have with J&J. This variability is caused by such factors as the timing of exits, the ramping up and down of certain expenses and the impact of foreign exchange.

You can see that variability sequentially in the fourth-quarter segment profit rate versus last quarter where I had indicated that the Q3 segment profit rate was somewhat elevated. As we expected, we should be fully stood up and exiting our TSA agreements in the fourth-quarter of fiscal 2017, while our transition manufacturing agreements will extend for a couple of years longer.

Let me share a quick update on Cardinal Health China. Our business in China generated over $3.5 billion in revenue for the year, resulting in solid top-and bottom-line growth. And as many of you know, our Chinese operations serve both our Pharmaceutical and Medical segments, each showing significant multi-year growth. We have 16 large-scale distribution centers and operate 29 specialized retail pharmacies in 20 of the major cities across China. The team there continues to execute well through a combination of organic and inorganic moves and we continue to gain share in our ranking among the top 10 healthcare distributors in China.

Finally, as I mentioned earlier, if you review the Q4 fiscal '16 GAAP to non-GAAP reconciliations on slide 8, you'll see three key reconciling items that are excluded from non-GAAP EPS.

First, amortization and other acquisition-related costs accounts for 32 cents per share. Second, net litigation recoveries, which includes proceeds of approximately $68 million in pre-tax anti-trust settlements, accounts for 13 cents. And third, as we closed fiscal 2016, we reviewed and adjusted our LIFO reserves based on the actual June 30 inventory balances. This resulted in a favorable 10 cent adjustment to GAAP EPS.

So with a very strong year behind us, let me now turn to our fiscal '17 outlook and relevant underlying assumptions. From an overall perspective, there are two items to note about our non-GAAP guidance range. First, all of my forward-looking comments will be focused on non-GAAP, as we do not provide GAAP future guidance due to the difficulty in predicting items that we don't include in our non-GAAP EPS.

And second, our guidance doesn't include the impact of the new accounting treatment for the tax effect of share-based compensation. We are currently assessing whether or not we want to adopt this earlier than the required Q1 fiscal 2018 adoption date. If we do early adopt, we will keep you informed and provide you with the impact and updated guidance range.

So now, let me walk you through our guidance for the upcoming fiscal year. Starting on slide 14, we expect high single-digit percentage growth in our consolidated company revenues and, as George stated, we expect our non-GAAP EPS to grow roughly 5% to 9% for a range of $5.48 to $5.73.

On slide 15 we've outlined five corporate assumptions. First, we expect a non-GAAP effective tax rate of 35% to 37%. As I've mentioned on prior calls, we only provide full-year guidance on tax rates as they can have natural quarter-to-quarter fluctuations resulting from discrete items.

Second, for fiscal '17, we are assuming diluted weighted average shares outstanding in the range of 324 to 326 million. As I mentioned earlier, we already completed $250 million of share repurchases in July which is included in this range. Third, we expect net interest and other expense of 190 to $205 million. Fourth, we continue to view reinvestment in the business as a priority to support acquisitions and growing demand. As a result, we expect capital investment to be in the range of $400 to $450 million.

And finally, we currently assume amortization of approximately $376 million or 74 cents, which includes all acquisitions closed as of June 30. Again, this is excluded from non-GAAP.

Now moving to the segment assumptions, starting with Pharma, which you'll see on slide 16. Beginning with revenues, we expect a high-single digit percentage increase versus the prior year. This is based on current pricing trends, contributions from existing and net new pharmaceutical distribution customers, offset by the loss of Safeway which impacts most of fiscal '17. We expect Pharma segment profit for the full-year to be essentially flat versus fiscal '16. While we don't normally provide quarterly guidance, Q1 is unusual. We expect Pharma segment profit to be down in the high teens to low 20% range as we navigate challenging year-over-year comps. Clearly the trends we saw this past quarter also factor into our guidance.

Of course, this will affect our company consolidated non-GAAP EPS for the first quarter. As a result, we expect consolidated non-GAAP EPS to decline by high-single to low-double digits year-on-year.

However, we do expect Pharma segment growth to improve and performance to be back half-weighted versus the prior year. Let me provide some additional context on Pharma.

As I mentioned just now related to revenues, we also expect the loss of Safeway to impact Pharma segment profit for the first three quarters of fiscal ‘17. As it relates to generic manufacturer drug price increases, we expect less contribution in fiscal ‘17 than we’ve experienced in fiscal ‘16. We are modeling generic manufacturer price deflation in the mid-single digits for the full fiscal year. Also, I want to point out that in last year’s Q1 fiscal ’16, we had several key generic items that we had previously disclosed as being unusual and significant drivers in that quarter. These items have now experienced meaningful deflation which creates some tough comparisons to Q1. We assume brand manufacturer price inflation to be approximately 10% for the full fiscal year.

FY17 expenses associated with modernizing our Pharma information systems to support our significant growing demand, as well as acquisitions, will be more than what we had incurred in FY16.

As I said earlier, we have the team and talent in place to ensure success of this multi-year project. We expect incremental year-over-year earnings contribution from both Red Oak Sourcing and new item launches, as well as measurable growth within our existing customers and new customer wins. However, that year-on-year benefit will be significantly less than fiscal ‘17. Red Oak Sourcing has been, and continues to be, an effective and productive partnership. As we’ve mentioned in the past, the achievement of certain milestones would trigger the second of two predetermined payments beginning in fiscal ‘17. Because of the excellent performance, Red Oak achieved these milestones and we will be making our second and final $10 million increase in our quarterly payment to CVS Health beginning in Q1. As anticipated our new quarterly payment will be $45.6 million for the remaining eight years of the agreement.

There are two other business assumptions that we have embedded in our guidance for Pharma. First, we expect continued contributions from our acquisitions. For Harvard Drug, we are reaffirming our original assumption of greater than 20 cents EPS contribution to fiscal ‘17. And second, we expect double-digit growth in our China business and in Cardinal Health Specialty Solutions. We expect that Specialty revenue and profit growth will continue in the double-digits again this fiscal year.

So again, to be clear, because of the exceptionally strong Q1 last year, smaller tailwinds from Red Oak Sourcing and launches, current pricing trends and the Safeway loss which impacts the majority of fiscal ’17, we now expect Pharma segment profit to be down in the high teens to low 20% range in Q1F17 and essentially flat for the year.

Let’s now talk about expectations and assumptions around our Medical segment for fiscal ’17, which you can find on slide 17.

We expect revenues to increase in the mid-single digit percentage range versus the prior year. We also expect double-digit segment profit growth and margin rate expansion. Medical segment profit growth stems mainly from three key assumptions.

First, we continue to expect great performance from Cordis with that acquisition adding more than 15 cents to fiscal ‘17 versus the prior year, net of transaction-related interest expense of 7 to 8 cents. This is a lower accretion figure than we originally provided, largely due to currency impacts as well as some increased SG&A investments compared to our original business case. Our commitment to serving this global customer base without disruption is our highest priority, and therefore some of the synergies originally associated with this complex acquisition will take longer to achieve than we originally modeled.

Second, we expect above-market revenue growth, and therefore solid contribution from Cardinal Health At Home.

And third, we are forecasting double-digit profit growth from Cardinal Health Brand.

In Q1 we began onboarding Kaiser with a dedicated customer service team. This new contract is already embedded in our assumptions, as is the assumption that our Cardinal Health Brand penetration will gradually increase over the course of this fiscal year.

On slide 18, we’ve provided an EPS bridge from our fiscal ‘16 finish to our fiscal ‘17 guidance midpoint of $5.61. Each category that you see on slide 18 is a mix of headwinds and tailwinds, and the number associated with each category reflects the midpoint of a risk-adjusted non-GAAP EPS contribution range.

We've tried to size each of these four categories for you so that you better understand the components of our growth for this fiscal year. This is not something that we plan to do on a go- forward basis. However, given current market dynamics, we thought it might be helpful.

As you see on slide 19, we expect core growth of about 3% to 6%, with capital deployment adding 2% to 3%, for total fiscal '17 estimated growth rate of 5% to 9% in non-GAAP EPS.

The higher end of our guidance range contemplates greater growth from the businesses as well as additional capital deployment, either through share repurchases, acquisitions or a combination.

Finally I want to address the aspirational goals for fiscal '17 year-end that we outlined at our December 2013 investor day because it's important to us that we stay accountable to you, our shareholders.

At that time, we outlined five goals we hoped to accomplish as we exited fiscal '17, and which we said would require both organic and inorganic moves. I'd like to update you on our progress toward each of these goals.

First, we targeted achieving a Pharma segment profit rate of at least 2.5%. As you know, we've grown with the addition of an important new mail-order customer that helps to increase our earnings, but is dilutive to margin rates.

So while this margin goal will be difficult to achieve, we will always pursue opportunities that are both incredibly capital efficient and overall accretive to earnings.

Second, for the Medical segment we targeted a segment profit rate of at least 5.75%. While this may take somewhat longer to achieve the Medical team is still committed to this target.

Third, we stated that 45% of the segment gross profit would come from Cardinal Health Brand, and we are very much on track to achieve this.

Fourth, we set out to increase income from Cardinal Health At Home by more than 50%. We've already made significant progress toward achieving this goal.

And fifth and finally, we said we wanted to deliver more than 70% of the Medical segment gross profit from a combination of Cardinal Health Brand, services and alternate site solutions, and we are also very much on track to deliver this.

I know we just provided a lot of information for you around our assumptions. So please feel free to ask any clarifying questions.

Allow me to briefly close by saying fiscal '16 was truly a remarkable year for Cardinal Health and our well-positioned portfolio. I'd like to recognize our team for all the work that they've done, and continue to do, to deliver meaningful, measurable results. I am confident about our plan for fiscal '17 and I look forward to the year ahead.

I'll now turn it over to the operator to start Q&A.

Operator: And thank you. If you would like to ask a question please signal by pressing star 1 on your telephone keypad. If you're using a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment. And we do ask that you please limit yourself to just one question and one follow-up question. Again that is star 1 to ask a question at this time.

And we will take our first question from Eric Percher from Barclays. Please go ahead.

David Ho: Good morning. This is David Ho on for Eric. So my first question is on that 55 cent headwind from net customer activity, I was just wondering, Mike, could you provide a little bit more detail? How much of that or, you know, is a majority of that due to the Safeway loss? And I'm assuming it also includes repricing assumptions around customers like Prime and Kmart. So I was wondering if you could provide a little bit more color on that.

Mike Kaufmann: Absolutely. Thanks for the question. Hopefully you guys all found this slide to be helpful. Let me do this just in case there's other questions, I'll give you a little bit of color on the 55 cents. But I'll give you also a little color on the other pieces too just to be helpful.

First of all, hopefully you got it in color -- the first three components: net customer activity, Generics Program and existing or remaining businesses. Those numbers all represent midpoints of a guidance range -- of a range that we established for each one of these. And so just think about that there is a range for each of these. The capital deployment is essentially the bottom of the range because we've already achieved the 10 cents through the share repurchases that we've done.

As far as the net customer activity, the things that are included in there would be, for instance as you mentioned, the loss of Safeway. All of the re-pricings that we experienced, that we expect to experience this year in Pharma which we expect to be at normal levels, is also included, as well as normal Medical re-pricings, and then the impact of any other wins or losses that we would be having with customers.

The Generics Program bucket includes the headwind we talked about with generic drug manufacturing pricing assumptions and then the tailwinds of both generic new item launches and Red Oak Sourcing, which again, while tailwinds will be less than what we experienced in '16 versus '15. And then also our assumptions around generic penetration are in there.

In that final bucket, existing or remaining businesses, that would be everything else such as Specialty, China, Harvard, the negative impacts of PMOD (pharmaceutical IT investment) that we talked about, etc. All those other things are in that bucket. So hopefully that gave you a little bit of color.

David Ho: All right. That helps definitely. And I guess my follow-up would be on that midpoint number we've noticed that Cardinal has a history of exceeding that midpoint by about 6%. And I was wondering is there anything different this year versus prior years? You know is this a year with less risk at the beginning of the year because maybe the generics piece, there's less upside? So I'm just wondering if there's more room to grow from here.

Mike Kaufmann: Yes. Thanks for the question. I would tell you that as every year, I don't think it's any different than we try to do any other year. I would tell you that I believe this is an achievable plan. We've put a lot of thought into this. Clearly there's a lot of different dynamics affecting the year. And we tried to risk adjust each and every one of those. So hopefully that helps a little bit.

Operator: And we'll take our next question from Ross Muken from Evercore ISI.

Ross Muken: Good morning guys. Appreciate you laying out sort of the challenges to this year in perspective of, you know, sort of your long-term aspirations. I mean as you were thinking about some of the temporal items that are affecting the business, you know, how did you think about sort of the pushes and pulls of maybe other things you could've done to accelerate the growth rate this year but maybe that's not in the best interest of sort of the long term whether it was getting more aggressive with acquisitions or something on the cost side? I'm just curious what the debate was like and, you know, I guess it maybe speaks to the fact of your confidence in the long term that you felt like you didn't need to do something now.

George Barrett: Yes. Good morning Ross. It's George. It's a little hard to answer that question but let me do the best I can. You know we obviously have a goal of having this long-term creation of value for our shareholders and of course in the short term making sure that we're hitting our numbers, executing and are very disciplined. We've tried to continue that tradition. You know we will be very disciplined about the moves that we make, the way we deploy capital, the acquisitions we consider. All of those are really with the thought about where care is going and make sure we're on the right side of care.

But again we are very much focused on making sure that we do what we say we're going to do in the short term. And that we execute very efficiently. But we'll continue to look for those opportunities to drive the business. As you know we're a pretty strong generator of cash. And capital deployment for us is a resource, that we recognize is an opportunity for us to create our value for all of you shareholders. So we'll continue to bring that approach to it.

Ross Muken: Great, thanks guys.

George Barrett: You're welcome.

Operator: Our next question comes from Charles Rhyee from Cowen & Company.

Charles Rhyee: Yes, thanks guys for taking the question here. You know maybe first I could ask you a question about medical here. You were talking about that as we move to sort of episodes of care, you know, across 90 days to kind of change the way providers have to think about their costs, are you kind of saying that are you then going to the market trying to sell a suite of products that crosses the, you know, sort of the episode of care itself?

So are hospitals really looking to buy, you know, maybe physician preference items within - that'll be used for a case tied then to discharge planning? Is that - my understanding is that is not really how they buy today. You know how are those discussions going? And, you know, how quickly do you think we'll get there that people think of it that way?

George Barrett: Yes. So let me just sort of respond to this broadly first Charles. I think the movement toward value-based care is pretty clear. I think the horse is out of the barn in that regard. Making it happen in practice as you know is quite challenging. We're at early stages in a sense. So there's certain episodes of care we're aligning on what the outcome we're looking for is. Where the appropriate period to measure can be quite straightforward there are other episodes of care where it's extremely difficult and the time horizon in terms of measuring outcomes is more difficult.

So I think we have to recognize that we're in a period of mixed system where we'll be living for some period of time with traditional fee-for-service models as well as outcome or value-based models. Not every provider or every payer is completely ready to move forward on all those programs. We feel like we're well positioned to serve in any of those kinds of markets. We're extremely efficient in driving our lines of businesses given the fee-for-service model. But we now have some tools that are enabling particularly very large complex systems that are beginning to wrestle with these issues. We have tools that can really help them whether or not it's reducing costs or standardization, the consumables, physician preference item strategy which links the device and the services around it where they're going to be paid a set fee for an episode or the work that we're doing in post-acute and discharge management which is really critical as you think about the amount of cost in the system post-discharge.

So I think we're going to live in a world that has both models in the short term. But we really are positioned I think to create value for our customers in either model. And actually just so you have this. Our legacy lines of business in our Medical segment during the back half of the year were actually very strong. And I think it's again a testament to the fact that we can compete effectively in either one of these financing models.

Charles Rhyee: Thanks. And I guess just to follow-up, so NaviHealth, right, if you think about really post-discharge planning, you know, is that a purchasing - I mean is that a decision made at what level in the hospital when you're going in and then, you know, because I'm trying to think about how quickly we could start tying, you know, these types of different product lines or offerings together into kind of a full suite offering.

George Barrett: Right. Well you have to remember that NaviHealth has two types of customers. They have payer customers and have provider customers. And I think the decisions this kind of work tends to get relatively high in the organization. It's not necessarily made in one place. But I will say that because the implications of post-discharge costs are very significant for our customers, these activities, the work that we're doing in this area tends to move fairly high up into the organization. But decisions are certainly made throughout different parts of any customer.

Operator: And we'll take our next question from Ricky Goldwasser from Morgan Stanley.

Zack Sopcak: Hey good morning. This is Zack in for Ricky. I wanted to ask first about the moving parts on the Pharmaceutical segment and how you think about what organic growth was in the quarter versus in fiscal '16 and how that compares to the - and I realize it's not organic but the flattish expectation for growth in fiscal '17.

Mike Kaufmann: Yes, thanks for the question, Zach. We're not going to get specific on the split between organic and nonorganic within the segments. But if you think about the slide on Page 19 we did split it down for the overall company to try to give you a little color, in that we're expecting the capital deployment which will be the combination of stock repo and some tuck-in acquisitions to be in the 2% to 3% range. And then we expect the business growth to be 3% to 6% in total. And, again, if you remember I did say that I expected the Pharma segment to be essentially flat for the year but a little different on a quarter-to-quarter basis.

Zack Sopcak: Got it. Thanks for that. And then a question on specialty so, you know, as you mentioned Specialty is exceeding your target and expectations for fiscal '16. As you head into '17 and further on how do you think about Specialty impacting both your margins as well as your cash generation?

Mike Kaufmann: Yes. I continue to be very excited about what's going on in Specialty. You know last year we wanted to give you a revenue goal which we said was $8 billion which we far exceeded. And really the reason we gave that

last year, it's probably not something we'll be giving forward is because we want you to understand the scale and breadth of that business that we've grown so quickly that it's truly at a scale where we have all the relationships that we need with Pharma manufacturers as well as the suite of services to serve the providers downstream. We do continue to expect double-digit growth in the Specialty business for '17. And we're excited about both our offerings upstream to providers as well as downstream, or upstream to manufacturers and downstream to providers.

So I think we're really well positioned in that business. I think that our margin rates, I think, you know, it's going to be higher margin rates on the upstream services to manufacturers. More typical distribution margin rates on the downstream services to the providers.

George Barrett: George Barrett: Zack, I would just add again something you probably well know, which is that if you look at the pipeline coming out of biopharmaceutical world, Specialty is going to continue to be a priority. So our positioning as Mike said both downstream with the providers and upstream with manufacturers I think is quite stronger now.

Operator: And our next question comes from Bob Jones from Goldman Sachs.

Nathan Rich: Hi. This is Nathan Rich on for Bob this morning. Mike going back to your comments on Cordis and the update to the accretion range. Specifically on the increase in SG&A investments that you guys are planning to make, could you just give us a little more detail behind the nature of these investments? And is there any change to your expectations for the top line contribution from Cordis?

Mike Kaufmann: So thanks for the question on Cordis. First of all, I just want to make sure you know that we feel really excited about Cordis. We think things are going really well. We've got all of the key employees, you know, Management Team, sales folks in place. Things are going incredibly well.

So just a couple quick things to note, really the difference between the 20 cents accretion we had last year and the 15 cents that we're now updating it to, is mostly FX. And, you know, obviously that's something that we can have some impact in the way we price. But it's obviously hard to control. So the biggest piece of that change really truly is FX.

Why I wanted to emphasize the SG&A just a little bit was to let you know that we're incredibly committed to making sure that we do no harm to the current sales business. And that as we get through our TSA Agreements with J&J that as we build up to and support it internally, and then exit off of those other agreements, we've decided to be -- I guess I'll use the word is conservative -- in the sense of managing our expenses so that we don't cause any disruption to the supply chain. Or do anything that would make our sales guys lives tougher.

So we feel good about this. We feel like we have really good plans to deliver. And that's also why I mentioned before, that we would have some variability between quarters. Because in some cases, you know, as we're ramping up our expenses we're also still on the TSA. So we kind of have slightly double expenses in certain periods as we then walk off the TSAs, as we move country to country.

Nathan Rich: Great. And then you also highlighted the record operating cash flow for the year. Just, you know, given your assumptions for fiscal '17, do you think that this level of cash flow performance is sustainable for next year?

Mike Kaufmann: Well I think we're going to continue to have strong cash flow. But we don't, you know, guide specifically to cash flow so I can't give that to you. But I think that we're going to be -- just by the nature of our business and our strong focus on working capital -- we're going to continue to have strong cash flow numbers. This was a record year. And it creates a lot of options for us to take a look at different ways to deploy that capital.

Nathan Rich: Okay, thanks for the questions.

Mike Kaufmann: Absolutely.

Sally Curley: Operator next question.

Operator: Yes. Our next question comes from George Hill from Deutsche Bank.

George Hill: Yes. Good morning guys and thanks for the taking the question.

George Barrett: Good morning.

George Hill: I guess Mike or George I'm going to go back to that Slide 19 where you guys talked about the multiyear aspirations. And that was kind of the '13 to '17 period. I guess if we think about the next five years should we think of those multiyear aspirations as still holding or is kind of the most recent year that being fiscal '17 kind of what we should think of as a kind of more normalized run rate for the business?

Mike Kaufmann: Yes. I, you know, wanted to make sure that I did emphasize. We still believe that over any three-year period we can achieve 10% to 15% non-GAAP EPS growth. So whether you look at '16 through '18 or '17 through '19 or going forward, there's nothing at this time that as we project out what we think we can do not only with the strong position and performance of our businesses but also with our significant and disciplined approach to capital that we think we can still continue to deliver the 10% to 15% non-GAAP EPS growth. And then on the dividend payout, we intend to continue to differentiate that dividend and keep our payout in that 30% to 35% range, which is again something we feel -- with our strong cash flow and continued earnings growth -- we're going to be able to continue to do.

George Hill: Okay, that's very helpful. And I guess just if we think about, you kind of highlighted moving pieces in the guidance in fiscal '17. If we look at the core U.S. drug distribution business, recognizing that there's the Safeway roll off, Nuclear, Specialty, and China are all growing fast. I guess what I'm trying to figure out is on a like-for-like basis is the core U.S. DSD business expected to be flat or actually shrink in fiscal '17?

Mike Kaufmann: Yes. I can't go into a split again with the core other than what I gave you from an overall Cardinal Health standpoint. I will tell you though that remember that we've mentioned a few other things related to the Pharmaceutical segment and the assumption. So from a headwind standpoint, you know, Safeway as you clearly mentioned is a headwind. Also we have our normal re-pricings. Then we have the headwind from the increased expense we're going to incur this year which is specifically related to our Pharmaceutical IT investments because we've had such significant growth in our Pharmaceutical business -- including acquisitions -- that it will be an important area for us.

And then the generic manufacturer deflation that we've talked about, the impact on our business from that. And then specifically the manufacturer branded agreements that we talked a little bit about. But I do want to make sure you know that PD is not shrinking. We feel really good about the strength of all of our businesses in PD both China, Specialty and the core PD businesses.

And then the tailwinds that we've talked about as I mentioned. Just remember one other thing I mentioned. It's important. We expect Red Oak and generic launches to continue to be tailwinds for us but just less in '17 versus '16 than they were '16 versus '15, just because of the nature of the generic launches. There's fewer of them out there. And because we synergized Red Oak so quickly and we had a lot of impact from it in '16. And again it'll be positive in '17 but less than it was the previous year.

Operator: And our next question comes from Lisa Gill from JPMorgan. Please go ahead.

Lisa Gill: Thanks very much and thanks for all the comments. George, I'm wondering if you can just maybe talk about what you're seeing in the marketplace for your contracts that you have with manufacturers that are not under Inventory Management Agreements. Are you seeing any changes at all in the marketplace? And, you know, obviously we've seen some of these manufacturers that have gone through some changes. Are they changing the way they're contracting with you at all?

George Barrett: Good morning Lisa. Yes. I'll start and I'll let Mike jump in. Actually we're not really seeing any noteworthy change here. Relationships with our manufacturers are really good. Again with different product lines that we're seeing launched these days so more products that are coming through Specialty. But I would say, in general, the basic tone of the conversations is positive. And the basic nature of contracting is quite similar. So, Mike, I don't know if you want to add to that.

Mike Kaufmann: The only thing I would add Lisa that is maybe a slight change that would be important to note is that typically in the past we've said that about 80% of our fees from branded manufacturers were non-contingent to inflation. And with recent renegotiations of agreements and various moving parts we expect that to be 85% at a minimum this coming year. And so that means that now 15% or less of our margins on branded manufacturers will be subject to inflation which, again, I think reduces the overall risk and exposure going forward.

And as you've heard me say in the past on that 15% that is contingent, you know, we do that in a thoughtful way working with manufacturers that we believe can still deliver a consistent type of return for us. So I think that's probably the only slightly moving part that I've seen with our agreements.

Lisa Gill: Okay, great. Thank you.

George Barrett: Thanks Lisa.

Operator: Our next question comes from Garen Sarafian with Citi.

Garen Sarafian: Hi. Thanks for taking the questions. A couple clarification questions actually. So on Red Oak I was under the assumption that it was already at a nice run rate. But you stated the incremental contributions. Just to be clear is this just the normal benefits as volumes increase to the JV or are there new functions Red Oak will be taking on?

George Barrett: So let me start and then again I'll make sure Mike clarifies it if it's not clear. So really what we were trying to say was the benefit as you move from '17 to '16 is less than the benefit that occurred from '16 to '15 because it was really the ramp-up basically. So we really had the first year ramp-up, which was more dramatic. But the general direction is positive. I would say the relationship right now is really strong. Red Oak is a highly functioning operating entity with some scale. And so we continue to explore ways to create value from that. Mike's on the Board there. Anything you want to add?

Mike Kaufmann: Yes. The only color I would add -- I think if I understand where you're going -- was while I would tell you we were fully ramped up with any sourcing business, every year you challenge yourself to take costs out and get better and better. Whether it's on the Medical side where the team this past year did an excellent job of continuing to take costs out on our Cardinal Health Branded products and the ones we source, no different than Red Oak Sourcing.

I was at our Board Meeting just last week. And I continue to be impressed with the data analytics and analysis the team are doing as they look for opportunities to lower our costs. And again, work with manufacturers in different

and unique ways that we hope are win-wins with always the goal being transparency and being clear with our manufacturers.

Garen Sarafian: Yes. I guess where I was going with that is with that nice slide on Page 18 with the bridging from '16 to '17. The Generics Program line is 35 cents attributed to it. So just trying to figure out how much of that was marketplace sort of dynamics versus very unique to Cardinal's Red Oak Program. So it sounds like most of that is from just the marketplace dynamics of generics coming onboard.

Mike Kaufmann: Well I would say, you know, Red Oak is going to be the - one of the big positives in there. Generic launches will be a positive. And then generic penetration will be a positive. And then on the flipside, what we're seeing in terms of generic deflation is the negative in there that offsets some of those upsides. And again, as George and I both mentioned, it is the upsides from Red Oak and launches that were a little smaller this year. But also, remember that it's really basically impossible to pull apart all those pieces because they all work kind of in tandem together. When you see pricing pressure you're looking for cost to, you know, costs and renegotiations and etc., etc. So a lot of that works together which is why we grouped it together.

Operator: And our next question comes from Greg Bolan from Avondale Partners.

Greg Bolan: Hey thanks guys for squeezing me in here. Just to keep it real quick, so if we think about, you know, kind of where your minds were at very end of April, last time we spoke with regards to generic deflation and where your minds are today, I mean our work suggests that, you know, the ratio of inflationary to deflationary generic prices has really come back into a more normalized level maybe even still slightly above a normalized level. Certainly, you know, less than 0.5%. Has that changed at all, just in terms of your mindset? Does it seem like there's more of a stabilization and as we think about kind of the back half of fiscal '17 into the first half of fiscal '18, I know we don't want to get that too far out but just does it feel like from a year-on-year comparable basis it's starting to stabilize?

George Barrett: So why don't I start just giving some historical perspective and then and I'll let Mike jump in. I don't - you know this is sort of the environment that we've been in. You know now for quite a number of months.

And so we have over the years seen these swings from time to time. And over the last couple years is a particularly noteworthy stretch. But I would say this is a dynamic with which we're familiar. And I'm not sure that it's changed our mindset in any way. I think we understand with the nature of the market this is a kind of market we've lived in. We're extremely effective at sourcing products. And I think our teams do a great job of commercializing them. And I think we've been picking up new customers. So generally speaking, I'm not sure that there's a …that our mindset has changed in any way. Mike, I don't know if you want to add anything that might differ?

Mike Kaufmann: Yes. I would agree with George on that in terms of a mindset. This is an environment we know how to operate in. And again, I think we're incredibly well positioned with our partnership with CVS Health and with Red Oak and the investments we're making in our Pricing and Analytics Teams across both Cardinal Health and at Red Oak. There are less items going up in price if you're talking about that from a mix standpoint. But when you take a look at the core items whether you look at it and look at items four years older or two years older, or how many players there are, generally we're seeing similar deflation to what we saw in historical periods in those buckets. We're just tending to see fewer and less larger, I guess, increases when we do see the increases, which I think is having the impact that you saw from a few years ago.

George Barrett: I think that's right. The difference is really in a relatively small set of the total.

Greg Bolan: Got it. Thanks guys.

George Barrett: Thank you much Greg.

Operator: Our next question comes from Robert Willoughby from Credit Suisse.

Robert Willoughby: Hey George or Mike. You've mentioned the Cardinal Health At Home products a few times here. You're expecting above market growth here. What's incremental to that strategy for '17? Why are you so upbeat that it's going to grow above the market? And then secondarily, where does that stand as a gross margin driver for you on your hierarchy of things? Is this in the top bucket or is that a "too small to care about" at this point?

George Barrett: Yes. Good morning Bob. I don't think it's small. Again, this is a big contributor to us. I think the drivers of growth here are largely demographic. I mean I think what we see is an increasingly aging population. And so I think, in general, the winds are going in our direction here. We have more patients being discharged in some cases more quickly. As you know the incentives are changing a bit. We are competing very, very effectively. We are generating more flow of Cardinal Health Brand, which is actually still in its relatively early phases of work.

So I would say as we are able to drive more of our own Cardinal Health Brand through that channel that actually makes us more effective. And that's a little bit of that fly wheel that we've seen in other parts of the business, where as we can create more product flow through it's more efficient for the customers, which creates more volume, which allows us to do that much more effectively. And so I think that's sort of the key to that business model. And we feel very good about our ability to source, drive Cardinal Health products and expand our presence in that channel.

Mike Kaufmann: The only thing I would add Bob around your question about why we're above-market is I think a couple other things hit me. One is we have tremendous billing capabilities there and also outstanding payer relationships. We think we probably have, it's not probably have, I think we have the largest breadth of relationships with payers. So we make it easy for discharge planners and folks when they want a one stop shop to go to someone who can handle all of the needs of the patients to come to us.

So I think our ability to make it easier for those folks, our breadth of our line including the Cardinal Health products, as well as I would tell you I really believe in the team up there, has some outstanding folks, I think are the reasons why we're growing above the market.

Robert Willoughby: Is there any change in the retail strategy itself, how many storefronts you might be selling through?

Mike Kaufmann: I wouldn't say there's any change. But we continue to grow that relationship with our various customers. The team is doing a nice job. Jon and Don work together across P&M to look for opportunities and work with whether its retail independents, regional chains or large chains to find opportunities where we can help them create, you know, endless aisles in this area of these type of products and us to be their back-office for them.

So, no, we are absolutely continuing to cross-sell those products.

George Barrett: Yes.

Robert Willoughby: All right, thank you.

George Barrett: Thanks.

Operator: Our next question comes from John Kreger at William Blair.

John Kreger: Hi. Thanks. Quick follow-up on Slide 19, Mike, the 10% to 15% longer term EPS growth goal, should we assume that there's any capital deployment in that number?

Mike Kaufmann: Absolutely. That assumes that there will be capital deployment in that number. It'll be a combination of stock repurchases, acquisitions as well as any capital deployment we use for capital expenditures. So it clearly includes capital deployment.

George Barrett: And by the way when we went back to the Analyst Day a couple years ago when we laid out these goals that was also something we articulated.

John Kreger: Great. And then just a similar follow-up, if you think about your segment level guidance for '17 are there any additional acquisitions baked into either Pharma or Medical guidance?

Mike Kaufmann: At this time the only acquisitions that would be baked in in a sense is - there's no real acquisitions baked in. But we said that capital deployment would be 2% to 3%. So we have given some room in there to either do some small tuck-in acquisitions or to be able to do some additional repo. So from that sense, from an overall company standpoint, there is some I guess capital deployment that could be either acquisitions or stock buyback embedded in our earnings guidance but no specific company necessarily at this point in time.

Operator: And we'll take our next question from Steven Valiquette from Bank of America Merrill Lynch.

Steven Valiquette: Thanks. Good morning George and Mike. We've also been publishing an EPS bridge from Fiscal '16 to '17 as well so I'm glad you guys are on board with the same concept. You know I clearly don't want to get granular as we try to compare on this call. But I would say just big picture we had a benefit from new generic launches but an equal-sized hit from generic price erosion on older products. So we were kind of right around, you know, zero or neutral for generic profits for Cardinal overall for fiscal '17. You guys obviously have, you know, a positive 35 cent contribution at your midpoint. I just wanted to try to dive in that a little bit deeper on what some of the positive contributors are. Maybe the first question might be, do you have generic pricing as a positive contributor or subtraction? And also are you anticipating maybe a lot of unit volume growth in generics within your customer base that might be driving a lot of that earnings as well? Just want to get more color on that 35 cents. Thanks.

Mike Kaufmann: Yes. The three positives that are in there would be Red Oak Sourcing would be the most significant of the positives in there, and again, the year-over-year benefit, right? I've mentioned a couple times it's smaller than '16 versus '15 but it's still a very important number to us. So that's clearly a positive. Generic launches are a positive, again while smaller than the prior year. And then we also do have some assumption of penetration of current accounts that we will be able to take, you know, some of the generics that they're buying direct or from other folks and buy them through us. So those are the three positives or the tailwinds. And then on the negative side it's the generic deflation, actually and the impact that that creates from inventory gains as well as the impact on our selling prices. That impact to generic deflation is the bad guy in there that we've talked about in the past.

Steven Valiquette: And would Harvard accretion be in there? I forgot if somebody asked that or not. Is that part of that?

Mike Kaufmann: No. Harvard and the overall performance would be down in the third bucket -- existing or remaining businesses. We just put all of that down in that bucket.

Operator: And our next question comes from David Larsen from Leerink.

David Larsen: Hi Mike, could you talk a bit about the operating margin in the Medical division? I think you mentioned there were a couple of like one-time benefits last quarter. It just seemed like the sequential delta there was fairly significant. Thanks.

Mike Kaufmann: Yes. Thanks for the question. So in Medical this was what we predicted in our last quarter. We thought with all of the moving parts on Cordis related to the building-up of internal expenses to take over the various operations being managed by J&J right now on the Transition Service Agreements -- that we would have some kind of variability between where we're ramping up and ramping down. We also have some FX impact in there.

And then there's a few other puts and takes that we've had in the - between the quarters that are just creating some variability. And so I'd probably look more at Q3 and Q4 combined than I would to try to look at any one single quarter over the last couple quarters. And this noise will begin to reduce as we go over the next couple quarters and begin to get off the TSA Agreements by our fourth-quarter this year.

David Larsen: Okay fantastic. And then Mike I know you led the Pharma division for a long time. You probably know more about, you know, Pharma pricing than, you know, pretty much lots of folks on the planet. How is Red Oak performing relative to your expectations? And what's going to turn that 20% decline in Pharma operating income in 1Q around so dramatically? It sounds like you're going to have to have a pretty good growth rate in 2Q and 3Q going forward. And in your view what's the one or two things that's going to turn that around?

Mike Kaufmann: Yes. Thanks for that question. A couple things, first off, remember a big reason for that Q1 decline is really how incredibly strong Q1 of '16 was. There were - if you remember back then I mentioned - there was a subset of a few specific generic items that we had anticipated would deflate on July 1 of last year. And they didn't. They ended up staying very much higher-priced than we anticipated, which created a lot of extra margin on those items in Q1. Those items have subsequently deflated. And so they're not creating as much margin.

So that's one of the big headwinds in Q1. You also have the Safeway piece in Q1 of this year where it was a customer that was very late in its contract life that we had fully synergized in terms of Red Oak Sourcing and had penetrated essentially about 100% of the generics there.

So you have those two big things that are there. And then as you really look forward the team is just doing a lot of things as I mentioned around focusing on penetrating current customers which is going to continue to grow us, continuing to invest in data and analytics. Some of the good work we're doing on Harvard, specialty. Nuclear is really improving as a business. And so I think we're going to have much better comps as we move forward over

the next couple quarters. So we would expect our second half to be much better than our first half on Pharma. But I don't think there's anything in there -- like we don't have to pull a rabbit out of a hat or anything to get there. I think Jon and his team have a really great set of plans to execute and get us where we need to be.

George Barrett: Dave if I could just add to it, our Pharma business is competing really effectively right now. Our position is really strong. I love where we are with our customers. Red Oak Sourcing is really effective. So as Mike said there's some somewhat unique things in the comparative data. But we really like the positioning.

Sally Curley: Operator I think we are going to try to go through the rest of the questions in the queue if we can.

Operator: Indeed. We had one final question actually from Mr. Eric Coldwell from Robert Baird.

Eric Coldwell: Hi. Actually my question was covered just a minute ago and for the sake of time I'll let you guys wrap up.

George Barrett: Thanks Eric.

Sally Curley: Thanks Eric.

Mike: Thanks Eric.

Operator: Okay. And there are no further questions at this time. So Mr. Barrett I'd like to turn the conference back over to you.

George Barrett: Sure. Thank you. Listen, I know all of you have a really busy day today. We appreciate you jumping on a little early with us today and very much appreciate you joining us for the call. So we hope to see many of you in the coming weeks. Thanks to all of you. And have a good day.

Operator: And that will conclude today's conference. We thank you for your participation. You may now disconnect.