Cardinal Health to Acquire Leading Patient Product Portfolio from Medtronic - Conference Call

April 18, 2017 8:30AM Eastern

Operator: Please standby, we're about to begin. Good day and welcome to the Cardinal Health conference call. Today's conference is being recorded. At this time, I would like to turn the call over to Sally Curley, Senior Vice President Investor Relations, please go ahead ma'am.

Sally Curley: Thank you, welcome to this morning's call to discuss Cardinal Health's planned acquisition of Medtronic's Patient Care, Deep Vein Thrombosis and Nutritional Insufficiency businesses as well as our preliminary thoughts on our future outlook. With me today are Chairman and CEO George Barrett, Medical Segment CEO, Don Casey and CFO Mike Kaufmann. George and Mike will have some prepared comments and then we'll move into Q&A where Don will join.

Before I turn the call over to George, since we will be making forward-looking statements, we need to remind you that 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 statements slide at the beginning of the presentation found on the investor page of our website for a description of risks and uncertainties.

We will be ending today's conference call promptly at 9:30am Eastern. To more efficiently get through our question and answer queue, please limit your question to one only with no follow-ups. I know we have a lot to cover this morning, and if we don't get to your question the investor relations team will be available throughout the day as always to answer anything that you may have.

Thank you and now I would like to turn the call over to Cardinal Health's Chairman and CEO, George Barrett. George?

George Barrett: Thanks Sally, good morning and thanks for joining us this morning. It's an important day for all of us here at Cardinal Health. As you saw in our press release, we've announced a definitive agreement to acquire some of the assets of Medtronic. For clarification, these product lines were part of the Patient Recovery Business in Medtronic's Patient Monitoring and Recovery division. But some of you might also know these product lines as Covidien's medical supplies and their compression businesses.

As we talk about the business today, we'll refer to this as the Patient Recovery Business. This is a product line that has been on our radar for many years. A business which we have always felt would be in strong and competent hands at Cardinal Health, given our strategic focus and extremely important to our customer base. The product categories embedded in this transaction fit naturally into the work that we're doing across the continuum of care from acute care, to surgery centers, to long-term care, into the retail setting and even to the consumer.

These are product areas and channels with which we have enormous experience going all the way back to our legacy in American Hospital Supply. What does this acquisition do for us? One, it broadens and deepens our reach, particularly in the OR, the ER, the nursing station, and the post-acute facility. And the products stand side-by-side with the products we already produce and source. In many ways, these are the staples of the healthcare delivery system. Two, our ability to offer such a broad line of products and services allows our customers to standardize, reducing redundancy and improving efficiency.

Three, the scale that some of these products bring to our manufacturing facilities and the addition of some very high quality manufacturing operations, heavily weighted in the U.S., will help us reduce cost. Four, these products, with some important household names like Curity and Kendall, improve our connection to our customers and patients and stand for quality at a time when quality matters.

Five, this expands our reach and product lines in global markets offering us the opportunity to leverage some of the capabilities we have been building in our international Cordis operations. Six, the addition of the Patient

Recovery portfolio improves the balance of our overall enterprise, which is so important at a time of great change. Seven, the transaction is highly accretive, while noting that in the first full year we will have to absorb an inventory step up, as we did with the Cordis acquisition. And we expect synergies to be in excess of $150 million exiting FY20.

Eight, this business is highly stable and generates strong cash flows. Nine, we will bring more than 10,000 talented associates into the Cardinal Health family, and a leadership team with decades of experience with these products and customers. We have a long-standing and strong relationship with Medtronic and appreciate their work in getting us to this stage. They are a valued partner and we look forward to working even more closely with their team going forward, particularly in that we'll be providing some ongoing services to one another.

This acquisition of the Patient Recovery portfolio continues a journey that we embarked on some eight years ago. That journey focused on bringing efficiency, quality, and safety to a healthcare system undergoing meaningful changes. Every line of business in which we compete is valuable in today's environment and perhaps, even more important as our population ages, these businesses will be increasingly valuable as healthcare continues to evolve toward a more patient-centered, value-based system.

This portfolio increases the relevance of these offerings and in fact, adds an element of patient familiarity that will only serve to reinforce the strength of our brand. With that in mind, the picture of Cardinal Health today looks quite a bit different than what you saw in 2009. Our customer base is larger. The mix of our product lines is broader, deeper, and more balanced. Our geographic footprint is considerably larger. And our capabilities and talent base is significantly stronger. Today we are one of the very few companies in the healthcare space who can address both the pharmaceutical and the medical sides of the industry.

With this as the overall framework, I'd like to make a few comments about the second press release that we issued this morning. In this release, we provided some commentary on the balance of our fiscal 2017 and some early thoughts on our expectations for our fiscal 18 which begins on July 1. As many of you know, we haven't yet reported our third quarter of FY17 but as we absorb the planning around this acquisition, we have taken considerable time to analyze the overall environment and model our portfolio.

We do not have a finished budget for FY18, and, as you know, we typically provide more detailed information about the upcoming year in our August report. Having said that, we do have some general observations which we felt were important to share with you at this stage. We expect to see continued strong growth in our Specialty solutions group, an increasingly important line of business given what is happening in pharmaceutical innovation.

We are very pleased to have grown this business to more than $10 billion in annual revenues, and are extremely excited about our capabilities here and our growth prospects going forward. As you've seen over this past year, we are continuing to experience very solid growth across the board in our medical segment with virtually all lines of business outperforming the market. This is the strongest fundamental performance that we have seen in the medical segment at any time during my tenure.

Our medical-surgical business is growing its customer base. Our broad line of Cardinal Health products is increasing in size and gaining penetration. We are expanding our ability to serve patients in the home. And our work in post-acute and discharge management is growing fast and creating real value for our customers. And, the addition of the Patient Recovery product lines will be a major contributor to our growth plans.

Our pharmaceutical distribution business is, however, going through a challenging phase. Let me put this in some context. We have seen in the last few years, and are likely to see in the coming years, breakthroughs that will change the lives of patients and their families.

We are proud to be part of a process helping to bring these medicines to patients, and in our role as a pharmaceutical distributor, we are indispensable in making this happen efficiently and safely, and, of course, we will expect to be compensated fairly for this value. At the same time, the public discourse around access and price is important. I know that many of my colleagues around the pharmaceutical industry wrestle with the tension between funding the innovation necessary to create these breakthroughs and making sure that these products are accessible to the patients who need them. Each company has its own view as to how best to reconcile this.

At the same time, the generic segment of the industry is going through its own dynamics. Generic manufacturers are working hard to bring more affordable medicines to the market while competing at a stage of the lifecycle

where reimbursement pressures are significant, and at a time where there is a lull in the number of branded products losing patent expiration and protection, excuse me.

And while the opportunities to launch biosimilars, and even generic biologics, offers exciting future promise, this part of the industry is still at an early stage of evolution.

How does this translate practically, to us? Based on the market conditions we see today, particularly around pricing, we expect to finish our fiscal 2017 at the bottom of the guidance we provided in February. Acknowledging that this is still very early in our annual budgeting process, we are modeling cautiously for fiscal 2018, given the overall pricing environment and at least $0.50 per share of Cardinal Health specific headwinds, approximately half of which flow through to the pharmaceutical segment.

Given this, our early model suggests that our pharmaceutical segment could be down high-single-digits next year. Mike will cover this in more detail in his commentary. Mike brings a unique perspective given his history leading our pharmaceutical business.

Let me be very clear here, we are seeing the vast majority of our business lines growing and our revenues are strong. Our pharmaceutical distribution business continues to grow its units, has a strong and stable customer base, has an outstanding driver of long-term value in Red Oak sourcing, and is an excellent generator of working capital, but the sheer size of our pharmaceutical distribution business will have a disproportionate impact on the overall performance of the enterprise in the near-term.

Based on this, we could see non-GAAP earnings per share flat to down mid-single digits in fiscal 2018, recognizing that we will have to absorb the inventory step-up from this acquisition. These are not the kind of numbers you've come to expect from Cardinal Health, nor are they the numbers we expect of ourselves. We have been, and are, taking the actions necessary to bring efficiencies to our business. At the same time, however, we are committed to investing in critical initiatives that will help drive and sustain our growth over the long-term.

We are still refining our numbers, but we felt that it was important to give you additional clarity and transparency around our current expectations. Let me brighten the picture somewhat, looking beyond 2018 and into 2019, we expect Cardinal Health's non-GAAP earnings per share to grow at least in the high single digits on a business

which has a better margin profile, is even more balanced, has a broader geographic footprint, and is driven by an organization not only possessing world class supply chain capabilities, but also, an organization with deep clinical expertise and strong analytical tools.

This is what we are seeing right now, and as has been our approach with you, we wanted to be as plain speaking as we could. Make no mistake, we continue to be extremely positive about our overall portfolio and our prospects for growth. Our enterprise is enhanced with the acquisition of the Patient Recovery Business. Our lines of business are on the right side of healthcare; were extremely - we're executing extremely well; we are very efficient at generating cash; and we are very well positioned in the market.

There's a lot to digest today, so I will turn the call over to Mike who will walk you through the mechanics of the acquisition and our early thoughts on fiscal 2018 and 2019. Mike?

Mike Kaufmann: Thanks George and good morning everyone. As you'd expect, we're all excited about the transaction we announced this morning. As George noted, we've had our eye on this product portfolio for many years and know we can create meaningful value with it. I'll come back to the acquisition in a few minutes, but let me first discuss our other press release from this morning, which addresses the balance of our year and some early thoughts on our fiscal 2018 and 2019. I know this is top-of-mind for all of you, and so I want to address it up front.

Let me begin by reminding you that it is very unusual for us to try to give any kind of guidance this early. We haven't yet reported our third quarter fiscal 17 but in light of today's acquisition announcement, and given our current insights into the pharmaceutical distribution market, we felt it was important to provide you with some early thoughts. During my second quarter prepared remarks, I noted the most significant moving parts for the second half would be generic market pricing, taxes and brand inflation. Taxes are expected to be better than anticipated and brand inflation slightly lower. Generic market pricing while less deflationary than what we saw in the first half, is still lower than we modeled.

Based on this dynamic, we are revising our generic drug pricing assumption from high-single digit deflation to low double-digit deflation for the full fiscal year. As a consequence of that, we now expect a full year 2017 non-GAAP

earnings per share from continuing operations to be at the bottom of our previously communicated guidance range of $5.35 to $5.50, with the EPS update attributable to expected fourth quarter results.

We will provide you with more details on our third quarter earnings call scheduled for May 1. Moving on, I'd like to share our preliminary thoughts on our expectations for the year ahead. Using the bottom of our fiscal 17 non-GAAP earnings per share guidance range as a base, we are currently modeling fiscal 18 non-GAAP earnings per share to be flat to down mid-single digits. Let me provide some color.

We continue to expect excellent growth across most of our businesses, including double-digit growth in Specialty Solutions and Nuclear. The medical segment profit, even before factoring in the impact of today's proposed acquisition is expected to grow at least in the high single digits. However, the impact of several discrete items, in addition to ongoing dynamics in generic market pricing, will create significant headwinds.

Let me take a minute to talk about those discrete items, which can be bucketed into four areas. First, in fiscal 17 we have had a number of positive discrete tax items. In addition, we recorded a number of favorable reserve adjustments, none of which individually were significant. We do not expect these items to repeat next year. Second, as is normally our practice, our models for fiscal 18 will include assumptions that we fund employee incentive compensation at target which creates a headwind versus our assumed actuals for fiscal 17. Third, during fiscal 18, we expect to make incremental investments in areas that we believe will be valuable and important to our long-term strategic positioning.

Fourth, we continue to invest in our multi-year information system refresh in the pharmaceutical segment. Over the last several months our initial launch efforts for this project have been very successful in several key areas, thus depreciation expense began this quarter as the system became operational.

This expense, combined with next year's investments and go lives will create a headwind for fiscal 18. This IT system refresh is critical to our pharmaceutical distribution customers. It will enable us to maintain the excellent service they have come to expect from Cardinal Health, provide us with the ability to expand in a cost efficient manner and better enable enterprise behavior. In total, these four areas, will create a headwind of at least $0.50

per share, or about ten percentage points of growth. Note that about half of these discrete items pertain specifically to the pharmaceutical segment while the remainder apply to taxes or the medical segment.

On top of these discrete items, we expect generic deflation to moderate from low-double digits this year to mid-single digits in fiscal 18 which still creates a headwind for the pharmaceutical segment.

While there are a lot of moving parts and there is still work to be done, when we take into account all of these items, we are currently modeling the pharmaceutical segment to be down high single digits and medical to be up significantly, resulting in total company earnings per share of flat to down mid-single digits.

Again, I would remind you that it is very early in our planning processes and we would not normally provide our preliminary thoughts on next year at this time. On our fourth quarter, fiscal 17 call later this year, when we have completed our budget process, we will share more specific details about our fiscal 18 guidance and segment assumptions.

Looking towards fiscal 19 and beyond, let me give you some thoughts on why we believe the growth trajectory of the company's non-GAAP EPS will be at least in the high single digits. First, we expect the pharmaceutical segment profit to grow in the low to mid-single digits. This will be accomplished through a combination of continued strong growth in Specialty Solutions and Nuclear as well as work in our pharmaceutical distribution business to better balance a generic deflationary environment with customer re-pricing's, brand and generic sourcing and improved mix. This is an incredibly resilient business and I am confident we can make the needed changes.

Next, on the medical side, when you combine the strong growth in the distribution, post-acute and services businesses with the accretion, synergies and scale from the planned acquisition, we expect significant growth.

Both segments, as well as corporate, will stay disciplined on expenses but not be afraid to invest for the future and, we will continue to have a balanced approach to capital deployment. We plan to continue to invest in our businesses, maintain a 30 to 35% dividend payout ratio and balance as appropriate M&A and stock repurchases. Note that our outlook for high single digits growth assumes share repurchases roughly equal to dilution from options. Hopefully this helps paint a picture for fiscal 19 and beyond.

Now let's turn back to the planned acquisition. As I mentioned before, we have evaluated this opportunity for some time, and like the rest of our team I'm excited for it to become part of our world-class portfolio. Since George has provided the strategic rationale, I'll cover the deal valuation and financing plans. As you know, we're acquiring the Patient Recovery Business of Medtronic for $6.1 billion in cash and expect cash tax benefits of at least $100 million thus we anticipate the net price to be slightly less than $6 billion.

We intend to finance the acquisition with a combination of $4.5 billion in new senior unsecured notes and existing cash on hand. We have secured bridge financing but plan to issue public debt to fund the transaction prior to closing. We do not intend to draw on the bridge facility. We will be monitoring the debt markets and will be ready to execute the best possible financing to secure attractive financing costs for the company. Given our current ratings, the margin accretion and strong cash flows of the new business, our commitment to repay $1.5 billion of this debt over the next three years and our long history of prudent capital deployment we fully expect to de-lever to an adjusted debt to non-GAAP EBITDA ratio of slightly greater than two times by the end of fiscal 2020.

The planned acquisition of the Patient Recovery Business will add a robust earnings contributor to Cardinal Health. We expect this transaction to provide at least $0.21 of accretion to our non-GAAP EPS in fiscal 18. This assumes our first quarter fiscal 18 closing, an inventory step up of approximately $100 million and interest expense from the incremental financing of up to $0.39 per share, subject to change based on our ultimate bond pricing and tax rate.

Remember, due to the requirements of purchase accounting, we will need to revalue inventory to its fair value, which will result in an unfavorable impact to cost of sales. We expect this step up to occur during the first couple of quarters post close. We will be sure to provide updates to these assumptions as actuals become available. In fiscal 19, non-GAAP EPS accretion should rise to more than $0.55 per share, and continue to grow from there. One driver of its earnings contribution will be synergies. By the end of fiscal 20, we assume operational synergies will exceed $150 million annually. From a GAAP perspective, it's too early in the process to provide any specific guidance on the intangible asset amortization. Once the transaction closes and the fair value estimates are complete, we will provide additional details.

Any amortization will, of course, be included in our future GAAP results but excluded from the non-GAAP financials consistent with our past practice.

Now I will walk you through the closing process at a high level. To support a successful integration, our experienced team will work with the highly knowledgeable Patient Recovery Business team to operate this business both in the U.S. and globally. Outside of the U.S. there will be back office transition support from Medtronic that will help us stand up these businesses without interruption. In addition, Medtronic will provide extended manufacturing facility support in some locations.

Furthermore, as part of our agreement, we will be providing to Medtronic some manufacturing and service support. While we will ensure optimal business continuity and efficiency, our general objective is to transition the various functions to our complete control as quickly as possible thus, the timelines for transition and the length of the agreements governing these support functions will vary.

The Patient Recovery Business will be reported in our medical segment and based on the margin profile of the planned acquisition, and assuming there are no other changes in mix, we are confident we will meet or exceed our medical segment target margin rate of 5.75%. In summary, this acquisition is a great strategic, cultural and financial fit. It creates scale and is one we feel confident we can execute on as it is at the core of what we do well today. We expect our entire company along with our customers, partners and shareholders to see sustainable benefits from this transaction.

Let me close with two thoughts. First, we always want to be as transparent and clear as we can be, and, I hope you found this information helpful. Second, I am convinced we are doing the right things at the right pace and are positioned well for the future. I want to thank you for your time and participation today and we will now turn the call over to Sally for Q&A.

Sally Curley: Let's open the call for Q&A if you could just make a couple of remarks.

Operator: Thank you, if you would like to ask a question, please press Star 1 on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. To reiterate, we will be ending promptly at 9:30 so please limit your question to one with no follow-ups in respect of time. The investor team would be more than glad to take any questions following the call. Once again, that will be Star 1 for questions and we will take our first question from Charles Ryhee with Cowen and Company.

Charles Rhyee: Yes, thanks for taking the question. You know, George, when we think about the business that you're taking on and when we think back a couple of years I know you guys had your eye on it. Is everything in this business today what you had been looking for or is there anything that Medtronic is keeping that was in the convenient business that you might have thought you could have gotten back then which you're not getting today? Thanks.

George Barrett: Thanks Good morning Charles. Actually, this turns out to be the portfolio we really hoped we would have access to. As you know, it's been part of a couple of different companies and so we were really thrilled that these lines are the lines that fit Cardinal Health. They're sort of down the middle for us so we were pretty excited about that mix.

Sally Curley: Next question?

Operator: We'll take our next question from Lisa Gill from J.P. Morgan.

Lisa Gill: Good morning and thank you. First congratulations I think this is a good deal but I just really wanted to ask a specific around the guidance and the thoughts around generic pricing going into 2018. Can you talk about what

visibility you have at this point and, Mike, I think you talked about re-pricing in the marketplace. Is it still highly competitive especially in the independence and with the GPO's, is that what you were talking about when we're thinking about pricing especially on the generic side going into next year?

Mike Kaufmann: Yes, thanks Lisa for the question. You know, I'll step back as you know we mentioned earlier in the year that what we saw early in the year was a lot more deflationary then we expected and then what we started to see was some improvement in the December, January timeframe and so - but we mentioned last time we spoke we said it was a little early to tell you what that meant as far as a trend but that it was not quite the same as what we saw in the fall.

And so that is what we're seeing, it's still competitive, it will always be a competitive marketplace but what we're seeing as far as on the sale side to the customers and I think you're about right mainly in that independent retail space, it's still a little bit more aggressive than we had modeled which is, you know, again better than what we saw and that's what's causing our discussions around both FY2017 and why we wanted to give you some thoughts around FY2018.

Lisa Gill: Great, we appreciate the transparency.

Mike Kaufmann: Thanks.

Operator: And we will take our next question from Eric Percher with Barclays.

Eric Percher: Thank you. Again, congrats on the acquisition but I think I want to focus on the pharma side. Last quarter you came out with what was a fairly unique definition of generic deflation so I know that includes both the math at

your side and your sales side. Could you talk a little bit about how much that step down from the prior guidance is what you're seeing with the math factors versus your - the comment you just gave us on the sale side and also I think you've talked about your secondary business giving you insight into the marketplace. How much of this is impact from secondary versus kind of primary?

Mike Kaufmann: Yes, thanks for the question. Yes, I would say this is more on the customer sales side than on the manufacturer side. We still continue to see the type of launches and deflation that we were expecting from manufacturers and we still continue to see excellent performance from Red Oak to be able to go out and work with our manufacturing partners to make sure that we're having excellent - having an excellent cost position. So I still feel very good about what they're doing.

So this is where really the sales side downstream to the customers is still a little bit more than we modeled. Again, it's getting better than what we saw and I think hopefully the market is beginning to understand this dynamic and as I also mentioned in my script, there's a lot of different levers that we have to think that are coordinated which is more than just Red Oak which would be also making sure that we drive our mix, making sure that we execute on launches really well, make sure that our pricing is exactly where we needed to be but, again, overall it is a deflationary environment and we expect this year to be down low double-digits and next year our early look is that we'll be in the mid-single digits in a total deflationary environment.

Operator: We will take our next question from Ross Muken with Evercore ISI.

Ross Muken: Good morning guys and congrats on the deal. I want to stick on the pharma business because it seems like that's where all of the questions are even though obviously a great transaction. Help us understand, you know, again I'm not asking for long-term guidance but obviously you talked about the trajectory of 2019, help us understand the cadence or the assumptions that go into your view of how pharma will trend throughout 2018 and then the jump off into 2019 and what are some of the key points you're looking for to kind of get confidence that

that business, which has been under pressure now for 12, 18, 24 months, depending on how long that the funds last.

You know, your assumptions for that returning to even flattish growth or flattish results or maybe even modest growth. What sort of needs to happen in the end market environment, how many of those sort of discrete items, you know, truly are discrete for this year and then aid the growth next year. We're just trying to compartmentalize, you know, again I realize giving like growth percent numbers I'm not looking for but more directionally and qualitatively, help us think about that cadence, the ramp and then the confidence and sort of the components in 2019 and beyond?

George Barrett: Ross, it's George, why don't we let Mike start on that and then I can jump in.

Mike Kaufmann: Yes, thanks Ross. You know, it's a little, again, early to give you tons of details because that's something for sure we'll do on our fourth quarter call is we'll give you a lot more, you know, clarity around that but let me see if I can help.

First of all, I think it's important to note about the $0.50 of one-timers - or I would call discrete items probably is actually a better word. And what I mean by those is that - let me just walk you through them, some of them were, as I mentioned in my script, was the tax and reserve adjustments. And what these are is we had some favorable one-time tax items that, again, we could have favorable items next year or unfavorable items next year or this year but so far through this year we've been at a net favorable tax position which generally means our tax rate is a little lower this year than we would expect it to be, all things being equal, for next year because of these individual discrete tax items.

And then we always have every single quarter, we have a lot of individual adjustments to various reserves that we would have. Some will go favorable, some will go unfavorable. This year what we've seen is the netting of all of those reserve adjustments. Again, none of them individually significant which is why you haven't heard us talk about any of them in the individual quarters but we take a look at them as we are trying to put some work together

for everyone. The net of all of those netted to be a positive item that we felt was important combined with the tax and called that out.

That would be the largest item of that $0.50, those combined and then after that it's - the other things that I mentioned which would be compensation related adjustments based on, you know, where we're performing this year, where we go back to our normal practice of accruing at 100%, investments that we plan to make next year in the business because we were very disciplined this year around managing our investments and then we see some areas next year that we think will be important that we'll invest in the business and then our P-modernization IT project which we've been talking about for about over a year that we had a five or so year plan on scheduled investments that we're making that and the costs that were associated with that or part of it.

So those are, first of all, the elimination of those is an important thing and then let me talk about the positive things that, you know, when you don't have the year-over-year from those discrete items we continue to feel excellent about specialty and nuclear. We think both of those businesses in the P segment are going to continue to grow significantly.

The acquisition alone in 19 will add at least $0.34 if you assume that it added at least $0.21 then it would grow to $0.55 so that's going to add at least $0.34 then the medical core growth has been excellent. So even if you take out the acquisition what medical has been doing with services, distribution, the post-acute space, at home, they've got a lot of good initiatives, that business is going to continue to grow well and then finally the pharma distribution team I'm confident they're going to do the things they need to do, it's an excellent group. As you know, I've worked with many of those over the years and they've got a lot of work on around pricing models, brand and generic sourcing and mixed management that I think are going to be drivers.

So George, let me just kick it back to you for a couple of minutes.

George Barrett: Yes Ross, let me just add a little bit to this. We've sort of got to get through this reset is sort of the way we see it in terms of the price and as Mike said some one timers. Revenues are strong, our customer-base is

strong, we've got limited big renewal exposure. Our enterprise selling is creating value across both segments. Red Oak sourcing is a really powerful engine. And so I think we feel very good about that.

Really what happened is we - as we came to this announcement and we got our early rollups, we just wanted to be transparent about what we were seeing and I think it was important for us to do that but I think our long-term view about the pharma distribution business is quite optimistic. We think it's an important business for the market, for our customers and for us. So that's sort of the general perspective I'd give on this.

Sally Curley: Let's go to our next question.

Operator: We'll take our next question from Michael Cherny with UBS.

Michael Cherny: Good morning guys and thank you for all of the details so far. You know, I know there's going to be a lot of other pharma questions so I'll ask the question on the medical side. You know, as you think about integrating the business and you think about the synergy capture that you have, the strategic rational you have, how do you think about the continued evolution of the medical segment in terms of positioning what's a growing private label, you know, self-branded products and how you sell that both within your own channel as well as through other channel partners and how you position that appropriately so that you're not offending some of your other supplier relationships while also positioning it appropriately within some of the other channel partners given that obviously these are not products that you want to keep simply within the Cardinal medical customer base.

George Barrett: So Michael let me start and Don is here and I would really love Don to sort of kick in. So let me just do it real quickly. First of all just as a reminder, we do report in two segments but increasingly the way that we - the value proposition that we offer the customers is about the overall portfolio and that is incredibly important at a time where there's a lot of change in convergence.

The second thing that I would say to you, and I've said this in a number of public settings, is that we often find throughout our business we have a business partner with whom we compete on one aspect of business but where we partner in others or where we're a supplier to one or a customer of another. So, we're sort of used to dealing at this point with an environment in which our business partners and Cardinal Health know each other well and we help navigate those things.

But let me let Don just sort of give a little bit more framework on the overall medical segment. I just wanted to make sure that I highlighted that we really work together at pharma and med. Go ahead Don.

Don Casey: Yes Michael, I think it's a great question first. Look, we believe these brands as well as the Cardinal Health brand can be pushed out internationally as well as the other channels here within the specific acute channel today where we start on the foundation of an outstanding distribution company we have to make that distribution process relevant to our national brand partners. And we believe day in and day out we offer an outstanding distribution service that gives them cost efficiencies, it makes them more effective with their customers and as long as we're doing that as well as providing novel solutions and providing them value, we expect to be able to work with them in a number of different ways.

As we look out over the next couple of years and we integrate this business, I think we view ourselves as a solutions company, not as a product company, not as a distribution company, and that service that we provide to national brands is relevant most importantly to our acute care customers so when we go to an acute care customer we can say, look, we have a broad portfolio of products and services that we provide and we're also helping bring efficiency in the system through some of our national brand partners.

So we look at that model as sustainable and providing excellent growth because it delivers value to all parts of the chain, all parts of the value creation chain.

George Barrett: Mike, I would just add to that, those acute care partners are often a highly integrated system now and so our ability to work across their whole system, as Don says, it just turbo charges the value proposition.

Sally Curley: Next question?

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

Steven Valiquette: Thanks good morning George and Mike. So I guess for me just curious on revised guidance on pharma distribution and generic deflation, does this assume that you're maintaining your market share within the independent retail pharmacy customer base and just the profitabilities being lowered again or are you assuming maybe some customer attrition within that independent retail category?

Mike Kaufmann: No, we're assuming that we will maintain our share and it's just that, as you said, our profitability would be squeezed a little bit as we work through the transition to begin to drive other opportunities like mix and more share of wallet and those types of things.

Steven Valiquette: Okay, I mean there are some independent retail GPO mergers that seem to be happening in the marketplace, I'm wondering if that was playing a role in your revision as well but it sounds like that's not really a factor.

Mike Kaufmann: No, we don't really see that at least so far with the ones that have happened as any factor for us specifically. Thank you.

Steven Valiquette: Okay, thanks.

Sally Curley: Next question? Thanks Steve.

Operator: We'll take our next question from John Kreger with William Blair.

John Kreger: Hi, thanks question for Don. Don, can you give us a sense about how many of your big IDN customers have sort of embraced your Cardinal branded product strategy and where you would hope to take that penetration over the next few years?

Don Casey: It's interesting, so to be specific in that question, if you look at within our channel and we defined it within our channel as where we are the prime distributor, the penetration has been excellent and as we've rolled out expanded - our expanded product portfolio I would say that almost every one of them that we were prime distribution partner with them has embraced either some form of product or service in an expanded way now that we've offered them.

More importantly over time you know we look to expand our channel and with wins that we had, that we talked about like at Kaiser Permanente, you can begin to see that we are looking to expand our channel and once we build that distribution relationship then you can have a different kind of conversation with those IDN, these integrated IDN partners about what services whether they're pharmaceutically based, whether they're about post-acute space or other areas we can have those conversations and expand it. And you know, not everyone takes every single thing that we offer but what we're finding is that the broader portfolio certainly gives us a number of different touch points within these integrated IDN's that we like to think makes us more relevant to them and really a partner in how they are going to approach this huge transition of them going for fee from fee for service to a fee for value.

George Barrett: And John I would add that the opportunity to expand that share of wallet is really there particularly as we add more product lines and today's announcement helps us.

John Kreger: Great, thank you.

Sally Curley: Thanks John, next question?

Operator: We will take our next question from Ricky Goldwasser with Morgan Stanley.

Ricky Goldwasser: Yes hi, good morning. So, one question and one follow-up. First Mike going back to your prepared remarks, I think you said high single digit EPS growth would apply to fiscal 19 and beyond. Is this a new long-term guidance for high single digit EPS growth as a sustainable long-term guide for the combined business?

That's question 1 and question 2, when we think about the pharma distribution margin, the guide that you give today implied distribution margins would contract back to about where you were in 2012, back we get to around 1.6%, 1.7%. So is that the right context for us to think about where distribution margin should go toward stable, should we go back to that kind of like period prior to generic inflation environment and prior to the relationship with Red Oak because it seems that now you might have to give some of that upside back to your client. Thank you.

Mike Kaufmann: Thanks Ricky for the questions. You know, there are so many moving parts and the business is so different today than it was in 2012. I think it's really hard to talk about a one for one type of trade when you look at mix, launch schedules, pricing, the way the fee for service model has changed and so at this point in time I really can't make any comments on where we would expect the pharma distribution margin rates to settle out.

That's something we'll take a look at and consider when we give more color around our 19 guidance and our 18 information when we get to our fourth quarter call. But as far as the long-term guidance and whether saying that 19 will be at least high single digits and whether you should interpret that as our new long-term guidance it's still just a little bit too early also for that. That's something that, again, we're going to re-evaluate over the long-term and take a look at and we'll come out with some more clarity at our fourth quarter call but we were just trying to give you some color here. So, knowing what we talked about in 18 we felt it important to give you at least some insight into 19 for now.

George Barrett: Yes, Ricky, again, just today's call wasn't really meant to update long-term guidance, we're trying to provide some clarity on 18 and we have some visibility on 19 at this stage and we'll go through our budget process and in normal course we'll continue to provide information as we look at long-term perspective.

Ricky Goldwasser: Okay, thanks.

Sally Curley: Next question?

Operator: Thank you. We'll take our next question from Robert Willoughby with Credit Suisse.

Robert Willoughby: CAPEX, do you envision the Medtronic assets will add to your business and can you speak to any synergies outside of the 150 that you mentioned from reducing inventory stock or bricks and mortar investment?

Mike Kaufmann: Yes, thanks for the question Bob, yes a couple of comments about the new acquisition. First of all, it is a very nice cash generating business as I mentioned in my prepared remarks, the margin rates are obviously very accretive to us and this will help us meet or exceed our 5.75% goal for medical.

The synergies are, for the most basis, they're cost-based synergies. We do feel there are some revenue synergies, obviously, as you heard Don talk earlier. We tend to have accounts when we have the distribution business, we penetrate our Cardinal brand very well. This will now be part of the Cardinal brand portfolio so we would expect some revenue synergies but the 150 I talked about was the vast majority there was cost synergies which would be looking at all of the various avenues that you can get at whether it be supply chain, sourcing cost and all of those types of things. We feel really good about being able to execute on those based on where we're at today.

Robert Willoughby: What's the annual CAPEX?

Don Casey: Yes, on CAPEX obviously when we inherit a series of manufacturing assets we've got to evaluate where they fit. But our modeling of this does include a significant chunk of CAPEX in two areas both from a manufacturing as well as some of the businesses are a little bit different in terms of the pump business as a rental business so, you know, that's kind of how we're looking at it.

Mike Kaufmann: Yes and we'll definitely get you a little bit more color on that as we move forward because we haven't yet had a chance to really, as you can imagine, get into the weeds of each one of the facilities and meet with the team to understand their needs. I don't have any concerns that it will still be a net cash generating business for sure after CAPEX but we still have a little bit of work there to do to give you a little bit of color on that.

Sally Curley: Let's go to our next question.

Operator: We'll take our next question from Dave Larsen with Leerink Partners.

Dave Larsen: Dave Larsen, so congratulations on the deal. Mike, can you give a little bit more color around the sale side pressure, so for example, it was my understanding that there were really like around five large GPO's on the independent side that repriced maybe six months to a year ago. Did they reprice again or were there terms in those contracts that caused the selling rates to come in sort of below expectations and then is there risk that you know you see sort of the same thing happen in six months and did this potentially sort of re-pricing sort of challenge spread to other segments of the market like some of the larger chains or physician groups or hospitals or anything like that. Thanks a lot.

Mike Kaufmann: Yes, let me see if I can help out a little bit there. First of all, I would say that as we've mentioned for the spreading as you say that the other groups that really happened earlier in the year with the rest of it. It was pretty quick. I don't think that's really what is causing this here. As far as the overall re-pricing of those agreements, again, a lot of that happened earlier in the year so I think that's what flowed through but as we've said before, generics are a spot market and so you don't fix a price and have the same price for three, four, five years, the length of the contract.

You will set your rebates and a base price but then every day you've got to be competitive in the marketplace and so what we're really seeing now is just the normal day-to-day competitiveness in that generic marketplace that you have to have to be able to compete and maintain your share and we, again as I mentioned earlier, fully expect to maintain our share and we'll do what it takes to do that and luckily we're at a great cost position to do that. We're just seeing a little bit more pressure on that side on that day-to-day re-pricing than we anticipated. But I don't see any really big re-pricing's coming or that being the cause of what I'm talking about here.

George Barrett: Yes Dave it's George. The other thing I would add to that I would add to that is you also probably - you're working off a sort of lower base. So I think part of what's at work is essentially we had the growth of this reset in the fall. And so that's part of, I think, what's at work.

Dave Larsen: Thanks.

Sally Curley: Okay, next question?

Operator: And we'll take our next question from Eric Coldwell with Robert W. Baird.

Eric Coldwell: Thanks very much. So thanks for the comments on the independence and not seeing major re-pricing's coming in general. I do have an add on to that. Do you have any customer losses that would be notable or worth calling out built into your fiscal 18 outlook, number 1. Number 2, what is your brand inflation outlook given that you highlighted that maybe you slightly over-modeled that again here in the fiscal 17. What's your brand pricing outlook for 18? Thanks.

Mike Kaufmann: Yes, I guess first of all from a customer perspective no we don't have any wins or losses baked into those 18 numbers. We feel we're in a great position with our customers today and are really modeling that to be a factor one way or the other. And, you know, as far as the brand pricing, it's just a little bit early to give you what we're modeling. You know, my guess is we probably won't model anything higher than what we see this year when we complete the year but whether we model a little bit lower we were trying to give ourselves a little bit of conservatism in our numbers to be able to model that if we wanted to a little bit lower then where we were. But, again, even if we do model it a little bit lower, as I've mentioned, we plan to continue to move to even a higher

percentage to the fee for service agreements and would expect that over time that brand impact would continue to decrease. So, again, the real driver of 18 besides the one-time discrete items is really the generic deflation, not our thoughts on brand.

Sally Curley: Thanks Eric. Next question?

Operator: We'll take our final question from Garen Sarafian with Citibank.

Garen Sarafian: Hi, thanks for squeezing me in. So, Mike and George, thank you for all of the commentary but on the sale side, you guys mentioned in the past that it's difficult to model generic pricing and it's very dynamic. But is there anything more just on a broad level as to what specific function just changed? I mean, you mentioned just to slightly more pricing but was it mix in the generics, was it a certain region of the country that you were expecting a different pricing structure that changed or just sort of the delta between where you were at before in broad terms versus now?

And then a quick follow-up is, with your agreement with CVS and Red Oak, there was a step up in the payments that were being made from Cardinal because you were exceeding benchmarks and targets. So just curious, is there a claw back at all at any point where depending on what's going on with the JV that you would start to pay less, just curious if you could elaborate on that? Thanks.

Mike Kaufmann: Yes, good questions on the Red Oak I'll cover it first just because it's easy to know, there is no, you know, claw back that is now fixed which is a positive thing because actually our metric around that is around our ability to sustain savings and stuff and we still feel great about that. The folks at Red Oak continue to just do fabulous work, the relationship with CVS couldn't be stronger and I wouldn't put any of this on Red Oak. Those guys are doing everything that we ask.

I would say, you know, the one thing I probably haven't mentioned that might be a little bit helpful on the generics is there are some - there are a discrete set of items within the generics that were probably, not probably, that we saw some greater deflation this year. So they were items that had limited competition.

At the beginning of the year they were more expensive type of generic items. We saw some additional competition on those items this year from generic manufacturers which I think, you know, then created some deflation in the market. A lot of those items we think will settle out to areas where we don't expect the deflation on those few key items to be the same as next year and so that's one of the reasons why we believe next year we won't see the same level of deflation that we saw or, you know, particularly early this year because those few key items won't be out there having that same impact.

George Barrett: So Garen before we finish up, let me just add real quickly because it's an important question that you're asking and I think we were being completely transparent here. We actually feel really good about that business. Pricing has been lower than we expected as we looked in our models and that and the one-timers, as Mike said, are primarily the dynamic. Customer retention is good, strength of that base, strength of Red Oak, we feel very good about that so it's - we're really trying to be as transparent as we can on this and so hopefully that's clear.

I think we're going to finish up the call so let me just do this, I'd like to thank everyone for joining us today. We look forward to speaking to all of you again, soon actually on our May 1 earnings call. If you have any questions on today's release, please reach out to our team. Thank you all for your time this morning and we look forward to speaking with you.

Operator: And this does conclude today's conference call, thank you all for your participation and you may now disconnect.