Q1 FY18 Cardinal Health, Inc. Earnings Conference Call

November 6, 2017 8:30AM Eastern

Operator: Good day and welcome to 1Q FY2018 Cardinal Health, Inc. Earnings Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Lisa Capodici. Please go ahead ma'am.

Lisa Capodici: Thank you Lisa. Good morning and welcome to Cardinal Health's first quarter fiscal 2018 earnings call. I am joined today by George Barrett, Chairman and CEO; Mike Kaufmann, CFO; and Jorge Gomez, CFO of the medical segment.

During the call, 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 our SEC filings and the forward-looking statement slide at the beginning of our presentation for a description of risks and uncertainties.

Today's press releases and presentation are posted on the IR section of our website at ir.cardinalhealth.com. During the discussion today, we will reference non-GAAP financial measures. Information about these measures and reconciliations to GAAP are included at the end of the slide presentation and press release. We would like to remind you that we will webcast our 2017 annual meeting of shareholders this Wednesday, November 8 at 8:00 am Eastern Time.

During the Q&A portion of today's call please limit your questions to one with one follow-up so that we may give everyone in the queue a chance to ask a question. As always, feel free to reach out to the IR team after this call with any additional questions. Now I would like to turn the call over to our Chairman and CEO George Barrett.

George Barrett: Thanks Lisa and good morning everyone. Before we turn to the earnings let me offer a few words about the succession plan we announced today. You all know Mike and I know you can appreciate why the board and I are so pleased that he will succeed me as our next CEO.

As our press release said, Mike will take on the CEO responsibilities in January and I will continue to serve as Executive Chairman through the annual meeting of shareholders a year from now in November of 2018. At that time Greg Kenny, our independent lead director, will assume the role of Cardinal Health next Chairman.

Mike is a veteran of Cardinal Health having been with us for 27 years. He knows our business inside and out. In addition to serving as our CFO, Mike has held senior leadership positions at both the pharmaceutical and medical segments and has been instrumental in many of our key strategic initiatives.

As everyone here at Cardinal Health knows, Mike lives our mission and embodies our values. He shares my view that it is a privilege and a responsibility to lead our company in service of our customers and their patients as well as the best interest of you our shareholders. Mike has been a superb partner to me. I am extremely excited for him and for us and I know that the transition will be seamless.

As Mike takes on his new role we are also delighted that Jorge Gomez, currently CFO of our medical segment, will succeed Mike as our next CFO. Jorge was a natural choice for this position. He has served as CFO of both of our segments as well as the company's treasurer and controller. He brings a deep understanding of our business and global financial experience in his new role. Mike and Jorge will make a great team and this is a natural evolution of the partnership they have already established.

While my role will shift in January, my ongoing commitment to Cardinal Health is deeply felt and unwavering. I look forward to supporting Mike and our board after spending more time focusing on the public and health policy issues critical to Cardinal Health, our industry, and our communities. With that, let's now turn to the performance of the quarter.

We're off to a solid start for our fiscal 2018. We had expected that our first quarter numbers would be down year-over-year. While that was the case, our business performed somewhat better than we had anticipated and we continue to see progress across most of our lines of business. For the first quarter, we achieved revenues of $32.6 billion, non-GAAP earnings per share of $1.09, and generated a robust $1.2 billion in operating cash.

Our pharmaceutical segment performed largely as expected. Our pharma distribution business did extraordinary work for our customers particularly in light of the devastating natural disasters that have affected multiple communities around the country including Texas, Florida, California, and of course Puerto Rico. And I will return to this subject later in my comments.

As a reminder, our revenue comparison year-over-year was affected by the loss of a large mail order customer Prime Therapeutics which we have previously disclosed. At the end of our fiscal '17 we noted that the deflation rate on generics seemed to be stabilizing. We still hold that view noting that the rate of deflation is less today than we saw at this time last year. And Mike will touch on this more in his comments.

Our specialty solutions group continues its robust growth. We have grown to a stage of significant sale - scale deepening our value proposition as we continue to bring our new biopharma clients and acute care customers. As a result, we are seeing growth both in the downstream provider side and in the upstream biopharma services side. We believe we have a significant value proposition in the specialty space not only in retail and physician office settings but also for large acute care and IDN customers who are increasingly responsible for these critical medications.

Turning to our medical segment, the team had a solid start to the year. As expected, our numbers this quarter were adversely affected by the year-over-year comparison associated with the previously disclosed loss of a large portion of a VA contract. We do however continue to see good growth across many lines of business specifically our naviHealth, Cardinal Health at Home kitting and lab businesses performed particularly well and our strategic account work continues to grow as we become increasingly valuable to our partners.

The Cordis business performed as we expected this quarter. We continue to make progress building out our product portfolio most recently signing an agreement with Medinol where Cordis has exclusive distribution rights in the U.S. to their coronary stent portfolio including a drug eluting stent upon FDA approval. We are also distributing the Tryton Side Branch Stent to treat bifurcation lesions. This is the first dedicated bifurcation device to receive regulatory approval in the U.S.

Finally, and quite significantly, we closed the acquisition of the Patient Recovery business this quarter and our integration work is off to an excellent start. Our sales forces have been combined and realigned and product training across the group is going extremely well.

We are seeing great opportunities to create mutual value between the historical product lines and channels of Cardinal Health and these new product lines and channels that have come to us through this acquisition. We are thrilled to have our new colleagues on board, they've shown great enthusiasm as they have joined the Cardinal Health family.

It would be incomplete to have a conversation with you without addressing the drug abuse issue that is affecting this nation. Cardinal Health continues to take an active role in the dialogue and the hard work associated with helping to tackle this national crisis. As I have said before this is an issue that is large, it is complicated, and most important it is tragic and personal. I believe most of you know that we have spent nearly a decade continuously enhancing our best in class suspicious-order monitoring tools and analytics to keep pace with the ever-changing shape of this crisis.

But we have been doing much more than this. Because we know that professional training and prevention education is critically important in this area we have committed heavily to this. Over the last nine years we have been proactively educating pharmacists and students through our Generation Rx program which was created in conjunction with The Ohio State School of Pharmacy. To date, our Generation Rx materials have been used by more than 1 million people.

We have been working for many months on ways to expand the successful program to provide emerging physicians training, expanded drug take back programs, and in coordination with local law enforcement a Narcan distribution strategy for the emergency treatment of a known or suspected opioid overdose.

As a wholesale distributor, we do not manufacture, promote, market, or prescribe these drugs. We do however take very seriously our responsibilities to serve our healthcare system. Our anti-diversion systems and controls are substantial, they are well funded, and they are best in class. I am enormously proud of the work that our people do in their communities to help face down the challenges of the misuse and abuse of prescription medication.

I have never worked with an organization so mission driven which brings me to the recent natural disasters we have seen in various parts of the U.S. and Puerto Rico. We have more than 8,700 colleagues across Puerto Rico, the Dominican Republic, Florida, Texas, and California. They have been truly heroic in the work they have done and continue to do to assist in emergency relief efforts and to serve our customers and the healthcare needs of their patients particularly at a time when many of them are personally vulnerable or affected.

Our employees have also generously supported one another through our Cardinal Health Foundation Employee Assistance Fund to provide financial support to the Cardinal Health families affected by these storms.

Related to this, I would like to share a quick story with you. Last week the leader of our Puerto Rico organization shared with me that not only did we have an overwhelming percentage of our employees working within 24 hours after the hurricane hit, but that our people and our operations served as a key logistics provider in collaboration with HHS, the CDC, the local Department of Health, as well as several NGOs.

Given our capabilities and footprint, we were in a unique position to provide aid even on products and in areas we don't typically serve. The sense of community that permeates our colleagues on the island has been inspiring.

As one colleague said to me, "Cardinal Health values are not a plaque on a wall somewhere, they live right here in what we are doing every day to help each other and our customers here in Puerto Rico." It is difficult to find a way to adequately thank them for their extraordinary and heroic work. This is an untold story but this is the Cardinal Health that I see every day and of which I am so proud to be a part. With that I will turn the call over to Mike.

Mike Kaufmann: Thanks for the kind words George. I will also share a few brief comments before we get into the financial results for the quarter. Let me start by saying how excited I am to take on this new responsibility. I have been with Cardinal Health for 27 years and as you can imagine this company, our people, and our mission are very important to me. It's an extraordinary honor to be selected to succeed George as CEO and I am grateful for the trust and confidence that the board of directors is placing in me.

Given the close partnership George and I have had over the past 9 years, I look forward to what I know will be a smooth transition as I will continue to benefit from George's valuable perspective and ongoing contribution as Executive Chairman.

The strategic steps we have taken this year and over the past several years put us in a strong position for the future. I believe that we are well aligned with the trends in both the pharmaceutical and medical segments of the healthcare industry.

I don't expect to be making dramatic changes to what we have built and will certainly plan to take full advantage of the many opportunities that our robust portfolio has to offer. While there will always be challenges, I feel very good about how the company is competitively positioned and believe we are on the right track.

I also want to say how excited I am that Jorge Gomez will become our new CFO. We have worked closely together for many years and I am glad to have a partnership with Jorge similar to the one I have enjoyed with George. Jorge brings a depth of experience and I am thrilled he has accepted the role of CFO.

Finally, I just want to say that one of Cardinal Health's great strengths is the enormously talented and dedicated team of professionals we have in place. Together with our team I look forward to building on our strong foundation while always keeping in sight our ultimate goal of supporting our partners in the critical work they do each and every day serving patients and their families.

With that let me turn to the review of our financial performance for the first quarter. As always, the financial results that I provide this morning will be on a non-GAAP basis unless I specifically call them out as GAAP. Slide 7 of the presentation includes our GAAP to non-GAAP reconciliations for the first quarter.

Overall our first quarter fiscal 2018 results came in ahead of our plan. Operating income was somewhat ahead of expectations due mainly to the timing of certain expenses. Diluted EPS of $1.09 benefited from share count and the timing of a few discrete tax items. Revenues increased 2% year-over-year totaling $32.6 billion. Total company gross margin dollars were up 5% to $1.7 billion versus the same quarter in the prior year.

Given our recent acquisitions, most notably the Patient Recovery business, our consolidated SG&A increased 15% versus the prior year as expected. Consolidated operating earnings were $610 million, a 9% decline versus

the prior year. This was affected by the inventory step-up in the medical segment which I will cover in greater detail later on.

Moving below the operating line, net interest and other expense came in as expected at $83 million in the quarter. The increase versus the prior year was primarily driven by the interest on the debt issued to finance the Patient Recovery acquisition.

Our effective tax rate this quarter was 34.1%, a 2.3 percentage point decline versus the prior year. During the quarter, we did see a couple of small favorable discrete tax items. As we have stated in the past, the quarterly effective tax rate will have some variability. We still expect our full year tax rate to be unchanged from our plans.

Our first quarter diluted average shares outstanding were 318 million, about 4 million shares fewer than the first quarter of fiscal 2017. We had $150 million of share repurchases in the first quarter and we have about $300 million remaining on our board authorized share repurchase program.

Our operating cash flow for the quarter came in strong at $1.2 billion. If you recall, in our fourth quarter the operating cash flow reflected the impact of nearly $400 million of vendor payments that were made early due to some changes during the pharma IT refresh implementation. As expected, this impact was recaptured in the first quarter and contributed to our strong operating cash flow performance.

Given that we benefited from this and other timing items we still expect annual cash flow to be in line with our original expectations. Our cash balance at September 30, was $1.2 billion with roughly $600 million held outside the United States. The reduction from our fourth quarter cash balance reflects the funding of the Patient Recovery acquisition in July.

Now let's move to segment performance. Our pharmaceutical segment revenue increased 1% to $28.9 billion. This increase was due to sales growth from specialty and pharmaceutical distribution customers which was partially offset by the previously announced loss of a large mail order customer Prime Therapeutics which George mentioned in his comment.

Segment profit for the quarter decreased 13% to $467 million, in line with our expectations and what we shared on the fourth quarter call. This was driven by our generics program performance and the costs related to the

ongoing investment in our pharma distribution IT refresh project. This project which we refer to internally as P-Mod is progressing well and is on time and on budget.

As an additional reminder, our generics program includes the benefit of Red Oak Sourcing as well as pharmaceutical pricing and volume changes. Let's now go to medical segment performance which came in largely as planned.

Revenues for the quarter grew 14% to $3.7 billion primarily driven by contributions from acquisitions and, to a lesser extent, new and existing customers. Medical segment profit increased 1% to $129 million during the quarter. This increase was primarily driven by the contribution from the Patient Recovery acquisition net of the inventory step-up. This was mostly offset by a reduced contribution from the previously announced loss of a large portion of a VA contract.

The Patient Recovery acquisition which closed on July 29 was successfully onboarded and performed operationally in line with our expectations. As I just noted, performance in the quarter included a $42 million inventory step-up. Excluding this, the medical segment profit growth would have been 34%.

While we have yet to finalize the inventory step-up calculations, our current estimate is that the remaining step-up to be recorded in Q2 will not exceed what we saw in the first quarter which is in line with our expectations.

With regards to Cardinal Health brands, the majority of our product lines performed as expected in the quarter. However, we did see some supply and commodity challenges primarily in our exam glove business.

Before moving to our fiscal year '18 outlook, you can turn to slide number 7 where you will see our consolidated GAAP to non-GAAP reconciliations for the quarter. The 73 cent variance was primarily driven by two factors. First, amortization and other acquisition related costs were 40 cents in the quarter. This includes all acquisitions closed as of September 30. Note that the year-over-year increase is a result of the Patient Recovery acquisition.

Historically we have utilized third party distribution partners to help get our products to market in countries where we haven't had a sales force and back office infrastructure. With the Patient Recovery and Cordis acquisitions, we now have a platform to distribute directly. Consequently, we deployed $125 million to regain direct distribution of our self-manufactured surgeon gloves in certain markets. This charge is reflected in the 27 cents in restructuring and employee severance.

Now let's talk briefly about total year financial assumptions on slides 9 and 10. First, we are reaffirming our full year non-GAAP EPS guidance range of $4.85 to $5.10. With respect to quarterly cadence we still expect the first and second half to be as we originally modeled. Consequently, the timing benefit in the first quarter should reverse in the second quarter.

Second, given the recent share repurchases I referenced earlier, we are revising our full-year share count projection to 318 to 319 million shares. And finally, we are updating the guidance for amortization and acquisition related intangibles to $560 million to include acquisitions that closed in our first quarter most notably Patient Recovery.

Our pharma segment assumptions on slide 11 remain on target and unchanged. However, let me give you a little more color on our generic and brand assumptions. Based on our first quarter generic deflation is trending as expected. Remember that our generic deflation calculation is a year-over-year point-to-point measurement of average selling price. We recognize that companies measure this differently. We continue to believe that we have appropriately risk adjusted our assumption for the year.

In addition, as it relates to brand inflation, while it is still early in the year we remain comfortable with our full year assumptions. Furthermore, if actual inflation falls below this assumption we expect it can be absorbed within our EPS guidance range given that over 90% of our contracts are now fee for service.

Our medical segment assumptions for fiscal 2018 can be found on slide 12 where we have no updates to report. We continue to feel we are well positioned especially with the recent onboarding of the Patient Recovery business. To close, with one quarter behind us we feel good about our overall positioning and our ability to execute throughout the remainder of the year. With that, I am going to turn the call back to George.

George Barrett: Thanks Mike. Before I turn to Q&A I would like to say a few words about Cardinal Health's unique value proposition in today's rapidly evolving healthcare landscape. Our healthcare supply chain capabilities are second to none. But being truly essential to care requires much more than that. We possess a unique set of skills and industry knowledge which when combined with our significant scale and a portfolio that spans the entire healthcare continuum, ideally positions us for continued leadership in the healthcare system.

For example, we provide a wide range of critical services negotiating on our customers' behalf to secure highly regulated drugs from around the world, working for them to secure inclusion in restricted networks, providing clinical pharmacy support and medication therapy management. We also provide population health tools to identify optimal pathways for post-acute care, medical product knowledge, and scale to allow medical providers to standardize their product selection and utilization and performance improvement services that reduce waste, improve efficiency, and increase patient safety.

These jobs require a deep understanding of the healthcare system, of hospitals, clinics, and pharmacies and an in-depth knowledge of an extremely complex regulatory framework. This expertise combined with our relationships and understanding of the intricacies of how healthcare is delivered has been honed by a team of thousands of professionals here at Cardinal Health over the past many decades.

Furthermore, we have built our portfolio with a conviction that our ability to provide solutions on both the medical and pharmaceutical delivery of care would be uniquely valuable to the system. This is why we remind you that while we are organized and report in segments, we often go to market as a broad suite of solutions across the enterprise. And this is why we are so confident that Cardinal Health will continue to grow while playing a vital role in healthcare.

Before we get to the Q&A I want to express my deepest thanks to all of you in the investment community for your support, confidence, and input over the years. I also want to thank our people 50,000 strong around the world for the amazing work they do every day living our mission as they serve our customers and their patients. I am honored and humbled by their dedication. With that let's now turn to Q&A. Operator?

Operator: Thank you. If you would like to ask a question at this time please press the star key followed by the digit 1 on your telephone. Please ensure that your mute function on your telephone is switched off to allow your signal to reach our equipment.

If you find that your question has already been answered you may remove yourself from the queue by pressing star 2. All participants are allowed to ask one question followed by one other question. Again, please press star

1 to ask a question. We will now pause for just a moment to allow everyone to signal. Now, we will take our first question from Ms. Lisa Gill from J.P. Morgan. Please go ahead ma'am, your line is now open.

Mike Minchak: Thanks it's actually Mike Minchak in for Lisa this morning, just a couple of questions. With respect to the outlook I was just hoping you could talk about some of the key factors that could drive the fiscal '18 adjusted EPS either toward the upper or the lower end of the guidance range. And then just as a follow-on to that, last quarter you had previously discussed a target of at least $5.60 in adjusted EPS in fiscal '19. I just wanted to know if you had any comment on that at this point.

Mike Kaufmann: Yes, a couple of things. First of all as far as FY '19 goes that was just some early guidance that we gave and we are not planning on updating that at this time. As we get through our work early in our Q3 and Q4 and when more appropriate we will come out with some further guidance and thoughts around FY '19.

As far as opportunities and risks in our FY '18 guidance, I would start with the good news first thing is I don't see anything at this time that would be a huge mover in either direction but I do see some things that I would probably say fit into the category of opportunities, risks, and things that could maybe go either way.

As far as the opportunities, I would say share count is in the opportunity. Some of the over performance that we have seen in the pharma segment in Q1 and part of that being our specialty division, I could see that to continue throughout the year. And we're seeing some excellent performance in our post-acute solutions business and could continue to see that to possibly be an opportunity for the year.

As far as risks go I would say that our Cardinal brand products area has some risk and that is really what I mentioned in my script around the exam gloves. We are seeing some commodity and supply issues in that particular area so that could be a little bit of a risk to the year.

If our China exit happens sooner than we expected, as I mentioned we said we have it in for the full year. If that were to get done and approved and exited before the end of the year that could have a little downside risk. And then of course while we don't believe it from everything we're hearing, if the medical device tax were brought back that could be a negative.

And then the things that I would say could go either way, effective tax rate, you know, was favorable in Q1. We expect to see puts and takes all year so we still feel comfortable about full year guidance but that could always go a little bit either direction.

The pharma pricing around, you know, generic ASP deflation, that could go, you know, could be a positive or maybe if it gets a little worse could be a negative. Timing and magnitude of the customer initiatives that I mentioned in the first quarter, those are with existing customers as I have stressed before. We continue to see good progress in those discussions but have not finalized anything there. And so depending on how that goes, that could be a little bit potential upside or maybe a little bit down.

And then finally the Patient Recovery performance. Again we feel really good about that but it's early. And so all of those things I would say could go either way but I want to stress none of them we see as significantly concerned that they would be a large driver one direction or the other.

Mike Minchak: Got it, I appreciate all the detail.

Mike Kaufmann: Absolutely. Next question?

Operator: And our next question is from Robert Jones from Goldman Sachs. Please go ahead sir, your line is now open.

Robert Jones: Great and my congrats to you Mike and Jorge on the new roles and, you know, George it has been obviously a pleasure working with you.

George Barrett: Thanks Bob.

Robert Jones: So just I wanted to go back to some things you guys talked about last quarter. You discussed 16 cents of investments related to customer initiatives and investments in tax and opioid prevention. But on the customer investments specifically I was wondering if you guys had an update on that opportunity, you know, both on the cost side and maybe when you could come to an agreement or be in a position to communicate around what that - what those investments were specifically related to.

Mike Kaufmann: Yes absolutely. So I would say the tax planning initiative is going as planned. The opioid one was one of the timing items that we were really talking about that we expected to be spending some of that in Q1 and we see that more as the expenses being spent in Q2 which is why we had a little bit of an upside in Q1 over our expectations.

But then specifically to your question around in customer investments, again those continue, discussions continue to go well. Nothing has been finalized there. We would expect that those discussions would probably have clarity by the end of our Q2.

And at that time at our next earnings release we think we ought to be able to give folks some clarity around whether or not there is some upside to this year if those don't happen or whether we have decided to expand upon those and do anything. But right now I am more anticipating that those will be about as planned or would provide some upside if they don't actually happen this year.

Robert Jones: Okay great and I guess just on the pharma segment, you know, margins came in better than at least we were expecting but there is obviously still a lot of debate in the market around generic pricing and, you know, some of the recent data points I would say from the generic manufacturers would probably point to a worsening environment. I know you guys have talked about this in the past but could you maybe just give us an update on what you saw with regards to generic pricing in the quarter both from a buy side and sell side perspective?

George Barrett: Yes Bob, good morning. Let me start and then I'll turn it to Mike. As we said in the comments, you know, if you compared where we are today to a year ago the rate of deflation is less dramatic. So we had seen some stabilizing of that rate as we came to the end of the fiscal year for us and I would say that has continued.

It is always difficult to comment on others' observations about price because as a manufacturer you've got your own portfolio which is actually unique to those products and as you know various of us who report publically actually use different methodologies. But, you know, ours has been consistent as Mike said on a point-to-point basis and so we feel fairly good about our forecast but maybe Mike you can jump in on that.

Mike Kaufmann: Yes the only thing I would add is as I have mentioned before both in my prepared remarks and before is our discussion of how we describe generic deflation is the point-to-point year-over-year related to average selling price. And everything that we see that we're forecasting for the current year still would say that our assumption of mid-single digits down would still be accurate.

And I have also said in the past the other important thing is, you know, not only how you see your selling price but also how you're doing on the costing side. And for us that is obviously mainly Red Oak and Red Oak continues to perform at or above our expectations.

So we feel good on both sides both from a selling standpoint and a costing standpoint which they both need to work out for you to get where you want to be and we feel good about both of those at this point in time.

Robert Jones: Great, thanks for all that, appreciate it.

Mike Kaufmann: Absolutely.

Operator: Thank you. Our next question is from Ricky Goldwasser from Morgan Stanley. Please go ahead, your line is now open.

Liza Garcia: Hi, this is actually Liza on for Ricky this morning, just a quick one. So we're fielding a lot of questions around Amazon. Can you maybe provide your thoughts on how you see Amazon in terms of maybe competition on the medical supply side and do you see an opportunity to work with Amazon if they were maybe to try and enter the drug supply chain?

George Barrett: Yes so Liza let me just sort of get broad issue for us. You know, as I have said in past calls we never dismiss any competitor or potential competitor. It's something we always take seriously. I think the thing that is worth noting if you think about the comments that we made during the course of the call today is the nature of what we actually do. And so we're sort of this critical interface between a highly regulated system of providers, manufacturers, and a regulatory system.

And so I think the heart of our competitive profile is really our ability to serve a healthcare system with a very complex and important suite of products and services that they need in order to be healthcare companies and providers. And I think that's at the heart of what we do. So it's very difficult to describe how we see that competitive landscape. We basically know what we do and what our value proposition is

As to working with them, you know, at this point we work very closely with our providers and manufacture partners. There is no particular plan right now to do anything distinctly with them but our primary goal and our focus is making sure that we add value for all of these customers with products and services that they very much need in order to do their work for patients.

Liza Garcia: Great, thank you so much.

George Barrett: You're welcome.

Operator: Thank you. Our next question is from Erin Wright from Credit Suisse. Please go ahead, your line is now open.

Erin Wright: Great thanks. I'm curious kind of how you're maybe applying some of the lessons you learned from Cordis on the medical side of the business and what you can leverage or apply to the Medtronic Patient Protection business that you acquired. Can you kind of give us an update on the integration process and any sort of surprises in the initial days there? Thanks.

George Barrett: Good morning Erin. It's George, I'll start and then I'll turn it to Mike. You know, I think every integration is its own learning experience. And I think, you know, I think for us the Cordis integration required a lot of international work some of which we had people on the ground doing and in other places we had to build that out. We also had to do some work in that integration with a third party which is the partner that sold us the product line. So that requires a lot of interfaces, moving parts, and great disciplines. And I think we have over the course of the year honed that increasingly.

I think Don and his team have done a great job in the Patient Recovery business of planning well ahead, of thinking carefully about that integration, and of leveraging the work that we have already done particularly outside the U.S. So, you know, I think each one of these is an opportunity for growth and learning and I think Don and team have done that extremely well. We're off to a really good start. Mike I'll let you jump in there.

Mike Kaufmann: Yes I would say a couple of things. You know, part of the learnings from the Cordis acquisition that we applied to the Patient Recovery business is not only around the execution things that we knew that we had to put the right things in place but also about estimating what those costs would be.

And so as we gave our guidance and thoughts around Patient Recovery we took a lot of those learnings such as the amount of start-up costs it would take, the amount of SG&A that we would need to put into the business, to make sure that we were estimating those right so that we were giving, you know, the appropriate guidance around that business.

So I feel really good about what we put out there as our goals from a financial perspective for the Patient Recovery business but also on the learnings on the execution standpoint. So whether it be in the area of

managing inventory or working through the SG&A cost structure or whether managing the TSAs with our partner in this case Medtronic, I think the team has - is working well on all of those.

Erin Wright: Okay great and just a follow-up on P-Mod, just your efforts there. Do you think they're running ahead of plan or how should we be thinking about kind of the recurring nature of some of those incremental investments? Thanks.

Mike Kaufmann: Yes as related to P-Mod I would say things are going really well. We are on time and on budget on that project. The pharma team is doing an excellent job of managing the cost, managing the scope, putting the right talented people on that project to deliver. So it's going really well.

As far as the cadence for P-Mod goes, as we have mentioned before we expect it to be a headwind in our Q1 as we just said, we expect it to be a headwind in our Q2 just from a year-over-year expense standpoint with some of the implementations that we did last year going live. It creates, you know, depreciation expense this year. And then we expect it to become essentially neutral in our Q3 and our Q4.

Erin Wright: Okay great thank you.

Mike Kaufmann: Thank you for your questions.

Operator: As a reminder, to ask a question at this time please press star 1. Our next question is from Eric Coldwell from Baird. Please go ahead sir, your line is now open.

Eric Coldwell: Hey thanks very much, two quick ones in medical. The first one, to regain control of the exam gloves internationally you had obviously a sizable outflow. Are there going to be other outflows for other product lines or how do you treat other product lines ex-U.S. in terms of regaining control of distribution?

Second of all, and this is for Mike, you know Mike I'm still - you and I have talked about this. I'm still a little concerned about medical revenue for the year with the VA loss, the slow market, annualizing Kaiser, various challenges that have been brought up. Can you just be more specific on what your interpretation of high teens revenue growth is, what that range is in your mind and just make sure we all understand how broad that range is? That's it, thanks so much.

George Barrett: Yes good morning Eric. I'll start the first one and maybe Mike can take the second one. We'll sort of tag team this. The move that we made to regain the rights in Europe really was very specific to an old agreement that really was a reflection of the product line that we had some years ago.

And so these are a series of products for which we had no commercial operations ex-U.S. and so we depended on third party to do that. And so now that we have operations in virtually all of these countries it was very logical for us to want to have the rights back to be able to commercialize our own products.

So it was specific to a set of products. There is nothing else to be forthcoming as it relates to other products but we were able to close off just this sort of legacy agreement and glad that we're going to be able to commercialize our own products.

Mike Kaufmann: Yes and that was really, you know, our surgeon gloves which is what we manufacture ourselves and have just an excellent reputation and outstanding, you know, quality and acceptance throughout both the U.S. and overseas was really the one product that we were selling significant amounts overseas. Now obviously with the addition of Cordis and Patient Recovery and commercial operations overseas we plan to sell other products of ours that we feel really good about. But that was really the only one that we had significant sales that we would create any type of, you know, restructuring charge like that.

As far as medical revenue goes, I really can't say more than the fact that we still feel good about the high teens revenue growth, percentage increase in revenue for this year. Our early looks at the Patient Recovery business, you know, while the first couple of weeks were a little variable after the first couple of weeks the business has looked very much as we expected for the year and the team is doing an excellent job. So to your point, while I mentioned the VA is a significant year-over-year headwind we still feel really good about our high teens guidance. Thanks, next question.

Operator: Thank you. Our next question is from Charles Rhyee from Cowen & Company. Please go ahead sir, your line is now open.

Charles Rhyee: Yes thanks and from myself also Mike congrats and George, a pleasure working with you. I had a question following up on Bob's question earlier. You know, when we think about the generic deflation and the comments we are hearing from manufacturers and then we also look at market data, when we as investors, when we're looking at this, you know, what do you think is a better guide to look at externally besides, you know, and obviously your comments on what you are seeing directly as we try to evaluate, you know, your comments and those of others.

Do you feel that the aggregate market data is reflective - is more broadly reflective or is there any limitations to that? You know, how should we kind of handicap, you know, the comments coming from different or the data sources that we can kind of get our hands on?

Mike Kaufmann: Thanks for the question. You know, this one is tough because really for anybody to really to understand the impact on our financials or probably any distributor's financials is really you have to understand both sides, both how you are affecting your sale price and your cost side. And for us to give exact numbers and guidance on both of those is probably not smart from a competitive standpoint. So we have always tried to give as you know our definition is really around the sell side of this.

And so to me I think you have to look at both. I think you have to look at what we are saying from the standpoint of what we expect our sale price erosion to be and then you have to take a look at what the manufacturers are reporting because those are probably good indicators of what we're able to do on the costing side.

And that when you look at the difference between our sale price going down less than what we are able to get on the costing side as a percentage then that's probably the indicators that you see are positive moves. And that's what we're seeing this year, we're seeing a nice balance between what is happening on the sell side versus what is happening on our cost side. George would you like to add to that?

George Barrett: Yes Charles I guess you've been doing this a long time so you know the challenges of using public data and I think the way I have heard you describe it is what I think has to be done. You sort of have to triangulate between all the various inputs. There are a lot of moving parts on this. But we'll try to be transparent with you about what we see in our numbers and then to the extent that we can we'll give color on the tone of the market.

But I think you're right in pointing out that it's very difficult to get a perfect signal from public data. You have to work across multiple sources and triangulate. But we understand and we know, again we've been at this a long time as have you. It's always challenging to get precise numbers.

Charles Rhyee: Yes I appreciate that. And just to be clear, right, I mean Mike if I understand what you're saying is that when we think about manufacturer comments, you know, all things being equal, that's really your acquisition cost of drugs. As long as you are not, you know, it's not 100% pass through to your sell side margin we're actually earning money on this - on that deflationary comments. Is that fair?

Mike Kaufmann: That's right. and remember the cost is coming off of a lower base because your cost is lower than your sale so the percentage decline off of the sale is going to be from a dollar standpoint worth more than a percentage, the same percentage decline off of a cost and that's why you want to see a spread between the two between what you're saying on sale versus cost. And that's what we feel good about at this point in time.

Charles Rhyee: Okay great, I'll leave it there. Thanks a lot.

Mike Kaufmann: Thanks Charles.

Operator: Thank you. And our next question is from Kevin Caliendo from Needham & Company. Please go ahead sir, your line is now open.

Kevin Caliendo: Thank you. And Mike congratulations, and George for someone who has known you since the Teva days, good luck and it has been a pleasure talking with you over all these years. Guys, any update on the 16 cents of EPS spend? I know you obviously kept your guidance the same so I'm assuming not. Is there any update on when we might get some more visibility on that?

Mike Kaufmann: Yes again, three components of that on the 16 cents. One was the spend on the opioid piece which I mentioned earlier is one of the timing things where we expected a chunk of that spend to happen in Q1 and we're really now more ramping it up in Q2. So we really saw no spend to speak of in Q1 and we expect it to happen in Q2. So we still expect the full year impact of that to be what we thought, it's just a timing move from Q1 to Q2.

As far as the tax initiatives we put in place, those are in place. Those are delivering what we expected and was built into our guidance for the year. And then as far as the customer initiatives, again we're continuing to have good discussions and these are again with existing customers which is important to know.

And, you know, it's still too early for me to call it on that but I would expect that we would have some clarity by the end of our Q2 that we would be able to communicate to folks on that. So no change in how those will impact our guidance for the year at this time.

Kevin Caliendo: Great. A quick question on Red Oak. There has been some sort of - some debate amongst investors and myself with regards. Given now that we have Webad and Claris 1 are all out there and the big three are purchasing a huge chunk of the generics in the marketplace, can Red Oak continue to grow? And if so, is it simply doing what they're doing now or would they expand into other products like OTC or other opportunities outside of the U.S.?

Mike Kaufmann: I think, you know, first of all I would just say our relationship with CVS continues to be incredibly strong and our interactions at the board level and working together have been incredibly positive.

So yes, we think Red Oak is an absolute asset not only in the generics side and something that we still feel will continue to deliver incremental value year-over-year as the years continue on it but also we will constantly look at that asset, both of us as two companies, and determined if there is other opportunities. So a little too early to say what those might be but it's absolutely on our mind to always think about what could we do to continue to, you know, create benefits for both Cardinal and CVS.

Kevin Caliendo: Great, thanks guys.

Mike Kaufmann: Absolutely.

Operator: And our next question is from Brian Tanquilut from Jefferies. Please go ahead sir, your line is now open.

Bryan Ross: Hi, good morning guys, this is Bryan Ross on for Brian Tanquilut. You know, I guess circling back to Amazon real quick, they have been in the more low end medical supply business for years and I guess more recently began getting into more complex regulated devices and supplies. I guess could you provide any color on, you know, if you have started to bump into them with any particular provider type or, you know, any particular product category?

And then I guess a follow-up to that is, you know, thinking more long term when you have a competitor that, you know, obviously largely competes on being the lowest cost provider, what are the strategies that Cardinal can pursue in order to, you know, maintain and grow their relationships with existing customers?

George Barrett: Good morning Brian it's George. I'll take this. So, you know, I described in my commentary a little bit about the work that we do. Let me start with actually answering the second - the first part of the question which was do we bump into them, have we seen them. And the answer is not really. Again we know that they have been talking about healthcare to some extent and obviously we follow that but in terms of practical impact, it's not something that we see on a daily basis.

I think the key for us is the value proposition. What do we actually do? And I described some of the activities in my commentary earlier but, you know, just sort of fill in the blanks on some of the things that we do. Red Oak, our ability to source global generics across the world probably at unprecedented scale, to understand that regulatory framework, to link our work in our specialty business with the connection between the pharmaceutical manufacturer, their innovation on the science side, and a very distinct customer need on the downstream side.

Work that we're doing in the continuum of care as we see these transitions of care and helping IDNs direct patients to the optimal site of care, our ability to aggregate demand across hospitals to provide scale and consumables at great efficiency, our work in terms of working across their networks. These are all very distinct healthcare capabilities and they really reside here at Cardinal. They have been residing here for decades and we just continue to build on those things.

So that's really at the heart of what we do. And I think that in some ways is the best protection and the best insurance as it relates to our value proposition and we're very excited about the work that we do in that regard.

Mike Kaufmann: The only thing I would add is even on the area where I think people think it is just pick, pack, and ship and where we would compete, just think about the things we do on that area besides all the value added that George has been talking about. Because we're talking about delivering in pallet loads, truck loads, large quantities, managing formularies, 24/7/365 emergency shipments. We're tied to their systems electronically to

path invoicing and help them bill per department and all those types of things as well as managing all the regulatory.

So even in what I think people think of the basic areas of pick, pack, and ship that the playing field may be level. We don't even think they're even level in those areas for what we do. And I would say that we are incredibly cost effective so I don't think the assumption that they would be more the lowest cost provider. When you look at the infrastructure we have in place every day to deliver to our customers I feel really good about our cost position also.

Bryan Ross: Great, thanks guys.

Mike Kaufmann: Thank you.

Lisa Capodici: Operator we have time for one more question.

Operator: Then our next question is from John Kreger from William Blair. Please go ahead sir, your line is now open.

John Kreger: Hi, thanks very much George and Mike, just a question about the medical business broadly. Can you maybe speak to the volume trends you're seeing across acute versus ambulatory versus home? How is that trending versus your expectations?

George Barrett: Yes John good morning. So I think we've said this before. It's a little bit difficult at times to get a good demand signal on utilization partly because what we're seeing is some shifting sites and also market-to-market variations. So we have customers who are gaining share and others that are losing.

In general the trend that we've seen is one that we should expect which is more care moving to ambulatory settings. Having said that, we do have some of our IDN customers that are actually having pretty strong volume in their hospital settings and so it really varies from hospital to hospital. But in general I would say we feel fairly good about what we're seeing on the demand side.

Now again we are probably gaining some share over these last two years and Don and team have done a good job of really providing that value proposition that seems to be encouraging some of our customers to want to grow more with Cardinal Health.

Mike Kaufmann: Yes the only thing I would add and I think George said it right there is that just be a little helpful generally as George said in the acute space, it's very dependent on the customer but generally in the flattish area. But we are seeing say low to mid-single digits in the ambulatory care space and in the home space where the care is shifting. And the nice thing is that, you know, we're highly represented in all three of those spaces so as share does move between those three we're able to take advantage of that with our broad set of offerings.

John Kreger: Great thank you and maybe just one quick follow-up relating to the Patient Recovery business. So I think that was a business that was kind of flat to down a little bit and obviously you guys think you can grow it better as being part of your portfolio. So, you know, are you willing to maybe quantify the step-up in growth that you think you can have on the asset and just how you intend to do that? Thanks.

George Barrett: Yes John, I won't quantify that for you. That's not something we can do at this point and it's obviously very early. I will say that the key for us is building that product line into now a very broad product line of products and services. And so we think the opportunities create value between our historical product lines and channels and theirs is really palpable.

As an example, they are much stronger in long term care historically than we have been. That opens up doors for us and so we see those opportunities. And I think for us also we have product lines inside that business that will fold very naturally into sort of the economic model that we deliver and there are other products that are much more clinically attribute driven and our product teams know how to do that really well. So I think we're extremely excited about the fit into our portfolio and I think the ability to leverage our channels is really the opportunity here.

John Kreger: Great thank you.

George Barrett: You're welcome.

Operator: That will conclude today's questions and answer sessions. I would now like to turn the conference back over to Mr. George Barrett for any additional or closing remarks.

George Barrett: Look I know it has been a busy morning for all of you so thanks everyone for joining us this morning. We will look forward to talking with you as the day and the days unfold and have a good day.