Q3 FY22 Cardinal Health, Inc. Earnings Conference Call

May 5, 2022 8:30AM Eastern

Operator: Good day, and welcome to the Cardinal Health Inc., Third Quarter Fiscal Year 2022 Earnings Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Kevin Moran, Vice President of Investor Relations. Please go ahead.

Kevin Moran: Good morning. Today, we will discuss Cardinal Health Third Quarter Fiscal 2022 results along with an update to our FY '22 outlook. You can find today's press release and presentation on the IR section of our website at ir.cardinalhealth.com. Joining me today are Mike Kaufmann, Chief Executive Officer, and Jason Hollar, Chief Financial Officer.

During the call, we will be making forward-looking statements. The matters addressed in the statements are subject to the 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 these risks and uncertainties. Please note that during the discussion today, our comments will be on a non-GAAP basis unless they are specifically called out as GAAP. GAAP to non-GAAP reconciliation for all relevant periods can be found in the schedules attached to our press release.

During the Q&A portion of today's call, we please ask that you try and limit yourself to one question so that we can try and give everyone an opportunity. With that, I'll now turn the call over to Mike.

Mike Kaufmann: Thanks, Kevin, and good morning, everyone.Our third quarter results reflect continued inflationary impacts and global supply chain constraints. As we continue to manage through the current macroeconomic environment, we remain focused on both near-term priorities and long-term strategies to drive growth and momentum across our businesses.

At an enterprise level, we're maintaining our focus on our 3 strategic priorities: optimizing our core businesses; investing for growth and innovation; and deploying capital efficiently.

In Pharma, despite the quarter being a little lower due to higher operations costs, we remain encouraged by the trajectory of the business. We saw resiliency in overall pharmaceutical demand, strong performance in our generics program, and continue to expect Pharma to realize mid-single digit profit growth in FY '22.

In Medical, our core US Medical Products and Distribution business continued to experience unprecedented inflationary impacts and global supply chain constraints. We continue to take action to mitigate the effect of these global challenges on our business, including taking pricing actions, evolving our commercial contracting strategies, and investing in additional supply chain capacity. While we remain confident these actions will deliver value, and are encouraged by the other areas of our Medical business and our opportunities for long-term growth, the current environment remains highly dynamic. Our updated outlook for FY '22 reflects our most current expectations.

I'll elaborate on the actions we are taking to drive performance, particularly in Medical, after Jason reviews our third quarter results and updated outlook.

Before turning the discussion over to Jason, it's important to note that the opioid settlement agreement was finalized during the quarter and became effective on April 2nd. This is an important and significant step forward for our company. We feel this settlement is the best way to deliver relief to communities across the United States and allow our company to move forward by putting thousands of lawsuits behind us. 46 of 49 eligible states, all 6 eligible territories, and over 98% of litigating political subdivisions are part of the national agreement. This comprehensive agreement will settle the vast majority of the opioid lawsuits filed by state and local governmental entities.

Additionally, we recently reached an agreement with the State of Washington and its participating subdivisions to resolve opioid-related claims on similar terms to the broader settlement, bringing the total number of states with which we have settled to 47 out of 49.

While these settlements do not cover all opioid-related claims, these comprehensive agreements are a significant milestone toward achieving broad resolution of governmental opioid claims, and include injunctive relief terms designed, in part, to increase transparency to the supply chain for these products and demonstrate our commitment to the safety of the pharmaceutical supply chain.

With that, I'll turn it over to Jason.

Jason Hollar: Thanks Mike, and good morning, everyone.

Beginning with total company results, third quarter revenue increased 14% to $45 billion, driven by sales growth from existing and net new Pharma customers.

Total gross margin was $1.7 billion, a decrease of 7% due to the elevated supply chain costs in Medical and the Cordis divestiture, partially offset by generics program performance.

Consolidated SG&A increased 2% to $1.1 billion, reflecting higher operations expenses and previously anticipated IT investments, partially offset by the Cordis divestiture and cost savings initiatives.

Third quarter operating earnings decreased 21% to $545 million, primarily reflecting the elevated supply chain costs in Medical.

Moving below the line, Interest and Other increased by $8 million, which reflects one-time gains in Other income in the prior year, partially offset by lower interest expense from debt reduction actions.

Our third quarter effective tax rate finished at 20.1%, eleven percentage points lower than the prior year due to certain discrete items affecting both periods.
Average diluted shares outstanding were 277 million, 6% lower than a year ago, due to share repurchases. During the quarter, we initiated a $200 million share repurchase program, which was completed in April and brings our year-to-date repurchases to $1 billion.

The net result for the quarter was EPS of $1.45, a decline of 5%.

In the quarter, we also recorded a $474 million non-cash, pre-tax goodwill impairment charge related to the Medical segment, which is excluded from our non-GAAP results. This accounting charge reflects an increase in the discount rate used in our goodwill impairment analysis.

Third quarter operating cash flow was a use of $419 million, and we ended the quarter with a cash balance of $2.4 billion and no outstanding borrowings under our credit facilities.

Looking ahead to the fourth quarter, in addition to expecting strong operating cash flow generation, we received the previously-defined tax receivable of approximately $1 billion in April. Timing, including the day of the week in which any period ends, affects point-in-time cash flows, and fiscal ‘22 is unfavorably affected by this dynamic. Additionally, we expect approximately $550 million in total litigation payments this year, primarily related to opioid settlements, which includes the initial payment for the national settlement already made.

Now turning to the segments, beginning with Pharma on slide 5…

Revenue increased 17% to $41 billion, driven by branded pharmaceutical sales growth from existing and net new Pharmaceutical Distribution and Specialty customers.

Segment profit decreased 5% to $487 million driven by higher operations expenses and previously anticipated investments in technology enhancements, partially offset by generics program performance.

During the quarter, we incurred higher costs supporting sales growth, including some initial customer onboarding costs, and inflationary impacts in areas like transportation and labor. Importantly, we also completed the launch of our planned technology enhancements.

As Mike mentioned, we continued to see resiliency in pharmaceutical demand. And, our generics program continued to experience generally consistent market dynamics, including strong performance from Red Oak.

Turning to Medical on slide 6…

Third-quarter revenue decreased 7% to $3.9 billion due to the divestiture of the Cordis business and lower products and distribution volumes, which includes the impact of global supply chain constraints. Segment profit decreased 66% to $59 million, primarily due to net inflationary impacts and global supply chain constraints in products and distribution.
During the quarter, our U.S. Medical Products and Distribution business continued to experience significant inflationary impacts across the global supply chain, particularly in the areas of international and domestic transportation and commodities. Additionally, increased pressures from global supply chain constraints affected the volume of some of our higher margin Cardinal Health brand products.

To a lesser extent, the third-quarter decline in segment profit also reflected a lower contribution from PPE, as well as the Cordis divestiture. On PPE, we saw unfavorable price-cost timing in the quarter, as well as lower volumes as we exited the quarter.

We were encouraged, however, by the resiliency in surgical product demand related to elective procedures, which was generally consistent with recent quarters and improved from a year ago. And, we continued to see strong performance from our Lab business.

We continue to take action to address the inflationary cost challenges and manage through the temporary supply disruptions, including pricing adjustments, cutting costs throughout the organization, and investing in our supply chain network, which Mike will elaborate on momentarily.

Now, transitioning to our updated fiscal ‘22 outlook on slide 8…

We now expect EPS in the range of $5.15 to $5.25 per share, reflecting updated expectations for Medical and a few of our corporate assumptions.

With the favorability seen to date from discrete items, we now expect our annual effective tax rate to be in the range of 22% to 23%. We expect diluted weighted average shares outstanding of approximately 281 million, which reflects the $1 billion in share repurchases completed to date. And with one quarter to go, we expect capex of approximately $400 million. We continue to expect Interest and Other in the range of $140 to $160 million.

As for the segments on slide 9…

For Pharma, no changes to our outlook, we continue to expect low-double digit revenue growth, mid-single digit segment profit growth, and as previously indicated, strong fourth quarter segment profit growth. With the culmination of our planned technology enhancements, we will now be lapping elevated expense levels from the initial deployment a year ago, which has been a year-over-year headwind the last several quarters. We are also lapping a few one-time items that we called out last year, which will create a favorable fourth-quarter comparison, and we expect strong underlying performance in the quarter.

For Medical, we now expect revenue at the low end of our previous range, down mid-single digits, and segment profit to be down 45% to 55% in fiscal ‘22, which includes a net incremental headwind of nearly $300 million due to inflationary and global supply chain constraints. Additionally, based on volume trends, the update from our previous Medical outlook primarily reflects a lower contribution from PPE.

Now, let me spend some time sharing a few high-level thoughts on fiscal ‘23 from our vantage point today ahead of providing our usual guidance in early August.

In Pharma, the business is tracking consistent with our long-term target of low to mid-single digit segment profit growth. With respect to a couple other notable Pharma puts and takes for next year, we do anticipate higher operations expenses based on recent inflationary trends, particularly in the first half of the fiscal year. Additionally, with the finalization of the global opioid settlement, we anticipate lower opioid-related legal costs, partially offset by higher costs for implementation of the settlement's injunctive relief terms. Together, we expect these litigation items to be a modest net tailwind in fiscal '23. For reference, we are currently estimating opioid-related legal costs of approximately $115 million in fiscal '22. We expect a further reduction in opioid-related legal costs in subsequent years.

In Medical, we are highly focused on the inflationary impacts and global supply chain constraints affecting our U.S. Medical Products and Distribution business.

At this time, we expect a similar to modestly higher net impact from inflation and global supply chain constraints in fiscal '23 as in fiscal '22. Embedded in this are two key assumptions:

First, with visibility generally limited to the first half of the year, we are assuming key cost drivers such as international freight and commodities have flattened and will begin to decrease slowly over the course of next fiscal year, affecting our results on a one to two quarter delay. This would result in a greater absolute impact from inflation and global supply chain constraints in fiscal '23 due to the annualization of the higher costs seen in the second half of fiscal '22.

Second, we also expect a greater impact from mitigation initiatives, with various waves of price increases going into effect throughout the year.

In total, these two assumptions result in a similar to modestly higher net impact from inflation and global supply chain constraints as in the current year. As we exit fiscal '23, we anticipate a run rate where our pricing actions will offset approximately half of the gross impact.

Though these inflationary impacts are persisting for much longer than originally anticipated, we remain committed to mitigating the effects on our Medical business over time. We continue to believe the majority of these impacts will prove temporary once global supply chain pressures eventually abate, or pricing will adjust accordingly.

Below the line, we anticipate a year-over-year headwind in our fiscal '23 effective tax rate with the discrete favorability seen in fiscal '22 not expected to repeat. And with our strong balance sheet, we see the potential for accretive capital deployment through a similar level of share repurchases over the course of the year, supported by the $2.7 billion of authorization remaining on our existing share repurchase program expiring at the end of 2024.

In summary, while there's obviously moving parts for fiscal '23, or any particular year, we continue to believe our previously-announced long-term targets for our businesses and for double-digit combined EPS growth and dividend yield are achievable over normalized, longer periods.

With that, I'll turn it back over to Mike.

Mike Kaufmann: Thanks, Jason.

Let me elaborate on the actions we are taking to drive Medical performance and maximize our differentiated strengths:

First, we're taking pricing actions, evolving our commercial contracting strategies, and focusing on driving mix across our global business. We have implemented a series of initial customer price increases on nine Cardinal Health brand product categories.

We've also implemented fee increases for certain Medical National brand suppliers to offset some of the elevated supply chain costs. We provide the most efficient and effective way for manufacturers to reach our customers and believe these increases help compensate us for the increased cost of providing this value. We have and will continue to be transparent and fair with customers and suppliers, and focused on delivering on our service. As it relates to our products and distribution contracts, we are focusing on future pricing flexibility for factors beyond our control.

To drive changes in mix, we're investing in new and innovative products to increase the breadth of our Cardinal Health Brand product portfolio.

One example of increased breadth is our recent launch of the first surgical incise drape using Avery Dennison's patented BeneHold CHG adhesive, which reduces risk of surgical site contamination yet still removes easily after surgery without harming a patient's skin.

Another example is our recently announced collaboration with Innara Health, the industry leader in feeding development for newborns and premature infants, to design Innara's next generation N-Trainer System, making it smaller, more intuitive, and easier to integrate into NICU feeding protocols.

We are also investing to increase supply capacity, particularly within our Protexis™ Surgical Glove line where we have increased our existing capacity by over 30% with a focus on long-term growth. We expect to invest over $125 million to expand our manufacturing footprint with the construction of a new facility dedicated to increase supply of our Protexis™ brand gloves and drive innovation in this important product portfolio.

Second, we are simplifying our operating model, and optimizing our international footprint.

A year ago, we announced our intention to exit 36 markets, and those exits are now complete. We have also decided to exit another 10 markets where we see limited opportunity for long-term growth. Once complete, these actions will reduce our international commercial footprint by 50%, allowing us to focus on approximately 45 remaining markets where we are best positioned to serve.
We are also optimizing our distribution network by consolidating less efficient facilities into larger, modern, more efficient distribution centers to deliver improved service to our customers. For example, we recently announced plans to build a new approximately 600,000 square foot medical distribution center in central Ohio, replacing a smaller facility nearby. This new facility – along with others we have planned – will improve service and quality; deliver operational efficiencies; and better support fluctuations in volume and labor.

Additionally, our Lab business is consolidating manufacturing and warehouse space into a new, larger 100,000 square foot facility. This move centralizes our high-growth lab kitting services and supports significant expansion of our direct-to-consumer kitting capabilities.

Third, in addition to investing in our core Medical business, we continue to invest in our growth businesses, at-Home Solutions and Medical Services, which are aligned with industry trends.

In at-Home Solutions, we continue to see strong demand as care continues to shift into the home. We recently partnered with Kinaxis to optimize digital supply chain planning, increase medical product visibility and supply chain agility. We're focusing initial implementation of Kinaxis' RapidResponse platform within at-Home Solutions with an expected completion date this summer. Furthermore, we've invested in a new warehouse management system across our at-Home Solutions network, which we expect to roll out next week. This new infrastructure will improve labor planning based on demand, increase operating efficiencies to deliver on our commitments, and streamline and standardize processes across our at-Home network. We're initiating a multi-year strategy to grow our warehouse footprint for at-Home Solutions in target markets, and will announce details for a new warehouse opening later this calendar year.

And in our higher-margin, technology-enabled Medical Services businesses OptiFreight® Logistics and WaveMark, we've invested in additional technology capabilities to expand our offerings in both businesses.

Turning to Pharma, we continue to make progress on our two primary objectives:

First, strengthening our core Pharma Distribution business.

We have completed all deployments of our multi-year investment to modernize our pharmaceutical IT infrastructure in order to standardize operations, drive efficiencies and enhance the customer experience. These investments, including the automation of business procedures and real-time line of sight transparency for our employees and customers, will result in operational efficiencies and a more connected pharmaceutical distribution supply chain. We expect to benefit from the conversion in FY '23 and beyond.

Second, we're fueling our growth businesses: Specialty, Nuclear, and Outcomes.

In Specialty, we continue to experience momentum in our oncology physician office business, driven in part by Navista TS, our technology platform for value-based care. In March, we further expanded our Navista TS offering with the launch of Decision Path, a digital solution to help oncology practices lower costs, improve patient care and drive success in transitioning to value-based care. Created by Fuse, our internal innovation engine, Decision Path is built into electronic health record workflow, allowing oncologists to easily compare cancer treatment options, both by clinical indication and cost, at the point of care.

And with biosimilars, we are well positioned to support the next phase of growth over the next several years as biosimilars expand into new therapeutic areas and sites of care. We believe the next phase of growth in the biosimilars market will predominantly come from products with a greater retail or specialty pharmacy presence. As more retail products with interchangeability come to market, our significant scale and capabilities designed to support retail pharmacies uniquely positions us to support and empower those pharmacists as they navigate the important operational complexities of managing multiple biosimilar launches against major reference products.

Our Sonexus digital services portal offers tailored solutions to help patients get on, and stay on, therapy. Patients who interact with our Sonexus portal experience shorter time to therapy for new patients and no gaps in therapy for existing patients. Digital re-enrollment via the patient portal increased approvals within the first 30 days by 10%, and delivered a retention rate greater than 90%.

In our Third Party Logistics business, we have won 66 manufacturer contracts this fiscal year. So far we have successfully launched 27 manufacturers, and we expect 5-8 additional launches by the end of the fiscal year. And specific to cell and gene therapy, we continue to win opportunities and have plans to launch 5 manufacturers in the coming years, based on FDA approval and manufacturer readiness.

In Nuclear, we continue to see the benefits of our investments in theranostics. Our Center for Theranostics Advancement in Indianapolis continues to be in high demand with the number of new innovators and products we are collaborating with doubling in FY ‘22 versus the prior year.

Our Outcomes business continues to add new payers, PBMs, pharmaceutical manufacturers, and expand clinical solutions for both independent pharmacies and retail chains. We have combined our Reimbursement Consulting Solutions and Outcomes Connect platforms into a single, unified platform that offers reimbursement assistance, decision support and scheduling to identify and complete clinical opportunities.

Across the enterprise, we continue to aggressively review our cost structure as we work to streamline, simplify and strengthen our operations and execute our digital transformation. We're pairing these cost reduction efforts with balanced, disciplined, and shareholder-friendly capital allocation according to our priorities. Looking ahead, we're confident in our ability to achieve our long-term targets.

Now let me give a little color on injunctive relief as part of the national opioid settlement. Injunctive relief relates to controlled substance anti-diversion efforts and includes enhancements to governance, independence and training of personnel, due diligence for new and existing customers, ordering limits for certain products, and suspicious order monitoring. In addition, we and the two other settling distributors will engage a third-party vendor to act as a clearinghouse for data aggregation and reporting, which the distributors will fund for ten years. These relief measures are intended to create additional transparency, and while there is additional cost, these initiatives demonstrate our commitment to being part of the solution to the U.S. opioid epidemic.

In closing, what we do matters. We aspire to be healthcare's most trusted partner, by delivering the products and solutions our customers need, advancing healthcare and improving lives.

And now, Jason and I will take your questions.

Operator: Thank you. If you would like to ask a question, please signal by pressing star 1 on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star 1 to ask a question. We'll go ahead and take our first question from Charles Rhyee, with Cowen.

Charles Rhyee: Yeah. Thanks for taking the question, guys. Mike, obviously it looks like there were a number of items here in the fiscal third quarter, particularly the pharma segment, and you highlighted that we're going to be lapping a number of these as in the fourth quarter and you're maintaining the fiscal '22 guide in that segment. Can you just remind us what those items are that we're lapping now? I know the technology investments you mentioned is one, but could you kind of help us size those so we get better sense? And is that then the right kind of jump-off point in the Pharma segment as we look into '23? And part of that you mentioned higher sort of operational expense and you kind of maybe highlighted inflation as in wage inflation, you kind of mentioned that should mostly just be in the first half of the year. Can you touch on why that might only be a half-year impact and not just a new baseline? Thanks.

Jason Hollar: Yeah, this is Jason, let me go ahead and start. There's a number of questions there, so hopefully, you can catch them all. So in terms of the IT enhancements, what we mentioned at the beginning of the year and is still very consistent with what we've seen roll out is about $80 million of incremental costs that we saw in '22 versus '21. And we indicated that would be spread somewhat evenly over the first three quarters of the fiscal year. So you can kind of think of roughly that one third per quarter is what we've been experiencing all year.

First two quarters, we had other actions that drove growth above and beyond that headwind, but that was with the inflation included in the third quarter, drove that 5% reduction. As it relates to the fourth quarter, the other unusual item, beyond that lapping, so there's very little year-over-year change as it relates to the IT enhancements in the fourth quarter. So that headwind goes away in Q4. But we also referenced last Q4, Q4 of '21, that we had some unusual items that were adversely affecting us. So that becomes a year-over-year tailwind for us this Q4. And then in addition to that, we indicated here in the call today just before this that we are also seeing some volume underlying operational improvements that are expected for the fourth quarter that then would also continue on at that point.

As it relates to inflation, what we saw here in the third quarter was elevated. It was a little bit higher than what we had expected. It is consistent with the range of our guidance, but nonetheless, it's an item that does impact our Q3 and we're expecting it to impact Q4 and then carry over our comments for the first half of fiscal '23 or just presuming that that cost will continue on at a similar elevated level and be a year of a year headwind such that by the time we get to the second half of fiscal '23, we would then lap it at that point in time. I think I captured all your questions there.

Operator: All right. We'll go ahead and take our next question from Eric Percher with Nephron Research.

Eric Percher: Thank you. I recognize you've had some unprecedented headwinds, but throughout the guidance has appeared to assume stabilization or improvement. And so we've seen step-downs of 100 to 125, 150 to 175, and now 300. It sounds like for ‘23, you're trying to let us know that we're going to see lapping and it doesn't get better, though there are actions being taken. Can you give us a feel for what actions you would take if it turns out that things continue to get worse? And have you thought about the profitability of elements of the business? What might need to change, or even whether the business might be better positioned for rebound if it's a multi-year rebound under someone else's ownership?

Mike Kaufmann: Yeah, I'll take that and then Jason can fill in if I miss any of the components of that. Thanks for the question. So yeah, what we had said last quarter, we expected 250 to 300 of incremental cost and now we think it'll be nearly 300. So that's adjusting the inflation component of it up to 300. And then you also heard Jason comment in his comments that we saw some as we look forward into Q4, we see some PPE cost timing and PPE volume impacts for us in Q4 that will also be an incremental negative for ‘22. So that's what's in our updated guidance to go to the new 45 to 55 down versus where we were before. So that's the change. The two key items that change there. Again, there was some small stuff we mentioned in Pharma and all that. We believe it's manageable within the guidance for Pharma. So no call out any change in guidance for Pharma, but that's the drivers for what we chose in Medical. As far as looking forward to ‘23, what we were trying to indicate is that we do believe as we annualize, if you think about the inflation increased over the year and it sits in our inventory for a while, so using the $300 million, obviously, we believe that will annualize to a greater number next year. And so the inflation actually on an absolute basis, the total impact of inflation will be greater next year in ’23 than it was in ‘22. That's what we were talking about there. But on the flip side, we also already have implemented price increases, some in March and additional ones as I mentioned, that go into effect here essentially July 1, that as we look at those in additional price increases that we would intend to take during the year, that we also will see a greater positive impact from price increases next year. So while inflation on absolute will go up, the positives that we will get from increased pricing will also go up and the two of those will net to a similar to slightly down overall net impact next year in ‘23. So that's how we're thinking about it next year. As you can imagine, we're going to continue to focus on those items and where we have opportunities based on the market, based on the conditions and costing, we will take more price to market.

And what Jason also said to be helpful, our goal is that when we exit the year next year, we plan to have at least 50% of those inflated items offset through either pricing actions that we will have taken, either both to manufacturers and to customers, or we will obviously have seen some of those costs come back down. So we do plan to exit at that level. So that's kind of financially I guess, an overall summary of that.

To your question around the Medical business, we still continue to feel very good about this business. As I look at this business overall yes, our medical products and distribution business is having some challenges, no doubt about it, obviously with lowering guidance three times. But when we look across the rest of the portfolio, whether it be at home, OptiFreight®, lab, WaveMark, we continue to see very strong growth from all of those businesses and we feel really good about those. We feel good about the actions that we're putting in place. As always, we always constantly look at our portfolio and make adjustments as necessary, but we feel good about where we are with Medical at this point in time.

Operator: And we'll go ahead and move on to our next question from Michael Cherny with Bank of America.

Michael Cherny: Good morning and thanks for all the color. Mike, I want to dive in a little bit more about the comments you've made tying into next year on Medical. As we think about both the fiscal 3Q numbers and the implied fiscal 4Q guidance. Is that the right annualization and jumping-off point as we think into next year? And along those lines with the pieces that you've given us, where do you see the dynamics? I know it's early, but around all these pieces coming together towards some level of EPS growth relative to long-range plan, and Jason hinted that you'll be below that. But should we expect to see EPS growth next year?

Jason Hollar: Yeah. Let me start with that. This is Jason. The '23 elements that we're providing here for Medical entirely focused on the inflation component. That is clearly going to be the most significant item that we are focused on for both the current year, and what we know will impact us this next year. We have not this is not a full comprehensive guidance and this is not meant to be complete with all the moving pieces. As Mike indicated, we're very focused on all those growth businesses that he mentioned. There's going to be other operational elements that will be working through and then we'll provide more color on. As it relates to inflation that $300 million impact this year is by far the most significant item. And when we think about our long-term targets, the reason we use the phrase normalized, is items like that $300 million do need to be adjusted, but as it relates to other moving pieces for fiscal '23, that will come at our normal guidance update next quarter.

Operator**:** All right. We'll go ahead and take our next question from Lisa Gill, JP Morgan.

Lisa Gill: Thanks very much. Good morning. Staying on the medical supply side of the business, I just want to better understand just a couple of things. Mike, you talked about the opportunity now to mitigate some of this by taking some price increases. Is there any reason we've been talking about all of these headwinds and pressures for several quarters now? Is there any reason why one, you haven't been able to do that historically, and why now you'll be able to do it? And then secondly, can you maybe just talk about the competitive landscape? Is there anything in the competitive landscape that has prohibited you from taking mitigating price increases during this time?

Mike Kaufmann: Yeah. Thanks for the question. So first of all, I would talk about it in two buckets. And as a reminder one, on the branded medical products, when we see price increases from those manufacturers, we are able to pass those through because it is like you're used to on the Pharma side, a cost plus type of model. So whatever that cost is, we pass it on. So what we're talking about specifically here is the impact on Cardinal branded products, whether it be the Cardinal brand or Kendall, Curity, Kangaroo. All of our brands that we have as we see input costs going up, whether that be transportation, ocean freight, commodities, etc., those are the types of things that are impacting. And so again, as I think about the entire Medical segment, remember it is highly focused in this one area. As we look across the rest of the segment, we see really good progress on our initiatives and the various activities that we have going on. Specifically related to this, to your point around taking pricing, as you know, taking pricing in this marketplace is complicated. First of all, you have to work not only with the actual customers themselves, but you also need to work with the GPOs and make sure that you are communicating what you intend to do, when you'll do it, you have to give notice. Remember, in many cases, these are contracts that we have that could be multi-year contracts in place at a fixed price because this is an industry that has historically not seen large fluctuations in pricing. It's been relatively stable. And while you might see little things here and there, it's generally been very stable. And so the industry itself has been comfortable with doing longer-term pricing. Obviously, that model needs to change going forward based on what we've seen in this hyperinflation environment that we're in that not only has occurred, but seems to be lasting at least a little bit longer. And so this is about working with customers on redesigning the contracts, working with the GPOs, working directly with the customers. We have been having those conversations. So we did take price increases on five categories, effective March 1. We recently added four more categories. This represents thousands of SKUs. In fact, it's almost half of our Cardinal Health branded portfolio we have now taken price on. And to your point, when we compete on products, that's not just against the other distributors. And in fact, in most cases, it's against many other folks in the marketplace, including some of the branded suppliers. So we do have to understand what they are doing in the market and understanding how that as we raise price, we still remain competitive in the best option for our customers.

Operator**:** And our next question comes from Ricky Goldwasser with Morgan Stanley.

Ricky Goldwasser: Yeah, hi. Good morning. So a couple of questions here. First of all, Mike, if we just step back, I think you talked in the prepared remarks about investing and building in new facility in the Medical segment. But if you really think back and we think about sort of the two segments that you have, are there any synergies between drug distribution and medical segments? And what is really the rationale to own a business on the Medical side that has been underperforming for a very long time?

Mike Kaufmann: Thanks for the question. I appreciate it. A couple of things. As we've said before, we do see some synergies between M&P. We go to market together with our GPO selling teams, we share corporate overhead together, we work on our innovation and technology group together. We work together on back-office types of things. Clearly, acute care customers are common to both segments. We don't see as much synergy as between the large distribution businesses, obviously because we maintain separate warehouses and there's different needs for the customers there in terms of specific go-to-market strategies, but we do see it a lot with our complementary businesses. Our at-Home, business works with our pharma distribution business, our OptiFreight® business works with them. So, we do see working together there. So that being said we do see opportunities. But as I've always said, we will always look at our portfolio, we'll always look to see what is the best opportunity to create shareholder value. And so at this point in time, we feel good about where we are and where we're headed, but there's nothing off the table when it comes to looking forward in order to create value for shareholders.

Operator: And our next question comes from Elizabeth Anderson with Evercore ISI.

Elizabeth Anderson: Hi, guys. Thanks so much for the question. I was wondering if you could talk a little bit more about the medical utilization assumptions embedded in 4Q, and then your comments regarding ‘23, both may be on the surgical side and at-home volumes. Thanks.

Mike Kaufmann: Yeah. Right now what we're seeing is we're seeing elective procedures be pretty similar to what we would say pre-COVID. Now, that's a hard phrase to use anymore, and it's probably one will begin getting away from because trying to measure something that's now over two years old with lots of puts and takes, with new items and changes in the marketplace and everything else, it's a little hard to compare to something that old at this point in time. But roughly what we would say is that, elective procedures in Q3 were pretty similar to the prior couple quarters, prior to and similar levels to pre-COVID. We expect about the same for Q4 and I'm not really expecting any differences in ‘23 as far as that goes, in either direction. We're not expecting that there's a big buildup of unmet needs that are going to fly through the system or vice versa, that we should see a significant reduction. Now, obviously, that could change if there's a flare up with COVID or something like that. But right now, we don't see anything at this point in time that we would forecast for the rest of this year and next year as it relates to differences in elective procedures.

Operator: Then we'll take our next question from George Hill with Deutsche Bank.

George Hill: Yeah. Good morning guys and thanks for taking the question. Jason, the med surg business, and I'm going to stay on this one, did about 60 million in EBITDA in Q3 and that's kind of the midpoint of the Q4 guide. But as we think about your fiscal ‘23 comments, we know that inflation is building and the impact tends to lag, I guess is the right way to think about med surge in fiscal ’23, is that this is kind of the jumping off the back half of fiscal ‘22 almost overstates the operating earnings run rate of the business. And that I guess I'm trying to get a sense of magnitude of how far down it can go in fiscal ’23, and to what degree can pricing initiatives kind of offset that?

Jason Hollar: Yeah. The area I can probably be a little bit more helpful is on the timing associated with that. The impact of that inflation from a year-over-year perspective will be more unfavorable in the first half of the year. If you think about what we had in fiscal ‘22, Q1 had much less of an impact, actually hitting the PNL we had seen the costs start to come start to build in terms of what was procured, but what actually hit the P&L escalated much more greatly in the second quarter and has increased from there in Q3, Q4. So that comparison from a year-over-year perspective, will be unfavorable for those elements, all things being equal. But given the magnitude of what we're talking about, I would expect that to be one of the more significant items, especially in Q1. And then as we get to the back half of the year, as I indicated in my comments and Mike reiterated a few moments ago, with the expectation that we are able to offset about half of the run rate at the end of the fiscal year as we jump into ‘24, that would imply especially over the second half of the year, that would be trending more favorably and then we would have much more of a tailwind associated with those items. There are always other moving items within each year in our guidance. As you go back and look at all of our commentary this year, there have not been too many significant items referenced other than inflation. So this one singular item is going to be the key driver of the year-over-year results for the Medical business next year. There will be other color of course, back to the growth businesses and other changes in underlying assumptions, but this will be driving the underlying performance for the segment very significantly from a year over year perspective. Again, in a general similar magnitude, perhaps a modest headwind associated with it based upon those underlying assumptions.

Operator: And our next question comes from A.J. Rice with Credit Suisse.

A.J Rice**:** Hi, everybody. Thanks. Just on the Medical, I don't think you've given in a while. How much of the revenues there is Cardinal branded products at this point roughly? And then as you're talking about the offset that will come from pricing - your price increases - offsetting about 50% by the end of next year of fiscal year, are there any other things that are meaningful that could be impactful? I don't know, diversification of sourcing, maybe toggling back and forth in the Cardinal branded products, anything else beyond just pushing for price increases, or do we are we basically waiting for the backdrop to improve from a macro perspective?

Mike Kaufmann: Yeah. We've not given any actual mixed percentages in terms of how much of our volume is Cardinal Health Brand versus others, so I can't do that at this point in time. But what I will say is that there's opportunity for growth there. We know that that's an area that we're excited about, and continue to put things in place, like working on our incentives for our sales force, expanding our product line to have more items to drive mix to, which you heard in my comments on our project with Avery Dennison and Innara Health. So we're both looking to expand the line, as well as drive the mix to our sales reps and continuing to work with customers. So while we don't give it, it's an area where we do see some real opportunity going forward to grow. As far as other things to your point. So yeah, number one is going to be pricing the customers. That's going to be initiative. I also mentioned that we are taking fee changes to our manufacturing partners to increase the fees. Our cost, as we said, have gone up. The service that we provide to manufacturers we believe is their best option to be able to get to market and get to the customers that we service. We want to obviously be fair with them and be a great and trusted partner, but we do need to make sure we're charging fairly for our services. So we have in our taking fee changes to those manufacturing partners that we have on the Medical side in order to help compensate us for the great service that we drive there. We continue to look at our cost side of the business. We continue to feel good about our $750 million cost takeout, and we're continuing to look at opportunities to be even more aggressive on that. And we'll continue to do that going forward. And then in our growth businesses. Focusing on those growth businesses, whether it be at-Home, or OptiFreight®, or lab. We're continuing to make investments, as I noted around where we're doing our lab business in the new facility to grow that, we've got some IP rollout of some new systems in OptiFreight® and in our at-Home business, that are going to both improve our costs and increase our offerings. So those are the ways that we're going to be getting after over the next year and over the following years to grow this business.

Operator**:** We will take our next question from Eric Caldwell with Baird.

Eric Caldwell: Hey. Thank you. Good morning. I wanted to go back to the first question, I think it was Charles asked. The Pharma comp in 4Q '21, you identified some good guys from last year. You have not given more specifics today on that those are. I think, we're all pretty hectic with earnings and everything else a lot's changed in the last year. Can you just remind us what those items were in the fourth quarter of '21 that were bad guys, and how much they were, so we know what the year over year good guy comp is going into this quarter. And then, are there any new good guys, things the street wouldn't know about, that you know are going to hit in the fourth quarter that get you to your Pharma profit margin target? Thanks very much.

Jason Hollar: Yeah. The primary item that we referenced last Q4 was inventory adjustments. We did not provide any specific number. I think we might have referenced modest, and so it was a reasonable number that you can look at the growth rates there and how that was impacted to provide a range. The key again is that we no longer have the headwinds of that 20, 30 million per quarter that we've seen over the first three quarters related to the IT enhancements. And then we have had some incremental volume through, we referenced some net new customer volume within the Pharma business that started to ramp up in the third quarter and is more significant in the fourth quarter, and those would be the most significant items that drive that year over year.

Operator: And we'll go ahead and take our next question from Steven Valiquette with Barclays.
Steven Valiquette: Great. Thanks. So regarding the elevated operating expenses in the Pharma segment exiting '22 and into the first half of fiscal '23, I guess it's still not clear which elevated cost categories are able to pass through to customers versus which ones you're absorbing in your own margins. When thinking about fuel costs, other transportation costs, higher labor expense, etc. So I guess just to confirm, in which cost categories are you seeing the greatest increase in operating expenses that you're not able to pass through to the Pharma customers? Thanks.

Mike Kaufmann: Yeah. I would say in general, the majority of these are not items that we can pass through. There are opportunities on fuel surcharges for sure, as those remain elevated to pass those through. But I would remind you there was a couple other things. Some of these costs were also focused more on the third quarter, such as we did roll out just a few weekends ago, the final rollout of our multiyear Piedmont project. So we've had some rollout costs and some making sure that we do that right in the quarter. We onboarded some new customers during the quarter and there's some initial costs there that we also incurred during the quarter. So I would say that the bucket is there's small amount that's passed through to the customers. There's another part that's a little bit I would say, temporary in the third quarter because they were unique to some work we're doing in the quarter. The majority is elevated transportation costs that we do see more permanent for at least for a while until they begin to come back down across the portfolio, and those are not able to be passed on. That being said, when we look at the level of those the amount of costs we're taking out of the business, that's why we're still comfortable with reiterating our overall guidance for Pharma that while they are somewhat elevated in the third quarter, there's something that we would expect and are continuing to address going forward to manage the both our guidance for this year as well as still feel confident about our longer-term guidance as it relates to pharma.

Jason Hollar: And just to be really clear in this point, we're not talking about any type of product cost inflation that's flowing through for the Pharma business, that is very much captured in the pass-through.

Operator: And it appears there are no further questions at this time. Mr. Kaufmann, I would like to turn the conference back to you for any additional or closing remarks.

Mike Kaufmann: I just want to thank everybody for their time to be on the call today and I appreciate all the questions. I'll just reiterate that we are taking action to mitigate these inflationary impacts and global supply chain constraints, and we're focused on driving improved performance across all of our businesses. Take care. And I hope to talk to all of you soon. Bye-bye.

Operator: This concludes today's call. Thank you for your participation. You may now disconnect.