Q4 FY22 Cardinal Health, Inc. Earnings Conference Call

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

Kevin Moran: Good morning. And welcome. Today we will discuss Cardinal Health’s fourth-quarter and year end fiscal 2022 results along with our outlook for fiscal year 2023. You can find today’s press releases and earnings presentation on the IR section of our website at ir.cardinalhealth.com. Joining me today are Mike Kaufmann, Chief Executive Officer, Jason Hollar, Chief Financial Officer, and Trish English, Chief Accounting 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 full 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 reconciliations 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 kindly ask that you please limit yourself to one question, so that we can try and give everyone an opportunity. With that, I will now turn the call over the Mike.

Mike Kaufmann: Thanks, Kevin, and good morning, everyone.

As I am sure many of you have seen, a short time ago we issued a press release announcing that I am stepping down as CEO and as a board member of Cardinal Health, but will continue to serve through August 31st. Effective September 1st, Jason will become Cardinal’s new CEO. He has also been appointed as a board member, effective today.

They say timing is everything, and I believe as we start a new fiscal year, the time is right for me to step away as CEO and open the door for a new leader to take Cardinal Health forward over the coming years. I have been blessed to be a part of the Cardinal Health family for 32 years. In that time, I’ve seen our company grow and evolve in many ways. We are truly essential to care and I’m honored to have been a part of it.

Jason has been a tremendous partner over the past 2-plus years, and has been instrumental in many of our strategic initiatives. He deeply understands our business, priorities, and industry landscape, and the Board and I are confident that he is the right person for the job.

With that, I would like to turn the call over to Jason.

Jason Hollar: Thanks Mike, I really appreciate the kind words and the opportunity to work closely with you these past few years. Let me start by saying how excited I am to be taking on this new responsibility. I am grateful for the trust and the confidence the Board of Directors is placing in me.

I would also like to thank you, Mike, for the leadership and the many contributions to the company over the years. I hope to preserve the culture that you've helped engrain into the fabric of our organization and I look forward to what I know will be a smooth transition.

I also want to welcome Trish English, who will be serving as our Interim Chief Financial Officer. Trish most recently served as our Chief Accounting Officer and has been a valuable member of the Cardinal Health family for over sixteen years. I look forward to continuing to work with her in this new capacity while we conduct an external search for a permanent CFO.

Before stepping into the details of our financial performance for the quarter, let me step back and summarize the key points for this past year. Within our Pharma segment, while we experienced the effects of industry-wide inflation and incurred incremental technology investments, we grew the business 5%, consistent with both our original guidance for the year as well as our long-term growth targets. The Medical business was more significantly impacted by these inflationary dynamics, which drove a significant impact on our results. However, we have strong mitigation actions in place, including pricing, and will present a plan to you today that mitigates all of the inflationary and global supply chain constraint impacts, plus an additional 8% of compounded annual growth by fiscal '25. Underlying these operating results this past year was a significant focus on cash flow, which results in increased financial flexibility. We are absolutely focused on shareholder value and intend to deploy these incremental funds to additional share repurchases for fiscal '23.

While we remain in a dynamic environment, I am excited to share further details of our plans with you today and commit to continuing to provide increased clarity to the drivers and the key metrics underlying our performance.

So, let's now turn to some of the details driving our results in the fourth quarter, beginning with the Pharma segment on slide 6…

Fourth-quarter revenue increased 13% to $43 billion, driven by branded pharmaceutical sales growth from existing and net new PD and Specialty customers.

Segment profit increased 26% to $451 million, driven by generics program performance and a higher contribution from brand sales mix, partially offset by inflationary supply chain costs. As we've previously noted, this also reflects a favorable comparison due to prior year inventory adjustments.

During the quarter, our generics program, including Red Oak, saw strong performance and continued to experience consistent market dynamics.

Regarding the inflationary supply chain costs, we saw impacts in areas such as transportation and labor, which we expect to continue into next year. We also incurred higher costs supporting sales growth.

And, with ongoing progress in opioid litigation matters, we saw a decrease of approximately $15 million in opioid-related legal costs.

Turning to Medical on slide 7…

Fourth-quarter revenue decreased 11% to $3.8 billion, due to the divestiture of the Cordis business and lower products and distribution volumes.

Medical segment loss of $16 million in the fourth quarter was due to net inflationary impacts and global supply chain constraints in products and distribution. On a year-over-year basis, the favorable comparison to the prior year $197 million PPE inventory reserve was mostly offset by the net inflationary and global supply chain constraint impacts, a lower contribution from PPE, and the Cordis divestiture.

During the quarter, our Products and Distribution business saw an approximate $100 million impact from net incremental inflation and supply chain constraints. This reflects a gross impact of approximately $125 million and approximate $25 million offset from our mitigation actions, which includes our initial wave of price increases on five Cardinal Health Brand categories that went into effect back in March. I'll elaborate on our plans for further mitigation in fiscal '23 and beyond shortly.

As mentioned, it continues to be a highly dynamic Medical environment, and our Q4 results came in lower than we had previously expected. This primarily reflects overall volume softness in our Products and Distribution business, including a lower contribution from PPE. Stepping back, demand for PPE has fluctuated significantly over the past couple years. We saw lower volumes as we exited Q3, and the fourth quarter experienced further declines. We believe this primarily reflects customers' higher inventory levels, and to a lesser extent, some PPE category-specific customer losses driven by supply constraints during the pandemic. We continue to have strong conviction in our overall value proposition which includes leading brands and clinically-differentiated products. For context, PPE represents approximately 15% of sales in our overall Cardinal Health Brand portfolio, as you'll see on slide 20.

Moving below the line, interest and other increased by $36 million to $64 million, due to a decrease in the value of our deferred compensation plan investments compared to gains in the prior year. As a reminder, deferred compensation gains or losses reported in Interest and Other are fully offset in corporate SG&A and net neutral to our bottom line. Additionally, in the fourth quarter a one-time write-down of an equity investment impacted EPS by $0.06 per share.

The increase in Other expense was partially offset by lower interest due to debt reduction actions. As indicated, we repaid the $280 million of remaining June 2022 notes at maturity.

Our fourth quarter effective tax rate finished at 25.4 percent, approximately 3 percentage points higher than the prior year.

The net result was fourth quarter EPS of $1.05, an increase of 36%, primarily reflecting the growth in Pharma segment profit.

Now, transitioning to our consolidated results for the year…

Fiscal ‘22 revenues increased 12% to $181 billion, driven by the Pharma segment.

Gross margin decreased 3% to $6.5 billion due to the Cordis divestiture.

Total company SG&A increased 1%, reflecting inflationary supply chain costs, our previously-mentioned IT investments and higher costs to support sales growth, mostly offset by the Cordis divestiture and benefits from cost savings initiatives.

Operating earnings decreased 12%, which primarily reflects a year-over-year headwind of approximately $300 million related to net inflationary impacts and global supply chain constraints in Medical, partially offset by Pharma segment profit growth.

Interest and other increased 24% to $165 million, largely due to the items affecting the fourth quarter. Of note, this came in higher than our guidance primarily due to the equity investment write-down in the quarter.

Our annual effective tax rate finished at 22.1%. The net result was fiscal ‘22 EPS of $5.06.

Now, turning to the balance sheet. In fiscal ‘22, we generated robust operating cash flow of $3.1 billion. This includes the previously-defined tax refund of nearly $1 billion and favorable timing of working capital. Additionally, in fiscal ‘22 we made approximately $500 million in litigation payments, primarily related to opioid settlements. In July, we made our second annual payment under the national opioid settlement agreement of approximately $375 million, which will be reflected in Q1 fiscal ‘23 operating cash flow.

We are focused on deploying capital in a balanced, disciplined, and shareholder-friendly manner. This year we invested approximately $385 million of capex back into the business to drive future growth, paid down approximately $850 million in debt to reduce leverage, and returned $1.6 billion to shareholders through share repurchases and dividends. We ended the year with a cash position of $4.7 billion, which does reflect some timing favorability, with no outstanding borrowings on our credit facilities.

As for the segment's full year results, beginning with Pharma on slide 10...

Pharma revenue increased 14% to $165 billion, reflecting consistent drivers with the fourth quarter.

Pharma segment profit increased 5% to $1.8 billion, driven primarily by generics program performance and an improvement in volumes compared to the prior year. This was partially offset by investments in technology enhancements and inflationary supply chain costs.

To be helpful, the tailwind from improved volumes and the headwind from incremental IT investments effectively offset in fiscal ‘22, each approximately $80 million on a year-over-year basis. Additionally, we saw an approximate $50 million headwind from inflationary supply chain costs, primarily in the second half of the year.

Moving to Medical on slide 11...

Fiscal '22 Medical revenue decreased 5% to $15.9 billion, primarily due to the divestiture of the Cordis business. To a lesser extent, lower products and distribution volumes were partially offset by growth in at-Home Solutions.

Segment profit decreased 63% to $216 million, primarily due to the net inflationary impacts and global supply chain constraints in Products and Distribution. Additionally, the favorable comparison to the prior year PPE inventory reserve was offset by a lower contribution from PPE and the divestiture of the Cordis business.

Now, for our fiscal '23 guidance on slide 13...

We expect earnings per share in the range of $5.05 to $5.40, which reflects the following assumptions.

First, for the enterprise, we expect interest and other between $140 to $170 million, which assumes approximately $550 million in debt paydown for the March 2023 notes at or before maturity.

We are assuming a non-GAAP effective tax rate in the range of 23% to 25%.

We anticipate diluted weighted average shares outstanding between 262 and 266 million, reflecting our plan to complete between $1.5 to $2 billion in share repurchases over the course of the year.

And, supporting our capital allocation priorities, we expect adjusted free cash flow in the range of $1.5 to $2 billion, which excludes litigation payments and any other significant and unusual or non-recurring items.

As for the segments, beginning with Pharma on slide 14…

We expect revenue growth in the range of 10 to 14% driven by growth in existing and net new PD and Specialty customers. We expect segment profit growth in the range of 2 to 5%, based on the following key assumptions:

We expect continued stability in overall pharmaceutical volumes, along with consistent market dynamics within our generics program.

A continuation of the inflationary supply chain costs we've seen the last two quarters should result in an approximate $50 million headwind, primarily in the first half of the year.

The completion of ERP technology enhancements should be an approximate $30 million tailwind.

We expect opioid-related legal costs, including initial costs for implementation of the settlement's injunctive relief terms, of approximately $80 million in fiscal '23, a $20 million tailwind. And, we see increased contributions from our growth areas, primarily Specialty, including biosimilars.

Before moving to Medical, a couple points on the Pharma fiscal '23 cadence…

Similar to last year, we expect the year-over-year segment profit growth to be significantly back-half weighted, which primarily reflects the year-over-year impact of inflationary supply chain costs in the first half. Specifically, in the first quarter of next year, we expect segment profit between $400 and $420 million. While we do not typically provide quarterly guidance, we thought additional color may be helpful given the puts and takes over the last several quarters.

Now turning to Medical on slide 15...

We expect revenue to decline in the range of 3 to 6% due to lower PPE sales and lab testing volumes. We expect segment profit ranging from a decline of 10% to growth of 10%, reflecting the following assumptions:

We expect a similar net impact of approximately $300 million from inflation, global supply chain constraints, and mitigation actions in fiscal '23, or a minimal impact on a year-over-year basis. This assumes an approximate $475 million gross impact from inflation and global supply chain constraints, partially offset by $175 million of mitigation actions, including pricing and evolving our commercial contracting.

While still significantly elevated relative to historical levels, we're encouraged by the recent improvements in spot rates of certain cost drivers such as international freight and some commodities. As a reminder, these product costs are capitalized and have historically been reflected in our P&L results on a one to two quarter delay, however, in the current period of elongated supply chains it is closer to two quarters. Our current assumption is that the impact of inflation and global supply chain constraints will peak in the first quarter of fiscal '23 and gradually decrease over the next couple years. Additionally, along with the pricing actions that went into effect at the start of the year, we are implementing additional waves of increases over the course of fiscal '23. We continue to expect that as we exit fiscal '23, the run rate of our mitigation actions will offset at least 50% of the gross impact from inflation and global supply chain constraints.

In terms of other key assumptions for Medical in fiscal '23…

As the operating environment continues to normalize, we expect an approximate $50 million tailwind from an improvement in PPE margins. We plan to sell-through the majority of higher cost PPE in the first half of the year, and for PPE margins to normalize as we exit the year.

We expect the PPE tailwind to be offset by a similar headwind from lower lab testing volumes.

We also anticipate a headwind of approximately $50 million from re-baselining incentive compensation following fiscal '22 underperformance.

And finally, we expect increased contributions from our strategic growth areas, primarily at-Home Solutions.

On Medical's quarterly cadence…

While we are assuming a similar segment profit total in fiscal '23 versus fiscal '22, we do expect the cadence to be the reverse of the prior year. Specifically, in the first quarter, we expect segment profit ranging from a loss of $20 million to profit of $20 million. We expect the gross impact of inflation and global supply chain constraints in the first quarter to be approximately $150 million, with approximately 25% of this offset through our mitigation actions.

As for the rest of the year, we expect the substantial majority of segment profit to come in the second half of fiscal '23, particularly in the fourth quarter. This sequencing primarily reflects our assumptions around inflation, global supply chain constraints, inflation mitigation, and PPE.

While there are many moving parts in fiscal '23, we are confident in our long-term outlook and are reiterating our previously announced long-term targets for our businesses and for double-digit combined EPS growth and dividend yield over longer, normalized periods. Additionally, we are introducing a new target for at least $650 million in Medical segment profit by fiscal '25, driven by the Medical Improvement Plan that we are introducing today.

Slide 17 highlights our four areas of focus to improve Medical performance:

Number one. Mitigate inflation and global supply chain constraints. We plan to fully address the impact of inflation and global supply chain constraints through mitigation initiatives by the time we exit fiscal '24, and are targeting to exit fiscal '23 offsetting at least half of the gross impact on our business.

Our second wave of price increases went into effect on July 1st on four more categories, and we plan on the next wave commencing on October 1st.

In addition, we've executed distribution fee increases for certain suppliers…and we are actively working with customers and GPOs to adjust language in our Product and Distribution contracts as they renew, allowing for greater price flexibility to respond to current and future macroeconomic dynamics.

Two. Optimize and grow the Cardinal Health Brand portfolio. Our $4.6 billion Cardinal Health Brand portfolio, which includes nearly $4 billion of non-PPE categories, offers leading brands and clinically-differentiated products. We plan to grow Cardinal Health Brand sales by a compounded annual growth rate of at least 3%, which will generate $75 million or more of incremental segment profit over the next 3 years.

This growth will be achieved through two key areas of focus. First, R&D and new product innovation. We see opportunities in key categories, such as nutritional delivery, where we will be launching the next generation Kangaroo Enteral Feeding platform. Second, is increased product availability as a result of investments within targeted categories such as surgical gloves and electrodes. For example, in our surgical glove portfolio, we are investing $125 million for construction of a new manufacturing facility dedicated to increase supply of our leading Protexis brand gloves.

The third area of focus is to accelerate our growth businesses, primarily at-Home Solutions. These businesses have growth rates in excess of our core, along with a higher margin opportunity, and we've been making investments to drive at least $60M of total segment profit growth by fiscal '25. At-Home Solutions, for example, is now a $2.4 billion business, that has consistently grown topline at around 10% as patient care continues to shift into the home.

And finally, our fourth area of focus is to continue our simplification and cost optimization efforts. We expect actions that increase productivity in our manufacturing plants, distribution centers, supply chain, and back-office to yield at least $50M of net cost savings by fiscal '25. Going forward, we are focused on driving simplification through value improvement projects, transportation management, and further optimizing our sourcing and manufacturing footprint, where possible. We expect these initiatives to contribute towards exceeding our existing enterprise $750M cost savings goal by fiscal '23.

While on the topic of our supply chain, let me take a moment to share some additional color, where we have received a number of investor questions. We operate a highly diverse global supply chain, with approximately two-thirds of our Cardinal Health Brand revenue coming from self-manufactured products. We have invested in additional self-manufacturing capabilities, many in our own North American facilities and today, approximately half of our Cardinal Health Brand revenue comes from North America in total. To best serve our customers, we continue to believe in the importance of a diverse global supply chain, and we are focused on responding to any global supply chain disruptions with resilience and agility.

In summary, we believe the introduction of measurable proof points in each of these four areas of focus provides visibility to measure progress against our plans going forward.

Let's now turn to the Pharmaceutical segment, where we continue to focus on strengthening our Core PD business and investing in our growth businesses, primarily Specialty.

In Pharma distribution, with our significant technology enhancements that we've been working on over the past several years substantially completed, we now focus our attention on increasing productivity, maximizing working capital efficiency, and prioritizing the customer experience.

With our generics program, anchored by the scale and expertise of Red Oak, we continue to further enhance our capabilities as we focus on share of wallet and maximizing margins.

We recently held our Retail Business Conference where over 4,000 customers attended live for the first time in 3 years and had an opportunity to see and experience our latest innovations. They also had the chance to register for services that would help them create an online shopping portal, advisory support to optimize reimbursement, and central fill compliance packaging services.

In Specialty, we are continuing to see downstream momentum in oncology and emerging therapeutic areas driven by our offerings, including Navista TS.

We recently announced a tuck-in acquisition of the Bendcare GPO and an investment in their managed services organization. These will further strengthen Specialty Solutions' Cornerstone Rheumatology GPO, which offers innovative office management solutions and robust specialty drug access to over 1,300 rheumatology providers nationwide.

Upstream with biopharma manufacturers, we are investing for future growth in our 3PL business, as evidenced through our cold chain storage expansion, which increases our current capacity by 200%. We also continue to see strong growth in Sonexus, our patient hub where our technology solutions help biopharma customers remove barriers to patient care.

And with biosimilars, we are proactively addressing common barriers to adoption by investing in education campaigns to build awareness, clinical comfort, and ensure accessibility. We continue to be excited about the future growth in this space and remain well positioned as new biosimilars come to market.

In closing, while there is a lot of work to be done, I am excited to work with our 44,000 teammates in executing our plans to grow in fiscal '23 and beyond.

With that, I will take your questions.

Operator: Thank you. Ladies and gentlemen, if you would like to ask a question, please press the star or asterisk key followed by the digit one on your telephone. Please ensure that the 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 two. Once again, please press star one to ask a question. We will take our first question today from Lisa Gill of J.P. Morgan. Please go ahead.

Lisa Gill: I want to say best of luck to you, Mike Kaufman. It's been great working with you all these years, and I look forward to hopefully staying in touch. And congratulations, Jason, on becoming CEO.

I really want to start with, you know, obviously you talk about this huge ramp, getting the medical side of the business back to $650 million of profit. And Jason, you just talked about four different areas. I really want to just focus on the first area and that's growing, you know, Cardinal brand products. And obviously for someone like myself, that's followed the company for a long time, you know, that's kind of ebbed and flowed as far as the focus of the company. Can you talk about, one, why now you think that you can really accelerate that? Two, I think you talked about nutritional. You know, we've had others that have had problems in that area, right? You know, why do you think that that that's a good area for Cardinal to go into? And then secondly, when we think about, you know, physician preference, etc., what are you hearing in the market around private label product? You know, to give you some of the insights as to the opportunities that you see here specific to Cardinal brand products. So I'll stop there.

Jason Hollar: Yeah, great list to start off the discussion. Thanks, Lisa. So first of all, let's start with your first one there about why now. So, ebbs and flows, I understand what you mean, and of course, I think what you're referring to is we especially talked about the sales force right before the pandemic, we made a significant restructuring to have that team very much focused on driving our Cardinal brand mix. And then COVID occurred, and it went from a sales focused challenge to now a supply chain challenge. And of course, our sales team, as well as our customers, were very much focused on PPE and getting care to COVID patients and the change in the mix was not exactly the highest priority. So I think it's always been a focus of Cardinal, but we recognize that we needed to change our priority to align with our customers' priority over the last couple of years.

But behind the scenes, especially with the pandemic, our Medical team realized that we needed to invest in our own supply chain capabilities, our own products, and a lot of the capacity that was necessary for the manufacturing, either, whether it's our own products or sourced products, to ensure further resiliency. So now that we are getting a little bit more normalized and we see that we have to invest in that supply chain, it not only helps provide resiliency to our customers, but it also allows us to grow high margin products where we have the right to win and expand our margins further. So now is the right time as we start to move on and allow our sales team to get re-engaged and focus on driving that volume. But of course we need the capacity and the products to allow them to be successful.

You asked a specific question about nutritional. You know, that's just one area, right? We have a very broad, diverse product line. We are successful in the category today. The Kangaroo brand is a market leader. So this is not necessarily we're getting into it, in fact, that's that's what gets me so excited about this item, this opportunity. The two items I referenced, the surgical gloves and nutritional are already areas where we're significant leaders. We are with good margins, good growth. We have the opportunity to just continue our leadership through additional products and additional capacity. So it's actually a lower risk strategy than entering in separately.

As it relates to your last question, again, we have very broad, diverse products and we can manufacture, we can source, and we're going to use all tools available to us and and use that diverse capability, internal or external, with partners or ourselves, and just continue to adapt and evolve as the market demands it and when we look at the supply chain constraints that go behind that.

Kevin Moran: Next question, please.

Operator: Thank you. Our next question comes from George Hill of Deutsche Bank. Please go ahead.

George Hill: Good morning, guys and Mike, I'll echo Lisa's comments in wishing you well. And Jason I don't mean this question to sound insensitive but I guess given the company's recent performance, could you talk about why the board chose to not run a process to replace Mike and why you guys kind of went with an internal promotion? And just kind of, I don't know if you're able to comment at all, just kind of on the board's perception of company performance and how it kind of wants to evaluate management going forward.

Jason Hollar: Well I certainly will not attempt to speak for the board, but what I will say is that my time both here, as well as elsewhere in industry, I'm very focused, very tenured on driving operational performance within the business. I have made a mark within this organization. I've been very focused on capital deployment, driving cash in the company and have made that impact. When I think about what, why I feel like I'm the right person going forward here, we have a lot of great aspects within the organization. We have a wonderful culture. We have wonderful products, leading positions, great growth areas. But what the pandemic has shown us is that we need to go back to some some level of basics here in terms of the operational core – in driving efficiency, driving simplification. So probably doing fewer things but doing them better. And that focus and that attention to de-risking the model and driving this profit improvement plan for the Medical business. The Pharma business has been very resilient. We hit our both short and long term goals this year. We need to keep doing more of the same, while also continuing to grow those growth areas of which of course specialty, is the largest one. So we're in a very different phase there. And then with this plan today, we're really highlighting how aggressive we're going to be with our capital deployment, that when we generate that cash, $3.1 billion in '22, we're going to deploy it effectively. I'm well positioned to take us through those those challenges that we've been faced with. And I am going to absolutely focus on taking the next steps here.

Kevin Moran: Operator, next question please.

Operator: Thank you. We now move to A.J. Rice of Credit Suisse. Please go ahead.

Jonathan Yong: Hi, it's Jonathan Yong on for A.J. I just want to echo my congrats to Jason and Mike as well. So you mentioned the various costs have been coming down within the Medical segment and understanding there is a lag between when the spot prices come down versus when it flows through your P&L. Should we take it that any further decline in the spot prices would be upside to the medical outlook for FY '23 and beyond? And then alongside that, you talked about the 3% revenue CAGR for the Cardinal Health brand products. I guess, what are you assuming in terms of pricing growth moving forward? And alongside that, utilization? Thanks.

Jason Hollar: Okay, so to start with – on the spot prices, well, that's why we always talk about the net impact because obviously there's a gross impact in and then a pricing in other contracting items that create that net. And so as I think about that dynamic in the short term, as as I think you indicate and understand, depends on what it is, right? If it's inventory costs like the freight, international freight, the product freight or the commodities, that will be rolled in and that will be more of that two quarter lag. But as it relates to the domestic transportation, that piece, which hasn't moved you know, very much in either direction, that is a little bit more real time. So it kind of depends on what cost you're talking about. Long term, we believe there's going to be a parity to pre-pandemic levels for this. So if costs weaken, get lower, then some of the pricing actions may change. In the near term, I don't think pricing is going to change. Under all these pricing scenarios, we're still not covering – expected to cover – more than half of that impact. So overall, we think in the short term, yeah, the costs are going to flow more to minimizing the impact of what we have. But again, that would be most likely in the second half of the year. In terms of the 3% CAGR, I'm not sure I fully understand the price question there. But within our Cardinal Health, it's specifically related to that $4 billion bucket that I referenced in my comments, that the underlying volume is what that's related to. There is pricing that goes along with that but I would say it's more on the volume side and the pricing side that's driving that type of CAGR. It's not double dipping on on the pricing actions. That is presuming a normalized level of inflation and pricing and so then it would be more of volume driving that incremental value.

Kevin Moran: Next question.

Operator: Thank you. Moving to Michael Cherny of Bank of America. Please go ahead.

Michael Cherny: Good morning. And Mike, obviously a theme here, but wish you best wishes as you move on. It's been a pleasure working with you over the years. Maybe, Jason, to dive a little bit also into the Medical transformation plan, as you think about the totality of Cardinal, as you step into the CEO seat. As you think about the moving pieces that you have and the drivers to push back towards growth, can you give us a sense as well on how much the linkage between the Pharma and Medical side will be able to help allow you to hit these targets that you've laid out? And how do you view the synergies, especially among this revamped Medical outlook between these two segments going forward?

Jason Hollar: Yeah. So when I step back and think about that plan, the area that is – there's a couple of areas that could be impacted, that have connectivity there. Probably the first one is the simplification and continued cost optimization. Those types of initiatives are wide ranging and as we implement a particular project to reduce cost, it's a lot of cherry picking between the segments and the corporate functions. When one person has a good idea, we push those across all of them, and in some cases we're leveraging that scale. We're doing a lot of centralization of work to standardize and offshore back office activities, things of that nature, using digital tools that when we can invest in those types of technologies and capabilities centrally and blow that out to the whole organization. So that's certainly a piece of it. And then when we talk about the the growing our Cardinal Health brand portfolio, while there's not a lot of crossover selling, and we do have the same customers, and so those relationships, those discussions can spawn into a variety of different opportunities. So that's not a huge enabler of that type of item, but it could be a component of it. And I would say that that's probably the areas that there's the most overlap.

Operator: We move now to Elizabeth Anderson of Evercore.

Elizabeth Anderson: Hi, guys. Thanks so much for the question. Best wishes, Mike, and excited to work with you in your new role, Jason. I had a question just in terms of you talked about, I think, on the last call that you had gotten sort of 50% of SKUs sort of at a higher – you'd been able to pass through higher cost there. I was wondering if you could update that, because I know you said in your slides, obviously, you were going to have offset about 50% of that gross impact exiting ’23. And I know there are a variety of things in there. So just wondering if you could update us on that?

Jason Hollar: Yeah. So that reference to 50% of SKUs was reflective of the expected July 1st price increases. So that is effective July 1st. Now, since then, we've now discussed and are informing everyone of the October 1st increases. I didn't provide that exact number, but remember, that's just the percentage of SKUs that we're touching. I think the more important way to think about it is the percentage of mitigation that we're targeting. So let me kind of walk through the flow and how I think you should think about it for this upcoming year. So just as an anchor point, I just walked it through in the prepared comments, in Q4 ‘22 what we just spent is about a 20% mitigation. So we indicated there was $125 million gross impact with $25 million of pricing. So it's a 20% mitigation. We expect that 20% with the July increases and phasing that in over the quarter, that's going to increase that to 25% average for the first quarter of '23. Now, we would expect that to continue to increase each and every quarter over the course of the year as we roll through various other increases. I mean, these are the big waves, but there's always going to be other increases along the way. And our supplier fees that go along with this too. And then that 25% we expect to double by the time we exit fiscal '23. So we expect a run rate of about 50% by the time we exit fiscal '23. And then as I indicated in my comments, we would expect to exit fiscal '24 with 100% mitigation. By the time you get to the end of '24, we would expect that part of this inflation continues to come down. So our gross impact in '24 would trend lower and then our pricing would trend higher until, until effectively those two numbers offset.

Operator: Thank you. We now move to Stephen Valiquette of Barclays. Please go ahead.

Stephen Valiquette: Yeah, thanks. I also just want to congratulate Mike on a rewarding 30 plus years at Cardinal. And Jason, here's to you, hoping you'll have 30 plus years at Cardinal as well. That would put you in your late seventies, but I think you can do it (laughter).

Jason Hollar: I'm not sure the math works for me (laughter).

Stephen Valiquette: Just the 10% to 14% revenue growth and Pharma jumped out is pretty high. I guess I was curious for more color on the drivers of growth within that. That's for fiscal '23, obviously. Just want more color around the double digit top line within Pharma.

Jason Hollar: Well, yeah. Okay. Got it. I think there's a couple of key points. First of all, it's very consistent with what we've done this past year. And that was driven by a couple of key drivers. And I think you should think about the drivers as being similar, because one of those drivers we've referenced a few times is some net new business that we referenced came in beginning of the third quarter of '22. So that would be a little bit more of a front end loaded type of revenue benefit as we as we see fiscal '23. And then we've also been highlighting the strength in our large customers, large PD specialty, and we've seen some some really good volume in the brand category. And so, as you know, some of that larger customers and some of the brand volume doesn't always bring with it a tremendous amount of margin. But that's one of the reasons why you see very robust revenue growth, and still profit growth well within the range of what we've indicated for both our short and long term goals. But those are the biggest drivers.

Operator: Thank you. Next, we move to Ricky Goldwasser of Morgan Stanley. Please go ahead.

Ricky Goldwasser: Yeah. Hi. Good morning. And Mike, all my very best wishes. And Jason, congrats and good luck. So a couple of questions here. So just to get a sense – and Jason, thank you for clarifying the $150 million in gross headwind in the first quarter versus the $125 million. So as we think about, it seems like you're, in your guidance, right, you're assuming that the headwinds are going to get worse in the first quarter versus the run rate, the exit run rate. I just want to make sure that I'm thinking about this correctly. And then we'll slowly improve throughout the year. As we think about the mitigation, I think your numbers imply about $38 million, right, in mitigation from better pricing in the first quarter. When you're saying 50%, should we assume basically a double from that? So $75 million. I just want to kind of like understand the reference of that 50%. And then an additional question on the the Cardinal brand, because it seems that that's a really important part of sort of the longer term plan.

It seems that it's about 29% of revenue for the segment that comes from Cardinal Health brand. So one, how do you envision this revenue mix, what it will be by 2025? And then how should we think about sort of the the EBIT mix? It's 29% of revenue. What percentage of profits today? Thank you.

Jason Hollar: Okay. Okay. So starting with the pricing, I think you get fairly close, but let me clarify a few points. Yes. On – you got the math right for Q1, that would be pretty pretty close to how you should think about it. So, yes, the gross impact is increasing a little bit from the $125 in Q4 to the $150 in Q1. And that is – just make sure we connect all the dots. Yes, spot prices we see are starting to soften in a few areas. Not all areas, there are some going the opposite direction too. But generally speaking, there's some some benefit there which – but it's not impacting our P&L because it's got that two quarter lag. So when you think about when, the international freight specifically, it started reducing dramatically about two months ago, two or three months ago, there was a really big reduction. So you wouldn't expect that and it didn't reduce – there's been a consistent reduction over the last several weeks. So it's going to take some time for that to flow through. So certainly Q1 is not going to see any of that benefit. And that's why you see the gross impact still increasing, is because that's from five, six months ago as well. As you think about the exit, and you're trying to get the math on the pricing, does the pricing double from that $37, $38? Probably not, because what you're missing, I think, in your math is that that $150 should come down over the course of the year. We are anticipating it will come down, in part because of that international freight. So that will begin to come down and then pricing will continue to go up. But by the time we exit again, that exit rate would be around 50%, but lower than the $150 and higher than the $37, $38 from the first quarter. As it relates to the revenue mix, you know, that's hard to say. I'm not ready to answer that specifically. The one thing I'll highlight is, as we indicated $2.4 billion of revenue for at-Home is a meaningful number when you when you look at that. So it's a matter of are you doing calculations on the full segment or only on medical products and distribution? At $2.4 billion of revenue, it's been growing consistently at 10%. We expect it to continue growing robustly. And so that will, in a way, have a mix effect. So percentage of revenue in the total segment, that will be a bigger piece and medical product distribution will most likely be the smaller piece. So we'll need to do a bit more math before we can respond more clearly on that one.

Operator: Thank you. We now move to Eric Percher of Nephron Research. Please go ahead.

Mr. Percher, your line is open. We move to our next question. Charles Rhyee of Cowen. Please go ahead.

Charles Rhyee: Yeah, thanks for taking the question. And Mike, congratulations and best wishes with everything. And Jason, I look forward to working – continue working with you. You know, I want to just to maybe follow up, you know, Jason, you talked about, you know, really using the cash and deploying it. And obviously, you outlined an amount for share repurchase. You know, when you think about getting to this $650 million sort of target in medical operating profit, you know, can you talk about maybe sort of M&A and other kind of capabilities that you might want to add? I know that, you know, we spent the last few years actually divesting assets, but is part of that growth inorganic as well? And then secondly, you know, producer price index kind of fell below, you know, was below what people expected. When we think about the gross impact from inflationary pressures, are you starting to see some of that ease as well, given sort of this July report? Thanks.

Jason Hollar: So as – the short answer for the medical improvement plan is no. M&A is not a cornerstone of that plan. We will be looking to always augment, especially our growth businesses. So, when we talk about that second point, the accelerating our growth business is primarily at-Home Solutions, that is very much an organic investment story. We are investing in distribution capacity. That 10% growth does mean that we have some constraints and we need to invest in that to ensure that that business can continue to grow profitably. So that is not a cornerstone. In fact, I would say maybe a little bit of the opposite. A lot of what this plan is, is very focused on the core. It's very focused on, you know, we have just increased our CapEx guidance this year from where it's been in the past. That was hinted at and signaled last quarter where we talked about some of these capacity investments that, again, we feel are relatively low risk and a good return. So it's more of that type of investment that we're focused on and that we believe is a better balance of risk and return as we drive this plan forward. We won't ever ignore it. And it could be a pillar – sorry, it could be an enable, at some point later on. But it's not the focus and not necessary for what we're doing. As it relates to PPI, I think just one maybe – I kind of talk about a lot of the pieces, but one area that is often referenced as a key driver for a lot of our costs is just oil in general. That has come down. So PPI in general, I don't pay much attention to. I do look at the price of oil at least two or three times a day. It does have an impact on a lot of the input costs. And we talk about polypropylene, polyethylene, polystyrene. All these polys have some input costs, that are petroleum based, that does impact it. But the supply-demand dynamics are so wonky right now that it's hard to see a one for one transition of these input costs. And I think at some point that will come through. But we're really not seeing it that much. We are seeing lower diesel costs, so that's going in the right direction, that I would expect at some point we'll help with the transportation rates, but we're not necessarily seeing those elements. Where it is most striking is the international freight and that continues to be the one that is clearly running lower. But it's just going to take time for that to run through our P&L. But I wouldn't call that a inflation driven or input cost driven point. The cost of diesel fuel for our freight is small, it's the supply and demand dynamics that were all out of whack early on in the pandemic that appear to be getting a bit more in line. And that's why at this point, I believe that that cost will maybe not keep going down at the pace that it's going down, but it does feel like we're seeing more flat and down days for those costs than than up days. Everything else, we're going to have to get more data to build to provide additional input.

Operator: Thank you. We now move to Kevin Caliendo of UBS.

Kevin Caliendo: Hi. Thanks for taking my call. And again, congrats to both you, Mike and Jason. I guess my question is, going back to the medical segment, there's a lot of execution that needs to take place between now and 2025 to hit these these targets. Are you happy with the team in place? How do you enhance your probability of success here internally? Is it bringing in new people, more people, or do you feel the team in place can do it? And the second part of that question is, a lot of this is price increases, which you've talked about. How are you competitively positioned now when it comes to price? You talked earlier about losing some share in medical because of PPE capacity and availability earlier. How are you now positioned competitively when it comes to pricing? And are customers asking for any offsets anywhere else? I know you've talked about some guarantees and the like, but just want to understand the competitive positioning as well.

Jason Hollar: Yes, I am happy with the team in place. This is our plan. They've been working on this for quite some time. We have shared elements of it conceptually with our investors, with you all in the past.

What this is doing is putting a finer point on this plan and making it more visible, the commitments that we're making. We are leaning into some of the investments I mentioned before, especially on the CapEx. I do think that we need to continue to augment some of the capabilities. We have several very key new team members in that team that, when you think about a lot of the supply chain challenges that we're talking about over, especially this past year and even the last quarter, we have augmented that team significantly with terrific talent, industry relevant talent, but most importantly, products talent, talent that knows the supply chain, knows manufacturing, that was able to make an immediate impact in finalizing this plan and allowing us to take it over the line. So I would not be presenting it this way if I didn't have the confidence that we have the people behind it to actually execute it. The other thing I'll say about a plan like this is I absolutely understand the intent of your question because there's several things that need to happen here. And one thing I've learned in my two years here is that it's not what's on the piece of paper that ends up taking us sideways, it's the things that are unforeseen, like COVID and like inflation. And so with that said, that's why you see, after every single one of these actions, at least, 'or $60 million plus,' 'or $50 million plus,' it's because our internal plans are definitely more aggressive than this. And we know that there's going to be some unforeseen things that are going to make us exceed some of these items so that we can hit it. So, yes, a lot of execution, but we have the team and we have the plan in place and that's where we have to start.

As it relates to your question on competitiveness, I think I'd like to answer that maybe a little bit more broadly, because let's just talk about inflation. As long as we have a cost competitive sourcing, manufacturing footprint, then inflation that we incur absolutely needs to be pushed down to the final customer. By its nature, inflation in most industries and most periods of time don't get absorbed in the supply chain. There's not – especially in distribution. There's not the margin to to absorb inflation. And so when that higher cost lifts the industry's costs over longer periods of time, we would expect that to flow, generally speaking. But how you get there is a very choppy type of process. That's why this is taking two, three years. It's also certainly because of the contracting nature where a lot of this is rolling over into more permanent contracts in addition to the shorter term actions. So there's nothing about industry dynamics, there's nothing about our competitiveness, that indicates that we should be losing margin here. We have to be versatile and move our supply chain if we're uncompetitive in a particular area. But if we're competitive from a cost perspective, there's no reason we shouldn't go back to historical margins.

Operator: Thank you. We now take our last question today from Eric Percher of Nephron Research. Please go ahead.

Eric Percher: Thank you. Am I coming through this time?

Jason Hollar: Yes.

Eric Percher: Perfect. So, Jason, as you take on the new role, I think a couple of questions came down to what you will do different. And what I heard during the call was you've had a desire to be more aggressive on returning capital to shareholders and, opioid settlement behind you, strong balance sheet, we're going to see that. I heard the focus on cost management. I want to ask if there are other elements that you think are important for us to understand. And then I want to also ask pointedly, will you reassess the portfolio and consider whether Medical and Pharmacy – Pharma – need to be together long term?

Jason Hollar: Yeah. So let me let me start – whenever I step into any project, let alone a role, it is always about defining where's the best opportunity to create value. Where is the opportunities? Where the challenge is? And what is clear to me is that until we can get better evidence of the progress on our medical business, we're going to be challenged. And so that is why I'm so focused on this medical improvement plan. Why we've provided such clarity on it, is that it is absolutely one of, if not my greatest focus, especially in the near term. And when you think about any type of process to fix anything, it has to be first and foremost defining what the challenge is. And I do want to step back for a moment. The – when you think about the challenges of Medical, I know there's been a lot of adjustments, I know there's been a lot of noise. But when you think about the vast majority of the issues, they do stem from one very common theme. It is related to the supply chain. Now I can start and highlight all the external influences with that and blame things that have happened to us, and then it's very, very true, but when you think about where we were pre-COVID, this type of business, this type of industry was extremely stable. Our volume was predictable, especially in areas like PPE, to think about going up 5, 10 x in terms of demand overnight and then not having a supply chain that could adjust with that, it really impacted our ability to execute in that environment and our diverse, low cost global footprint. What went from a strength to a challenge pretty much overnight. So now we've learned from that. That's what this plan is talking about. It's building in resiliency and capacity into our system so we can be a lot more flexible. We can de-risk the model, while also growing profitable categories. So this is very much a cornerstone of what needs to be the focus. But it's not just cost, it's simplification to reduce cost. It's also about driving the right volume, driving organic volume, driving high margin volume and simplifying everything about how we operate so that we can be more nimble and we can de-risk. And then again, within both segments, there is an absolute need to continue to grow our growth businesses. What you heard me say today was more of an emphasis on specialty and on at-Home. Of course, we love all of our growth businesses, but what I'm really indicating here is for for us to achieve that $650 million, what we need are those two businesses to continue to grow the top line and to have a good flow through on that incremental volume that comes with it. And with that, then we have high confidence that we'll be able to get the pieces of growth for both segments necessary to hit their longer term objectives. So that is very much a growth based story, but it's about, again, prioritization and being really, really focused on the core of both businesses so that these two growth businesses can can build from there. In terms of the portfolio, – hey, – it's something that I believe in continually evaluating our portfolio for all of our businesses, and the company has demonstrated this in the past. You know about China, naviHealth, and more recently, Cordis. We've monetized several billion dollars over the last several years through those activities and was responsible with the capital deployment thereafter. I'm not going to attempt to define what the appropriate long term course of action is for this business, for the Medical business, but under all scenarios, what's really, really clear to me is that the near-term actions need to be very focused on this improvement plan, and then that will set us up for the best actions thereafter.

Operator: Thank you. I would now like to turn the call back over to Mr. Mike Kaufmann for any additional or closing remarks.

Mike Kaufmann: Thank you. Before Jason ends the call, I would like to say that I appreciate all of your congratulations and comments and enjoyed working with all of you. I look forward to a smooth transition with Jason and I have complete confidence in his leadership. Jason, to you.

Jason Hollar: Yeah, thanks Mike. I want to thank everybody for taking the time to be on the call today and for all your questions. In addition to the leadership succession, I acknowledge we threw a lot out at you today – including new disclosures, various puts and takes, and examples of incremental actions we are taking. We did all of this in an effort to provide additional visibility as we are confident and excited about these opportunities to drive growth. But there are three takeaways that I want you to have:

First, we are committed to improving our results, as demonstrated by the introduction of our Medical Improvement Plan.

Second, we continue to be encouraged by the resiliency of our Pharma segment, which continues to meet both our sthort and long-term objectives.

And third, that we continue to take actions that are in our shareholders' best interest.

With that, thank you and have a great day.

Operator: Thank you, ladies and gentlemen. That will conclude today's conference call. Thank you for your participation. You may now disconnect.