# Q1 FY23 Cardinal Health, Inc. Earnings Conference Call

**November 4, 2022, 8:30AM Eastern**

Operator: Good day and welcome to first quarter Fiscal Year 2023 Cardinal Health Earnings Conference Call. Today's call is being recorded. I will now hand the call over to Kevin Moran, Vice President of Investor Relations. Please go ahead, sir.

Kevin Moran: Good morning. And welcome. Today we will discuss Cardinal Health's First-Quarter Fiscal 2023 results along with updates to our full year outlook. You can find today's press release and earnings presentation on the IR section of our website at ir.cardinalhealth.com. Joining me today are Jason Hollar, Chief Executive Officer, and Trish English, Interim Chief Financial Officer.

During the call we will be making forward-looking statements. The matters addressed in the statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected or implied. Please refer to our SEC filings and the forward-looking statement slide at the beginning of our presentation for a 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 please ask that you try and limit yourself to one question, so that we can try and give everyone in the queue an opportunity. With that, I will now turn the call over the Jason.

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

Now that I've had a couple months to settle into the CEO role, I am feeling even more energized and excited about the opportunities in front of us.

My recent conversations with customers, suppliers, employees, and shareholders have reinforced my perceptions that: Our company's role in healthcare and our mission to improve the lives of people every day remain as critical as ever. Our customers and their patients rely on us to deliver the right products, to the right places, at the right time. And yet, there's also a collective recognition of the need for simplification, focused execution, and clarification of our company's strategic direction.

Our goal today, along with reviewing our recent results, is to summarize the key near-term priorities and progress to-date on our plans, which I will discuss later in my remarks. However, before I turn it over to Trish, let me share some initial perspective on the first quarter.

Overall, our performance in the first-quarter demonstrated continued stable fundamentals in our largest business, and tangible progress in Medical.

In Pharma, we tracked slightly ahead of our expectations, as we delivered growth while managing industry-wide inflationary headwinds. We are encouraged by the ongoing stability in prescription volumes and strong performance of our generics program.

In Medical, the quarter's results were also a little better than expectations we announced in September. While I am pleased with our team's efforts in the quarter to achieve these results, there is more work to be done to drive better, more predictable financial performance in-line with the underlying potential of this business. We are highly-focused on executing our Medical Improvement Plan initiatives, which I will cover in greater detail later in my remarks.

Across the company, our team is operating with urgency to drive our businesses forward and committed to creating value for our shareholders.

Now, I'll turn it over to Trish to dive deeper into our results and outlook.

Trish English: Thanks Jason, and good morning everyone. It's great to speak with you all.

Today I'll share details on three areas of focus – our consolidated first quarter results, the key drivers underlying our segments' performance, and our updated fiscal '23 outlook before turning it back to Jason for final remarks.

First quarter total company revenue increased 13%, driven by Pharma segment sales growth.

Gross margin decreased 2% to $1.6 billion due to net inflationary impacts in Medical and one month's impact of the Cordis divestiture, partially offset by our Pharma generics program performance.

Consolidated SG&A increased 7%, reflecting inflationary supply chain costs and other operating expenses such as higher costs to support Pharma sales growth. This increase was partially offset by the Cordis divestiture and benefits from enterprise-wide cost savings initiatives.

Operating earnings decreased 20% to $423 million, reflecting the decline in Medical segment profit, primarily due to net inflationary impacts, and partially offset by growth in Pharma segment profit.

Now, moving below the line, Interest and Other decreased 25% to $27 million dollars, primarily driven by increased interest income from cash and equivalents. As a reminder, our debt is largely fixed rate, resulting in a net benefit from rising interest rates.

Our first quarter Effective Tax Rate finished at 16.9%, approximately 7 percentage points lower than prior year due to certain favorable discrete items.

Diluted weighted average shares were $273 million, 6% lower than a year ago due to share repurchases. We are focused on balanced, disciplined, and shareholder-friendly capital deployment and in mid-September, we initiated a $1 billion dollar Accelerated Share Repurchase program that we expect to complete in the second quarter.

The net result for the quarter was Earnings Per Share of $1.20.

Now, turning to the balance sheet.

We generated first quarter operating cash flow of approximately $25 million dollars. This includes total litigation payments of approximately $390 million dollars, primarily consisting of the second payment under the national opioid settlement. Adjusted free cash flow in our first quarter was $342 million dollars.

We ended the period with a cash position of $3.5 billion dollars, with no outstanding borrowings on our credit facilities.

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

First-quarter revenue increased 15% to $46 billion dollars, driven by branded Pharmaceutical sales growth from existing and net new Pharmaceutical Distribution and Specialty customers.

Pharma segment profit increased 6% to $431 million dollars, driven by generics program performance and a higher contribution from brand and specialty products, partially offset by inflationary supply chain costs.

During the quarter, we were pleased to see strong execution and continued consistent market dynamics in our generics program, including Red Oak.

As we've previously noted, inflation continues to impact supply chain costs across the industry, particularly within transportation and labor. We saw an approximate $20 million dollar year-over-year headwind from these areas, which was consistent with our expectations. This headwind was effectively offset by year-over-year tailwinds from our completed ERP technology enhancements and lower opioid-related legal costs.

Okay, turning to Medical on slide 6…

First-quarter revenue decreased 9% to $3.8 billion dollars driven by lower Products and Distribution sales, primarily due to PPE pricing and volumes, and to a lesser extent the Cordis divestiture. Continued strong growth in our at-Home Solutions business offset some of this revenue decline.

Medical segment loss of $8 million dollars was due to net inflationary impacts in Products and Distribution as well as a lower contribution from PPE, both of which I will discuss in more detail.

Importantly, these results reflect approximately $20 million dollars in total inventory charges related to our previously-announced simplification actions. This includes the sale of our gloves portfolio that is primarily utilized in non-healthcare industries.

As a reminder, this non-core product line has been a source of volatility and distraction in recent years. These actions, despite the one-time costs, are an example of our ongoing commitment to strengthening the Medical Products and Distribution business through simplification.

During the quarter, the gross impact from incremental inflation in our Products and Distribution business was in line with our expectations, of approximately $150 million dollars, and we successfully achieved our inflation mitigation target of 25%. Our mitigation efforts have continued to accelerate, most notably with the implementation of the second wave of product pricing actions in July. Jason will elaborate on our plans for further mitigation shortly.

Now, a quick update on the overall utilization environment. We've previously noted some overall volume softness in our Products and Distribution business, including a lower demand for PPE, which we believe primarily reflects customers' higher inventory levels. In the first quarter, we saw generally consistent overall Products and Distribution volumes sequentially, including with PPE. While we do anticipate gradual improvement in volumes relative to these recent lows, we continue to expect choppiness in demand levels going forward.

Now, for our fiscal '23 outlook, beginning on slide 8…

We are reiterating our EPS guidance of $5.05 dollars to $5.40 dollars. This includes our updated Medical Segment outlook, which has been adjusted for the impact of simplification actions in the first quarter, and a few below-the-line improvements. Based on the first quarter performance, we are confident in lowering the top end of the ranges for Interest and Other, our Effective Tax Rate, and diluted weighted average shares for the fiscal year. We now expect I&O in the range of $140 to $160 million dollars, an ETR between 23% and 24%, and diluted shares between $262 to $264 million.

Our expectations for the remaining items listed on slide 8 remain unchanged.

We are also reiterating our fiscal '23 outlook for the Pharma segment, seen on slide 9. We continue to expect revenue growth in the range of 10% to 14% and segment profit growth in the range of 2% to 5%.

Before transitioning to Medical, two key call-outs on the Pharma cadence:

First, with a stronger start to the year, we now expect more balanced year-over-year profit growth between the first and second halves of fiscal '23. And, specifically for the second quarter, we expect segment profit dollars to be similar to the first quarter.

Turning to Medical, we expect segment profit ranging from flat to a decline of 20%, which as I indicated, reflects the impact of the simplification actions in the first quarter.

With respect to inflation and our mitigation actions, there is no change to our expectation of a net impact of approximately $300 million in fiscal '23, or a minimal year-over-year impact. The macro-economic environment remains dynamic, and while we've seen some decreases in spot rates of certain cost drivers such as international freight, other areas, such as commodity costs, remain

significantly elevated. As a reminder, these product costs are capitalized into inventory, and in the current environment of elongated supply chains, reflected in our P&L results on an approximate two-quarter delay. While we now expect gross inflation in the second quarter to be similar to what was seen in Q1, we are implementing additional actions and working proactively to mitigate these pressures. It's important to note that we continue to expect that as we exit the year, the run rate of our mitigation actions will offset at least 50% of the gross impact from inflation.

On Medical's quarterly cadence…

In Q2 we expect similar segment profit dollars as the first quarter, excluding the impact of the first-quarter simplification actions. As we have noted before, we continue to expect the substantial majority of segment profit to come in the second half of fiscal '23, and particularly in the fourth quarter. This sequencing primarily reflects our assumptions around inflation, inflation mitigation, and PPE.

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

Jason Hollar: Thanks Trish.

I concluded our August earnings call with 3 key takeaways that I'd like to provide updates on.

Number one: Improving the underlying performance of the Medical segment through our Medical Improvement Plan initiatives.

The key driver to achieving our segment profit target of at least $650 million by fiscal '25 is our mitigation actions for inflation and global supply chain constraints. Though elevated inflation has persisted in the macro environment for longer than expected, we are on track to exit fiscal '23 offsetting at least 50% of the gross impact on our business. As I've previously mentioned, we plan to fully address the impact of inflation and global supply chain constraints through mitigation initiatives by the time we exit fiscal '24.

Our third wave of price increases went into effect on October 1st, and we are planning additional actions for the third quarter. To date, we have adjusted product categories representing nearly 90% of US Cardinal Health Brand sales, excluding PPE. Additionally, we've successfully adjusted language in product contracts as they've renewed to allow for greater pricing flexibility to respond to macro-economic dynamics. We've also executed distribution fee increases to offset higher transportation, labor and fuel costs, and continue to explore other opportunities for further offsets with urgency.

Outside of our mitigation actions, we expect the largest contributor to our growth to be our ability to optimize and grow our $4.6 billion Cardinal Health Brand portfolio. This will be achieved through new product innovation and increased product availability as a result of targeted investments.

Additionally, I am confident in our ability to optimize our cost structure and our sourcing and manufacturing footprints as we focus on driving simplification across the Medical organization. The team is energized by the goals we have laid out in the Medical Improvement Plan and has already hit the ground running on execution.

Moving to item number two: For the Pharma business, continuing to build upon the growth and the resiliency that we've seen by executing in the core and accelerating our growth areas, primarily Specialty.

Similarly, continuing on talent and leadership, we are excited by the appointment of Debbie Weitzman to CEO of the Pharma segment. Debbie has a deep understanding of our industry landscape, longstanding and strong relationships with our customers, and a proven track record as a commercial and operations leader across her 17 years at Cardinal Health.

Debbie's appointment was part of a recently announced segment restructuring designed to reduce complexity, drive productivity and efficiency gains, and simplify how our customers and our manufacturing partners do business with us. These changes are intended to maximize the strength of our Pharmaceutical Distribution and Specialty businesses, bringing together similar services under one team, enabling us to respond faster and more effectively to changes in the healthcare landscape while keeping the customer at the center of everything we do. Simply, it is allowing us to reposition with both the right talent and organizational design.

In Specialty, we have a robust service offering both downstream with providers and upstream with bioPharma manufacturers, and we continue to build upon our capabilities. In the area of Oncology, we've expanded our best-in-class offering for value-based care, NavistaTs, which will continue to serve as a vital resource for oncologists transitioning to the new CMS Enhancing Oncology Model. In Rheumatology, we've closed on our recent tuck-in acquisition of the Bendcare GPO and our investment in their managed services organization has expanded our capabilities in the space and contributed to new customer growth. In just 30 days, this cross-functional leadership team worked diligently to onboard over 250 healthcare providers onto our distribution and logistics platforms.

With biosimilars, we remain well-positioned to distribute and provide the surrounding services as they come to market, particularly in the new therapeutic areas and sites of care. We continue to expect increased contributions from biosimilars in fiscal '23 and beyond.

Upstream in Specialty, our third-party logistics business continues its strong growth, with more than double the launches in the first quarter compared to a year ago, as well as double-digit new contract wins. And, our continued investment towards the digital transformation of our Sonexus access and patient support business has enabled us to realize benefits from new business wins and expansion of existing clients.

And finally, number three: A relentless focus on shareholder value creation. This includes maximizing sustainable, profitable growth and cash flow generation, as well as our return of capital to shareholders.

We continue to expect strong and resilient cash flow generation, supporting our capital allocation priorities. We are prioritizing organic growth, deploying capex to the highest value projects. We've made tremendous progress on reducing our long-term debt, which has created additional flexibility for shareholder return. We were pleased to initiate the $1 billion Accelerated Share Repurchase program

in the first quarter and continue to expect $1.5 to $2 billion in total share repurchases in fiscal ‘23, in addition to our ongoing dividend of over $500 million annually.

Beyond these actions, we also announced enhancements to our governance structure, including four new independent Board members, and a new Business Review Committee tasked with supporting a comprehensive review of our company’s strategy, portfolio, capital allocation framework, and operations. Our Business Review Committee, which I chair, has already held multiple meetings and is working through the detailed review covering every business. We expect to share conclusions publicly at an Investor Day in the first half of calendar 2023.

In closing, I recognize there is still a lot to accomplish, yet I remain excited about these opportunities to drive growth. I believe that our resilient business models, robust operating cash flow generation, favorable capital structure, and capital allocation flexibility differentiate us in this time of macro-economic uncertainty, and I am confident in our future.

Before we open it up to Q&A, I do want to spend a moment thanking our dedicated team around the globe. I’ve had a number of opportunities to connect with them across the last couple months, and it’s truly a privilege to lead every day. They are driving the execution of the initiatives that we’ve discussed today to deliver for our shareholders, for our customers and for their patients, and we are very much looking forward to the opportunities that remain ahead.

With that, we will take your questions.

Operator: Thank you. Ladies and gentlemen, if you would like to ask a question, please press star one on your telephone keypad. We will take the first question from Elizabeth Anderson with Evercore.

Elizabeth Anderson: Hi, guys. Thanks so much for the question. I was just wondering if you could talk a little bit about the sort of embedded expectations in the back half of the year. You obviously, it's the first quarter and you had some nice outperformance and hitting some early milestones on key initiatives. But in terms of how we think about that outperformance versus sort of how you still see the progression in terms of the quarterly ramp in the back half, more color on that would be very helpful. Thanks.

Jason Hollar: Sure. Is your question, Elizabeth, specific to any particular business or you just talking generally.

Elizabeth Anderson: Specifically in terms of Medical, but I would also be curious on the Pharma side as well.

Jason Hollar: Okay. Yeah, for Medical specifically, it's - the biggest driver by far will be the mitigation actions to address inflation. That's as we talked our first pricing actions went in place March 1st of fiscal ‘22. And then we had another wave in July of fiscal - the very beginning of fiscal ’23, and then another price adjustment that occurred October 1st. We do expect further price adjustments in the third quarter of the fiscal year. And then at the same time, we would expect, especially in the fourth quarter of fiscal ‘23 to start to see some of the lower costs, especially with the international freight piece finally starting to hit our P&L.

As Trish highlighted in her comments, the supply chain remains very elongated. And so we would anticipate it's going to take, again, at least a couple of quarters before lower costs actually come through the P&L. But as we indicated in our comments, the international freight is really the only area of any significance that we're seeing cost reductions at this point. We do see some of the other commodities coming down, but not to the same extent.

The other key components from a first half, second half perspective for Medical is just the normalisation of PPE. We talked about the higher cost PPE being on our balance sheet. When volumes fell quite a bit at the latter part of fiscal ‘22, that meant that higher costs stayed in our balance sheet longer. And while we're pleased to see that - feels like we've come off the lows here from the fourth quarter in terms of demand, it remains still something that will take a few quarters to work through. And then beyond that, really for all of our businesses, it's just normal cost reduction and other growth initiatives over the course of the year just build up.

Within Pharma, the specific item to remember from a first half, second half, specifically the third quarter is always just the recognition of the brand inflation. While that continues to be a small portion of our overall brand margin, less than 5%, it does remain highly concentrated in the third quarter and that's the biggest driver for that particular business. The next question, please.

Operator: We will now take the next question from Lisa Gill with JP Morgan.

Lisa Gill: Thanks very much, Jason. I wanted to spend a couple of minutes on the Pharmaceutical distribution side of your business. So a few things. One, one of the things that really stuck out to me is you talked about strong performance in your generic program and having enhancing programs going forward. I kind of think of where we need to be in generics. So maybe can you talk about what you're seeing in the market and incremental opportunities? And then secondly, when I look at the revenue on Pharmaceutical distribution, you're coming in well above where the industry is. Can you maybe just talk about where you see that over time? And again, even your guidance is above where industry rates are. What's the key drivers there?

Jason Hollar: Let me start with the revenue point. So revenue for this particular quarter we highlighted was driven by brand products as our - with our larger customers. So when you think about the flow through of that, that typically brings with it a lower margin profile. But brand has been very strong and our larger customers have been an overweight of that. So we're kind of winning with the winners. We are - our bigger customers have been growing nicely and that has been driving our revenue quite a bit higher, but that tends to be the lower margin product. And so that's why you don't see quite the same flow through in terms of margin dollars. That's fairly consistent to what we've seen for quite some time.

We also highlighted in the third quarter of fiscal ‘22 some new business wins that did benefit our revenue as well. And with that it means that the first half of fiscal ‘23, we would anticipate our revenue having a little bit of a tailwind relative to the full year because we will then anniversary lap that new business win come the third quarter of fiscal ‘23.

And so your first question - oh, I'm sorry. The first question on generic. Yeah. So it continues to be a very consistent dynamics in the marketplace. You know, some of the new business wins have benefited that as well. You know, we continue to have very strong performance within Red Oak sourcing and the underlying utilisation continues to be much more consistent and stable and predictable than what we've seen ever since the beginning of the pandemic. So it feels a little bit more as business as usual and less fluctuations. And then underlying that, driving margin through sourcing and driving the new business through our system. So those are the primary drivers. Next question, please.

Operator: The next question comes from Kevin Caliendo with UBS.

Kevin Caliendo: Great. Thanks for taking my question. I wanted to talk a little bit about the contracting. I think the last time Cardinal went through a lot of contracting through COVID, it ended up kind of working against you as things reverse. So I just want to understand more about how you're amending these contracts. Are customers comfortable with this? Is there any pushback? There seemingly is efforts amongst almost all hospital companies to reduce their supply costs right now or reduce costs in general? So just wondering how it works. Does it - is it impacting you immediately or is this more of a cushion for longer-term? Anything there would be helpful. And then one other follow-up is I read that there was a real estate transaction done and if that was part of the business review potential outcomes was to maybe monetise some real estate. Can you talk about the opportunity size to be able to do that in terms of generating capital for the business?

Jason Hollar: Sure. So on the contracting, first of all, Kevin, I'm presuming you're talking about the Medical inflationary price impacts?

Kevin Caliendo: Yeah.

Jason Hollar: Yeah, okay. So the way the pricing that we've defined, those are temporary in nature to get us to the contracting that you're talking about. So as the contracts renew, those temporary price increases are then flowed through to the permanent structure with - then having adjustments within there so that we don't have the same issue again in the future that we've had to experience here. So as you can imagine, those contracts roll over, over the course of multiple years. We've highlighted three to four years and we're still in the earlier phases of innings with that. However, I'll tell you, it's going consistent with my expectations. These are never easy conversations. But to your point and how you even frame the question, inflation is everywhere. And while some of this is more temporary in nature, a lot of it is going to be long lasting and permanent. You know, when you think about especially labor, right, those costs are never going to come down. And a lot of the transportation costs feel like it's going to be at very elevated levels for quite some time. So there's some components that will be more variable. But ultimately, the one thing that's clear to us is that there will be a permanent step-up increase in that level of cost. And depending upon exactly how the Fed moves here and how macroeconomic factors roll into this, we need to be positioned so that we have a structure that allows us to claw this back by the time we exit fiscal ‘24. So again, not easy, but it's a process that our customers understand that we're in the middle of this supply chain and that we have to have the assistance bill to offset these costs. And you can just look at our public financial

statements to understand that we're not making anything in addition on this. We are still funding this gap, and that's why we have this urgency on this issue and why it's our highest priority as a business.

As it relates to the real estate transaction, we've had some small transactions. There's nothing material at all to call out. You know, there's always evaluation. We do own some real estate. It is a component of one of those factors that we look at. At this point, it's too early to talk about any type of opportunity with that. Next question, please.

Operator: The next question comes from Erin Wright with Morgan Stanley.

Erin Wright: Great, thanks. And can you speak a little bit to the long-term strategy and what's feasible in terms of your opportunity to improve mix and increase your exposure to specialty over time? And as we think about kind of specialty, can you also speak to the biosimilar opportunity and your near-term positioning to participate with like Humira biosimilars as well as others? Thanks.

Jason Hollar: Yeah. Well, first and foremost, absolutely appreciate and understand the question. This is a key reason for our recent reorganisation within the Pharma segment. We have structured the team to have specialty in PD all together, reducing the complexity, driving not just productivity, but more importantly, simplifying how we go to market with both our customers as well as the manufacturing partners. So this is all to recognise the importance of driving that favorable mix. The market is going to in part be a rising tide, but we definitely want to do as much as possible to participate in as much of that growth as there is. We did just recently acquire Bendcare. That gives us an additional exposure here. We have invested organically in all the different businesses and tools that I referenced in my script. So we're investing both inorganically as well as organically and have now a structure and a leadership team that's intensely focused on this. So we feel like we're really well positioned to be able to take advantage of that into the future.

On biosimilars, that is absolutely a component of this as well. You know, the same point, we've invested into our capabilities and our team. We participate in that today. It is a nice driver for our business, not large enough that we have called it out specifically but nonetheless, it is an area that as we continue to see evolution of the sites of care and the therapeutic areas, then we would anticipate that to be further opportunities for us and it fits nicely into our capabilities.

I know we get a lot of questions specifically about Humira and how that is going to benefit us. You know, there's a lot to be still played out here in terms of how all participants drive the different processes for this, specifically, the payers and PBMs, how they go to market and work with the market to implement these evolutions. So a lot to be learned there. But the point is we are positioned very well to be able to take advantage of that. But there's some level of uncertainty, but we do have confidence it will be a tailwind for us going forward as it has been in the last few years as well. Next question, please.

Operator: Our next question comes from Michael Cherny from Bank of America.

Michael Cherny: Good morning. I have one kind of just technical question and then a bit more on the numbers. So just first on the ASR, you said you launched it in mid-September. Is there any way to

quantify how much of the ASR you completed in 1Q relative to the timing of the 2Q finish? And then on the guidance, and I hear you on especially the trajectory of Medical per Elizabeth's question earlier, but if you think about the moving pieces and what you updated today, it seems like there's more tailwinds when it comes to tax interest expense and share count than there are headwinds on the Medical guide down. Any thought about why reiterating the guide versus not maybe bringing up the low end at a minimum?

Jason Hollar: Sure. As it relates to the ASR, the - your technical question, yeah, about 80% is what you would expect for the immediate benefit. And like you appropriately referenced, it was implemented in mid-September. So a relatively small impact to the current quarter. As it relates to the guidance changes, well, hey, it's the first quarter, it's certainly early. It's we're also talking about still a fairly uncertain macroeconomic environment. We're also talking about a lot of news out there that we're always looking at in addition to our own data in terms of utilization. So as our comment highlighted, we did not see a lot of surprises as it relates to utilization in either of our businesses, either our segments this particular quarter. And that was certainly welcomed given what the last couple of years have looked like. But nonetheless, we continue to see more data points on that through a lot of external references. And that's something that we continue to look at. But mathematically, I don't think there's that much difference in terms of the offsets that we took both the take down with Medical driven in part by that simplification efforts. But then also those other items where we took the top end down, it's still a reasonable range considering how early it is in the year as well as the drivers that are all around us. Next question, please.

Operator: Our next question comes from Eric Percher with Nephron Research.

Eric Percher: Thank you, I'd like to return to Medical. And relative to the offsets that you're attempting to achieve in '23, it sounds like we have three factors, the pricing efforts letting some of the supply chain and cost flow through normalise and then access to private label. Could you speak to what portion of the offset for fiscal year ‘23 falls into those buckets, and if you think those are the right buckets? And then as you move to '24, how does that change in terms of how much is driven by each of those factors?

Jason Hollar: So to make sure I understand the question, so we have our gross inflationary impacts and then we have the mitigation actions that get us to the net. You're specifically asking about the mitigation actions and how to think about what's driving those both for '23 and '24?

Eric Percher: Exactly. What are the most material factors of the mitigating actions and how do they change '24 versus '23?

Jason Hollar: Yeah, by far it's pricing. That is there's opportunity. And of course what we want to do is work with our customers as much as possible to reduce what is necessary to flow through in terms of pricing. But the amount that can be moved on those items as well as others is relatively small. So pricing will be the predominant element there. The other component is just the costs coming down naturally as well. So we have two things happening between now and the end of the fiscal year. Pricing will continue to go up period to period, quarter to quarter, and our costs will at some point here peak, which we're pretty close to that. We believe we indicated similar gross costs in Q1 is what we

expect in Q2, and especially into Q4 with the international freight piece. That's the one area that we have some confidence is going to come down. And so I know your question is specifically on the mitigation items, but the gross will come down, is expected to come down right now specifically because of the international freight. The other components to inflation and other commodities, especially, we are seeing them come down a little bit in some areas, but not very significantly and certainly, at a pace less than what we had thought. And then a handful of them are actually going up. But overall, I would expect to exit the year with a little bit lower cost run rate than what we have coming into the year. Next question.

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

George Hill: Yeah. Good morning, guys, and thanks for taking the question. Jason, I'm going to come back to the Med segment again. I was just wondering if there's kind of a way to quantify like what part of the book has the new contracting terms in place. And I don't know if you can talk about kind of actions taken by peers and then kind of - I'd kind of roll that into kind of timing of implementation. Like, you kind of talked about the two quarter lag between - not really the lag, but like kind of the timing of the supply chain in that segment of the books. I'm just trying to think about how long it takes the entire book to get re-contracted to the new terms and kind of what is the end date by which we should expect the full Med surge book to kind of be operating under the new model.

Jason Hollar: Well, it's going to take at least a few more years to get to the essence of where you're going with that, to get the full book there. But it will be relatively consistent between now and then. So every - remember, these are not necessarily massive cliff event contracts or products. We've got a couple dozen different product lines and they have different dates with different GPOs and different customers. So, it's a fairly consistent stair stepping towards that. It's not like one big cliff event. So, you can think about it as every day we have to work on this and every day it's incredibly important that we roll over the temporary prices into permanent prices, given the permanent nature of so much of this cost.

So we are considering different ways to give you a little bit more insight to that. I'm not going to go into that further yet, other than to say we are having the success as expected with this. We feel it's the right thing and we feel very good about this plan and there's still a lot of work we need to focus on. But it's the right plan, it's the right thing to do. And we have not been surprised with this at this stage of the year and at this stage of the plan. Next question, please.

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

A.J. Rice: Hi, everybody. I might just ask. Obviously, you've got a lot of things going on and seemingly having some success with your simplification and mitigation strategies. Now you have this business review committee or the guard - and that's, I know, still early in getting up and running and going. Are the guardrails as to the things you're already doing to improve performance versus what the Business Review Committee is doing pretty clear? And did I hear you right in the prepared remarks that you think a review committee will have an update at the calendar ‘23 Investor Day? I assume that would be preliminary if there's anything you shared then.

Jason Hollar: Sure. So, yeah, there's a charter for the Business Review committee. It's very consistent to what I provided my comments. Of course, there's a portfolio element, there's a strategy and operations element. And you know, importantly, there's a capital allocation framework. As we communicated before, we had these types of evaluations and communication with our board prior. We now have new board members. Of course, we have the Business Review Committee as well. So it's a bit more of a formalised process. We are taking full advantage of the insight and experience that all of those board members are bringing to the discussion. And the Business Review Committee acts as any other board committee where we work and provide insights and advice to the broad board and make it a bit more of a formal process. But the guardrails are, as I just described there, and there's very clear what we work on. As I chair it and I lead the agenda, I've of course, also listened to the committee as to what they believe are the key areas of opportunity, and it's very collaborative and constructive. So from my perspective, we're getting good insights. I think that all of our board members, but the committee specifically is doing the best we can to think through the lens of the investor, and make sure that we're driving the business, we're evaluating the portfolio. And of course, we're in a fairly uncertain time, both operationally and from a macro-economic perspective. So we have that that filter as well that comes through our work that we evaluate. But nonetheless, we - as I commented already, we are meeting frequently, we are meeting with urgency and we're very focused on this.

As it relates to the readout. Yes, you heard that right. The calendar ‘23 - by the first half of calendar ‘23, we will have that Investor Day. And we'll have an update as to what is potential to update at that point in time. And I see this as a journey and not necessarily just a sprint, but we are working with urgency to have as much completed by then as possible. Next question, please.

Operator: Our next question comes from Charles Rhyee with Cowen.

Charles Rhyee: Yeah, thanks for taking the questions. Just two really here. Just to follow up, on the Medical guide - and I might have missed it, but obviously, you've changed that. Was there - has there been any change in your assumptions in the macro-environment between July and now? That's - is it really macro-driven is how, in fact, because it seems like you have control over the pricing part of things. Is it just waiting for the environment itself and some of the natural inflations that's floating around here to come in line to get to your targets? And then secondly, there's been news a lot about a shortages in amoxicillin. Just any of your thoughts here on drug shortages elsewhere possibly in the supply chain? Any thoughts on the outlook there? Thanks.

Jason Hollar: Sure. Yeah. In terms of Medical, it's - the underlying performance that we are anticipating for the business is really unchanged. The key item we highlighted is the simplification cost that has been wrapped into this. But the underlying business volume utilization, other performance elements are relatively unchanged, there is always puts and takes. Not a lot of new news there for really either business. In both businesses, we had a few non-recurring items, a little bit of timing in Medical, but overall, not too many surprises there. As it relates to any type of product shortages, there's always some of that in any of our business. There's a few items that are being chased within the Pharma segment. Nothing that I would call very unusual and certainly nothing at this stage that I would anticipate being a significant impact or really any noticeable impact for the segment for the current quarter or the fiscal year. But that's why we believe that, obviously just

sourcing in general is an incredibly important function specifically to generics. It's - the Red Oak sourcing is a huge driver for not just cost control, but for delivery. And certainly there's been some strong demand for some of those products like amoxicillin that you just referenced for respiratory challenges that we're seeing some drive for in the marketplace. But again, it's something that we don't think will be either lasting or any type of impact for us. Next question, please.

Operator: And our last question comes from Steven Valiquette with Barclays.

Steven Valiquette: Great, thanks. Good morning. So you guys touched on this topic a little bit, but this quarter, we saw your largest publicly-traded hospital distribution and self-manufacturing Med surge competitor really struggle with delayed product reorders by their acute care hospital customers who chose to deplete the stockpiled items. I know you have a different set of SKUs versus that competitor for the self-manufacture component, but can you just confirm that you generally are able to successfully track the level of inventory sitting within your health system customers in the Medical segment? And that Cardinal will hopefully not see a similar inventory destocking trend within the health system customer base that could be a risk factor for the recovery as the fiscal year progresses. Thanks.

Jason Hollar: Yeah, so those types of comments are very consistent with what we've been saying in the last couple of quarters. So we have seen destocking of our customers' inventory. We are very close with them and have that dialogue all the time. And that is what we have been seeing. We referenced in our comments that our volume specifically to PPE, but even more broadly is fairly consistent sequentially from Q4 of last year to Q1 of this year. So we're not seeing significant changes in the pull. But we did call this out last quarter, because there was a fairly significant reduction we saw sequentially at the latter end of fiscal ‘22. So the concept we absolutely have referenced ourselves and have seen, but we have seen pretty consistent demand patterns here this last quarter, and while it's still very early in Q2, I can say that we haven't seen anything significantly different so far at the beginning of this quarter as well. But there's really nothing else to add at this point.

So I think that's the final question. So I'll just end it with just a couple of closing comments here. I'll end where I began my comments this morning that I am pleased with the progress that we're making in our core business fundamentals. We are driving lasting improvements in both segments while maintaining a relentless focus on shareholder value creation. So with that, thank you and have a great day.

Operator: Thank you for joining today's call. You may now disconnect.