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Q2 FY23 Cardinal Health, Inc. Earnings Conference Call

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Operator: Hello and welcome to the second quarter FY 2023, Cardinal Health Earning Conference Call. Please note, this call is being recorded and for the duration of the call, your lines will be on listen only. However, you will have the opportunity to ask questions at the end of the call. This can be done by pressing star one on your telephone keypad. I will now hand over to your host, Mr. Kevin Moran, VP of Investor Relations, to begin today's conference. Thank you.

Kevin Moran: Good morning. And welcome. Today we will discuss Cardinal Health's Second-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, our Chief Executive Officer, Trish English, our Interim Chief Financial Officer, and Aaron Alt, who will take over as our Chief Financial Officer beginning February 10th.

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.

Before we dive in, I'd like to take a moment to welcome Aaron Alt to Cardinal Health as our incoming Chief Financial Officer.

We're excited to have Aaron onboard. He brings a breadth of financial and operational experience to our organization, including a background in distribution, and he's already hit the ground running in his first few weeks. I am confident he will be a valuable addition as the leader of our finance organization, contributor to our Executive Committee, and a seamless fit with our company culture.

Aaron Alt: Thanks Jason, and good morning.

I am excited to be part of the team here at Cardinal, particularly at such an important time, not only for our company but for the entire healthcare industry. What attracted me to Cardinal Health was the broad portfolio, the overall culture and a leadership team that is motivated to win. While still early

days for me, I can already tell that while there is work to do, Jason and the team have a plan and there are significant opportunities for value creation in front of us.

I look forward to interacting with you all further in the weeks and months to come as I continue to ramp up.

Jason Hollar: Thanks, Aaron. Now let's begin with some high-level perspectives on the second quarter.

Overall, our Q2 results demonstrated continued momentum against our plans.

In Pharma, we've seen ongoing stability in the macro trends and underlying fundamentals of the business. In the quarter, we saw particular strength in overall pharmaceutical demand and strong performance from our generics program. We've seen increasing contributions from specialty products, which is a key strategic area of focus. And, we continue to effectively manage through the inflationary headwinds affecting industry supply chains. In short, Q2 was another data point that Pharma is a resilient and growing business.

In Medical, we remain highly-focused on our Medical Improvement Plan initiatives. Overall, despite some puts and takes, Medical's Q2 results were consistent with our prior commentary, and we were pleased to see a return to profitability in the quarter. We continue to take actions to drive more predictable financial performance in-line with this business's underlying potential.

At an enterprise level, we continue to see benefits below the operating line from our capital deployment actions and favorable capital structure.

With the first half of fiscal '23 behind us, we are pleased to raise our full year EPS guidance and outlook for the Pharmaceutical segment.

Our team remains focused on executing our 3 key strategic priorities of executing on the Medical Improvement Plan, building on the growth and resiliency of the Pharmaceutical segment, and maintaining a relentless focus on maximizing shareholder value. I will update you on these priorities in a few moments.

Before I turn it over to Trish to review our results from the quarter and revised outlook, I'd like to thank her for stepping in as interim CFO over the past six months. Trish has brought leadership and continuity to the organization, and will be instrumental in ensuring a seamless transition with Aaron. Thanks, Trish.

Trish English: Thank you Jason, and good morning everyone.

I'll begin today with our consolidated second quarter results.

Total company revenue increased 13% and gross margin increased 3%, both driven by the Pharma segment.

Consolidated SG&A increased 4%, primarily reflecting inflationary supply chain costs. Benefits from our enterprise-wide cost savings initiatives offset some of this increase.

Operating earnings of $467 million dollars were in-line with the second quarter of last year. This reflects growth in Pharma segment profit, offset by the decline in Medical segment profit, which was anticipated.

Moving below the line, Interest and Other decreased nearly 30% to $18 million dollars, driven primarily 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 second quarter Effective Tax Rate finished at 23%, approximately 3.5 percentage points higher than prior year, primarily due to net positive discrete items in the prior-year period.

Diluted weighted average shares were 263 million, 6% lower than a year ago due to share repurchases. In the second quarter, we completed our $1 billion dollar Accelerated Share Repurchase program and initiated a new $250 million dollar program, resulting in a total of $1.25 billion dollars deployed year-to-date. We continue to expect $1.5 billion to $2 billion dollars in share repurchases in fiscal ‘23, which reflects our continued focus on maximizing shareholder value.

The net result for the quarter was Earnings Per Share growth of 4% to $1.32.

Now, turning to the balance sheet.

We generated second quarter adjusted free cash flow of $439 million dollars, bringing year-to-date adjusted free cash flow to $781 million dollars.

We ended the period with a cash position of $3.7 billion dollars, with no outstanding borrowings on our credit facilities. As a reminder, we continue to expect to pay down the $550 million dollars of March 2023 notes, at maturity with cash on hand.

Now, I will cover our segment performance, beginning with Pharma on slide 5.

Second-quarter revenue increased 15% to $48 billion dollars, driven by brand and specialty pharmaceutical sales growth from existing and net new customers.

Pharma segment profit increased 9% to $464 million dollars. This was driven by a higher contribution from brand and specialty products and generics program performance, partially offset by inflationary supply chain costs.

During the quarter, we saw strong overall pharmaceutical demand, including from our largest customers, reflecting their strength in the market. To a lesser extent, we also saw year-over-year contributions from the net new customers that we’ve previously mentioned and more robust seasonality with cough, cold and flu products, as others have noted.

Regarding our generics program, we are pleased with the solid execution and consistent market dynamics we continue to see. This includes strong performance from Red Oak Sourcing, not only controlling costs but also in maximizing service delivery for our customers.

Within our supply chain, we continue to effectively manage through the industry-wide inflationary costs seen in the areas of transportation and labor. In the second quarter, these inflationary impacts were generally consistent with our expectations. Similar to last quarter, this headwind was 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.

Second-quarter revenue decreased 7% to $3.8 billion dollars driven by lower Products and Distribution sales, including PPE pricing and volumes. Continued strong growth in our at-Home Solutions business partially offset this decline.

Medical segment profit finished in-line with our prior commentary, decreasing 66% to $17 million dollars. This was primarily due to lower Products and Distribution volumes and net inflationary impacts, partially offset by an improvement in PPE margins.

During the quarter, the net impact from inflation was in-line with our expectations, and we achieved inflation mitigation of over 30%. This sequential improvement from the first quarter was driven by the continued acceleration of our mitigation efforts, including the implementation of additional product pricing actions in the quarter.

On our last two earnings calls, we have discussed overall volume softness in our Products and Distribution business. In the second quarter, we saw generally consistent overall volumes on a sequential basis, including our Cardinal Health Brand products. With respect to PPE, we did see some slight improvement in volumes on a sequential basis. Additionally, we've made significant progress in selling through higher cost inventory on our balance sheet, leading to normalized PPE margins in the quarter.

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

We are raising our EPS guidance by $0.15 at the lower end and $0.10 at the higher end to a new range of $5.20 dollars to $5.50 dollars, which represents 6% year-over-year growth at the mid-point.

This update reflects improved outlooks for the Pharmaceutical segment and for Interest and Other.

We now expect Interest and Other in the range of $115 to $130 million dollars, with the improvement primarily driven by the increased interest income on cash and equivalents.

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

Turning to slide 9 and the Pharmaceutical segment…we are raising our outlook for revenue to a new range of 13 to 15% growth and for segment profit to a new range of 4 to 6.5% growth, both of which primarily reflect our strong first half performance.

As we look to the second half in Pharma, we anticipate the year-over-year profit growth to be fairly balanced between the third and fourth quarters.

Turning to Medical...we continue to expect a revenue decline of 3 to 6% and segment profit ranging from flat to a decline of 20%.

With respect to inflation and our mitigation actions, we continue to expect a net impact of approximately $300 million dollars in fiscal '23, or a minimal year-over-year impact.

On the cost side, while still at elevated levels, we've seen a general stabilization across most areas, along with improvement in international freight. 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.

Importantly, we continue to expect to exit the year with a run rate of at least 50% inflation mitigation.

And finally, no changes to the expected cadence of Medical segment profit. We continue to expect segment profit to improve sequentially and be particularly weighted towards the fourth quarter. This sequencing primarily reflects our assumptions around the net impact of inflation, and to a lesser extent, a gradual improvement in overall volumes and the continued implementation of our cost savings measures.

For the enterprise, a key factor continues to be the overall utilization and demand environment. In Pharma, we expect continued strength in overall pharmaceutical demand in the second half, albeit at a more moderate rate than we've seen to date. In Medical, we expect a gradual improvement in overall volumes, including with Cardinal Health Brand. Therefore, if the trends from the first half of the year continue, we would anticipate segment profit more towards the upper end of our range in the Pharma segment and more towards the lower end of our range in the Medical segment.

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

Jason Hollar: Thanks Trish. Let me now provide a few updates on our 3 key strategic priorities for fiscal '23.

First, executing our Medical Improvement Plan initiatives.

Importantly, we remain on track with our mitigation actions for inflation and global supply chain constraints, the number one key to returning the business to a more normalized level of profitability. I am pleased with the incremental progress achieved in the second quarter, as we mitigated over 30% of the gross impact to our business in Q2.

Taking a step back, over the past 9 months we have made a series of widespread temporary price increases across nearly all of our Cardinal Health brand product categories. We've also executed supplier distribution fee increases to offset higher transportation, labor, and fuel costs, and continue to explore other opportunities for further offsets with urgency.

We will continue to monitor cost trends and work with our industry partners to make pricing adjustments that are reflective of current market conditions. Because we have taken a transparent approach working collaboratively with our partners, we continue to make progress on this front by successfully adjusting product contracts as they renew. We are also including language that allows for greater flexibility to respond to future macroeconomic dynamics. We continue to expect to exit the year with a run rate of at least 50% inflation mitigation, and to fully mitigate inflation by the end of fiscal '24.

Outside of our mitigation actions, we are focused on optimizing and growing our Cardinal Health Brand portfolio. As Trish indicated, the market demand environment in Medical has been relatively stagnant over the last couple quarters. Additionally, some of our higher-margin Cardinal Health Brand categories remain under-penetrated, which we are addressing through targeted investments to increase product availability, new product innovation and a continual focus on commercial excellence.

For example, we recently expanded our Sustainable Technologies™ manufacturing facility in Riverview, Florida, doubling the size to roughly 100,000 square feet. This facility will enable us to better meet increasing demand for single-use device collections, reprocessing, and recycling services supporting future growth while also delivering supply resiliency, sustainable solutions, and cost savings for customers.

We are also investing to accelerate our growth businesses, primarily at-Home Solutions, where we've seen strong growth fueled by the secular trend of care shifting into the home. Our new, central Ohio distribution center, equipped with robotics and automation technology, will be fully operational soon as we continue to expand our footprint to match the sustained growth of home healthcare we are seeing in the industry and our business.

And, in our higher-margin Medical Services business, OptiFreight Logistics recently expanded its offerings with TotalVue™ Tracking, a new capability offering healthcare providers real-time shipment tracking to enhance supply chain visibility and resiliency.

Second, moving to the Pharma segment, where we're building upon the growth and the resiliency of the business, we're focused on executing in the core and accelerating our growth areas, primarily Specialty.

In the first couple months, we've already seen efficiency and effectiveness gains from our recently combined Pharmaceutical and Specialty Distribution organization.

We've seen strong growth across Specialty Distribution, including within acute health systems and alternate care. Additionally, our recent acquisition of the Bendcare GPO and investment in their managed services organization has been positively received by customers.

As part of the recent segment organizational changes, we also created a new Sourcing and Manufacturer Services organization, enabling a more holistic approach to enhance our strong pharmaceutical manufacturer partnerships. This includes strategic sourcing, along with the high demand area of manufacturer services. In Q2, we saw double-digit growth from manufacturer services, where we continue to invest to build upon our capabilities, such as our leading Specialty 3PL and Sonexus, our access and patient support portal. And, in the area of cell and gene therapy, we are excited about the work we are doing in this emerging space across all of our service offerings, expanding our capabilities and the opportunities we see in the future.

We are investing in automation and enhancing technology across our supply chain today in order to drive operational productivity for the future.

We're striving to deliver a flawless end-to-end customer experience supporting our strong and diverse customer base. For example, our recently-announced collaboration with Palantir will offer customers a solution that connects diagnostic and clinical data with real-time purchasing and consumption data. By leveraging AI and machine learning, our customers will be empowered to make better purchasing and inventory management decisions for their businesses and patients. We are privileged to serve and partner with leaders across the various classes of trade such as retail pharmacy chains, mail order and grocery, as well as retail independents, long-term care and health systems, all of whom provide essential healthcare access for their respective communities.

And lastly, a brief update regarding our relentless focus on shareholder value creation.

In addition to the shareholder value creation initiatives we've already announced, such as our governance enhancements and simplification actions, we continue to place a strong emphasis on responsible capital deployment, including the return of capital to shareholders through share repurchases.

Our Business Review Committee continues to work through the comprehensive review of our company's strategy, portfolio, capital allocation framework, and operations.

We plan to hold an Investor Day on June 8th in New York City, where among other topics, we will provide an update on our company's long-term financial outlook, detail our growth strategies, and share any relevant conclusions from the ongoing review.

Before I wrap up, I want to touch on our new ESG report, which was released just last week. This expanded report outlines the steps we are taking to operate in a more sustainable and equitable world through our established ESG and diversity, equity and inclusion initiatives. We continue to make progress against our long-term targets and are committed to regularly updating our stakeholders. We believe that we can simultaneously drive ESG improvements in support of our ongoing business transformation.

In closing, while there remains work to do, I am encouraged by our team's progress to date and excited about the opportunities ahead. I want to thank our dedicated Cardinal Health employees who

are driving the execution of these critical priorities and who keep our customers and their patients at the center of everything they do.

With that, we will take your questions.

Operator: As a reminder, if you would like to ask a question, please press star one on your telephone keypad. To withdraw your question, please press star two. The first question comes from the line of Lisa Gill calling from JPMorgan. Please go ahead.

Lisa Gill: Thanks very much. And thanks for all the details, Jason. Just on the Medical side, one of the things that stuck out to me is you talked about the improvement, and you talked about needing improvement in volumes. So, as we think about that, can you maybe talk about your expectations around surgical procedures as we move into calendar 2023, the back half of your year? And secondly, has part of the issue on the hospital side been staffing issues? And as they start to resolve that, will things get better for Cardinal as well?

Jason Hollar: Yeah. Hi, Lisa. I think you're connecting all the right points there. You know, that's what we hear from our customers and broadly from our peers in the industry is that there continues to be some constraints as to getting to the free level of demand there. And we do think that's a component of what's impacting the lack of growth that we're seeing within Medical. You know, it's impossible to tell definitively, but that's the anecdotal feedback that we are hearing. To help provide a little bit of color around the impact, that's why Trish had made some comments within her commentary there, highlighting that we do anticipate that gradual improvement over the course of the year. So not significant but getting back to closer to more normalized level of growth. As a reminder, when we provided our Medical improvement plan, we highlighted, you know, a 3% CAGR total volume growth over the three-year period and we anticipated that about half that would be market growth, about half that would be our own innovation and capacity expansion plans for our products. So, you're talking about a couple of percent type of growth and that would be more normalized. And that kind of differentiator between our more of a midpoint of our guidance to what would be more in the lower end. And that's why Trish had provided that type of clarity.

Lisa Gill: So is the right way to think about that kind of half of its Jason, you feel like you have some level of control because it's new products that you're bringing to the market, and the other half is you're going to have to wait to see if those volumes come back? Or do you feel like you really, truly have visibility around the whole 3% that you're talking about?

Jason Hollar: Yeah, no, I think you have it a generally right. Now, remember that a lot of the part that we have control over is new product innovation and capacity expansions. And that’s always an element of the three-year plan, I would expect to be weighted a little bit more towards the later end because it takes time to spool up those investments and getting those products into the market. So we didn't ever indicate it was a linear type of plan.

And volumes, we had to be careful too, that we had a period here the last two to three years that's been incredibly choppy in terms of the volumes. Obviously down during the beginning of the pandemic and has come back for the most part. The last couple of quarters have been very predictable, very

consistent types of volumes, but even that's a bit of an anomaly from what we've had over the last few years. So presuming that that maintains, then that's the range that we should be thinking about, but if we get back to an increased level of volatility, which at this time we don't foresee, but that's certainly a possibility as well.

Lisa Gill: Okay. Great. Thank you.

Jason Hollar: Next question. Yes. Thanks.

Operator: The next question comes from the line of Elizabeth Anderson calling from Evercore. Please go ahead.

Elizabeth Anderson: Hi, guys. Thanks so much for the question. I was wondering if you could talk a little bit more about the Pharma improvement in the back half of the year and specifically like as you've had time to sort of think through the Pharma reorganization, is there a continued cost-cutting benefit, is that just improving the operating profit growth? Are you starting to get pricing in certain places where you had before? If you can help us kind of understand that mix. And then secondly, on the interest expense guide, it looks like the back half guide has a big sort of step-up versus what you did in the first quarter, or the first two quarters of the year, in terms of interest expense. So is that just sort of changes in cash balance in terms of the net interest contribution or are there other factors going on there? Thank you.

Jason Hollar: Yeah. I'll start with your second question there because you nailed it. It's really about cash balances. We don't anticipate there being significant differences in the interest side. Let me just kind of step back. We have a very fixed interest expense for our debt. So our interest expense side is quite predictable and known. It's really the interest income is the part that we've seen favorability in year to date. And our cash balances were higher than anticipated over the first half of the year. We do have the $550 million note coming due here in March and we anticipate to pay down. And there's just a seasonal aspect of our cash flow as well. So we would not anticipate the same lower levels or say improved interest income that reduces our interest expense in the second half like what we saw in the first half. So you should take away that we continue to have a very advantaged balance sheet, especially as it relates to the fixed variable mix of our debt.

As it relates to Pharma, it's really more about volume than anything else. We're not seeing a lot of other key variables. Underlying dynamics within the generics business continue to be very consistent. We continue to see very broad-based volume strength. Q2 was certainly a very strong quarter as it relates to volume, and we saw that broad-based. I referenced my comments between Trish and I, brand specialty, as well as generics. It is a lot of volume drivers within that. And as we think about the growth in the second half of the year, it's very consistent with what we had indicated at the beginning of the year. So our second-half expectations remain consistent with what we had indicated before. A little bit less growth than what we've seen in the first half and that's just a reflection of, again, Trish's comments that we anticipate it being closer to more normalized level of growth in the second half. But if we maintain the same level of strength that we've seen in the last couple of quarters and then there's some opportunity in the high end of that.

And then just one other comment about the Q2, why it was so strong. If you're thinking about it from a year-over-a-year perspective, we also just have the added points that we did introduce a new customer in the third quarter of last year and that has been a nice tailwind for us the last four quarters. But this would be the last quarter until we start to lap that. So that's part of the driver from a year-over-year perspective.

And then not significant, but there is an element of cough, cold, and flu. That's a nice little tailwind for the quarter, but at this point, we don't anticipate that being a driver for the full year. In fact, this could be a little bit of a headwind as it relates to Q3 specifically, because it looks like the season is ending earlier than normal. So those are all the key moving pieces.

Elizabeth Anderson: Got it. Thank you so much.

Operator: The next question comes from the line of Michael Cherny calling from Bank of America. Please go ahead.

Michael Cherny: Good morning and thanks for taking the question. So just to parse through your numbers a little bit. I just want to get a sense. You've had strong outperformance here to date based on typical timing and annualization and what you're calling for relative to growth rates. It seems like there's more opportunity for upside on your EPS. I know you talked about Medical basis, but you see now coming at the low end of the range. But can you give us some of the other potential concerns or headwinds that are built into this number? Mathematically, you could argue that your EPS baseline should be higher, and annualising it, you'd get there, too. So I want to make sure I understand all of the I guess takes against the positive puts that you update in your guidance.

Jason Hollar: Yeah. Thanks, Michael. First of all, overall, I think it's a balanced outlook that we have. I think a couple of the key drivers of the first half, second half, I just went through on Elizabeth's question, you know, interest expense is going to be higher. We expect it to be higher in the second half. So that's one of the components you're thinking about from an EPS driver.

And then Pharma is a key driver as well. Still solid growth in the middle of that range that we had at the beginning of the year. Not at the same pace of growth that we had in the first half, but still growth and also just to kind of step back a little bit and we had a similar level of growth, about 5% growth in the prior fiscal year. So now we're on 18 to 24 months, a pretty consistent, stable, much more predictable type of growth that we've seen in that business as we step farther and farther away from the pandemic. And we think overall that's balanced. Of course, in the second half of the year, there's a meaningful step up in the Medical segment performance and that's, of course, being driven more than anything by the pricing on inflation. And the first instance we would expect of cost stepping down as it relates to the international freight. But all the other drivers, I think are fairly consistent with what we outlined. Next question, please.

Operator: The next question comes from the line of Erin Wright calling from Morgan Stanley. Please go ahead.

Erin Wright: Thanks. So, you haven't really participated much in COVID treatment or vaccines obviously, with the contracts that are out there. But as those open up to the private market, could that provide an opportunity for you as we're looking into next year? And maybe thinking about some of those other anomalies kind of into next year, what are some things that you're thinking about in terms of opportunity across that core Pharma segment as well in terms of drivers, or is it a continuation of the same in terms of specialty drivers and otherwise? Thanks.

Jason Hollar: Thanks, Erin. Overall, first of all, as I think about fiscal ‘23, it's a fairly normalized level of performance that we have in our current outlook. Again, growth for the reasons I highlighted, is a little bit stronger in the first half than what is in our longer-term targets. And we’ve seen that very broad strength that I would not expect to continue long term at that pace, especially when we consider that incremental new customer.

The longer term, I think what this year reinforces is that we're on track for those long-term growth targets. Specifically to your question around COVID therapies and vaccines, you have it, your inclination is correct. We participated very little on any of that. Over the pandemic, frankly, we've had more of a headwind than a tailwind because of the volume impacts on our underlying utilization. Of course, we're all the way through that at this point in time and have been so for about a year. So we're at a very normalized level at this stage.

As it relates to commercialization, I think all data points point to that beginning in the summertime, of course, after our fiscal year. So certainly no impacts for ‘23. There would be some opportunities for ‘24 and beyond, however, I'd highlight the types of products and vaccines we're talking about, historically outside of the pandemic have not been significant drivers of profitability. So it's something that should be a tailwind, but I would not jump to the conclusion that it will be as significant as what we've seen in the marketplace for others, given how the government had isolated that and procured for that. So something we'll keep an eye on and clearly something we'll be providing some context for further as we understand it better and as we get closer at that point in time. And the one final point on that is even though the commercialization is scheduled for the summer, there is certainly a lot of dialogue and uncertainty as to exactly how much is stockpiled within the government and how long will it take for that to work through. So while it may go commercial, it could take us some time to actually see a pull in terms of non-governmental sources. Next question, please.

Operator: The next question comes from the line of George Hill calling from Deutsche Bank. Please go ahead.

George Hill: Yeah. Good morning, guys, and I appreciate you taking the question. And I guess Jason, my question is probably a derivative of Mike's question, which is kind of given the guidance for the year and the expectations of the back half, it would seem that the street is probably too high. So I guess maybe could you talk about the big moving pieces just as it relates to the back half of the year? And should we think about the current guidance as probably a little bit on the conservative side or are there real areas of weakness particularly in Medical, that we should be worried about in the back half of the year as it relates to where the company plans to deliver results versus where the strain is?

Jason Hollar: Sure, I'll try George, but I'm afraid it's going to sound very similar to what I said to Michael. Again, I feel good about the balance that we have here. I feel very good about the progress to date. We have growth, implied growth in the middle of the range for Pharma in the second half of the year. So if volumes continue at a more recent pace, then we'd have some opportunity.

On Medical, a lot has to occur still for us to execute upon our plan. It's very consistent with the plan, we have good step up expected to continue.This guidance provides sequential improvement for each and every quarter throughout the year. We would anticipate the next two quarters to have sequential improvements as it relates to the ongoing pricing for inflation, the ongoing cost reductions, a gradual improvement in volumes. But importantly, the big step up will be in the fourth quarter as we see international freight, which is a very high confidence element now given that we're now less than six months by the end of the year, these lower costs are almost certainly going to start to flow through our P&L here in the fourth quarter. Still, at levels well below the pricing we're getting, but nonetheless, that's a pretty well-known part of that equation. So a lot of actions still in front of us, but the plan remains entirely intact.

And so when you talk about the first half, second half, you're implying there's some difference somewhere. And I think the primary difference is related to the growth within Pharma still growing. And maybe one other point to remember Q4 of last year for Pharma was a very strong quarter. We had very strong growth. It was a good quarter and that's one that we still anticipate there being growth on top of that this year as well and that low to mid-single-digit range. So we feel good about where we're at. There's opportunity in Pharma, there's some things we've got to watch out on Medical and we continue to execute all the below line items very consistent to our expectations. Next question, please.

Operator: The next question comes from the line of Andrea Alfonso calling from UBS. Please go ahead.

Andrea Alfonso: Thank you so much, Trish and Jason, I appreciate you taking the questions. So just on the Med-surge side, again, you've discussed, you know, the different tranches of price increases on the Med-surge side that you're going to be taking with customers. I guess we just going to just love to get a qualitative update on GPO and customer receptivity in general. And should we expect, as we think about the cadence for the second half, those would more fully manifest in the numbers in 4Q?

And again, just as a corollary to that, you highlighted some investments around private label with the current constraints and the purchasing environment for hospitals. Have you observed changes and just the general appetite here for private label? Thanks so much for the question.

Jason Hollar: Sure, terrific. Happy to do so. So on pricing, I would think about pricing as being a fairly stair-step process, beginning back with our first temporary price increase in March of '22. So, what we have and what we first shared was the 20% mitigation of inflation soon after in the fourth quarter of last year, then that went to 25% in the first quarter of this year. And then now we are saying it's over 30%. So you can see that a fairly consistent stair step. And that's how I think about the pricing side. Less on the temporary price increases going forward and more on the rotation to more renewals as

they come up. And that's just a natural function of where we're at in this process as we get farther away from the initiation of those temporary price adjustments. So a continuation of more of the same.

How you get to a widening of that 30% to 50% by end of the fiscal year is the cost starting to come down. So and again, that's largely focused on the international freight. So pricing, I would expect to just continue blocking and tackling all the way through to the end of fiscal '24 is where most of the prices will adjust. And that's why we indicate that we won't get to full mitigation until about that point in time.

As it relates to private label, I think it's an interesting related question to pricing, because, yes, we want to work with our customers. All of our customers are dealing with challenges beyond the inflation. In this category, they have actually much bigger challenges than other categories, and, you know, the desire on our part is to work with them if there's a possible win-win to find value in other ways, whether that is to more private label, it's, of course, we're doing everything we can to offset the increase or the increases to start with, to mitigate the inflation through other non-pricing means. And of course, part of this is also working with the supply base and we indicated that we're working on the distribution fees as well so that the supply base does their part, we do our part and our customers are going to have to absorb this as well. So it's a whole industry has to address this and that's the collaborative approach that we're taking with it. Next question, please.

Operator: The next question comes from the line of Charles Rhyee calling from Cowen. Please go ahead.

Charles Rhyee: Yeah. Thanks for taking the questions, guys. Just two real quick ones, maybe on the model first. Trish, I think you talked about Pharma distribution, we should think about the, it sounds like you kind of saying the contribution should be kind of even through the back half of the fiscal year here. It's a little different than I think when you look back in normal seasonality. Anything specific that you'd call out to, you know, why that might be this year?

Jason Hollar: Yeah. Let me take that. So that comment was the growth rates were going to be even year over year. So you're exactly right, Charles, that there will continue to be the expectation of normal seasonality that largely comes from the brand inflation, albeit much lower than what it has been historically. You know, we're still talking less than 5% contribution, but that is all in the third quarter. So sequentially, we would still expect the third quarter to have that element associated with it. Trish's comments were specifically related to the year-over-year growth rates being relatively equal between the two quarters.

Charles Rhyee: I see. Okay. I might have misheard. Maybe if I could just follow up on you know, you keep talking about the at-Home. I'm sorry. You keep talking about at-Home solutions and how that's a good growth driver. In the past, you've kind of given a little bit of a breakout of the size of the business. Is there any kind of additional color you can give us here in terms of sizing of this business, you know, how much it's grown relative to the rest of the segment?

Jason Hollar: Sure. Yeah. You can also go to our segment foot note, this is one of the two businesses we every quarter provide incremental revenue information on. And that business, I think

last year was $2.4 billion of revenue. And I believe for both the first and second quarter, we grew it by around 9%. But again, you can look to the segment to get the precise numbers each and every quarter.

Charles Rhyee: Great, thank you.

Operator: The next question comes from the line of Steven Valiquette calling from Barclays. Please go ahead.

Steven Valiquette: Great. Thanks. Good morning, everyone. So on page five in the slide deck, you talked about the quote-unquote, you know, just generics program as one of the positive key variables. So I just wanted to get a little more color just to confirm kind of what referring to as the biggest component within that. When thinking about are you just referring to just better generic volume and generic compliance rates with customers? Or is it just better buying through Red Oak? And also, it's been really a much stronger new first-time generic launch calendar as well. But just curious, what's the biggest piece within your comment about just the generics program? Thanks.

Jason Hollar: Sure. Yeah. Overall, the biggest component for this particular quarter and most quarters that we see more recently has been volume. I continue to use the statement consistent market dynamics that's referencing essentially the margin per unit. Yes, there's ongoing deflation, but the buy side sell-side continues to be relatively in balance. And so when we see a year-over-year driver, it's driven often by volume and/or mix and we continue to see very broad strength across all the products, whether it be generics, brand specialty. And so this particular quarter, we saw that as well.

Again, not the biggest driver, but when I talk about cough, cold, and flu, a lot of those products have gone generic. They're more mature products. So they do tend to carry with it a little bit lower margin price points, things of that nature. But that would be a component as well. But again, I'm only highlighting that given how many questions we get on the topic, not that that's a significant driver, but overall the short answer is volume and mix. Next question.

Steven Valiquette: Got it. Okay, thanks.

Operator: The next question comes from the line of Eric Percher calling from Nephron Research. Please go ahead.

Eric Percher: Thank you. A question on nuclear or theranostics, can you remind us where your investments are targeted in ’23, and where and when do we see ROI on those investments? And then given the developments around Alzheimer's treatments, what are you looking for relative to approval or policy change on testing that could lead to more significant step up in demand in that business?

Jason Hollar: Sure, so the theranostics business launched sometime in the last six, nine months and we're starting to see now more of that contribution over the last couple of quarters. So it's in the ramp-up phase. So we are seeing positive returns already on those investments. This is a business case.

The thing with the nuclear business that is both wonderful and also at times a little bit frustrating is that the business is a long-term business. It means that we have good visibility long term, but also means that we have to wait until we can get that benefit.

The theranostics has been something we've been working on since well before I arrived here in the organization three years ago, and it's one that we're now seeing the fruits of all those investments and efforts from that team.

As relates to the second part of your question, Eric, I get lots of questions around trying to link our business, our nuclear business, to specific approval, specific other drugs, and therapies and how we can attach that. I would say that the beauty of this business and the success of this business is that it's not directly linked to a very specific particular outcome. We have broad expertise capabilities. We are not dependent on any one particular area. And is that diversification of which we're seeing with the theranostics expansion being even more accentuated because we get to work with so many more manufacturers and partners that it just creates a broad opportunity for us to grow across the spectrum. So our business case for continued growth, our goal of achieving a doubling of the profit in this business from fiscal ‘21 to ‘26 is predicated on a lot of singles and doubles, not triples and home runs by attaching to a blockbuster type of drug. So beyond that, you know, we don't talk about individual drugs, individual manufacturers, or products. And so I would, but like I said, I just don't think that that's the real draw for this business is the breadth that we have and the broad capabilities.

Eric Percher: Thank you.

Operator: The next question comes from the line of Brian Tanquilut calling from Jefferies. Please go ahead.

Brian Tanquilut: Thank you. You have [inaudible] on for Brian. So, you mentioned expecting stabilization of supply chain headwinds, particularly in freight transportation. Can you just discuss any sense you might have around the cadence of that improvement moving forward?

Jason Hollar: Well, I wish I had more clarity. I would say that it's a lot more stable than it has been over the last few years, and we have to break apart freight into the components. So within international freight, that I believe, was an anomaly that is unlikely to occur anytime soon, if ever again. We need to be prepared for it. We've diversified our supply chain further as a result of living through that. But where those costs are, and it's still elevated in certain areas, right? The main China to North America channels are much, much lower. But there is now a lot of sourcing through other parts of Asia that are higher than historical levels, but nowhere near the peaks. So we're clearly seeing at least an 80% reduction of what those were at the peak and certainly much closer to pre-pandemic levels.

So as relates to international freight, it's not my big worry at this point and it's one that we have to continue to keep an eye on and manage. The more elevated remains the domestic transportation. It's also down from its peak, especially as it relates to anything related to diesel fuel. So that's also off its peak. And we're seeing certain pockets of improvement, but it's still very elevated compared to pre-pandemic. And there I have less confidence that it's going to materially reduce from here. There's a

lot of inputs that go into transportation other than just diesel fuel. You have, you know, the equipment and the drivers, all of which, you know, are higher cost and they're not expected to come down any time soon. So I expect domestic transportation to be higher longer, perhaps forever. And it's why we need to have permanent pricing because of that component. But on the international freight side, that is why we are not pushing for faster price increases right now is because we believe that will be coming down on our P&Ls this next quarter. And as we get through fiscal '24 those two lines, the price line and the cost line, will finally intersect and we can see that that will be fully mitigated. Next question, please.

Operator: And our final question comes from the line of A.J. Rice calling from Credit Suisse. Please go ahead.

A.J. Rice: Yes. Thanks a lot. I know growing specialty has been a priority for the company as this management team set out. And you've mentioned, again today that you're having progress there. I guess can you just maybe tell us where you're seeing success in the specialty area? And is the plan progressing as expected as it was talked about over the last year or so? Or is that an area of outperformance for you or how would you describe that?

Jason Hollar: Sure, it's absolutely meeting our expectations. It was a call out in terms of the broad volume that we had this last quarter. So we had strength across a number of many different categories and customers. We also called out double-digit growth within our sourcing and manufacturier services group, which is a key component of the upstream elements of specialty. So the business is strong, it's large, it's growing nicely. You know, we have I think like the rest of the industry, biosimilars is a nice tailwind that we're seeing, not large enough to call out as an individual driver. Our 3PL business, especially with the regulatory approvals being a little bit more normalized, is well positioned and we're continuing to invest in areas that will be growth opportunities in the future. Whether that be cell and gene or just where value-based care is going, where we have our Navista TS platform. So we're investing organically and of course, within our inorganic, we've had a nice success with our Bendcare GPO, and the investment in the MSO, that I think has given us some additional opportunities to think about in the future as well. So not any one item to highlight, but there is a strong breadth across many different pillars of the specialty business that we feel good is a very strong foundation and platform for future growth. I believe that was our last question. Yes. Thank you. And I'll wrap it up here real quick. Yes.

Operator: Yeah. There are no further questions, so I would hand you back to your host to conclude today's conference.

Jason Hollar: Yeah, thanks. I appreciate that. Just to summarise real quick, I'm pleased with the continued stability in Pharma, as we just discussed here today, as well as the progress that we're making in the Medical business. We are committed to executing on our key priorities, including 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. Host, please stay connected on the line.