Q2 FY24 Cardinal Health, Inc. Earnings Conference Call

February 1, 2024, 8:30AM Eastern

Operator: Good day, and welcome to today's Second Quarter Financial Year 2024 Cardinal Health Earnings Conference Call. This meeting is being recorded. At this time, I'd like to hand the call over to Matt Sims, Vice President of Investor Relations. Please go ahead, sir.

Matt Sims: Welcome to this morning's Cardinal Health Second-Quarter Fiscal 2024 Earnings conference call and thank you for joining us. With me today are Cardinal Health's CEO, Jason Hollar, and our CFO, Aaron Alt.

You can find this morning's press release and investor presentation on the investor relations section of our website at ir.cardinalhealth.com. Before I turn the call over to Jason, since we will be making forward-looking statements let me remind you that the matters addressed in the statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected or implied. Please refer to our SEC filings and the forward-looking statement slide at the beginning of our presentation for a description of these risks and uncertainties.

Please note, that during the discussion today, the 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 supporting schedules attached to our press release.

For the Q&A portion of today's call, we kindly ask that you limit questions to one per participant, so that we can try and give everyone an opportunity. With that, I will now turn the call over to Jason.

Jason Hollar: Good morning, everyone.

In the last few weeks, we've made several notable announcements regarding our company's continued progress, including yesterday's news on our agreement to acquire Specialty Networks, which will further our specialty growth strategy and create value for specialty providers, manufacturers, and patients in exciting new ways.

And, as we highlighted at a recent industry conference, we're continuing to take actions to become a simplified and more focused company, with further progress achieved on our ongoing business and portfolio review and our updated enterprise operating and segment reporting structure, which will be reflected in our financial reporting beginning next quarter. We plan to go further into our recent updates with you today, but first, let me begin with a few brief comments on our results.

In Q2, we delivered strong profit growth in both segments, demonstrating continued operating momentum and execution against our strategic priorities.

Pharma again delivered strong performance. Overall, the business is performing consistent with our expectations, and we're pleased to reiterate our outlook for 7% to 9% segment profit growth in fiscal '24.

We've seen ongoing stability in macro trends, including in our generics program, and continued broad-based strength in overall pharmaceutical demand.

Our Specialty Distribution business also continued to see strong demand, including with COVID-19 vaccines in the first part of the quarter.

Turning to Medical, Q2 segment profit was consistent with Q1, despite some non-recurring adjustments in the second quarter, which we've reflected in our updated fiscal '24 outlook for the former Medical segment.

We're encouraged by the underlying improvements in operating performance, reflecting further progress with our Medical Improvement Plan efforts, focused on our Global Medical Products and Distribution business.

Notably, we saw a change in trend in revenue growth for the Medical segment in the second quarter. Along with continued growth from at-Home Solutions, we're seeing the effects of our 5-point plan to grow Cardinal Health Brand volumes yield positive results.

And, as we continue to optimize not only the performance of our businesses, but also the financial strength of the broader enterprise, we're generating robust cash flow and seeing meaningful benefits below the operating line.

As a result of our first half performance, and increased confidence as we look ahead, we're pleased to raise our fiscal '24 EPS guidance and our outlook for adjusted free cash flow.

Of course, our customers remain at the center of everything we do, and our team continues to prioritize core operational execution to best serve them and their patients with essential products and services, as we drive our company forward.

Now, let me turn it over to Aaron to review our results and updated guidance in more detail.

Aaron Alt: Thanks Jason, and good morning.

Before we begin, let me remind you that our Q2 segment commentary will be according to our former segment structure, Pharma and Medical.

Let's start with total company results for the second quarter.

Q2 delivered another strong quarter across the enterprise, with EPS of $1.82, growth of 38%, which included operating earnings growth of 20%.

We also delivered strong cash flow and ended the quarter with $4.6 billion of cash, even following incremental share repurchase activity in the quarter.

As seen on slide 4, total company revenue increased 12% to $57.4 billion, reflecting growth in both the Pharma and Medical segments.

We drove operating leverage for the enterprise, despite incremental investments in the business and higher costs to support sales growth.

Gross margin increased 11% to $1.8 billion, driven by both segments, and consolidated SG&A increased 8% to $1.3 billion.

With the strong profit growth in both segments, we delivered operating earnings of $562 million, 20% higher than a year ago.

Moving below the line, interest and other decreased by $26 million to $8 million in income, due to increased interest income on cash and equivalents from higher cash balances and higher rates. As we've noted, our debt is largely fixed rate, resulting in a net benefit from rising interest rates in the near term. Additionally, Q2 interest and other benefitted from nearly $10 million in income from the quarterly revaluation of our company's deferred compensation plan investments, which as a reminder has a matching offset above-the-line.

Our second quarter effective tax rate of 21.3% was 1.7 percentage points lower than a year ago and better than we anticipated, due to positive discrete items in the period.

Q2 average diluted shares outstanding were 246 million, 6% lower than a year ago due to share repurchases in each of the last four quarters.

And as I mentioned earlier, the net result for Q2 was EPS of $1.82, reflecting growth of 38%.

Let's turn to the Pharma segment on slide 5.

Second quarter revenue increased 12% to $53.5 billion, driven by brand and specialty pharmaceutical sales growth from existing customers. We saw strong pharmaceutical demand across product categories: brand, specialty, consumer health, and generics, and from our largest customers. We also continued to see robust demand for GLP-1 medications, which provided a revenue tailwind in the quarter.

Segment profit increased 12% to $518 million in the second quarter, driven by positive generics program performance and a higher contribution from brand and specialty products, including distribution of COVID-19 vaccines.

Our positive generics program performance continued to reflect volume growth and consistent market dynamics.

With respect to COVID-19 vaccines, we saw the strength in demand from September for the fall immunization season carry into October, before peaking mid-month and trending to a much lower run rate as we exited the second quarter.

The Q2 increase in segment profit includes a partial offset from higher costs to support sales growth, driven by increased pharmaceutical volumes.

Turning to the Medical segment on slide 6.

Second quarter revenue increased 3% to $3.9 billion, which as Jason alluded to, reflects quarterly revenue growth for the Medical segment for the first time in over two years. This increase was driven by growth in both at-Home Solutions and Global Medical Products and Distribution, with the GMPD growth primarily related to higher Cardinal Health Brand volumes.

Medical delivered segment profit of $71 million, a $54 million year-over-year increase, driven by an improvement in net inflationary impacts, including our mitigation initiatives.

Consistent with the expectations communicated a few weeks ago, segment profit was 'generally consistent' with Q1, despite some non-recurring adjustments in the quarter. We continue to be encouraged by the underlying performance of the business, which through the first two quarters of the year, has tracked consistent with our original plans.

Now, turning to the balance sheet.

We generated robust adjusted free cash flow of $1 billion in Q2, bringing our year-to-date adjusted free cash flow to $2 billion, and as I noted earlier, ended the quarter with $4.6 billion of cash on hand.

We remain focused on doing what we said we would, deploying capital according to our disciplined capital allocation framework.

Thus far, through the first half of fiscal '24 we've continued to invest against our highest priorities, including investing back into the businesses to drive organic growth, with over $200 million in year-to-date capex.

In the first half, we have returned $1 billion total to shareholders, which includes our quarterly dividend payments and $750 million in year-to-date share repurchases. These share repurchases are in excess of our committed baseline repurchases of $500 million.

And in January we made certain opioid settlement prepayments of $238 million at a pre-negotiated discount, which is expected to result in a GAAP-only gain of approximately $100 million in the third quarter.

Now, for our updated fiscal '24 guidance on slide 8, beginning with the enterprise.

With our strong first half performance and positive outlook, we are again raising our fiscal ‘24 EPS guidance. Our new range of $7.20 to $7.35 reflects a $0.45 increase at the bottom end and $0.35 increase at the top end from our Q1 guidance range, and a mid-point which is 26% above our fiscal ‘23 EPS results. We are encouraged by the operating performance of our businesses, and our strong cash flow generation, which is certainly contributing to the improvements below the line.

Interest and Other is reduced to a range of $50 million to $65 million, which primarily reflects increased interest income from higher-than-anticipated cash balances. We expect lower average cash balances in the second half of the year, due in part to the seasonal timing of anticipated cash flows. We are evaluating opportunities to refinance our upcoming 2024 debt maturities in the back half of the year.

We are lowering the top end of our effective tax rate guidance to a new range of 23% to 24% to reflect the positive discrete items we’ve seen in the first half of the year.

We also are lowering our shares outlook to approximately 247 million, which reflects the $250 million accelerated share repurchase program we completed in Q2. No additional share repurchases are assumed in our updated guidance for fiscal year ‘24.

Now, turning to the fiscal ‘24 outlook for our segments.

While we will be transitioning to our new segment reporting structure beginning in Q3, let me start with our former segments as a comparison point for the updated structure.

No changes to the outlook for the former Pharma segment, we are reiterating the 10% to 12% revenue growth and 7% to 9% segment profit growth.

For the former Medical segment, the fiscal ‘24 outlook is updated to approximately $380 million of segment profit to reflect the net impact of Q2 non-recurring adjustments. Outside of these, our overall operational expectations are consistent with delivering the prior $400 million in segment profit for the year, as well as the corresponding prior expectation of $650 million in segment profit for fiscal year ’26. We have consistently highlighted the back-half weighting of the Medical guidance, driven by progress within GMPD on Cardinal Health Brand volume growth, the cumulative impact of inflation mitigation, and some business-specific seasonality. Our expectations there continue.

For example, with inflation mitigation, we have strong visibility to overall cost improvements in the second half of the year, driven by reductions we’ve observed in international freight, which as a reminder reflect in our income statement on a two to three quarter delay. And as we exit January, the mitigation initiatives necessary to achieve our year-end target are now largely in place.

Now, as seen on slide 10, let me comment on how this fiscal year ‘24 guidance translates to our updated segment structure, to go along with the preliminary recast fiscal ‘23 actuals and long-term targets we provided a few weeks back. Our new structure went into effect January 1st, so beginning in Q3, we will report results and provide drivers according to the new segment structure, Pharmaceutical and Specialty Solutions and GMPD, and separate from these two segments, Nuclear, at-Home and OptiFreight® aggregated in Other. At that time, we also plan to provide a recast of the results for fiscals ‘22 to ‘24 on the new segmentation.

Beginning with the Pharmaceutical and Specialty Solutions segment, the guidance ranges are consistent with the former Pharma segment, even excluding our higher-growth Nuclear business. We expect 10% to 12% revenue growth and 7% to 9% segment profit outlook for fiscal ‘24, and a 4% to 6% segment profit growth CAGR over the long term.

Turning to GMPD, where we remain encouraged by the improvements in this business.

Through the execution of the Medical Improvement Plan initiatives, we expect to drive GMPD from an operating loss of approximately $165 million in fiscal ‘23 to operating income of approximately $65 million in fiscal ‘24. From the fiscal ‘23 low point, this $230 million year-over-year improvement would position us roughly half-way towards our fiscal ‘26 target of approximately $300 million of segment profit.

Finally, we expect the businesses included in Other, at-Home Solutions, Nuclear & Precision Health Solutions, and OptiFreight® Logistics to collectively deliver 6% to 8% segment profit growth in fiscal ‘24. The difference between this fiscal ‘24 growth rate and the long-term CAGR of 8% to 10% for fiscal ‘24 to ‘26 reflects the portion of the Q2 non-recurring adjustments within at-Home Solutions, with the remainder residing in GMPD.

Before I close, a couple comments on our recently announced acquisition. We’ve noted that the specialty category has been our highest priority for potential M&A and a primary consideration for our opportunistic capital deployment as part of our disciplined capital allocation framework. Given our financial flexibility and strong presence in the other 60% of the specialty market in therapeutic areas outside of oncology, we have evaluated a range of potential acquisition candidates to further accelerate our Specialty strategy.

We are thrilled to reach an agreement for Specialty Networks to become a part of the Cardinal Health family. Jason will elaborate on the strategic aspects of the deal, but we plan to include the expected financial impacts of the transaction in our guidance upon closing, which of course is subject to the satisfaction of customary closing conditions, including receipt of required regulatory approvals. For general modeling purposes, we expect the deal to be accretive 12 months following close.

So, to wrap up, tremendous progress in the first half of the year, with exciting value creation opportunities still in front of us. We are confident in our plans, and grateful for the efforts of our team, who continue to drive our ongoing initiatives and prioritize the needs of our customers. With that, I will turn it back over to Jason.

Jason Hollar: Thanks, Aaron. Now, for some additional perspective on our strategic priorities, beginning with priority number one and building upon the growth of Pharma and Specialty Solutions, our largest and most significant business.

Though this segment's structure has slightly changed, our focus on executing in the core remains. We're building upon our strong foundation, while investing to accelerate growth in Specialty both downstream and upstream.

We believe that this new segment structure further enables those efforts, by enhancing management focus, leveraging the connectivity between Pharmaceutical Distribution and Specialty, and positioning the business for long-term growth and investment. More on that front shortly.

A key component of our strong core foundation is our generics program, anchored by Red Oak, which continues to do an excellent job fulfilling its dual mandate, managing both cost and supply. Red Oak leverages proprietary analytical tools and their deep industry expertise to help maximize service delivery for customers.

We're continuing to invest in our business to provide customer-focused solutions and evolve our commercial engagement strategies to prioritize addressing the complex challenges our customers face every day.

For example, at Investor Day we highlighted our first-to-market clinically-integrated supply chain, the Cardinal Health Intelogix™ Platform. This innovative solution leverages artificial intelligence and machine learning through the Palantir Foundry platform to help providers reduce costs, optimize drug inventories, and generate actionable insights to simplify and streamline medication supply. We've continued to develop our offerings, such as the Contract Optimizer tool, which drives savings and value through contract compliance, cost controls and product alternatives like brand-to-generics, blood plasma and more. Key health system customers are already benefiting from these capabilities, and we see opportunities for further future expansion.

Shifting to Specialty, where we have also been investing to expand our offering into complementary areas.

The acquisition of Specialty Networks is exciting to us on a number of fronts. This is a business with which we were already very familiar, given the long-standing partnership to service their members through our Specialty Distribution.

Specialty Networks is a technology-enabled multi-specialty group purchasing and practice enhancement organization, serving 11,500 total providers today, including more than 7,000 physicians across 1,200 independent urology, gastroenterology, and rheumatology practices. We see their service capabilities as accelerating our efforts in critical ways:

First, further extending our reach, expertise, and offerings in key therapeutic areas to provide increased clinical and economic value for specialty providers. Specialty Networks is a leader in specialty practice management, research and technologies that support physicians in lowering costs, operating more efficiently, and delivering best-in-class care to their patients. For example, the company provides solutions that improve clinical and economic outcomes to over 3,000 urologists through its leading UroGPO.

Second, creating a platform for our expansion across specialty therapeutic areas. The company's PPS Analytics solution is a subscription-based advanced technology platform that utilizes artificial intelligence, such as continuous learning algorithms and natural language processing, to analyze data from electronic medical records, practice management, imaging and dispensing systems and transform it into actionable insights for providers and other stakeholders. We see this complementing our suite of clinical, practice management and distribution solutions to specialty practices nationwide. Specialty Networks experience and capabilities in clinical engagement are robust, which also accelerates our upstream data and research opportunities with biopharma manufacturers.

Third, enhancing the capabilities of our Specialty business, including supporting the ongoing build of the Navista™ Network. Specialty Networks has a deep understanding of independent physician practices, and we see capabilities and expertise that will accelerate our ongoing development of the Navista™ Network, which is focused on supporting the clinical and operational needs of independent community oncologists.

In summary, this transaction enhances our specialty strategy by providing new capabilities that strengthen the link between our downstream and upstream services, enabling us to create further value for customers, manufacturer partners and patients.

Turning to priority number two, and the GMPD business, where we're executing the Medical Improvement Plan.

While the business and portfolio review of GMPD continues, the team continues to prioritize and make significant progress on turning around the operational performance of this business, as Aaron indicated with our expectation that the business returns to profitability in fiscal '24.

The number one priority remains mitigating supply chain inflation, where we remain on track to address the impact by the time we exit fiscal '24. As of Q2, we're approximately 75% to target.

On the cost side, while overall still elevated, we've seen lower international freight costs reflected in our results, as anticipated, and we have strong line of sight to continued improvement in the second half of the fiscal year. We've continued to make progress with our mitigation initiatives and commercial contracting efforts and are continually taking additional actions to offset elevated inflation, such as through sourcing initiatives.

As Aaron indicated, the work we've accomplished to-date provides increased confidence in achieving our fiscal year-end target, as overall cost improvements continue to reflect in our second half results.

We're continuing to invest in the resiliency of our supply chain and our manufacturing and distribution capacity. We have opened three new distribution centers in the past year, adding capacity for growth while featuring state-of-the-art automation technology to streamline operations. For example, our new Greater Toronto Area DC expands capacity to serve Cardinal Health Canada customers, while leveraging autonomous mobile robots to increase picking and packing accuracy and drive efficiencies.

We are also continuing to invest in new product innovation and portfolio expansion in key categories, in alignment with our disciplined portfolio management approach.

As a result of our team's collective efforts, we're seeing our 5-point plan to grow Cardinal Health Brand volume result in improvements in our leading indicators, and most importantly, strong customer retention and product volume growth.

Finally, we continue to drive simplification and optimize our cost structure by exiting non-core product lines, rationalizing our network, and streamlining our international footprint.

We believe our new structure will further enable our Medical Improvement Plan efforts, as we continue to execute the plan and deliver value for customers.

Now, priority number three, accelerating growth in key areas.

We are excited about the strong demand we are seeing in our at-Home Solutions and OptiFreight® businesses, and our recent determination to further invest in and develop these businesses for long-term value creation as part of our portfolio.

In at-Home Solutions, we continue to focus on enabling and supporting comfortable, home-based care for patients with acute and chronic conditions. To support the growing demand for home healthcare, we're investing to expand the capacity of our network, the breadth of our offering, and in new technology to drive operating efficiencies. We recently announced plans for a new distribution center to be built in Texas, with increased capacity, advanced automation technology and robotics within the facility. And our previously announced 350,000 square foot facility being built in South Carolina is on track to open this calendar year.

In OptiFreight® Logistics, we're continuing to invest in digital tools to enable healthcare supply chain leaders to better manage their shipping spend and support the core volume growth in our business. We've launched new offerings to give our customers more supply chain visibility, and we are receiving great feedback. For example, we now have more than 1,000 healthcare providers leveraging our TotalVue™ Insights platform to gain valuable insights on their operations.

In Nuclear and Precision Health Solutions, we're continuing to see above-market growth in both our core business and theranostics, as we're a premier partner of choice due to our strong core foundation and differentiation with pharmaceutical manufacturers looking for commercialization success of their future radiopharmaceutical portfolios. For example, in theranostics, prostate cancer radiodiagnostics are important tools for healthcare providers to assess and properly treat the disease. We saw meaningful year-over-year revenue growth in the first half of fiscal '24 from the ramp-up in demand of these diagnostics. From a pipeline perspective, we're investing to expand our Center for Theranostics Advancement, with demand from pharmaceutical manufacturer partners currently oversubscribed. And we're investing to expand the capabilities and resiliency of our PET manufacturing network to enable portfolio diversification and accommodate growth from the increasing demand for PET agents. This is driven by trends such as an aging population, cancer prevalence, emerging Alzheimer’s therapy availability and reimbursement, and increasing clinical trial needs.

Finally, priority number four, maximizing shareholder value creation.

We’re continuing to maximize shareholder value creation through our improved operational performance, robust cash flow and responsible allocation of capital.

As Aaron noted, our robust cash flow generation is not only driving benefits below the operating line, it is enabling our opportunistic capital deployment, with additional share repurchases in the quarter beyond our baseline plan and our ability to pursue value-creating M&A in Specialty.

We remain well-positioned with the financial flexibility to continue opportunistically evaluating disciplined M&A not only in Specialty but in our other growth areas, and potential additional share repurchases.

With our recent conclusions on our business and portfolio review, we do not have further updates to share today, but plan to keep you apprised of our progress.

To close, we had a strong first half of the year and are excited about the many initiatives underway to build upon our momentum. I would like to thank our highly-engaged and talented team for driving our progress and prioritizing our customers, as we fulfill our critical role as healthcare’s most trusted partner.

With that, we will take your questions.

Operator: Thank you very much, sir. Ladies and gentlemen as a reminder, if you have any questions, please press star one on your telephone keypad. Our first question is coming from Stephanie Davis, calling from Barclays. Please go ahead.

Stephanie Davis: Hey, guys. Thank you for taking my questions and congrats on the continued progress. Jason, you already shared a lot of color around the acquisition, but I was hoping you could dig in just a little bit further on Specialty Networks of mix and capabilities, just given the higher margin nature of both GPO and analytics solutions. And then just following up, given the pipeline that you mentioned, I was hoping you could share some thoughts on hurdle rates for future deals as that becomes a bigger part of the story. Thank you.

Jason Hollar: Great. Thanks. Good morning, Stephanie. Yeah, we're really excited about Specialty Networks. And I love how you asked the question, Stephanie, because it's, there's a lot that goes into this business, and we love all of it. Whether it's the GPO or the analytics and technology behind it, specifically PPS analytics is something we thought was really special, not just in terms of how this team has created this capability for their original primary business of urology, but then how they've extended into other therapeutic areas. And we felt we could learn from that further and use that technology across potentially other therapeutic areas beyond the three that they're in today.

So, that was really exciting to us and it's certainly a key part of the value. So, we definitely attributed good value to that technology and where we believe that can go. And not only is that good for our business, but importantly, we see that technology is really solving a lot of customer, both provider and manufacturer challenges, and ultimately giving a much better solutions to the end patient.

So, it's a win-win across the industry and one that plugs in nicely to our strategy and to be throughout the specialty space. So, we feel great about that. And I certainly don't want to miss that we are also through this transaction, acquiring a fantastic leadership team that will plug in very nicely to our own existing team. And so, it's a culture that I think will work very well together. And we've had a fantastic, very quick process. We've known Specialty Networks for quite a while, but from the point that we started talking about a possible tie up, we went from the beginning to the end, of course, going deep and thorough diligence. But, nonetheless, knowing the business well so that we could quickly understand the value for us.

As it relates to your second question on hurdle rates, I'm not sure exactly, which part of the business you're referring to. But generally speaking, I think no matter what part of our business we're talking about, it's a competitive and stable type of environment. So, I'm not normally going to go deeper into that anyways, but generally speaking, we're not really calling out anything from an overall market perspective today regardless of what our business we're talking about, utilization continues to be quite good and predictable. So, we're in a nice environment for ongoing growth, both organically as well as then able to look opportunistically at transactions like this.

Aaron Alt: Probably worth noting that it is a profitable business today. And as Jason highlighted, we do intend to invest in the business early on to expand the scope of what they are doing across not only their own initiatives, but our initiatives within Specialty as well.

Operator: Ladies and gentlemen, our next question is going to be coming from Lisa Gill calling from JPMorgan. Please go ahead.

Lisa Gill: Thanks very much for taking my question, and good morning. Just really wanted to ask two things, Jason. One, on the strategic side as we think about your core Medical business. One, do you still feel a commitment to that business going forward? And then secondly, as we think about the shift and the new reporting structure, it does look like you're taking down the margin on the core business. Is there something that's either changing and the timeline of the turnaround? Is there something else that's shifting competitively or incremental costs? If you could just help us understand that. Thanks so much.

Jason Hollar: Sure, Lisa. Very clear here. No, there's no change in our commitment to this business. It has been there from the very beginning and continues to be. As I highlighted from the first moment when we talk about Medical in the context of the business and portfolio review, our number one priority has always been and continues to be turning the business around.

Everything that we are working on has been in service of, first of all, the 5-point plan to drive Cardinal Health Brand volumes to mitigate inflation and drive additional value through simplification and cost reductions. That message and the progress we've made is entirely consistent with that. The core operational performance of the business is exactly how we've laid it out. So, the only update that we've had today were in recognition of some of those non-recurring items. But the plan in the fiscal year ‘26 aggregate targets that we're going after are absolutely unchanged to this re-segmentation.

We did have to bucket the Medical Improvement Plan into the various buckets because we did have the growth businesses that were a component of that. But that was just moving the pieces. The pieces are absolutely unchanged, and the overall aggregate profitability in that long-term plan is absolutely unchanged, and our commitment is absolutely unchanged to this business. And I'm really excited about the progress that the team is making in service of all those goals.

Matt Sims: Next question, please.

Operator: Thanks so much, sir. And our next question will be coming from Elizabeth Anderson, calling from Evercore ISI. Please go ahead. Your line is open.

Elizabeth Anderson: Hi, guys. Thanks so much for the question. I had two sort of maybe more financial questions going forward. Can you talk to us about sort of the interest expense, obviously, you had a pretty big step down. I just wanted to understand that in terms of that and your sort of ongoing thoughts on the capital structure. And can you also talk about why the, about the free cash flow improvement? That was nice to see that step up in the quarter as well in terms of the guidance.

Aaron Alt: We're happy to offer some perspective. We're quite pleased with the below-the-line results, of course, for the quarter. I'm going to start with the fact that as we announced, we ended the quarter with $4.6 billion of cash on hand. And of course, that's driven by the strong cash generation, which was the end part of your question. If you think back to our Investor Day, we had highlighted that further optimization of our cash flow position was something we were focused on doing. And the team has delivered against those efforts internally and generated strong cash flow in the first half for the business, thus the balance. Of course, the knock-on consequence of that is where we have more cash on hand, particularly in the higher interest rate environment, which we've been operating, we'll get a higher return, right? And we have indeed benefited from a greater rate of return on the larger cash balances that we've had in place. It's also the case that there is some geography within our statement because deferred comp was a positive for us below the line. That's an offsetting negative above the line in the quarter as well. And so, it's really the aggregation of those three things, of those several things, which led to the results for the quarter.

And you asked about the financing as well, and I should be clear on a couple of things, just as we think about our models going forward. We do have maturities coming in June and November. We're assessing what our opportunities are there, nothing to announce today in that respect, but we will address that at some point as we carry forward. And it is also the case that our cash balances fluctuate seasonally in the back half as well. And so, we wouldn't expect the high balance to remain where it is, just given the seasonal demands on the business.

Matt Sims: Next question, please.

Operator: Yes, sir. Our next question is coming from Mr. Eric Percher of Nephron Research. Please go ahead.

Eric Percher: Thank you. On the Medical side, it's hard to see through the one-time items. So, I want to ask what you can give us on the nature of those one-time items? What the trajectory looked like, excluding one-timers in the quarter and any views on the exit trajectory for the year and going from $140 million first half to $240 million second half, how you're pacing relative to that?

Aaron Alt: Thank you. We were really encouraged by the underlying performance in Q2 of the Medical business. Just to restate the results. The Q2 results were consistent with the expectations we communicated several weeks ago at the JPMorgan Conference, and generally consistent with Q1 despite some of those adjustments that we took in the quarter. I want to emphasize, as you move away from the adjustments that we took, the underlying elements of the Medical Improvement Plan, they're on track. You heard some of my prepared remarks relative to our progress against the mitigation of inflation and how our cost structure is building. The benefits of these actions we've taken will benefit our cost structure in the back half of the year. You heard us announce that we had revenue growth for the first time in two years in the quarter as well, and we were pleased with the Cardinal Health Brand growth that comes with that. And the team continues to execute against the simplification initiatives that have been a core part of the Medical Improvement Plan all along. So, I'm going to go back to where I started, which is we were quite pleased with the operational performance in the quarter.

I also want to point out that from a guidance perspective, while we updated the guidance for the year to reflect the nonrecurring, the relative impact of the nonrecurring adjustments, that was the sum change of the guidance to reflect that, which is behind us, not that, which is ahead. And if you think through how we have guided Medical for the year all along, there's always been a very back half focused trajectory for our guidance here for the year, and that remains unchanged along with how pleased we are with the core operational performance.

Jason Hollar: Yeah. If I could just add, when you think about that first half, second half cadence and why we still anticipate the same step-up in the second half versus the first half, there's a couple of key points.

First of all, inflation mitigation. This is one where it's a significant part of that combined with Cardinal Health Brand volume growth, which I'll get to in a moment. But on inflation mitigation, there's of course two elements. There’s a cost side and then there's a price side. In both cases, we have very good line of sight. On the cost side, as we've talked really for quite a while now, it's been international freight and that while we have a little bit of noise with the Red Sea, it is largely as anticipated. And that cost is already on our balance sheet and is rolling through as expected, especially given our volumes have been as expected. So, we have a very high line of sight and confidence the cost is going to continue to step down in the second half of the year. And then on the pricing side, as we talked before, there's always the contract rolling, roll-through that we then update the pricing on, we do have a little bit more at the beginning of the calendar year of some of those price adjustments. So, January being behind us, we have really good line of sight to the pricing side as well.

So, there's some time now for the next couple of quarters needed to get that to roll through our income statement. But the actions now are largely behind us as it relates to inflation mitigation. We've always had confidence we would get to this stage, but we're now at this stage and have even more confidence actually seeing it start to come through in the second half of the year.

Now the other component is the Cardinal Health Brand volume. Part of that's going to be market-driven and the market volume, that utilization continues to be quite good. And what was exciting about the second quarter is seeing that further inflection and actually participating in that market growth, really for the first time at the extent of what the market is growing. So that gives us much greater confidence that we'll continue to see that growth and that step up as we get over the course of the year. But there are some variables like the market itself that will always be an impact here, good or bad, that we will continue to monitor and track. So those are the key points I'd give us from the first half to the second half.

Aaron Alt: Eric, it's probably worth offering one additional point in perspective. We're not reporting on the new segment structure this quarter. That will follow in Q3, but we can offer the observation that the GMPD core part of the Medical business has operated at near breakeven levels in the first half of fiscal ‘24. And I offer you that in contrast with where they were from a fiscal ‘23 perspective, and where we're going from an overall guidance perspective, we view that as a key sign of positive progress.

Operator: Thank you very much, gentlemen. Sorry to interrupt you earlier. Our next question is going to be coming from Erin Wright of Morgan Stanley. Please go ahead.

Erin Wright: Great, thanks. On the drug pricing front, you do continue to mention generics as a key driver. Are you still seeing that using deflationary dynamics that others have noted too? And how material is that for you? And also, how sustainable is it? What are some of the key drivers that you're looking at there? And how are you thinking about that for the balance of the year as well as we think about the quarterly cadence here for the Pharma segment, particularly with the COVID dynamics, too. Thanks.

Aaron Alt: Appreciate the question. One of the things we called out in commenting on the strong quarter that our Pharma business had was that the continued consistent market dynamics within the generic space matched with volume. Strong volume was a reason for one of the reasons for success in the business. We often talk about the two sides of the equation being in balance. And indeed, that's what we continue to see within our generic business, and that is indeed a core component of our guidance for Pharma as we carry forward. One last reminder, I do want to remind that last quarter, we actually took our Pharma guidance up from a profit perspective to 7% to 9%. Thank you.

Operator: Thank you, sir. We'll now move to Allen Lutz calling from Bank of America. Please go ahead.

Allen Lutz: Good morning. Thanks for taking the question. Can you talk about growth of SG&A in the quarter? You flagged incremental investments in the business and higher selling costs, can you unpack exactly what those expenses are? And then how should we think about SG&A growth for the remainder of the year? Thanks.

Aaron Alt: Happy to offer some perspective. We were pleased in the quarter to actually achieve operating leverage with gross profit growing faster than SG&A. SG&A did grow, of course, volume also grew. And so, the primary component of our increase in cost was tied to the variable cost of serving higher volumes. It is also the case though that, as Jason has highlighted in his strategic remarks, we are investing against our business. And some of the SG&A growth was purposeful relative to the investments we're making in places like Navista™ and other elements of our growth plans. I will end with the fact that we are very focused on SG&A as a whole, and the team continues to look for further opportunities as we have in prior years to optimize our cost structure.

Operator: Thank you very much, sir. We'll now move to Kevin Caliendo of UBS. Please go ahead.

Kevin Caliendo: Thanks. Thanks for taking my question. I have two. Can you give us an update on the progress of the United contract renewal timing? Any updates you have there? And just to follow up on that SG&A question. Were there purposeful investments made when you saw upside from interest and other things in SG&A in the quarter? I'm trying to quantify how much was in the original plan versus maybe how much is incremental given some of the upside that you saw below the line?

Jason Hollar: Yeah, sure. I'll touch on both points here. There's no updates with the Optum contract that goes through this fiscal year. And as I highlighted before, they are a great customer of ours, long-standing customer, one that brings a lot of innovation to healthcare and one that we've worked very hard over the years to attempt to exceed their expectations, and we think we're doing a great job of that and we'd love to keep working with them, of course. Now I do get a lot of questions around the order of magnitude of this, and I'm not going to go into details. But just a couple of points, given the number of questions I've received is we have disclosed in the past, and I think it comes through in every K, just the order of magnitude. So last year, they were over a $30 billion customer of ours. And I see a lot of people attempting to try to model out impacts and things of that nature. And just a couple of things that I'm not sure it's real clear about the scope of business we have with them today. The majority of the revenue we have with them is through our base PD business, and a lot of that is mail order volume. So, what you have here are the typical markers of large customer, PD majority and mail orders. So, those are all markers of lower-than-average margin type of business. And so, we do have other business with them, of course, too, they are very large and have a lot of breadth into various parts of the industry. But for us, those tend to be a little bit of the overweight of how we support them.

As it relates to the SG&A, the only thing I would say is, no, it's not like that. What we do is we look at the capabilities and the necessities needed both short-term and long-term. Short-term is going to be on volume and making sure we can support our customers in getting that strong volume growth across the enterprise in place. We are then looking to balance that with longer-term investments, whether it's the Navista™ Network we've called out before as investments. But we also have others that we went through during Investor Day and have had a number of updates even today. Within our at-Home business, we have three new facilities that we're bringing online over the course of the next year or two, within the Medical distribution three facilities I talked about today. We have on the

Pharma side, the consumer health new logistics center. So, and I also made some comments around some of the IT capabilities within Pharma and the e-commerce and Intelogix™ capability. So, we are investing where it makes sense, efficiently, very well-aligned to our strategy. And these are not investments that you can just turn on and off. So, it's something that we're going to invest as appropriate, but only what we have to do as well. We want to take away waste and invest it where there's growth is the key objective.

Aaron Alt: For those working on their models, it's probably worth pointing out that with respect to the Q2 profitability in the business, it was the case that last year, we called out unusual strength in the overall Pharma demand, particularly from large customers, as well as very strong cough, cold and flu season. So, as you're looking at your comparisons, keep that in mind.

Operator: Thanks a lot sir. Ladies and gentlemen, if your question has been answered you may remove yourself from the queue by pressing star two. We'll now move to Mr. George Hill of Deutsche Bank. Please go ahead.

George Hill: Yeah. Good morning, Jason and Aaron. And forgive me if I kind of missed this or if you guys talked through this already. But as it relates to the planned restatement of the other segment, it looks like the growth in the near-term is coming in [inaudible] but kind of the long-term targets and which I kind of wonder if you could address kind of or disaggregate in which sub-segments you're seeing with softness relative to the long-term expectations for the balance of the year or this year versus what you think kind of accelerates coming out and kind of closes the gap in the longer-term guidance?

Aaron Alt: The businesses that report through Other for us going forward will be our at-Home business, our Nuclear Precision Health business and our OptiFreight® business. Those are what we have traditionally called our growth businesses as part of other segments. And indeed, over the long term, we expect the CAGR on their collective growth to be 8% to 10%. The disconnect you're referencing, which is the 6% to 8% in fiscal ‘24, is only driven by the impact of the non-recurring adjustments from Q2 on the at-Home business that we referenced a couple of weeks ago as we talked about our expectations for Q2. Each of the businesses contribute to the revenue and profit growth for Other for us as we carry forward. In our earlier disclosures, I think you can get pretty close, we disclosed the revenue of the individual pieces. And indeed, we've talked about Nuclear doubling its profit off of its fiscal ‘21 baseline by fiscal ‘26 as well, I believe, and so you're able to get to that component of Other through that.

Matt Sims: Next question, please.

Operator: Yes, sir. Will now take Stephen Baxter of Wells Fargo. Please go ahead, sir.

Stephen Baxter: Yes. Hi, good morning. Thanks for the questions. A couple of quick ones. On COVID vaccine commercial channel, I think last quarter, you kind of indicated or implied that the contribution was around $25 million. I was hoping you could update us on what the performance was this quarter and whether you factor anything in for the balance of the year? And then just to try one more time on the non-recurring Medical adjustments. Can you just tell us on the $20 million, like what does that actually represent in terms of the underlying accounting and our business activity. Thank you.

Jason Hollar: Yes. So, for the vaccines, let me just kind of walk through the last couple of quarters, and that will give you a flavor of the benefits and the trends and such. When we talked last quarter, we've highlighted in Q1, with the FDA approval at the beginning of September, we were staged to hit the ground running, and we had fairly significant volume in that first quarter. But as anticipated, we indicated at that point that we would expect it to peak within Q2. And so, we expected higher volume, higher contribution in Q2 versus Q1. And that was because we saw October as the largest month within that season. And then as expected, we saw that wind down over the course of November and December. Still seeing some level of volume in Q3, but I would expect it to be quite insignificant compared to what we saw in Q1 and then Q2.

Overall, I think the key message is that this is consistent with our expectations. As Aaron highlighted in his comments already, we had multiple drivers of growth for the Pharma segment in the second quarter. It was strength with the generics program within brand, it was COVID driving that component. And then we have these investments and primarily the cost to serve a partial offset to those other two drivers. So overall, feel good about the overall health of the business and the contribution of COVID within it. Aaron, any comments from that?

Aaron Alt: With respect to the non-recurring adjustments, we previewed this back at the JPMorgan Conference when we updated our commentary around the Medical business. And our comment that is our comment now, which is as we have continued to dig deep across the portfolio, we've taken a decision to take some nonrecurring adjustments, which, the majority of which hit the at-Home business, which now reports or will report as part of Other in Q3. As well as component hitting the WaveMark business, which is part of the new GMPD business. So, if you read through the update to our guidance for the year where we moved from approximately $400 million to approximately $380 million driven by the impact of the nonrecurring adjustments, you can reach your own conclusions as to the relative quantification and the distribution given those comments. Thanks.

Operator: Thank you very much sir. Our next question is coming from Charles Rhyee of TD Cowen. Please go ahead.

Charles Rhyee: Yeah, thanks for taking the question. Just wanted to follow-up on a [inaudible] there on the vaccine impact. I understand you're saying that you expected to peak in the December quarter. Would you say that the contribution, though, from vaccine was higher than in the first quarter given that you had still three months overall? And if we look at that, relative to what you had expected, the higher costs that you incurred, did you use that to fund those kind investments? Just wanted to get a sense on relative contribution.

Jason Hollar: Yes. As I highlighted, October was the peak month and since we only had a partial September, it's clearly higher in Q2 than in Q1. We did have November, December contributions as well, but it really tailed off by the time we got to the end of the quarter, and that's why you would expect there to be very little. It's just typical for vaccines in general. So, there's nothing we're seeing there. And again, I think the way you asked the question around the funding of investments; I'll just go back to my prior answer to that question. There were costs associated with the vaccine rollout. As you can imagine, that's a lot of volume to ramp up for really two months' worth of support. Our team did a fantastic job working with the manufacturers and our customers to play that role when we were not involved in the vaccine discretion before COVID. So, I feel very good about our role, and we did have to incur costs associated with the ramp-up and ramp-down in such a short period of time. But that was not necessarily used as currency to fund other programs. Those programs are important strategically and all very consistent with the plans and the actions and the forecast we've laid out here. So, there's no changes as it relates to how we're approaching these both short-term requirements as well as long-term investments.

Aaron Alt: Probably worth emphasizing that Jason's point is that September and October were the high points for COVID for us from a distribution perspective, quickly tailing off thereafter.

Matt Sims: Next question, please.

Operator: Thank you very much, gentlemen. And our last question today will be coming from Mr. Daniel Grosslight of Citi. Please go ahead, sir.

Daniel Grosslight: Hi guys. Thanks for taking the question. I wanted to just go back quickly to the Medical profitability question and confirm one thing. That $20 million one-time item, that was wholly concentrated this quarter. So, without that, the Medical profitability would have been around $90 million. And then on your commentary around shipping rates coming down and benefiting you and the volatility in the Red Sea, if you look at the China to West Coast shipping rates, they have spiked materially in January. So, I'm wondering how, I guess a couple of things there. One, how that may kind of roll through your contracts? And then given that you capitalize those costs and then expense it over two to three quarters post those costs being capitalized, how that might impact the cadence of your Medical Improvement Plan in fiscal ‘25. Thank you.

Aaron Alt: I'll start with the first half of that question. You are thinking about things correctly. I'll go back and emphasize we were really pleased with the operational performance of the business. And given that we've adjusted our yearly guidance just to reflect the impact of the non-recurring adjustments in Q2, your conclusion on the math would be reasonable.

Jason Hollar: Yeah, on the second component, you are correct that shipping rates have spiked. I think the word use was materially and how I would characterize it is, yes, that's accurate, but substantially less materially than where they were in the past. So, the order of magnitude we're talking about is vastly smaller. It is also something that we do not believe that that will be the permanent level. Yes, we have more flexibility in our contracts, and that will continue to be a lever and a component that we'll be evaluating determining on whether, how permanent these are or not. I would also say that our maturity, our capability within this space has substantially improved as well as we've invested in the underlying processes and procedures to manage through these types of, that type of volatility. So overall, we feel very good about where we stand and generally don't see this being as a material item, but we'll continue to watch it closely.

Operator: Thank you very much, sir. Ladies and gentlemen, that will conclude today's Q&A session. I'd like to turn the call back over to Mr. Jason Hollar for the additional or closing remarks. Thank you.

Jason Hollar: Yeah, thanks everyone, for joining us this morning. We're clearly excited about the momentum that we have in our business. Both the shorter-term operational elements that we've talked a lot about today, but also about the longer-term strategy with the announcement of specialty networks this week, it just highlights that we're looking and acting both short-term and long-term and are really excited about the opportunities still in front of us. So, thanks again for joining us today, and have a great day.

Operator: Thank you very much, sir. Ladies and gentlemen, that will conclude today's conference. Thank for your attendance. You may now disconnect. Good day, and goodbye.