Q3 FY24 Cardinal Health, Inc. Earnings Conference Call

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Operator: Hello and welcome to Third Quarter Fiscal Year 2024 Cardinal Health Inc. Earnings Conference Call. My name is George, and I will be your coordinator for today's event. Please note this conference is being recorded and for the duration of the call your lines will be in the listen-only mode. However, you will have the opportunity to ask a question at the end of the presentation, and this can be done by pressing star one on your telephone keypad to ask your question. We ask also that you limit yourselves to one question per person to allow the maximum number of attendees to ask a question. If you require any assistance at any point, please press star zero and you will be connected to an operator. I would like to turn the call over to your host today, Matt Sims, Vice President Investor Relations. Please go-ahead, sir.

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

You can find this morning's earnings press release and investor presentation on the investor relations section of our website at ir.cardinalhealth.com. Since we will be making forward-looking statements today, 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 our discussion today, the comments will be on a non-GAAP basis unless 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.

A year ago at our Investor Day, I reflected upon what attracted me to Cardinal Health. Our strong culture, values, and mission to be healthcare's most trusted partner. How the company was uniquely positioned with its breadth and scale to navigate the complexities of the healthcare ecosystem and serve the needs of customers, manufacturers, and ultimately, patients.

At the same time, I was open about some of the opportunities in front of us as an organization. Together, we laid out a clear but aggressive strategic plan, streamlined our focus, and the team got to work. All the time, prioritizing our core business to emerge as a stronger, more resilient company.

And we have a recent proof point. Over the last several months, we deeply focused on preparing for a variety of alternatives regarding a particular large, low-margin customer contract, which has allowed us to quickly navigate the upcoming contract change and confirm that we expect to grow our earnings in fiscal ‘25. By driving improvements in our core operations, investing to expand our offerings in key areas like Specialty and evolving our commercial approach in ways which have resonated elsewhere in the marketplace, we demonstrated that we have made progress on positioning our business for sustained success and growth.

As we look ahead, the current quarter’s results reinforce our confidence. We’re operating from a position of growing strength and resiliency, with industry trends that remain stable and in our favor.

In Q3, we delivered broad-based growth, while executing on our 4 strategic priorities: building upon the growth and resiliency of Pharmaceutical and Specialty Solutions, executing our GMPD Improvement Plan, accelerating growth in key areas, and maintaining a relentless focus on shareholder value creation.

In our most significant business, Pharmaceutical and Specialty Solutions, we again drove solid profit growth, on top of a difficult comparison to last year’s strong performance. We’ve seen ongoing stability in pharmaceutical demand, consistent market dynamics in our generics program and strong performance in Specialty, both downstream and upstream, all of which enables us to raise our fiscal ‘24 profit outlook for the segment to a mid-point of 9% growth.

In GMPD, we were pleased to see the strong top-line and bottom-line performance, with an acceleration in growth reflecting further progress against the business’ turnaround plan. GMPD’s quarter was overall consistent with our expectations and the team is already working hard on the continued ramp-up in Q4.

Among our Other operating businesses, our new reporting structure implemented at the start of Q3 is reinforcing our focus on performance and purposeful investment in growth. The strong demand we are seeing across Nuclear, at-Home Solutions and OptiFreight®, fueled by favorable industry trends, excites us about the long-term potential as these markets and businesses continue to develop.

And, as we’ve optimized the financial strength of the broader enterprise, we’ve seen meaningful benefits below the operating line this year.

Putting it all together, we’re pleased to be in a position to raise our fiscal ‘24 EPS outlook, provide preliminary guidance for fiscal ‘25 of profit growth in each of Pharma, GMPD and Other, as well as overall EPS, and reiterate our long-term targets for our businesses and enterprise.

Our strategy and long-term outlook are unaltered, and our team remains focused on executing our plan, as we serve our customers and continue to drive our company forward.

With that, let me turn it over to Aaron to review our Q3 results, fiscal ‘24 guidance and early fiscal ‘25 outlook in more detail.

Aaron Alt: Thank you, Jason.

This morning, we are reporting our financial results on the new financial reporting segment structure we implemented at the beginning of Q3. To that end, we released an 8K on April 23rd which provided the recast historical quarterly results for fiscal year ‘22, fiscal year ‘23 and fiscal year ‘24 through Q2, reflective of the new segmentation for Pharmaceutical and Specialty Solutions, GMPD and Other. As we called out at the time, the new segmentation is designed to provide greater transparency, focus and accountability across our businesses, and we are already seeing those benefits.

Overall, Q3 was a strong quarter, with double-digit operating earnings growth and 20% EPS growth. We accomplished that growth while at the same time leaning in and making significant investments of time, expense and capital against our longer-term strategic plan.

With both continued confidence in our strategies, and a resilient business and team, we are pleased to again raise our EPS guidance for fiscal year ‘24. More on that shortly.

As seen on slide 4, total company revenue increased 9% to $55 billion, reflecting revenue growth in the Pharmaceutical and Specialty Solutions segment, the GMPD segment and in all of the businesses making up Other. We were particularly pleased to see the second consecutive quarter of revenue growth in GMPD, at 4%.

We are also pleased that gross margin increased 9% to $1.9 billion. While consolidated SG&A also increased just under 9% to $1.3 billion in the quarter, the increased amount reflects technology and other purposeful investments against the future of the business and higher costs to support sales growth.

With strong broad-based profit growth, we delivered operating earnings of $666 million, 10% higher than last year.

Moving below the line, interest and other was generally consistent with the prior year at $26 million. And our third quarter effective tax rate of 20.4% was better than we expected due to positive discrete items.

As a result of our prior share repurchases, Q3 average diluted shares outstanding were 245 million, 5% lower than a year ago.

As I mentioned earlier, the net result for Q3 was EPS of $2.08, reflecting growth of 20%.

Now, turning to the segments, beginning with Pharmaceutical and Specialty Solutions on slide 5.

Third quarter revenue increased 9% to $50.7 billion, driven by brand and specialty pharmaceutical sales growth. We continued to see strong pharmaceutical demand across product categories: brand, specialty, consumer health and generics, and from our largest customers. While we again saw robust demand for GLP-1 medications, recall that we had guided that the revenue growth rate would moderate this quarter, as it did, given the acceleration that we started to realize last year during Q3.

Excluding GLP-1 sales, the segment's Q3 revenue growth would be 7%. As we've previously noted, these sales did not meaningfully contribute to the bottom line.

Segment profit increased 4% to $580 million in the third quarter, driven by positive generics program performance. Our generics program continued to see both volume growth and consistent market dynamics.

Within our brand and specialty products, demand for COVID-19 vaccines in the quarter was, consistent with our expectations, not a meaningful contributor.

As anticipated and guided, lower branded inflation than last year's relative high-point was a year-over-year drag on profit growth.

So overall, we were pleased to deliver 4% segment profit growth in Pharmaceutical and Specialty Solutions, solid growth on top of an exceptionally strong quarter a year ago which grew 23%.

Turning to the GMPD segment on slide 6.

Revenue grew for the second quarter in a row, by 4% in Q3, to $3.1 billion. This increase was driven by volume growth from existing customers.

The GMPD segment delivered segment profit of $20 million, a $66 million year-over-year increase, driven by an improvement in net inflationary impacts, including our mitigation initiatives. GMPD continued its strong turnaround trajectory, achieving its highest level of quarterly profitability in the last 2.5 years.

We continue to be encouraged by the underlying improvements in the business, driven by the team's efforts against the GMPD Improvement Plan. As a reminder, the components of the former Medical Improvement Plan are now split between GMPD and Other, and the plan continues to be on track. The team achieved notable progress on inflation mitigation in the quarter, and we again saw year-over-year improvement and growth in Cardinal Health Brand volumes, providing continued fuel for the business' ongoing turnaround.

Finishing with the businesses that aggregate into Other as seen on slide 7.

Third quarter revenue increased 14% to $1.2 billion due to growth across all three businesses, at-Home Solutions, Nuclear and Precision Health Solutions and OptiFreight® Logistics.

Collectively, the businesses grew segment profit in the quarter by 5%, with OptiFreight® Logistics showing particular strength as we worked during the quarter to create the foundations for future profit growth in all of the businesses.

Jason will further discuss our excitement around these businesses and some of the recent trends momentarily.

Now, turning to the balance sheet.

We ended the quarter with a strong cash position, with $3.7 billion of cash and equivalents on the balance sheet.

Year to date, we've generated $2.1 billion of adjusted free cash flow and have continued to deploy capital according to our disciplined capital allocation framework, including investing approximately $320 million in capex back into the businesses to drive organic growth, and funding the $1.2 billion acquisition of Specialty Networks.

Over the past several years we've made tremendous progress with our balance sheet. At the end of the quarter, we received a further update to our ratings outlook, with Moody's moving our outlook to positive. We issued $1.15 billion in new notes during the quarter to refinance our upcoming June and November debt maturities. We plan to hold the cash proceeds in time deposits until the calendar year '24 maturities come due. I'll note due to the nature of these contracts, only about half of the total cash received is reflected in our Q3 ending cash balance. The remaining $550 million is recorded in Prepaid Expenses and Other on the balance sheet.

We have returned over $1 billion total to shareholders year-to-date, which includes approximately $375 million of quarterly dividend payments and $750 million in share repurchases, which is in excess of our committed baseline repurchases of $500 million.

Now, for our updated fiscal '24 guidance on slide 9, beginning with the enterprise.

We are raising and narrowing our fiscal year '24 non-GAAP EPS guidance. Our new range of $7.30 to $7.40 reflects a mid-point which is 27% above our fiscal '23 EPS results. We started the year working to deliver our guidance of 14% EPS growth at the mid-point, what a year it has been so far.

Before we turn to the segments, a few comments on our enterprise assumptions.

With the year-to-date results, we are improving our fiscal '24 effective tax rate guidance to an updated range of 22% - 23%. And we are reiterating our fiscal '24 expectations for adjusted free cash flow of approximately $2.5 billion, capex of around $500 million, diluted shares of approximately 247 million and share repurchases of $750 million, which consistent with our framework, does not assume further repurchase activity this year.

Now, turning to the fiscal '24 outlook for our new segment reporting structure as seen on slide 10.

With another solid quarter from Pharmaceutical and Specialty Solutions, we are raising and narrowing our segment profit guidance for the full year to 8.5% to 9.5% growth, which at the mid-point, implies continued mid-single digit profit growth in the fourth quarter.

We are reiterating our guide for GMPD segment profit of approximately $65 million for fiscal year '24. We continue to expect to address the impact of inflation as we exit fiscal '24, along with continued

Cardinal Health Brand volume growth and benefits from our continued cost savings initiatives. Additionally, we anticipate a positive impact from seasonality in Q4 compared to Q3.

We are also reiterating our segment profit guide for the Other businesses, 6% to 8% segment profit growth for the full year, given that we expect a strong Q4 for those businesses. On the top line, we now expect Other full year revenue growth of approximately 12%.

So, as I highlighted earlier, we are raising our guidance for fiscal year ‘24 to $7.30 to $7.40. Finally, let me conclude my remarks by providing a guidance preview of fiscal year ‘25. We will provide formal fiscal year ‘25 guidance during our Q4 and full year earnings call in August. However, with the benefit of our raised fiscal year ‘24 expectations and the action plans already underway in response to recent market changes, here is our preliminary perspective.

For our largest business, Pharmaceutical and Specialty Solutions, while revenue will reset in the year as we offset a recent customer nonrenewal, we notably expect to deliver at least 1% segment profit growth in fiscal year ‘25, before returning to more normalized growth in fiscal year ‘26.

Looking forward, our commercial and operational teams have been busy, and our value proposition is resonating in the marketplace. Over the past several months, we have had some attractive wins with new customers and also existing customers expanding their own footprints with us. Some of these are already under contract and ordering, and others are scheduled for implementation in the second half of next fiscal year. So, over the course of the upcoming year, we expect new volume coming our way at sustainable margins.

We completed the Specialty Networks acquisition quickly, which will be additive to our efforts in fiscal year ‘25. Separately, we have turned a further eye to optimizing our cost structure across the Pharmaceutical and Specialty Solutions portfolio. Regarding some environmental factors, we are expecting brand inflation to be roughly equivalent to fiscal year ‘24 levels while we remain watchful relative to the contribution of COVID-19 vaccines.

For the GMPD segment, we expect continued growth in fiscal year ‘25 on our path to approximately $300 million in segment profit by fiscal year ‘26, driven by the annualization of inflation mitigation, progress with Cardinal Health Brand growth, and continued simplification and cost optimization. We expect approximately $175 million in GMPD segment profit in fiscal year ‘25.

And for the businesses included in Other, we expect the strong demand we’ve seen across these businesses to continue. With positive industry trends and the strength of our competitive positioning, we expect collective segment profit growth in fiscal year ‘25 at the top end of our long-term target, approximately 10%.

During fiscal ‘25 we will be investing across all of our businesses, with key examples being new facilities like our Consumer Health Logistics Center, at-Home Solutions facilities in Texas and South Carolina, and further geographic reach of our Nuclear and Precisions Health Solutions PET network. We’ll also continue our build-out of Navista™ and investments in GMPD supply chain resiliency.

Now, a few callouts below the line and with the balance sheet.

We anticipate a significant step-up in Interest and Other next year, primarily due to much lower average cash balances, due to cash already deployed for specialty networks and due to the one-time unwinding of negative net working capital from the large contract nonrenewal. We also expect lower short-term investment rates on cash and higher interest rates on debt resulting from the refinancing of our calendar 2024 maturities, leading to an interest and other range of $160 million to $190 million in fiscal year ‘25.

We expect our fiscal year ‘25 effective tax rate to be in the range of 23% to 24%, slightly higher year-over-year due to the discrete favorability seen this year.

Partially offsetting these impacts, we would expect a lower share count, between 244 million and 245 million, due to the $500 million of baseline share repurchases we’ve previously outlined.

Finally, while we continue to expect to generate adjusted free cash flow of approximately $2 billion on average from fiscal 2024 to ‘26, we think it’s important to call out that fiscal 2025 will be lower than that average, primarily due to the large contract unwind, as well as quarter-end day of the week timing. These dynamics will significantly influence our cash flow in Q1 of next year. However, our strong investment grade balance sheet positions us well to manage through these fluctuations.

With respect to the long term, it is full speed ahead. We are reiterating our fiscal year ’24 to ‘26 targets for the enterprise and segments and expect to deliver at least $7.50 of non-GAAP EPS in fiscal year ‘25, which reflects at least 30% total EPS growth on a two-year basis.

With that, I will turn it back over to Jason.

Jason Hollar: Thanks, Aaron. Now, for some additional perspective on our businesses, beginning with Pharmaceutical and Specialty Solutions, where our focus remains executing in the core to build upon our strong foundation.

We’re continuing to invest in our core business to drive operational efficiency and provide improved customer-focused capabilities. At the same time, we have been evolving our commercial engagement strategies to get closer to the customer, better understand their complex needs and provide proactive solutions.

As an example, we’ve highlighted our first-to-market clinically integrated supply chain, the Cardinal Health InteLogix Platform, which deploys AI and machine learning through the Palantir Foundry platform to analyze real-time clinical and purchasing data to help providers reduce costs, optimize drug inventories, and streamline medication supply. We’ve also developed the Cardinal Health Atrix™ Elements offering, which is a suite of hospital reimbursement services that help improve hospitals’ workflows and efficiencies. We’ve driven tremendous progress in our services for health systems, leading to the successful onboarding of a new key customer and additional new health system business coming in fiscal ‘25.

We recently broke ground on our new 350,000 square foot Consumer Health Logistics Center in Central Ohio that we see as a differentiator in the marketplace. Over the past several years, we've experienced growing demand for over-the-counter consumer health products, which are an important part of our offering for retail pharmacy customers, particularly among our valued retail independent community pharmacies. With the innovative technology and automation solutions powering the new facility, which will serve as a centralized replenishment center, we anticipate improved inventory efficiency across our network and providing unparalleled supply chain responsiveness for our customers.

We see the rapid development of advanced automation technologies as an ongoing opportunity for our business. During the quarter we deployed new sortation systems in a number of our distribution centers, with a continual focus on employee safety, customer service and operational efficiency.

Turning to Specialty, where we have and will continue to invest to accelerate our growth. As Aaron noted, our integration of Specialty Networks is underway and the reaction from the providers we serve and the energy from our new teammates has been extremely encouraging.

Specialty Networks' mission as part of Cardinal Health remains creating clinical and economic value for independent physicians by lowering costs, operating more efficiently, and helping them deliver best-in-class care to their patients. We see greater opportunities together, with the business' multi-specialty platform, proprietary technology and deep clinical expertise being a natural extension of Cardinal Health's suite of solutions for specialty practices across the country.

Specialty Networks expands our offerings with physicians in the areas of urology, GI, and rheumatology, while providing a proven platform in PPS Analytics that we'll further invest into in fiscal '25 and look to extend into other therapeutic areas, such as oncology. The platform's insight generation capabilities for clinicians are robust, which accelerates our upstream data and research opportunities with biopharma manufacturers.

We see these and other capabilities as supporting our ongoing build-out of Navista™, our clinician designed oncology practice alliance offering advanced services and technology. Navista's™ mission is to unlock the power of community oncologists to secure their independence and revolutionize patient-centered cancer care. This build-out continues to progress according to plan, as we actively pilot next generation technologies and capabilities with select oncology practices.

Upstream with manufacturers, we saw strong performance from our Biopharma Solutions business during the quarter. With scaled assets, differentiated solutions and a tenured team of experts, our leading Specialty 3PL has supported 23 launches year-to-date through March, with more anticipated in the coming quarters.

Our 3PL and regulatory consulting capabilities helped pioneer the commercialization of the first CAR-T cell and gene therapies years ago, and we continue to bring innovative services to the market.

Opening in May, our Advanced Therapy Innovation Center that features a deep-frozen storage suite will support the complex storage requirements of cell and gene therapies. And we've seen our

Advanced Therapy Solutions and Nuclear and Precision Health Solutions businesses successfully collaborating in support of cell and gene manufacturers.

Turning to the GMPD business, where we're executing our GMPD Improvement Plan, we continued to drive momentum across the business in Q3, with strong sequential segment profit growth and significant improvement versus prior year.

During the quarter we offset approximately 90% of the gross inflation impact on our business. Through the execution of our mitigation initiatives, commercial contracting efforts and the continued realization of reduced costs for international freight, we're on track with our target to address these impacts by the time we exit fiscal '24.

We were pleased to achieve 4% topline growth in the quarter, reflecting the improving health of our business. We saw growth across Cardinal Health Brand and core distribution, and in our domestic and international businesses.

Specifically, our five-point plan to grow Cardinal Health Brand volumes continues to show positive trends across the key leading indicators. Our customer loyalty index score for U.S. Distribution has increased by 14 points in the past two years and is up over 20 points from its pandemic low a few years ago. We've successfully retained key distribution customers, and the team is gearing up for some new customer implementations in the months ahead.

Our product backorders remain near multi-year lows, and we've continued to develop and commercialize new products such as our Kendall Pediatric Sleeve to prevent deep vein thrombosis risk in young patients.

We've noted our investments in the resiliency of our supply chain to better service our customers. In Q3, our efforts were recognized as the first distributor to achieve the highest rating by Healthcare Industry Resiliency Collaborative's Resiliency Badge program, a key industry benchmark of our progress.

Finally, we are executing our simplification initiatives across our business, with a continued focus on optimizing our cost structure and global manufacturing and supply chain.

In Nuclear and Precision Health Solutions, we're realizing continued double-digit growth in theranostics, driven by the successful launch execution of new and advanced theranostics in oncology. For example, we have realized meaningful growth in fiscal '24 from the adoption and growing demand of prostate cancer radiodiagnostics, which are an important tool for healthcare providers to assess and properly treat the disease.

We see a large, growing and diversified pipeline, positioning our business to deliver value long into the future. The pipeline consists of more than 60 opportunities across oncology, cardiology and neurology that are either contracted, in negotiations, or being actively explored with pharmaceutical companies. As an example, in oncology, we look forward to expanding our support of novel prostate radioligand therapies in fiscal '25. As we look into the future, when you consider the strength of the theranostics pipeline, only a handful of successful products are needed to deliver the strong growth outlined in our long-term targets.

Our at-Home Solutions business plays an instrumental role in providing patients and caregivers the critical products and services they need for care in the home. We continue to see strong demand for home healthcare, and over the past decade, we've grown from servicing about 1 million customers annually to around 5 million today. Our business is positioned to accelerate in the coming years as we invest to expand the capacity of our network, the breadth of our offering, and deploy new automation technology. We're excited that our new distribution center being built in South Carolina, featuring the fastest order fulfillment system per square foot in the market, is scheduled to open by early next fiscal year.

In OptiFreight® Logistics, we continue to hear from our customers the value our TotalVue™ Insights technology platform is providing as they seek to control their shipping spend and drive performance. Our technology provides action-driving analytics and benchmarks, with shipping status and delay visibility. We continue to invest in new technology-driven solutions, and true to our commitment to innovation, we collaborate side-by-side with customers. For example, this quarter, we successfully co-developed and introduced a tailored pharmacy shipping solution with a strategic customer, across multiple facilities.

Across our businesses, opportunities are everywhere we look.

We've affirmed our long-term targets for the enterprise and segments, which reflects Cardinal Health's ability to achieve sustained growth and deliver attractive returns for shareholders through an ongoing focus on value creation.

We continue to prioritize the prudent management of our balance sheet and responsible capital allocation. We remain well-positioned with the financial flexibility to continue investing in our business and returning capital to shareholders.

As part of our simplification journey, we are taking proactive actions to optimize our future cost structure and enhance our ability to grow well into the future. During the quarter, we took substantial steps to reduce our corporate real estate footprint and reorganized certain teams for greater efficiency and effectiveness.

Our Business Review Committee continues to make progress on our ongoing review of the GMPD business. We have no further updates to share today, but plan to keep you apprised of our progress. Driving the improvement plan remains the near-term priority, and the team is making excellent progress.

To close, we've had a strong first three quarters of the year and are focused on sprinting through the tape. Plans are in place to deliver growth in fiscal '25 and beyond, and we're eager to continue delivering for our many stakeholders. None of this would be possible without our highly-engaged and talented team, who continues to lean in, drive our company forward, and 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 wish to ask any questions, please press star one on your telephone keypad. Please also [indiscernible]. Also, please limit yourselves to one question each. Thank you. Our first question today is coming from Lisa Gill, coming from JP Morgan. Please go ahead.

Lisa Gill: Hi, good morning, and thanks for taking my question. Jason, I just really want to dig into the 2025 guidance that you have given, especially when we think about the Rx and specialty business. We clearly know that revenue will be down, because of the change Rx, I am sorry because of the OptumRx contract, but [indiscernible].

Operator: Very sorry about that gentlemen, her line appears just a drop suddenly, so she could just dial back in I will put her back in a queue but now we will move to Michael Cherny. Please go ahead.

Michael Cherny: Good morning. Hopefully my line won’t drop. I probably have a similar question to Lisa, so hopefully you can address this directly. Relative to the ‘25 segment EBIT, as you think about the moving pieces here, maybe it's a two-part question. First, is there any way you can give us underlying growth rate beyond the loss of Optum? And then second, as you think about the at least 1% segment performance, can you give us just a further breakdown on how much of that is volume growth versus mix, versus new customers? Any more color you can provide on that as we think about the jumping off point and how that factors into ‘26 would be great. Thanks so much.

Aaron Alt: Sure. Good morning, this is Aaron. I appreciate the question and happy to provide a little more context. I want to start by observing that the PS&S team have strong plans for ‘25 as they continue to deliver against what was a very strong fiscal ‘24. We had provided long-term guidance for PS&S of 4 to 6% profit growth. As we now think about that in comparison to the guidance we provided today of at least 1% profit growth within that segment. The delta you should think about it is really the impact of profit, net impact of profit so far, relative to the Optum business. And the simple math I do is if you take the midpoint of our long-term guidance, the 5%, each percentage point is worth about $20 million. If you take it down to the 1%, the at least 1% that we have guided, that's about an $80 million net impact so far that we are working through. So, that's the profit guide I would give you.

On the revenue side, I would observe that we have already provided the impact that fiscal ‘23 was about 16% of our revenue. Fiscal ’24 is not yet done, we will land somewhere between $35 million and $40 billion of revenue. Back that out but recognizing that the portfolio is still growing 10% or so, as we push ahead.

And then lastly on the cash flow side of the house, I hope you noted my comments that we are holding to our average of $2 billion of adjusted cash flow each year in the ‘24 to ‘26 period. It will be lower in ‘25 as we work through the negative working capital position from that non-renew contract and a days of the week impact. But this is manageable, and I hope you take away from the fact we're calling growth as we push ahead for PS&S, we have plans in place. Jason, do you want to add?

Jason Hollar: Yes. Just I'll build out a little bit further the puts and takes for ‘25. As Aaron highlighted and scoped it, the delta is a net approximately $80 million when you look at those different reference points. So, that obviously implies an Optum impact of something greater than that. That's being partially mitigated through several different items that we have called out. One is the other customer progress that we have had. So, there's value proposition is definitely resonating well with our customers, and so we have had good win rates in other areas, so that would allow us some opportunity to partially offset that. That's included in that net $80 million, as well as the inclusion of Specialty Networks. So overall, Specialty growth we expect to continue to be strong and then we have the Specialty Networks acquisition that closed last month. So, we'll get kind of get a three-quarter type of year-over-year benefit because we'll have it in our fourth quarter as well and the ongoing growth with that. And then there's some opportunity to further reduce costs by streamlining our processes even further, simplifying even further. So overall, we feel really good about those offsets, and that gets us to that net about 4 percentage points that we're calling out right now.

Matt Sims: Next question, please.

Operator: Thank you, sir. We will now move to George Hill of Deutsche Bank. Please go ahead. Your line is open.

George Hill: Yes. Good morning, guys. Jason, I have a question around the intersection of the competitive environment in Specialty. The industry's been pretty stable without any large contract switches for a while, though we saw two kinds of in the last handful of months. And my question is like given the composition of assets in the Pharmaceutical business right now, are you seeing more of a demand for what I would call like cross-functional service where people want to see core pharmaceutical distribution with other parts of specialty as it relates to oncology? And just trying to figure out like how do you guys feel with the breadth of solutions that you offer as the competitive environment evolves?

Jason Hollar: Yeah, there's a couple of things I think about with this, George. First of all, thanks for the question. As I step back and think about just the backdrop of your question on the competitive environment, while there are a couple of changing hands, as you highlighted, I think the overall market continues to behave in a very rational way. We continue to be very thoughtful and disciplined in how we participate within it. And it's the exception of those contracts changing hands. The vast majority of contracts don't change hands as they come up for renewal. So, I don't think that, that changes things. And while you're still stepping back from everything, our role, ultimately, on the distribution side is to safely, securely, and efficiently deliver these products for our customers. That hasn't changed. Now I think your question is, are there other elements that make that evolve further? Hey, we've got the full suite of services. We are building those out further. I think our customers always are looking for opportunities where we can add additional value. That hasn't changed either, it just evolves as to where they are most focused. And each customer has a little bit different value proposition from which to build from. So that will resonate better with some customers than others. And our objective is to continue to build out those capabilities, both upstream and downstream, so that we can be that full-service supplier and partner to ensure that we can help them to grow their business.

Aaron Alt: George, I would add one further thought, which is, as you see from examples like our acquisition of Specialty Networks. Of course, we continue to work to get closer to the ultimate practitioner so that we are prepared to offer the incremental services that the industry is demanding.

Operator: Thank you. We now move to Lisa Gill of JP Morgan. Thanks. Please go ahead again, ma'am.

Lisa Gill: Good morning and thank you. And hopefully, this time it will work. So, my question was actually asked, but I want to just really dig in just a little bit deeper. As I think about the cadence for 2025? I know you're not giving specific guidance, but maybe even first half, second half as we think about some of the comments you made, for example, simplifying costs, right, that [indiscernible].

Operator: Okay. Very sorry about that. It would appear I'm very sorry [indiscernible].

Jason Hollar: I think we can understand where she was going with trying to build out further for first half versus second half. So, the one thing I would stress, let's talk about the puts and takes and the timing of the puts and takes. So, this customer migration will be somewhat of a cliff event at the end of the fiscal year. So, the June 30 to July 1, which is exactly the beginning of the fiscal year. So that first quarter, we'll see that volume drop off fairly precipitously. And then the other business that we've won, some of it is already feathering in. Some of that will continue over the course of the year, and we've highlighted in our comments, a lot of it will be in the second half of fiscal '25. So, the timing of that piece of the puts and takes will be a little bit more second half weighted, especially networks. I referenced that is a nice tailwind that is going to start benefiting us. It's included in our guidance for the fourth quarter. But we'll have 3 quarters of year-over-year performance driven by that business being added in and continued just overall growth of utilization over the course of next year that we expect as well. The other cost actions will be varied. There are some things we've been planning for this for quite some time. And so, some of those cost actions will be in place by the end of the year. Some of those will need to take time to allow our operations to settle with that lower volume. So, this is a customer that beyond it being, it's a large and growing customer, so we definitely like that volume. At the same time, it was a customer that had a lot of non-standard and customized processes, and the demand profile was a bit more volatile. So, we'll be able to operate more efficiently as this volume exits, but that won't necessarily be a day one type of thing. It will take us a little bit of time to get to each of the individual sites to be flowing with the new product that is coming in, but also just optimizing with the existing product. So, the puts and takes there are all items that we start to see some mitigation at the very beginning of the fiscal year and then build over the course of the year.

Matt Sims: Next question, please?

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

Allen Lutz: Good morning and thanks for taking the question. We've heard anecdotally that generic prices are a little bit firmer this time versus maybe last year. Can you talk a little bit about buy side and sell side pricing here of generics and maybe how gross profit dollars in that part of the business and generics are trending versus [indiscernible].

Aaron Alt: Thanks for the question. What we would tell you is as we continue to be in an environment of consistent market dynamics where we see stability on the buy and the sell within our generic business. As we've talked about in the past, the stability that comes with that is when we see a rising tide of volume and a strong prescription demand environment, which we have, we continue to see strength in the generics portfolio and that's where we are. We are aware that others have made comments somewhat vary from that over time, but we see consistent market dynamics and view that stability as a strength of our portfolio.

Operator: Thank you. We'll now move to Kevin Caliendo, calling from UBS. Please go ahead.

Kevin Caliendo: Thanks. I'll try to ask quickly before it gets dropped. Can you help us bridge on the Medical side, sort of the inputs to get to your fiscal ‘25 operating income from sort of where we are today? What are the most important factors that will get us from, sort of, where we are with the run rate through fiscal 3Q of ‘24 to the expected numbers in fiscal ‘25? And then just a quick follow-up. Does the loss of Optum and your partner in Red Oak also lost a large payer contract, has that affected Red Oak in any way, shape or form or you're purchasing power or your economics there? I'm just wondering how to think about that because it's two sizable chunks of business, but I just don't know how to think about the impact on Red Oak. Thank you.

Aaron Alt: Why don't I start with the Med cadence and then turn it to over to Jason to talk further about Red Oak. Look, the Med, the GMPD business, we are executing against the plan that we've now been talking about for several quarters. And a couple of numbers on the page, fiscal year ‘23, it was a negative $165 million. In fiscal ‘24 today, we've confirmed we're calling a positive $65 million. That's about a $230 million swing, which puts us halfway to the fiscal ‘26 target of $300 million. Fiscal ‘25, we've called today will be approximately $175 million, really a midpoint between those. How we get there is how we've gotten halfway there so far. The single biggest initiative, the single biggest impact to those numbers is continuing to achieve the inflation mitigation that we've been talking about for several quarters. We exited Q3 at about 90%. We expect to achieve full mitigation by the end of the fiscal year. But as we move into next year, of course, we'll be lapping a lower percentage execution. So that will be a tailwind. That will be a significant tailwind for us certainly in the first half, indeed, the first, for the full year. It's also important that we continue to see the good revenue growth and in particular, the good volume and revenue growth tied to the Cardinal Health Brand is that is a broader, that is a more profitable part of our business. I know you noticed that in Q1, we called out a positive change in trend relative to the revenue in that business. In Q2, we saw 2% growth. Q4, we saw 4% growth. And so, we're seeing signs of progress that give us reasons to believe that we can achieve both the $65 million this year and the $175 million next year.

Lastly, on the cadence and the importance of the team will continue to do what they've been doing around simplification and cost out, right? It's a very complex business, and the team has been doing a good job of simplifying and identifying sources of cost this year, and that will continue into next year as well.

Jason, anything you want to add or talk about Red Oak?

Jason Hollar: Nothing to add on that component as it relates to Red Oak. We feel very good about the scale and competitiveness of that venture, joint venture that we have with CVS, the combined volume that we both bring is sufficient to have significant scale in the space. The percentage of volume that was related to the lost customer is quite small relative to the total that we have that remains. So, we feel good about our, continuing our mandate of both continued value for our partners and ultimately our customers, and as well as the dual mandate aspect of also driving supply as much as possible.

Matt Sims: Next question, please.

Operator: We'll now go to Eric Percher calling from Nephron Research. Please go ahead.

Eric Percher: Thank you. A couple of modest items relative to Pharma that I want to tick through. One is in discussing the headwind penciling out to $80 million used the comments so far, once or twice, is that so far reflecting that there may be more mitigation or that this is in flux? That would be one. Number two, is there a contemplation of any incentive comp reduction in ‘25 that would then reset in ‘26 in that mitigation? And the last one is Specialty Networks, it sounds like you're expecting a benefit at the op profit line. I believe the comment when you closed it would be accretive 12 months following close. Any commentary on contribution there would be helpful as well. Thank you.

Jason Hollar: Yes. So, the ‘so far comment’ was simply to highlight that we are guiding to at least 1% growth. And so that reference is entirely around of course, we continue to look for other opportunities to mitigate further and depending upon our success with those additional actions will be the answer to your question about incentive comp. We’ll of course, appropriately define a target with the alignment with our Board to ensure that we are motivated to drive the business forward. And then as it relates to Specialty Networks, our underlying assumptions are unchanged. The accretive comment was, you're right, Eric, that the reference point was a year after the close, and that was including the dilutive effect on the interest. So, the lost interest on the $1.2 billion is the offset to the operating earnings that we see within the Pharma business. So, it's really just the geography of the plus and minus with that.

Aaron Alt: Eric, you had also asked about the impact to compensation plans and the point I would make is we set compensation plans on an annual basis for the management teams. But we also have a long-term element, which is highlighted in our proxy, the targets there and we'll continue to, the teams will be continually motivated to hit those objectives.

Matt Sims: Next question, please.

Operator: The next question will be coming from Stephanie Davis of Barclays. Please go ahead.

Stephanie Davis: Hi guys. Thank you for taking my question. You called out a few new wins and expansions in the prepared remarks, and you did highlight some customer progress that offsets the Optum headwinds. So, I was hoping we can dig in there a little bit more. Can you tell us about the nature of these wins? Is this more core? Is it on the Other-ologies. And how much the bridge from

FY25 to the three-year guidance relies on further progress with these wins versus more of the streamlining and cost out that you've called out.

Jason Hollar: Yeah. So, it's across various classes of trade. So, its broad-based wins that we've received. We are not anticipating needing additional new wins beyond what we've already completed or in process of completing. And that's why when you think about the embedded guidance that we're talking about in terms of maintaining our long-term targets of that 4% to 6% growth. Some years, like this year, we're at above the high end and next year will be a little bit below the low end the average is out to that 4% to 6%. And so, it implies a ‘26 and beyond type of rate, that continues to be in that 4% to 6% range, which is kind of a normalized ongoing type of earnings level. So, how I step back and think about our progress to date, it really comes down to our service levels and our customer service and really listening to what is important to those customers and working with them for a solution that is not necessarily customized, it is standardized, but with their needs in mind. And we're getting fantastic feedback from our current customers in terms of what that service level has been, that is translating over to the desire by customers that we're not working with today to consider using Cardinal Health. And so, we have the time, attention and energy now that we're able to devote even more to those existing customers to streamline those processes in a little bit more of a simplified fashion, and we'll continue to drive that value proposition with those new customers. But it's very much a booked-business type of perspective that we're now into execution mode. And after this year, fiscal ‘25, we'd expect it to be even more normalized at that point.

Aaron Alt: I would add a couple of things to that. First, you asked about cost out and my response, or our response, is that simplification has been a priority of ours for the last couple of years, and we will, of course, continue to go looking for ways we can simplify our operations and optimize our cost. But let me be clear, right, we are not backing away from customer support, particularly the new customers coming on board so that we do that seamlessly. And we're not backing away from investing in our future across our enterprise. And so, we will continue to talk about the highlights of those as we make them in future earnings calls, but we will optimize as appropriate, while focused on the long-term.

Operator: Thank you, sir. We'll now move to Eric Coldwell calling from Baird. Please go ahead.
Eric Coldwell: Thanks, and good morning. I wanted to talk a bit about Specialty in general and then tie in Specialty Networks. So, in the recent past, you've given a sizing of your overall Specialty business in the low-to-mid $30 billion range. You will lose some of that with the Optum roll off, probably $3.5-$4 billion, I'm guessing, you're going to add some with Specialty Networks and then you have normal market growth. So, netting this all together, what would you anticipate the baseline specialty business to be sized at when you start fiscal ‘25?

Jason Hollar: So those are a number of puts and takes that as you noticed, I'm sure, Eric, we did not provide revenue guidance in this update. We will be providing that in the next update, of course. So certainly, you're in the ballpark on the Optum piece because as I've highlighted before, that is about 10% of that overall book of business. That Specialty, everything else will be PD non-specialty. And Specialty Networks, the revenue is quite low because it's the service revenue, it's not distribution revenue, so that's what I would think of independent is that we, of course, would expect our non-Optum Specialty revenue to continue to grow nicely, and we will frame that. But don't think about that as something specifically related to Specialty Networks.

Operator: Thank you very much. Our next question is coming from Elizabeth Anderson calling from Evercore. Please go ahead.

Elizabeth Anderson: Hi guys. Thanks so much for the question. I was hoping you could talk a little bit more about GMPD. It seems like the competitive environment maybe is improving in your favor, it seems like maybe there's some benefit from underlying, just like utilization demand. Could you please just give us a little bit more color on sort of those underlying changing dynamics and maybe more conceptually and above some of the specific cost cutting and other inflation offsets that you've already talked about?

Jason Hollar: Yeah, I think the competitive environment, I'm not sure I'd put much into that. Our performance within this industry has improved dramatically. I referenced in my comments the customer loyalty scores have improved consistently and dramatically from the bottom of the pandemic a couple of years ago. So, our performance is noticeable. Our customers are feeling it that customer loyalty index, the score is behind it improving because we have the low back order. We have product availability. We have great service levels. We're very engaged from a sales force perspective. So, we're out there now selling instead of reacting to the challenges of the pandemic. So, our customers are feeling that. We have very stable win-loss types of rates. We're growing at least with the market now. So, it's more of us showing up, I think, the right way than the market being overly growing more or growing less. The market utilization continues to be more and more normalized. So, there's maybe a little bit of volatility here and there, but it's much more normalized compared to where it has been in the last several years. And that's the environment we like. We like to see predictable, consistent lower single-digit type of utilization rates that we can grow a little bit above that through our mix and other actions. And then, of course, as Aaron highlighted, the single biggest driver, not only this past year, but what we expect at least in the first half of next year would be the, just the lapping of the inflation impacts and everything we've done to mitigate that. Which that's another thing that's helpful for us to get that behind us so that we're focused on selling and talking to our customers what the value that we can help provide them as opposed to dealing with inflationary fluctuations that have occurred in the past. So, we're well positioned to now drive the other elements, the Medical, the GMPD improvement plan, which is the ongoing simplification, the ongoing cost reductions, but just continuing to really prioritize more than anything that Cardinal Health Brand volume growth.

Matt Sims: Next question, please.

Operator: Yes, sir, the next question is coming from Stephen Baxter calling from Wells Fargo. Please go ahead.

Stephen Baxter: Hi, thanks. Just one quick confirmation and then the actual question. I think what you're suggesting is that beyond fiscal 2025 there is no direct or indirect impact from the Optum contract loss to compensate. Just wanted to confirm that point, that there's no earnings contribution from a transitional period inside the 2025. And then the actual question is from the Other segment, the revenue growth has been quite strong. It's taken a little bit of the profit growth to kind of catch up to your long-term expectations. Just remind us of the key moving parts there are to accelerate the profit growth in the next couple years? Thanks.

Aaron Alt: Sure, in answer to your first question, our guide today does confirm the long-term growth within the Pharma business of 4% to 6%. It will be off a lower base in fiscal ‘25 as we grow at least the 1%. We have not commented on absolute dollar basis, but we will provide more context on that when we get to our year end results and final guidance for fiscal ‘25 during our August earnings call.

With respect to the Other business, we are pleased with what we're seeing so far. We re-segmented the operation to create additional transparency focus and accountability, and I referenced in my prepared remarks that we are already seeing the benefit of that. The top-line results are good, right? And we guided 6% to 8% profit growth for this year. We were a little bit lower than that in Q3 for the businesses aggregating in Other so far, and of course we had the impact of some of the non-recurring adjustments that we called out in Q2 tied to the at-Home business which reports into Other in the second quarter. But I want to emphasize we did confirm that we are expecting to achieve the higher results, the 8% to 10%, for the fiscal ‘24, and we confirmed the high end of that range for fiscal ‘25. As Jason digs in with the businesses now reporting directly to them, and as we invest as an enterprise against setting those businesses up for a higher growth trajectory.

Jason Hollar: Yeah, just a couple things to add. First of all, the first question, just to be real explicit, given it's a cliff event, customer transition that we are anticipating for July 1, we have anticipated that that would be largely in fiscal ‘25 results and there's nothing that we're calling out or indicating at this point that would carry over into ‘26. And as it relates to the other businesses, how I think about them, they are each growing very nicely. They each have strong industry, strong sectors of the industry that are benefiting from their own individual secular tailwinds, so they each have different reasons for their growth, but ultimately it's because each of these three areas provide a real interesting value proposition to customers and ultimately to the patients, and each of these three we have a leadership position in, so we're not only benefiting from that secular trend but we’re leading and maintaining or growing our own fair share within it. So, we are well-positioned for each one of these three and why we have confidence. We are investing into them, as Aaron highlighted. That's driving the growth that we believe will be driving long-term profitability as well.

Matt Sims: Next question, please.

Operator: Yes, sir. Next question will be coming from Charles Rhyee of TD Cowen. Please go ahead. Your line is open.

Lucas Romanski: Hi, this is Lucas on for Charles. I wanted to ask about Cardinal Health Brand and get a sense of where we're at to the path of realizing $50 million in targeted growth by fiscal ‘26. I understand that you have expanded the number of products you offer under a private label and that you're starting to see momentum in growing volumes. Can you help us understand how much of that $50 million has already been realized, and then how much we should expect you guys to realize in fiscal ‘25? Thanks.

Jason Hollar: Yeah, so I would, we inflected a couple quarters ago, right? You saw that with our overall revenue growth that is partly driven by the Cardinal Health Brand volume growth. So, we saw, for example, this quarter our revenue growth of 4% was prorated within that national brand as well as Cardinal Health Brand, so we are seeing distribution stabilize. We are seeing that we have won some business there that has allowed us to grow at or a little bit better than the market, so overall we are seeing that this business has now stabilized at a growth consistent with the market. We expect that to continue. This is something that we do have as a component of that growth. As Aaron highlighted, the single biggest driver of profit performance from ‘24 to ‘25 is the annualization, the carryover of the inflationary pressure. So, that’s the biggest item of that implied $100 million to $110 million year-over-year profit improvement. Then beyond that you have Cardinal Health Brand volume growth, cost reductions and other actions, and so it is a component. It's not the biggest component, and then it would be from ‘25 to ‘26 the primary components that then drive that growth would be Cardinal Health Brand volume as well as further cost reductions as we continue to look to streamline and optimize our footprint, as well as our other supporting costs. So, we're not going to break out the individual pieces there, but those are the biggest pieces then when you go from ‘25 to ‘26.

Matt Sims: Next question, please.

Operator: Yes, sir. Our last question today will be coming from Daniel Grosslight of Citi. Please go ahead. Your line is open.

Daniel Grosslight: Hey, guys. Most of my questions have been asked, but I was hoping to just get an update on Navista™ and any metrics you're able to share on the market adoption you're seeing there, number of providers aligned to it, et cetera. And I know one of the key strategic objectives of the Specialty Networks acquisition was to kind of integrate some of their technology, [indiscernible] into Navista™ and other specialty assets. I'm also curious if you can provide an update on how quickly you can integrate that technology or if you have already kind of started on that path. Thank you.

Jason Hollar: Yeah, thanks for the question, Daniel. And so, with Navista™, we are on track to everything that we laid out first raising this about a year ago. As I think about the progress that we have made, I break it into a few key buckets. First of all, first and foremost, we have hired and brought in a fantastic team, a great mixture of internal and external talent, really drawing from industry those that have done this before and understand what that looks like, but also using our own expertise that have been more focused on other therapeutic areas, but a nice augmentation of the two. And then that new team quickly went to work and defined, well, went in front of our customers and perspective customers and really listened as to what is it that they need to run their practice, their business more efficiently, more effectively. And it was through that work that we then came to the final point, which is defining the tools, the capabilities that we are building within Navista™. So, we didn't just go off and build it. We are building it around what the customers are demanding that they need, those community oncologists, those independent community oncologists, really looking at differentiating for what they need to run their business, both again efficiently, but also effectively to further improve upon the lives of their patients. So, that is the work that's been done, and we are every day building out more elements of this. So, I wouldn't think about it as a particular date that everything goes live, and we suddenly have this influx of volume. This is the type of thing that builds out our capability over time in different ways and working with our current customers as well as the prospective ones to layer in when they come into this network and which services they utilize within the network. So that leads you to the Specialty Networks piece, which I would think about it as we now have an internal technology and capability set that's augmenting what we had before. But Navista’s™ always approached us in terms of the best of the best in the industry. Using what we have is great, but we also are using a lot of third-party partners to bring in their tools and capabilities because we're going to put the customers' needs first, the providers' needs first and then build around that. So, we do see that there's a role for Specialty Networks and their PPS analytics platform. But we're not going to make that the priority. We're going to listen to the customers and then determine which pieces of that to bring into that network. So, we haven't finalized those decisions as it relates to Specialty Networks. But what I will tell you, on day one, just having that team's insights and expertise has been very beneficial to our own Navista™ team. And I mentioned this when we announced the acquisition of Specialty Networks, yes, the assets are fantastic. The business is fantastic, but the most important thing for us was the leadership team and the capabilities that they're bringing along with it is every bit as great as what we thought it was when we made the announcement, and we're seeing that with boots on the ground now as we work, not just with Navista™, but with the broader business to further improve our capabilities across all the therapeutic areas.

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

Jason Hollar: Yes, thank you. Just to close, I appreciate everyone spending some time with us this morning. We hope the overall message that you took away from the call today is that we have a strong and resilient business and a very clear plan for us for '25 and '26, and we're excited about the opportunities and ensuring that our customers and their patients continue to get fantastic service. So, thanks again for joining us today, and have a great day.

Operator: Thank you very much. Ladies and gentlemen, that concludes today's presentation. Thank you for your attendance. You may now disconnect. Have a good day, and goodbye.