

Cardinal Health

Awaiting further execution across both segments

Reiterate Rating: NEUTRAL | PO: 115.00 USD | Price: 105.10 USD

Favorable industry trends, but segment level questions

We continue to view drug distributors as one of the best sub-sectors in healthcare services, driven by steady competitive dynamics and above trend utilization. Cardinal's gross profit beat expectations, indicating to us that the core Pharmaceutical segment is performing in-line with expectations. The higher than expected operating expenses reflect reasonable investments across both businesses (ex: investments in the Navista network, variable costs related to incremental volume, and new medical distribution facilities in Texas/South Carolina). Overall, the combination of weaker Medical EBIT and slightly higher operating expenses indicates core growth is trending below our prior expectations, though management indicated it has strong line of sight into drivers of the 2H ramp, particularly in Medical. At this time, we wait for continued execution across both segments before becoming more constructive. We maintain our Neutral rating on CAH and increase our PO to \$115 from \$112, based on ~15.0x CY24 EPS (15.5x prior) with the multiple reduction to reflect higher execution risks.

Raising FY24 EPS on primarily on below-the-line items

We are increasing our FY24E EPS from \$6.90 to \$7.32 and increasing our FY25E EPS from \$7.70 to \$8.06. We are increasing our EPS estimates primarily to reflect lower interest expense and share buybacks.

Key themes from here: Medical trends, Pharma utilization

For FY24, we continue to monitor broad healthcare utilization that will drive trends across both segments, as well as inflationary impacts (commodity pricing, transportation pricing) that impact Medical. The key focus for FY24 is on the company's ability to ramp Medical EBIT in line with expectations. Moreover, we will keep an eye on hospital utilization trends which is an additional swing factor to Medical EBIT.

Estimates (Jun) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	5.06	5.80	7.32	8.06	8.76
GAAP EPS	10.89	8.57	8.16	7.25	7.86
EPS Change (YoY)	-9.0%	14.6%	26.2%	10.1%	8.7%
Consensus EPS (Bloomberg)			6.98	7.77	8.48
DPS	1.99	2.01	2.05	2.05	2.05
Valuation (Jun)					
P/E	21.6x	18.8x	14.9x	13.5x	12.5x
GAAP P/E	10.0x	12.7x	13.4x	15.1x	13.9x
Dividend Yield	1.8%	1.8%	1.9%	1.9%	1.9%
EV / EBITDA*	15.6x	15.1x	12.8x	11.6x	10.8x
Free Cash Flow Yield*	10.2%	8.8%	9.5%	10.3%	10.9%

* For full definitions of *IQmethod*SM measures, see page 10.

01 February 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	112.00	115.00
2024E EPS	6.90	7.32
2025E EPS	7.70	8.06
2026E EPS	8.44	8.76
2024E EBITDA (m)	2,885.0	2,861.2
2025E EBITDA (m)	3,156.3	3,165.5
2026E EBITDA (m)	3,394.4	3,393.9

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Stock Data

Price	105.10 USD
Price Objective	115.00 USD
Date Established	1-Feb-2024
Investment Opinion	B-2-7
52-Week Range	68.53 USD - 111.40 USD
Mrkt Val (mn) / Shares Out (mn)	25,904 USD / 246.5
Free Float	99.3%
Average Daily Value (mn)	209.31 USD
BofA Ticker / Exchange	CAH / NYS
Bloomberg / Reuters	CAH US / CAH.N
ROE (2024E)	NA
Net Dbt to Eqty (Jun-2023A)	NA
ESGMeter TM	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

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iQprofileSM Cardinal Health

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	9.8%	13.0%	17.0%	17.5%	18.3%
Return on Equity	261.0%	NM	NM	NM	NM
Operating Margin	1.1%	1.0%	1.1%	1.1%	1.1%
Free Cash Flow	2,735	2,358	2,555	2,771	2,926

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	2.2x	1.9x	1.7x	1.7x	1.6x
Asset Replacement Ratio	0.6x	0.7x	0.7x	0.7x	0.6x
Tax Rate	22.2%	22.8%	23.7%	25.3%	25.3%
Net Debt-to-Equity Ratio	NM	NM	NM	NM	NM
Interest Cover	13.3x	22.1x	46.9x	NM	NM

Income Statement Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	181,363	205,012	224,706	240,972	257,272
% Change	11.6%	13.0%	9.6%	7.2%	6.8%
Gross Profit	6,547	6,889	7,457	7,984	8,512
% Change	-3.0%	5.2%	8.2%	7.1%	6.6%
EBITDA	2,348	2,434	2,861	3,166	3,394
% Change	-9.3%	3.7%	17.6%	10.6%	7.2%
Net Interest & Other Income	(164)	(88)	(58)	(57)	(58)
Net Income (Adjusted)	1,420	1,518	1,809	1,985	2,130
% Change	-13.2%	6.9%	19.2%	9.7%	7.3%

Free Cash Flow Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	(932)	262	2,140	1,812	1,940
Depreciation & Amortization	692	692	705	775	836
Change in Working Capital	831	1,431	(81)	31	5
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	2,531	454	289	683	684
Capital Expenditure	(387)	(481)	(498)	(530)	(540)
Free Cash Flow	2,735	2,358	2,555	2,771	2,926
% Change	34.8%	-13.8%	8.4%	8.5%	5.6%
Share / Issue Repurchase	(1,000)	(2,000)	(750)	(1,100)	(1,500)
Cost of Dividends Paid	(559)	(525)	(507)	(505)	(498)
Change in Debt	(885)	(579)	64	0	0

Balance Sheet Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	4,717	4,043	3,827	4,319	4,571
Trade Receivables	10,561	11,344	12,464	13,334	14,200
Other Current Assets	17,657	18,446	20,285	21,818	23,363
Property, Plant & Equipment	2,361	2,462	2,728	2,900	3,053
Other Non-Current Assets	8,582	7,122	7,837	7,674	7,463
Total Assets	43,878	43,417	47,142	50,045	52,651
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	29,970	32,914	35,792	38,226	40,643
Long-Term Debt	5,315	4,701	4,765	4,765	4,765
Other Non-Current Liabilities	9,299	8,653	8,810	9,327	9,830
Total Liabilities	44,584	46,268	49,367	52,318	55,237
Total Equity	(706)	(2,851)	(2,226)	(2,273)	(2,587)
Total Equity & Liabilities	43,878	43,417	47,142	50,045	52,651

* For full definitions of iQmethodSM measures, see page 10.

Company Sector

Healthcare Technology & Distribution

Company Description

CAH is one of the largest drug and medical product distributors. The company generates approximately two-thirds of its profit from the pharmaceutical business and nearly one-third from its medical business. The pharmaceutical distribution business supports retail/mail/hospital/physician clients as well as drug manufacturers. The medical business manufactures its own portfolio of medical products and distributes brand-name products to hospitals and physicians. The company is based in Dublin, OH.

Investment Rationale

Our Neutral rating accounts for improving macro trends across both segments but also ongoing operating headwinds (both market and company-specific) that are weighing on overall EBIT growth. We see uncertain path for upside catalysts to drive incremental growth (beyond capital deployment acceleration), leaving limited overall visibility even with solid free cash flow generation and an attractive dividend yield, but also see Pharma growth as providing baseline support in healthy end market.

Stock Data

Average Daily Volume 1,991,574

Quarterly Earnings Estimates

	2023	2024
Q1	1.20A	NAA
Q2	1.32A	NAA
Q3	1.74A	NAE
Q4	1.56A	NAE

FY2Q'24 call takeaways

Prepared remarks

- Specialty Networks acquisition to expand access
- Taking action on portfolio review and segment structure updated (to be reflected in 3Q)
- Pharma – reiterating outlook for 7-9% profit growth
 - Overall strength in pharmaceutical demand on brands/generics
- Medical – Say change in trend in revenue growth. 5-point plan to grow volumes yielding results.

Financials

- 2Q performance:
 - EPS of \$1.82, growth of 38%
 - Incremental share repurchase activity in the quarter
 - Higher costs to support sales growth
 - Interest expense down /interest income benefit. \$10MM income from quarterly compensation plan revaluation. Higher cash balance, and lower interest expense
 - Pharma segment:
 - Driven by brand and specialty pharma growth from existing customers
 - Brand, consumer health, generics strength
 - Robust demand for Glucagon-like peptide-1 (GLP-1)- tailwind to quarter
 - Segment profit driven by positive generics performance and higher contribution from brand/specialty and COVID vaccines
 - Medical segment:
 - Reflects quarterly revenue growth for the first time in over two-years
 - At home health and cardinal-health brand products
 - Segment EBIT – consistent with 1Q despite non-recurring events
 - Tracking consistent with original plans
 - \$200MM in year-to-date capex, and returned \$1Bn to shareholders
 - Share repurchases in excess of commitments
 - GAAP only gain of \$100MM on settlement



- FY24 Guidance:
 - Non-GAAP EPS of \$7.20-\$7.35 vs. \$6.75-\$7.00 prior
 - At midpoint 26% y/y growth
 - Interest and Other: \$50-\$65MM from \$100-\$120MM prior. Due to higher than avg. cash balances. Expect lower cash balances in 2H with seasonality and looking at refinancing options for 2024 notes due
 - Non-GAAP Effective Tax Rate: 23-24% vs. 23-25% prior
 - Diluted shares of 247MM vs. 262MM, reflects accelerated share repurchase in 2Q
 - Share repurchases of \$750MM vs. \$500MM prior, but \$250MM of accelerated was done in 2Q.
 - Capex of \$500MM unchanged
 - Adjusted free-cash-flow of \$2.5Bn vs. \$2.0Bn prior
 - Pharma segment – no change to outlook
 - Medical – FY24 outlook segment profit of \$380MM vs. \$400MM prior. Back half weighting for guidance (inflation mitigation, seasonality)
 - Reductions in international freight with 2-3Q delay to reflect in 2H
 - New structure:
 - Beginning 3Q
 - Plan to provide recast of results for 2023/24 on new segments
 - Pharma: Guidance ranges consistent – even excluding higher growth nuclear segment in pharma
 - Global Medical Products and Distribution (GMPD) – operating income of \$65MM in FY24. Roughly have way on a run rate basis to FY26 target
 - Other – Delivery 6-8% segment profit growth. Difference vs. long-term CAGR is due to portion of non-recurring adjustments in at-home health
- Recent acquisition:
 - Specialty is highest priority for acquisition
 - Presence in other 60% of specialty disease states outside of oncology
 - Plan to include financial impact to be in guidance upon closing
 - Expect deal to be accretive 12months after close

- Key goals:

- Focus on specialty and driving growth in pharma
- Generics program (Red Oak) – continuing to invest for commercial engagement and customer engagement. First to market clinically integrated supply chain introduced at investor day. Simplifies supply chain.
- Specialty networks acquisition:
 - Long-term partnership to support distribution – already familiar with business
 - See service capabilities to accelerate:
 - Extending reach across key specialty areas
 - Leader in specialty practice management – to support lower costs
 - Solutions that provide 3k+ urologists
 - PP Analytics platform:
 - Analyzes data to provide actionable insights
 - Improves upstream clinical research solutions for Biopharma
 - Supports Navista network – focused on supporting clinical and operational needs of clinical oncologists
- GMPD business – medical improvement
 - Portfolio review continues. Expects profitability in FY24
 - Mitigated supply chain inflation. As of 2Q, 75% to target
 - Lower freight costs in 2Q and expect this to be the case in through FY24 -have strong line of sight here
 - Opened three new distribution centers. Uses autonomous mobile robots.
- New structure will improve medical improvement efforts
- Accelerating growth:
 - Strong demand in at-home and Opti-freight business. Expect to invest further in these businesses
 - At-home: supporting acute and chronic conditions. Investing to expand capacity. Recently announced distribution center in Texas. Previously announced South Carolina facility to be opened in 2Q
 - 1000+ healthcare providers using insights platform
 - Nuclear/Precision health – above market growth in core and theragnostic. Saw meaningful revenue growth in demand for radiological diagnostics



- Investing to expand Pet manufacturing network – increasing demand for pet
- Shareholder value creation:
 - Cash flow generation driving benefits below operating lines
 - Supports M&A – not only in specialty, but also in other growth areas and for additional repurchases

Q/A

- Hurdle rates for future deals and prioritization in pipeline?
 - Specialty networks – Group Purchasing Organization and PPS Analytics key.
 - PPS Analytics – key part of the value. Believe in where this can go
 - Solving a lot of customer/provider/manufacture challenges. Improves end-patient outcomes
 - Specialty is a profitable business today – investing to expand
- Strategic side on medical – do you still feel a commitment to the business? Seems like core business margins are coming down?
 - Very clear – no changes in commitment to business
 - Medical in context of portfolio review – turning the business around. Working has been in service of mitigating inflation
 - Core operational performance is in line with expectations
 - Non-recurring items in medical – targets unchanged from re-segmentation
 - Pieces unchanged and overall aggregate profitability unchanged
- Interest expense step-down and ongoing thoughts on capital structure. FCF improvement for guidance?
 - Driven by strong cash generation in 2Q. Highlighted that further optimization of cash flow position was a focus. Delivered to those efforts.
 - Some geography within statement. Deferred comp was a positive below the line
 - Have maturities in June/September – reassessing
 - Cash balances fluctuate due to seasonality, expect balances to be lower in 2H
- On medical – hard to see past one-time items. What was trajectory excluding one-time items? What are the other items?
 - Encouraged by underlying performance in medical
 - Sum changes in guidance is the non-recurring items

- Back-half focus remains unchanged
- Cost side – international freight, some noise with red-sea, largely as anticipated. Costs on balance sheet and rolling through as expected. Expect it to step down in 2H
- Contract roll through – updated pricing. More price adjustment impact early in year. Need it to roll through, but have large line of sight into this. Seeing it start to come through now
- Utilization quite good – seeing inflection in revenue growth and participating in market growth. Variable of market still a flux point.
- Not reporting on new segment in 3Q. GMPD core part of business has operated at near breakeven in FY24 so far vs. losses in FY23
- SG&A growth/color for rest of the year?
 - Gross profit grew faster than SG&A
 - Primary growth was variable costs to serve higher volumes
 - Investing in SG&A purposeful – Navista and other parts of growth plan
 - Focused on SG&A as a whole. Looking for further opportunities in cost structure
- Progress on United Healthcare contract? Were there purposeful investments made in 2Q due to upside or all planned?
 - No updated to Optum contract. Goes through this fiscal year.
 - Have disclosed in past – last year, over \$30Bn customer
 - Primarily through base mail order volume business. Typical customer with PB and mail order business. Lower margin business, but has some other business as well.
 - SG&A – look at capabilities and supporting short-term volumes and longer-term investments (Navista, others – at-home business, medical distribution 3 facilities, pharma consumer health logistics center, ecommerce capabilities)
- Other segments?
 - Expect 8-10% long-term growth
 - In FY24 guidance there is non-recurring items in at-home health that lowers the growth rate vs. long-term
 - Nuclear doubling profits from FY21 baseline in FY26
- Contribution of \$25MM and anything factored in for the rest of the year on vaccines? SG&A non-recurring \$ amount?
 - Highlighted in Q1 that with approval – would expect higher volumes in 2Q vs. 1Q. Still seeing some volumes in 3Q, but overall lower vs. prior quarters



- Had multiple drivers of growth for pharma segment: Covid, branded, generics
 - Previewed at prior conference: Majority of non-recurring revenue hits at-home health (Other) and Wavemark business (GMPD)
- Vaccine impact expected to peak in the quarter? Was contribution higher in 2Q vs. 1Q?
 - October was the peak month, so clearly higher in 2Q due to full 3-month contribution
 - Tailed off through 3Q – so expecting less contribution
 - There were costs associated with Vaccine roll-out. Lots of volume to roll out for a few months of work. Had to incur costs to ramp up and down.
 - September/October high points of COVID distribution
- The \$20MM one-time concentrated in Medical just this Quarter. If you look at China to West coast shipping costs. How may that roll-through contracts? How would that impact cadence of medical plan?
 - Operational performance in medical reflects expectations
 - Shipping rates have spiked, but substantially lower than in past
 - Do not believe rates to be at high level
 - Have flexibility on contracts

Price objective basis & risk

Cardinal Health (CAH)

Our \$115 price objective is about 15x CY24E EPS. This multiple is above the five-year average of 11x, but below peer multiples. We believe CAH should trade at a discount to distributor peers due to CAH's recent execution challenges, particularly in Medical. The discount incorporates differential in growth rates across both the comparable pharma distribution businesses as well as the long-term appeal of the ancillary businesses.

Upside risks to our PO are any potential volume pickup, increases in buy-side/sell-side spreads, quicker contribution from the various growth initiatives, accelerated capital deployment beyond what we currently forecast, and any value-added changes from the Board strategic review. Downside risks to our PO are incrementally worse drug pricing pressure, increased competition creating gross profit headwinds, the risk of Amazon or another disruptive force entering the supply chain market, ongoing uncertainties to finalizing the opioid litigation process, demand challenges caused by a COVID outbreak, and Medical revenue/profit shortfalls related to market-wide pricing dynamics as well as ongoing supply chain/inflation headwinds.

Analyst Certification

I, Allen Lutz, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Healthcare Technology & Distribution Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Accolade	ACCD	ACCD US	Allen Lutz, CFA
	American Well Corp	AMWL	AMWL US	Allen Lutz, CFA
	Cencora Inc	COR	COR US	Allen Lutz, CFA
	CVS Health	CVS	CVS US	Allen Lutz, CFA
	Definitive Healthcare Corp	DH	DH US	Allen Lutz, CFA
	dentalcorp	YDNTL	DNTL CN	Allen Lutz, CFA
	Envista	NVST	NVST US	Allen Lutz, CFA
	HealthEquity Inc	HQY	HQY US	Allen Lutz, CFA
	Hims & Hers	HIMS	HIMS US	Allen Lutz, CFA
	McKesson	MCK	MCK US	Allen Lutz, CFA
	Omniceil Inc.	OMCL	OMCL US	Allen Lutz, CFA
	Patterson Companies	PDCO	PDCO US	Allen Lutz, CFA
	Progyny	PGNY	PGNY US	Allen Lutz, CFA
	R1 RCM	RCM	RCM US	Allen Lutz, CFA
NEUTRAL				
	Cardinal Health	CAH	CAH US	Allen Lutz, CFA
	Dentsply Sirona, Inc.	XRAY	XRAY US	Allen Lutz, CFA
	Doximity Inc	DOCS	DOCS US	Allen Lutz, CFA
	Teladoc Health	TDOC	TDOC US	Allen Lutz, CFA
UNDERPERFORM				
	GoodRx	GDRX	GDRX US	Allen Lutz, CFA
	Henry Schein	HSIC	HSIC US	Allen Lutz, CFA
	Owens & Minor	OMI	OMI US	Allen Lutz, CFA
	Premier, Inc.	PINC	PINC US	Allen Lutz, CFA
	Walgreens Boots Alliance	WBA	WBA US	Allen Lutz, CFA



iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} +$

Other LT Liabilities

Enterprise Value

Denominator

$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$

Sales

Basic EBIT + Depreciation + Amortization

iQmethodSM is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

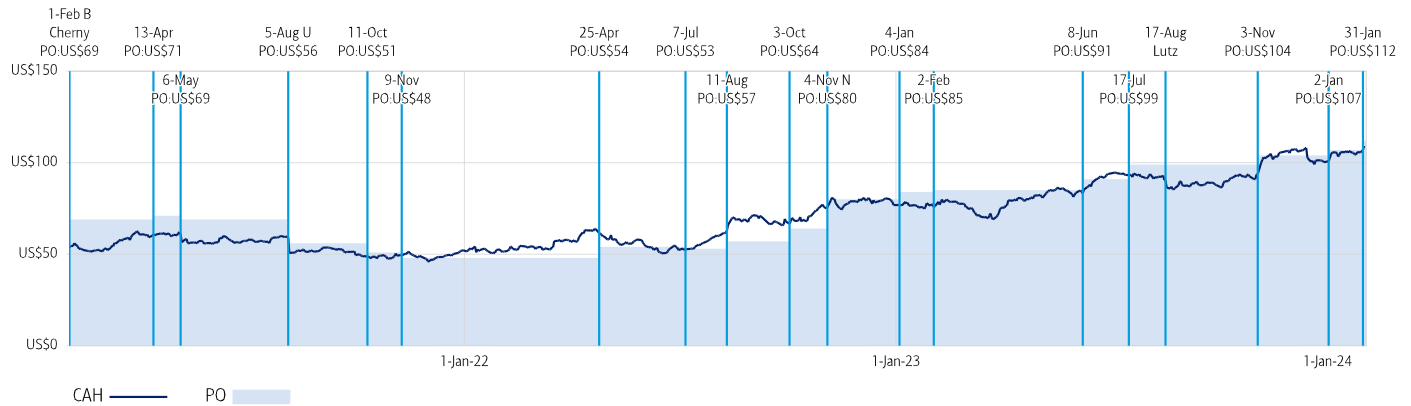
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Disclosures

Important Disclosures

Cardinal Health Inc (CAH) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Health Care Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	234	60.94%	Buy	115	49.15%
Hold	80	20.83%	Hold	36	45.00%
Sell	70	18.23%	Sell	29	41.43%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

INCOME RATINGS, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. **Coverage Cluster** is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

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