

Cardinal Health

Specialty Networks acquisition supports continued growth in specialty

Reiterate Rating: NEUTRAL | PO: 112.00 USD | Price: 107.06 USD

The News: CAH to acquire Specialty Networks for \$1.2Bn

This morning, Cardinal Health announced that it has entered into a definitive agreement to acquire Specialty Networks, a technology-enabled multi-specialty group purchasing and practice management organization for \$1.2Bn cash. Specialty Networks is an integrated multi-specialty platform with group purchasing organizations (GPOs), life sciences, and research solutions in urology, gastroenterology, and rheumatology. The company also provides patient population health management, patient engagement, clinical research, and workflow automation technologies through its PPS Analytics Platform to support standards of care, clinical research, practice operations, and value-based care. According to the Specialty Networks website, the company supports 10,000 providers across 1,500 independent physician practices. The transaction is expected to be accretive to non-GAAP earnings per share 12 months following close. CAH did not provide expectations for when the transaction will close.

Why It Matters: Improves positioning in high-growth area

Today's news is a positive for Cardinal Health, as it further improves the company's positioning within specialty, the fastest growing part of the pharmaceutical supply chain. Specialty has been a key focus area for Cardinal since Jason Hollar took over as CEO in late 2022. At Cardinal Health's investor day in June 2023, the company launched the Navista Network, a set of solutions for community oncologists that helps practices remain independent while allowing them to participate in real-world evidence and outcomes research to monetize their data. Today's acquisition should provide access to more providers, expanding Cardinal Health's reach into specialty further. At Cardinal Health's June 2023 investor day, it noted that specialty was a \$30Bn+ revenue business, growing 14% over the past 3 years. We expect Cardinal's specialty business will continue to grow double digits. We maintain our Neutral rating and increase our PO to \$112 on c15.5x CY24E EPS (15x prior), due to our positive view of this morning's deal and an increase in peer multiples.

Estimates (Jun) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	5.06	5.80	6.90	7.70	8.44
GAAP EPS	10.89	8.57	7.75	6.89	7.55
EPS Change (YoY)	-9.0%	14.6%	19.0%	11.6%	9.6%
Consensus EPS (Bloomberg)			6.98	7.77	8.48
DPS	1.99	2.01	2.05	2.05	2.05
Valuation (Jun)					
P/E	21.2x	18.5x	15.5x	13.9x	12.7x
GAAP P/E	9.8x	12.5x	13.8x	15.5x	14.2x
Dividend Yield	1.9%	1.9%	1.9%	1.9%	1.9%
EV / EBITDA*	15.3x	14.8x	12.5x	11.4x	10.6x
Free Cash Flow Yield*	10.4%	8.9%	9.6%	10.3%	10.9%

* For full definitions of *IQmethod*SM measures, see page 5.

31 January 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	107.00	112.00

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Stock Data

Price	107.06 USD
Price Objective	112.00 USD
Date Established	31-Jan-2024
Investment Opinion	B-2-7
52-Week Range	68.53 USD - 108.85 USD
Mrkt Val (mn) / Shares Out (mn)	26,387 USD / 246.5
Free Float	99.3%
Average Daily Value (mn)	218.88 USD
BofA Ticker / Exchange	CAH / NYS
Bloomberg / Reuters	CAH US / CAH.N
ROE (2024E)	NA
Net Dbt to Eqty (Jun-2023A)	NA
ESGMeter™	High

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Timestamp: 31 January 2024 08:18AM EST

iQprofileSM Cardinal Health

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	9.8%	13.0%	17.3%	18.7%	19.6%
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	2,545	2,706	2,876

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	2.2x	1.9x	1.8x	1.7x	1.6x
Asset Replacement Ratio	0.6x	0.7x	0.7x	0.7x	0.6x
Tax Rate	22.2%	22.8%	26.0%	25.4%	25.4%
Net Debt-to-Equity Ratio	NM	NM	NM	NM	NM
Interest Cover	13.3x	22.1x	22.4x	21.7x	24.3x

Income Statement Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	181,363	205,012	225,538	241,881	258,260
% Change	11.6%	13.0%	10.0%	7.2%	6.8%
Gross Profit	6,547	6,889	7,427	7,953	8,478
% Change	-3.0%	5.2%	7.8%	7.1%	6.6%
EBITDA	2,348	2,434	2,885	3,156	3,394
% Change	-9.3%	3.7%	18.5%	9.4%	7.5%
Net Interest & Other Income	(164)	(88)	(122)	(130)	(126)
Net Income (Adjusted)	1,420	1,518	1,726	1,920	2,076
% Change	-13.2%	6.9%	13.7%	11.2%	8.1%

Free Cash Flow Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	(932)	262	2,081	1,744	1,887
Depreciation & Amortization	692	692	712	777	838
Change in Working Capital	831	1,431	(66)	31	6
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	2,531	454	318	686	687
Capital Expenditure	(387)	(481)	(500)	(532)	(542)
Free Cash Flow	2,735	2,358	2,545	2,706	2,876
% Change	34.8%	-13.8%	7.9%	6.3%	6.3%
Share / Issue Repurchase	(1,000)	(2,000)	(1,430)	(1,100)	(1,500)
Cost of Dividends Paid	(559)	(525)	(513)	(511)	(504)
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	4,034	4,454	4,650
Trade Receivables	10,561	11,344	12,511	13,384	14,255
Other Current Assets	17,657	18,446	20,365	21,906	23,458
Property, Plant & Equipment	2,361	2,462	2,636	2,810	2,963
Other Non-Current Assets	8,582	7,122	7,027	6,863	6,651
Total Assets	43,878	43,417	46,573	49,416	51,978
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	29,970	32,914	35,933	38,379	40,808
Long-Term Debt	5,315	4,701	4,765	4,765	4,765
Other Non-Current Liabilities	9,299	8,653	8,843	9,363	9,867
Total Liabilities	44,584	46,268	49,541	52,507	55,441
Total Equity	(706)	(2,851)	(2,968)	(3,091)	(3,463)
Total Equity & Liabilities	43,878	43,417	46,573	49,416	51,978

* For full definitions of iQmethodSM measures, see page 5.

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 2,044,473

Quarterly Earnings Estimates

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



Price objective basis & risk

Cardinal Health (CAH)

Our \$112 price objective is about 15.5x CY24E EPS. This multiple is above the five-year average of 11x, but below peer multiples. 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.

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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

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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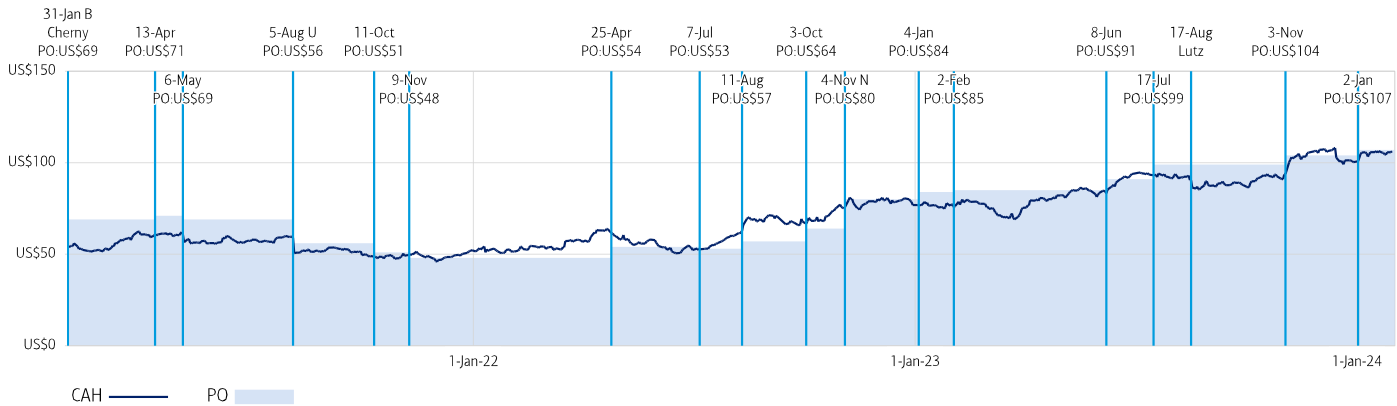
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Disclosures

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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.

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