AmerisourceBergen Corp (ABC) CEO Steve Collis on Q4 2019 Results - Earnings Call Transcript

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Press Release *10-K* *Slides*

EPS of $1.61 beats by $0.03 | Revenue of $45.64B (5.41% Y/Y) beats by $483.6M

Earning Call Audio

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AmerisourceBergen Corp (NYSE:ABC) Q4 2019 Earnings Conference Call November 6, 2019 8:30 AM ET

Company Participants

Bennett Murphy - Head of Investor Relations

Steve Collis - Chairman, President & Chief Executive Officer

Jim Cleary - Chief Financial Officer & Executive Vice President

Conference Call Participants

Robert Jones - Goldman Sachs

Glen Santangelo - Guggenheim Securities

Steven Valiquette - Barclays

Lisa Gill - JPMorgan

Kevin Galindo - UBS

Charles Rhyee - Cowen & Company

Lee Lueder - Deutsche Bank

Ricky Goldwasser - Morgan Stanley

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the ABC Earnings Call. At this time all lines are in a listen only mode. Later, we will conduct a question-and0answer session and instructions will be given at that time. [Operator Instructions] As a reminder, today's conference is being recorded.

I would like to now turn the conference over to Head of Investor Relations, Bennett Murphy. Please go ahead.

Bennett Murphy

Thank you. Good morning and thank you all for joining us for this conference call to discuss AmerisourceBergen's fiscal 2019 Fourth Quarter and Full Year Financial Results. I am Bennett Murphy, Head of Investor Relations, and joining me today are Steve Collis, Chairman, President and CEO; and Jim Cleary, Executive Vice President and CFO.

On today's call, we will be discussing non-GAAP financial measures. Reconciliations of these measures to GAAP are provided in today's press release and are also available on our website at investor.amerisourcebergen.com. We have also posted a slide presentation to accompany today's press release on our investor website.

During this conference call, we will make forward-looking statements about our business and financial expectations on an adjusted non-GAAP basis including but not limited to, EPS, operating income and income taxes. Forward-looking statements are based on management's current expectations that are subject to uncertainty and change. For a discussion of key risks and assumptions, we refer you to today's press release and our SEC filings including our most recent 10-K. AmerisourceBergen assumes no obligation to update any forward-looking statements and this call cannot be rebroadcast without the expressed permission of the Company. You’ll have an opportunity to ask questions after today's remarks by management. We ask that you limit your questions to one per participant in order for us to get to as many participants as possible within the hour.

With that, I will turn the call over to Steve.

Steve Collis

Thank you, Bennett, and good morning to everyone on today's call. I am very pleased to discuss AmerisourceBergen's strong fourth quarter and full fiscal year results, as well as to look ahead and highlight how AmerisourceBergen continues to execute a differentiated strategy and foster a purpose-driven culture to position itself for long-term growth.

Before we discuss our results for the quarter, I want to comment on some of the recent developments regarding the opioid epidemic and related litigation, which we recognize is of concern to our stakeholders including our investors.

As you all know, we have been consistent in stating our desire to address the enormity of the opioid challenge by bringing solutions to the table. We continue to work diligently and alongside partners to combat drug diversion while supporting real solutions to help address the crisis the communities for home, work, in and serve.

As we communicated a couple weeks ago, AmerisourceBergen along with our peers reached a settlement with two Ohio counties in the first track of the multi-district opioid litigation. We believe that safety in the case is an important stepping stone to achieving a global resolution and demonstrating that our industry is being constructive and thoughtful in how we can address this crisis and try to resolve related litigation.

We expect settlement funds to be used in support of initiatives to combat the opioid epidemic including treatment, rehabilitation, mental help and other important efforts. With the Ohio settlements agreed upon, AmerisourceBergen and the other parties will continue the complex process of working towards a global resolution. We are hopeful that the necessary parties including many state and local governments will understand and see the merits of the global framework as a practical path for global resolution.

We take our role in the supply chain seriously. As we continue to work closely with stakeholders to evaluate next steps concerning these complex mattes, AmerisourceBergen will remain responsible stewards of the shareholders' capital. Together, our Board of Directors, management team and associates are focused on developing meaningful solutions for this epidemic.

AmerisourceBergen also remains committed to transparency and as we are able to provide shareholders and other stakeholders the information on our efforts and solutions to address the opioid epidemic and related litigation.

Now turning to our business results. Overall, AmerisourceBergen performed extremely well in fiscal 2019 driven by execution across our Pharmaceutical Distribution and Global Commercialization Services & Animal Health teams.

Revenues were up solid 5% to $45.6 billion for the quarter and reached almost $180 billion for the full year, a 7% increase year-over-year. We delivered adjusted diluted EPS of $1.61, for the fourth quarter and $7.09 for the full fiscal year, an increase of 12% and 9% respectively compared to the previous fiscal year periods.

This strong performance reflects the hard work, dedication and solution-oriented mindset of our 22,000 associates who enable our company to create value for our shareholders, partners, customers and the patents they serve.

Together, we accomplished many notable achievements in fiscal 2019. First, starting with the Pharmaceutical Distribution Services segment, overall, our core Pharmaceutical Distribution business achieved strong performance despite challenges at PharMEDium.

Our distribution businesses are delivering best-in-class service and solutions to assorted portfolio of customers, while maintaining strong execution across the various teams. Our continued strength in specialty distribution and wraparound downstream practice management services produced another year of double-digit growth.

We strengthened our relationship with pharmaceutical manufacturers and grew our provider customer base in addition to benefiting from a robust top-line of pharmaceutical manufacturer innovation.

Additionally, our expertise in areas such as oncology, ophthalmology and rheumatology continue to create an advantage for our market-leading specialty distribution franchise in multiple classes of trade including health systems and physician practices.

Finally, we successfully integrated H.D. Smith and realized the operational synergies of the acquisition more quickly than we expected which bolstered the strong performance of this segment. I am extremely pleased with how associates continually utilize a customer-centric approach to address current market needs and to capitalize on new opportunities and believe that this approach will continue to differentiate AmerisourceBergen in the market and drive our success.

Turning now to an update on PharMEDium. Although this business faced challenges in fiscal 2019, we continue to make progress. In August, PharMEDium completed third-party order inspections at its two open facilities. Based on the findings of the audit, PharMEDium's operations remain on track and importantly, in compliance with the consent decree.

The two open facilities continue to operate with enhanced quality assurance and quality control procedures. In fiscal 2020, we will continue to remediate and optimize operations as we continue to evaluate appropriate next steps for the business.

Next, turning to the performance of our Global Commercialization Services & Animal Health businesses, as a group, these businesses continue to unlock value through their focus on building strong partnership with and providing robust services for manufacturers.

MWI Animal Health delivered strong results as it continues to support growth and demand of its strong customer base, particularly within corporate accounts where the business is successfully collaborating with key partners to create value commercially. MWI continues to further expand relationships with customers who are growing faster than the market.

Additionally, our commercialization businesses are benefiting from investments in leading data and technology platforms across the group, like World Courier, and Fusion at Lash, which continue to drive efficiency and execution excellence, we are pleased with the differentiated services these businesses provide and believe that their performance will continue to create value for manufacturers especially as the increasing number of new innovative therapies come to market in the coming years.

As a central commercialization partner, AmerisourceBergen is committed to the ongoing development of an investment in forward-thinking and patient-centric solutions that further enhance the customer experience and advance access and adherence outcomes for manufacturers.

In addition to supporting manufacturers, we are continuously driving innovation across all points of care given the ongoing evolution of the entire healthcare landscape. In this dynamic market environment, AmerisourceBergen continues to focus on the elements we can control namely, number one, innovating and investing to support growth across the enterprise; two, maintaining focus on execution excellence; three, strengthening associate experience; and lastly, continuing arm roof towards one ABC.

These objectives are in place across the enterprise as we begin the new fiscal year. Furthermore, our differentiated portfolio of businesses and solutions position us well to achieve them. First, our core Pharmaceutical Distribution business continues to enhance safety and security and improved product access and efficiency throughout the healthcare supply chain.

Our state-of-the-art distribution network ability to competitively source generic pharmaceuticals and extensive footprints in physician administered products are some of the differentiated capabilities that enable us to drive access to pharmaceutical care across all points of the healthcare spectrum, as well as remain well positioned for future opportunities such as biosimilars, a market that is involving and remains promising.

In addition to our Global Commercialization Services & Animal Health group continues to be the essential partner for manufacturers through all phases of product development and commercialization. MWI's highly efficient distribution network and strong demand creation capabilities provide pharmaceutical manufacturers with the capabilities required to advance Animal Health while our Portfolio

Commercialization Services businesses offers a critical global specialty and third-party logistics services, market access strategies, patient access and adherence solutions and regulatory and compliance support to facilitate access to pharmaceutical manufacturers' life-saving products.

As we enter fiscal 2020, we have a clear vision for execution across these pillars to deliver on continued shareholder value creation. First, we will continue our focus on alignment with key customers. We are proud of our strong customer partnerships that continue to grow well in each market segments.

As a pharmaceutical sales company, AmerisourceBergen will continue to leverage our pharmaceutical supply chain expertise and scale to deepen relationships and drive additional shared value for all of our partners both upstream and downstream.

Second, we will continue to pull on our leadership in specialty distribution and services. AmerisourceBergen provides unparalleled value through a comprehensive offering in both Pharmaceutical Distribution and commercialization services.

Our extensive footprint in specialty distribution and capabilities uniquely position AmerisourceBergen to provide the innovative commercialization and wraparound services required by complex specialty products.

Leveraging our strength and scale, we are growing manufacturer provider relationships providing the base services and solutions that serve the evolving need while developing – while delivering a seamless customer experience.

Third, we will leverage unique insights for our partnerships and relationships across the globe and industry to bolster our development and delivery of innovative services and solutions. We continue to create and evolve our customer-focused offerings to further enhance and expand value for manufacturers and our provider customers.

For example, we are developing marketing services, digital tools and benchmarking solutions that help pharmacy customers overcome the barriers and complexities of today's healthcare ecosystems.

In addition, we are accelerating the use of technology and data platforms to meet the data, product commercialization and patient adherence needs of our manufacturer partners. Through our businesses, we are constantly exploring ways to apply or expand our expertise to solve new challenges such as bringing simplicity and efficiency to the complex and challenging world of cell and gene therapies.

As connectors between manufacturers and providers, we remain relentless in our pursuit of the most innovative services and solutions that support manufacturer growth and enable providers to run their businesses efficiently.

Finally, AmerisourceBergen continues to focus on strong corporate stewardship. On the financial side, we remain focused on cash flow generation and strategic capital allocation to continue value creation for our shareholders.

On the people side, we are investing both on people and culture through talent development, career growth and diversity initiatives.

I am proud to work alongside the 22,000 purpose-driven associates at AmerisourceBergen and I want to take a moment to thank all of them for their tireless commitment to our customers, unwavering compassion for the patients they serve and for the collaborative innovative and purpose-driven approach towards solving unmet needs.

Our talent is a competitive advantage and we continue to make additional investments to enhance our associates experience. I am personally committed to further strengthening the collective engagement of our associates to move closer towards one ABC becoming even more unified and united in the execution of our strategy and acceleration of our growth.

Our strategy focused on customer partnerships, specialty dealership, innovative services and solutions and successful stewardship are colors that differentiate AmerisourceBergen and it is AmerisourceBergen’s purpose that provides the direction and guidance through which we evaluate everything that we do.

That purpose of being united and our responsibility to create healthier futures means that we recognize our responsibility to efficiently and effectively deliver healthcare.

Our purpose unites, motivates and empowers us to deliver value for all of our shareholders making a positive impact on our communities, our partners and the patients they serve. Our purpose exists in harmony with our growth strategy to ensure that we are a company that does well, while also being a good corporate citizen.

This is a challenge and a commitment we have always accepted and one that we are well positioned to achieve. We are confident in our growth strategy, focused on execution and dedicated to bringing long-term value for all of our stakeholders, working as one unified and connected organization to improve product access and efficiency throughout the healthcare supply chain.

Thank you again for your interest in AmerisourceBergen. I will now turn the call over to Jim for a more in-depth review of our fourth quarter and full 2019 fiscal year financial results, as well as our financial guidance for fiscal 2020. Jim?

Jim Cleary

Thanks, Steve, and good morning everyone. My remarks today will focus on our adjusted non-GAAP financial results unless otherwise stated. Growth rates and comparisons are made against the prior year June quarter. For a detailed discussion of our GAAP results, please refer to our earnings release.

Fiscal 2019 has been an impressive year for execution and performance across AmerisourceBergen’s portfolio of businesses.

In our Pharmaceutical Distribution segment, we continued to expand our leadership position in specialty distribution, successfully integrated H.D. Smith into our infrastructure and worked diligently across our business to deliver on initiatives to offset the headwind caused by PharMEDium for the year.

In our Other segment, Global Commercialization Services & Animal Health, we delivered on our high-single-digit operating income growth expectation, as our businesses in the Group continue to differentiate themselves in their markets.

Our execution and focus on delivering best-in-class service and solutions for our partners combined with our unique pharmaceutical-centric foundation of businesses enables us to successfully navigate the complex healthcare environment.

Turning now to discuss our results in fiscal 2019 and our expectations for fiscal 2020, I will provide commentary in three main areas this morning. First, I will detail our adjusted quarterly consolidated segment results. Second, I will highlight our full year fiscal 2019 performance and third I will cover our fiscal 2020 guidance.

Moving now to our fourth quarter results, we finished the quarter with adjusted diluted EPS of $1.61, an increase of 11% primarily due to higher operating income, a lower share count and lower net interest expense.

Our consolidated revenue was $45.6 billion, up 5%, driven by solid revenue growth in both the Pharmaceutical Distribution Services segment and our Global Commercialization Services & Animal Health group.

Gross profit increased 7% or $1.2 billion. In the fourth quarter, we had earlier than expected vaccine sales, which results in a pull-forward of gross profit recognition that we had initially expected to realize in the December quarter. This represents a roughly $0.05 EPS shift from fiscal 2020 to the fourth quarter of fiscal 2019.

As expected, our operating expenses were higher in the fourth quarter as we exited the fiscal year in part due to an increase in associate incentive compensation, as a result of strong performance in many of our businesses.

Consolidated operating income was $456 million, up $24 million or 5%, with our operating margin flat. Net interest expense increased $7 million to $36 million, as we continued to benefit from interest income related to our higher average invested cash balance and better interest rates.

Moving now to income taxes, our income tax rate was 19.6%, the same as the prior year quarter. Our diluted share count increased 4% to 210 million shares for the quarter driven by opportunistic share repurchases in the year.

This completes the review of our consolidated results. Now I will cover our segment results. Beginning with Pharmaceutical Distribution Services, segment revenue was $44 billion, up 5%. The segment continues to benefit from strong specialty product sales and overall customer growth.

Segment operating income increased about 3.5% to $369 million, with our operating income margin down 2 basis points driven by the higher operating expenses in the quarter.

I will now turn to the Other segment, which consists of businesses that focus on Global Commercialization Services & Animal Health, including World Courier, AmerisourceBergen Consulting and MWI Animal Health.

In the quarter, total revenue was $1.8 billion, up 13%, primarily due to growth at MWI and Consulting's Canadian operations and reflecting significant overall growth across the group. MWI had a 10% revenue growth as the business continued to benefit primarily from increased sales to existing customers and the Global Commercialization Services Group, which will be our Consulting Group and World Courier had revenue growth in the mid-teens.

From an operating income standpoint, the Other segment had operating income of $87 million, up 15%. This group is lapping some quarters that were challenged quarters and experienced some nice growth in all three subcomponents, MWI, World Courier and Consulting.

This completes the review of our segment results for the quarter and now I will turn to our full year fiscal 2019 performance. Our consolidated revenue was $179.6 billion, up 7% driven by growth within our broad portfolio of customers and multiple strategic partnerships. Our largest customer, Walgreens represented 34% of our total revenues and our second largest customer Express Scripts represented 13% of our revenues.

Looking ahead to fiscal 2020, we expect that Express Scripts will be a larger portion of our overall revenue in fiscal 2020 compared to fiscal 2019 as we onboard incremental volume through the relationships stemming from the merger with Cigna.

Consolidated operating income grew 3.5% for the year to over $2 billion, while our operating margin declined 4 basis points primarily related to the operating loss from PharMEDium in fiscal 2019 compared to a small operating profit in fiscal 2018. Excluding the impact of PharMEDium, operating margin declined 1 basis point in fiscal 2019 compared to fiscal 2018.

The performance in both groups, Pharmaceutical Distribution and Other is quite impressive as the teams executed to grow their operating income. Pharmaceutical Distribution segment operating income grew 2.7% while growth in Other was over 7%.

In Pharmaceutical Distribution, we saw balanced performance across business and customer segments, we experienced good growth and expanded share of wallet within anchored customer relationships and segments including strong performance in specialty where there continues to be notable growth in immuno oncology and oncology products more broadly.

Additionally, while still in the early phases of utilization, we saw better than expected uptake of oncology biosimilars. While we are still talking about relatively small dollars, the growth we are seeing in biosimilar uptake is encouraging for the future as this part of the market is certain to grow to a more meaningful size.

In other, MWI continues to drive the value-added business, supports the growth of their strategic customer relationships and leverage market data to enhance profitability and performance. World Courier’s strong business fundamentals position it for another strong year of growth as Nova, their transport platform implementation continues to progress well and pay commercial dividends.

Additionally, we saw meaningful growth in our Consulting businesses. Taking a step back, we did have a significant favorable impact on operating expenses in fiscal 2019 from better than expected healthcare costs. This benefit created a year-over-year tailwind of over $0.05 in fiscal 2019 and we did not expect the same tailwind in fiscal 2020.

Regarding income taxes, our full year adjusted tax rate was 20.6% reflecting a lower mix of U.S. taxable income and a one-time discrete item both of which had a favorable effect on our tax rate.

Turning now to EPS, our full year adjusted diluted EPS grew 9% primarily due to our execution to deliver operating income growth and also a lower share count. Adjusted free cash flow for the year was $1.9 billion, higher than expected, primarily due to inventory management and timing of customer and supplier payments.

We continue to take a strategic approach to capital deployment in fiscal 2019, we returned $1 billion to our shareholders through opportunistic share repurchases and dividends and invested $310 million in our businesses through capital expenditures, all while successfully integrating our fiscal 2018 acquisition of H.D. Smith.

We understand and appreciate the importance of maintaining the appropriate balance between returning capital to shareholders and investing internally and through acquisitions to both sustain our business and further enhance our commercial value proposition.

As I now enter my second year as Chief Financial Officer of AmerisourceBergen, I can confidently say that the optimism I had for the company when I began this role has proven to be warranted. The associates, businesses and culture across ABC are fundamental to our success and to the incredible value proposition we deliver for our manufacturer and provider partners.

In fiscal 2020, we will again look to deliver on innovating and investing to support growth and focus on executional excellence, all while furthering our talent and continuing our move towards one ABC. Now regarding some working assumptions that are factored into our fiscal 2020 expectations, first, brand pricing. We assume that brand inflation will be similar to fiscal 2019.

Now on the generic pricing front, we are anticipating a generic pricing environment similar to the one that we experienced in fiscal 2019 the trend of stabilization on the buy side remains encouraging and on the sell side, we expect the competitive but stable dynamic to continue.

Turning now to our financial guidance for fiscal 2020. As a reminder, we do not provide forward-looking guidance on a GAAP basis. So all of the following metrics are provided on an adjusted non-GAAP basis.

Starting with revenue, we expect consolidated revenue growth in the mid to high-single-digit percent range and roughly a quarter of the growth is due to the onboarding of incremental volume through our Express Scripts relationship.

While we do not provide gross profit guidance, it is worth noting as we have said in the past that that relationship is predominantly mail order and specialty pharmacy brand product business which is good for profit dollars. But as a reminder, this type of business is inherently lower margin.

Now turning to operating expenses. We expect consolidated operating expenses to grow in the mid-single-digit percent range. Understanding the importance of expense management, we will certainly work to ensure that operating expense growth is at the low-end of that range.

However, there are a couple items impacting the year-over-year growth. First, the previously discussed level of reduction in healthcare cost experienced in fiscal 2019 is not expected to repeat and second, in fiscal 2020, as a result of adopting the new lease accounting standard, certain leases that were previously accounted for as built-to-suit leases will be accounted for as operating leases.

This change negatively impacts operating expenses and therefore operating income but has offsetting favorable impact on the interest expense line. Regarding operating income, we expect to grow operating income in the low to mid-single-digit percent range with growth expected by both our operating segments.

From a segment standpoint, we expect the following. In Pharmaceutical Distribution Services, we expect the segment’s operating income to grow in the low to mid-single-digit percent range.

This segment continues to benefit from our leadership in specialty distribution where we could buy key specialty physician services and our key anchored customer relationships across Pharmaceutical Distribution are all in good standing.

The lease accounting adoption represents almost 1% headwind to segment operating income. In regards to PharMEDium, we continued to make appropriate progress with our remediation efforts as it pertains to financial expectations, we continue to expect a loss at the business, but do not expect it to be a headwind in fiscal 2020 compared to fiscal 2019.

Moving now to the Other segment, the businesses that focus Global Commercialization Services & Animal Health, this group is expected to continue on its positive trajectory in fiscal 2020 by growing operating income in the high-single-digit percent range. This growth is supported by our expectation for continued strong momentum from MWI, World Courier and our businesses within consulting.

As it pertains to Lash, the business will continue to be in transition as the team is focused on migrating existing manufactured programs to the new Fusion platform in fiscal 2020. While we don’t expect Lash to be a tailwind in fiscal 2020, we are greatly encouraged by the new business development wins in fiscal 2019 and by the onboarding of new and existing programs to the Fusion platform this past year.

Lash and the other businesses in this group are well positioned in their respective markets, where organic growth drivers exist in niche and investments and innovation has been positively differentiated for long-term value creation.

Now turning to our consolidated tax rate expectations, our guidance assumes a full year adjusted tax rate of between 21% and 22%. The fiscal 2019 tax rate benefited from a discrete item which will not repeat and our higher mix of foreign-based income than expected in fiscal 2020.

Regarding share count, as a reminder, we do not include unidentified capital allocation in our guidance. Our fiscal 2020 guidance assumes that we finished the year at between 209 million and 210 million weighted average shares outstanding.

Moving to earnings per share, we expect our fiscal 2020 adjusted EPS to be in the range of $7.30 to $7.60 reflecting growth of 3% to 7%. While we do not provide quarterly guidance, I will note that our EPS growth in the fiscal first quarter of 2020 will likely be in the lower part of the full year growth range.

Turning now to cash flow expectations. First, CapEx is expected to be about $400 million, much of the spend relates to key projects being carried over from fiscal 2019 and no one project dominates the spend in fiscal 2020.

The projects each have a particular focus or business need and fall into categories ranging from normal run the business projects to investments aimed at supporting growth, increasing efficiency or enhancing our capabilities.

For example, in the past few years, we have experienced solid growth related to our national distribution center offering, manufacturer demand for our national distribution center service has reached the point where we must now invest in expansion this year in order to expand capacity to facilitate continued growth.

This is an example of an investment that supports growth and increases efficiency for our manufacturer partners.

Now for free cash flow. We expect our free cash flow for fiscal 2020 to be approximately $1.5 billion. In closing, the execution, expertise and solutions delivered across AmerisourceBergen continues to fortify and enhance our undeniable value proposition in healthcare.

AmerisourceBergen’s strategy, leadership in growing markets, strong customer relationships, talent and culture helped us well positioned to continue to create long-term shareholder value and deliver on our purpose of being united in our responsibility to create healthier futures.

Thank you for your interest in AmerisourceBergen. Before we jump into the Q&A portion of today’s call, we understand the opioid issue continues to be at the forefront of many of our stakeholders’ minds. Due to the ongoing litigation and work towards a settlement we are unable to comment deeply on these matters.

We will seek to your answer your questions in earnest, but do want to remind that group here that we are limited in what we can say at this time. We appreciate your patience.

Now I will turn the call over to the operator to start our Q&A. Operator?

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from the line of Robert Jones with Goldman Sachs. Please go ahead.

Robert Jones

Great. Thanks for taking the questions. I guess, just, Jim, I wanted to go back to some of the comments around the moving pieces as we think about fiscal 2019 turning into fiscal 2020. Some of the pieces that we considered in 2019 like PharMEDium, H.D. Smith, I think there were some lapping SG&A benefits.

Adjusting for those, it seems like you are guiding to core growth in the Pharma Distribution segment, consistent with 2019, if not slightly better considering things like the lease accounting change.

Just wanted to make sure we were thinking about moving pieces in fiscal 2020 correctly. So, other than the lease accounting which you size, is there anything else that you have us note as a considerable change year-over-year as far as headwinds and tailwinds outside of the underlying business?

Jim Cleary

Yes, thanks a lot, Bob. So we feel really good about our guidance in fiscal year 2020 and of course the way that we finished fiscal year 2019. You asked about growth in Pharmaceutical Distribution and moving pieces. Overall, our operating income guidance is low-to-mid single-digit growth and Pharmaceutical Distribution is low to mid-single-digit percent growth and Other is high-single-digit percent growth.

And some of the moving pieces, we had mentioned, I had mentioned in my prepared remarks, vaccine revenues and related gross profit, we had some vaccine sales that came earlier than expected in the fourth quarter fiscal year 2019. That positively benefited the fourth quarter by about $0.05 I indicated.

So that moves about $0.05 a share from fiscal year 2020 to fiscal year 2019 and brings the growth rate little bit down. And I talked about the change in lease accounting standard on built-to-suit properties. That creates about a 1% headwind in Pharmaceutical Distribution's segment operating income.

There will be an offsetting benefit to interest expense, but it does create about a 1% headwind in operating income. We talked about the healthcare cost throughout fiscal year 2019. They brought over $0.05 of benefit to fiscal year 2019 as a tailwind. We don't expect to have the same tailwind in fiscal year 2020.

And then just one other thing I'll call out, kind of comparing revenue growth to operating income growth. We are expanding sales to Express Scripts as a result of the merger with Cigna and that represents about one quarter of our revenue growth and that's business that is inherently lower margin business. So it impacts some revenue growth more than operating income growth.

Those are some of the moving parts in PharMEDium. There was a headwind in fiscal year 2019. We don't expect it to be a financial headwind in fiscal year 2020. So those are the moving parts, But overall, we feel very good about all the business operations and performance, particularly our specialty businesses which are performing especially well.

Robert Jones

That's helpful. And I guess, maybe just a follow-up actually related to specialty, Steve you made a comment about biosimilars. I know, it sounded like it's early days. But I am just curious if you could maybe expand on that a little bit? What are you in fact seeing within the specialty channel as it relates to biosimilars and how big of a contributor can this be as we think about, not just fiscal 2020, but beyond?

Steve Collis

Yes. Hi, Bob. Thanks. Biosimilars, definitely, we began to see the beginning of some traction. The numbers are still small, but of course, are particularly in distress given our specialty franchisees those buy our products, our injectable products that are utilized in the physician office setting.

And I think it's just a matter of quantity we are getting more of those which is great for patient choice, great for affordability and I think what we've always said is remaining very true that these products will be priced appropriately with they will be able to afford not only on distribution services, but many of the services that companies like Ion and Xander offer field-based training and Lash with patient support.

So, we think that it's definitely one of the most positive aspects if you look at it over the next couple of years. And the sweet spot for us as we have mentioned our two to three different products, which gives us a chance to compete uniquely with our customer base. So, thank you.

Robert Jones

Great. Thanks.

Operator

Our next question comes from the line of Glen Santangelo with Guggenheim. Please go ahead.

Glen Santangelo

Good morning, and thanks for taking the question. Jim, I just wanted to follow-up on one question on that – on the 2020 guidance that you gave. I think you suggested in your prepared remarks that EPS growth in 1Q would be at the lower-end as compared to the full year growth rate.

I was just kind of curious, is that solely related to the vaccine issue that you were just referencing that might have shifted from 1Q to 4Q 2019 or is there anything else in there?

Jim Cleary

Yes, that's the key driver there, Glen, our guidance for the year, I guess, it's 730 to 760. So that 3% to 7% growth and we indicated that we expected that 1Q to be in the lower-end of that range and kind of pull-forward of the vaccine sales and gross profits are driver. One other thing I'll just remind everyone with regard to our EPS growth as we - in our guidance, we don't include any unidentified capital allocation in our guidance.

Glen Santangelo

And that was going to be my follow-up question. I am kind of curious, because when you look at the balance sheet now, you are sitting with net debt of about $800 million. And based on your cash flow guidance for the year, you'll be in a net cash position potentially by the end of the year.

But, as you just pointed out, with your REPO guidance, there is - I am sorry, with your share count guidance, there is no capital deployment in there. And I was just kind of curious is there a specific reason for that? Or are you saving that cash? I mean, obviously, there is some outstanding potential litigation exposure? Or any other changes in the priorities for capital deployment that we should be thinking about?

Jim Cleary

Glenn, I think you called out a number of key things we feel really good about the strength of our balance sheet. Our free cash flow is $1.9 billion for the year, higher than we had expected. And we have strong free cash flow guidance for fiscal year 2020 and yes, as we both said in – posted in our guidance is we don't have unidentified capital allocation there in our guidance.

Glen Santangelo

Okay. Thank you.

Operator

All right. Our next question comes from the line of Steve Valiquette with Barclays. Please go ahead.

Steven Valiquette

Great. Thanks. Good morning, Steve and Jim. So, just a question around the free cash flow guidance of $1.5 billion for fiscal 2020. I heard the comments that you made that the $1.9 billion in fiscal 2019 was higher than expected due to timing of customer and supplier payments.

Because – so for me, I just want to confirm, is the $1.5 billion a normal annualized runrate relative to your net income? Or is that $1.5 billion lower because some of it was pooled into fiscal 2019? Thanks.

Jim Cleary

Yes, let me give you a little bit more color around free cash flow. I mean, we had really good performance in 2019, it was driven by really solid inventory management which you will see with regard to inventory levels, when you look at our balance sheet. Part of that is due to the success with the H.D. Smith integration and pulling some inventory out as a result of that integration.

Also, if we look at fiscal year 2019, we just had really good timing of receipts at the end of the year and given the scale of our business, that can happen. So we took very strong receipts at the end of the year. And as we look at fiscal year, 2020 I mean, we feel very good about that is a level of free cash flow.

We do have higher CapEx. No single major projects that I'll call out. But our highest returns are reinvesting back in our business and we have little bit higher CapEx in fiscal year 2020 than we had in fiscal year 2019.

Steven Valiquette

Okay. And a quick follow-up on this, I mean, obviously cash flow is becoming a little more important with the talks around potential several years of opioid settlement payments et cetera. But separate many payments.

I think you guys had a target previously returning to get free cash flow as some percent of a net income, I think of 115% or whatever, I forgot what it was, but just a question is that are those numbers still valid. Do you still have a target and this would be obviously separate from the inclusion of any sort of opioid settlement payments? Thanks.

Jim Cleary

Yes, and so, on free cash flow, it's clearly a strength of our business and so, maintaining high levels of free cash flow is something we've done in the past and continue to plan to do in the future, so that we can continue with our capital deployment strategies.

We are really only guiding to fiscal year 2020. At this point in time, and the guidance is $1.5 billion which we feel provides really good free cash flow to handle our capital deployment priorities.

Steven Valiquette

Okay. I appreciate the color. Thanks.

Operator

Our next question comes from the line of Lisa Gill with JPMorgan. Please go ahead.

Lisa Gill

Thanks very much. Good morning. I just wanted to go back and just make sure I understand around the potential opioid settlement. So, what's your understanding around the tax deductibility of the potential settlement?

And so, how do we think about that? When we think about this number, how do we think about the actual impact to cash flow? Number one, and then, two, what it would mean to potential debt rating? How would they look at this potential settlement as well?

Jim Cleary

Yes, so let me talk about how we handled the recent opioid settlement in Ohio and there what we've done is we've agreed to a joint $215 million settlement with the two counties involved, other distributors also. And what we have done this quarter is we've accrued $66 million pre-tax $50.9 million after-tax.

That's 31% of the aggregate settlement and you ask about assumptions on tax and what I'll do is, comment on our assumption on this particular settlement in Ohio. It's based on our assumption of how the agreement will be finalized and also based on other past settlements with those counties and manufacturers, that we've treated with that settlement on an after-tax basis, as an after-tax charge.

And then, I think you also asked about credit rating and of course, an important part of running our business is remaining investment-grade, that's very important to us which we've been aware of conscious of throughout this process.

Lisa Gill

Okay. Great. Thank you.

Operator

Our next question comes from the line of Kevin Galindo with UBS. Please go ahead.

Kevin Galindo

Hi, good morning guys. Thanks for taking my call. What is your process for actually accruing a liability settlement for opioids? Is it have to actually be finalized? Take me through when you actually decide to accrued for these on your balance sheet and going forward like, when would you actually feel comfortable enough to want to accrue?

Jim Cleary

Yes, and so, as Steve talked about and we are currently engaged in discussions that include the four attorneys general that announced the potential framework on October 21, as well as plaintiff's lawyers representing local governments and other attorneys regarding the terms of the potential framework.

And the parties' objective is to reach agreement in principal long-terms for the potential framework which could be the foundation for a global resolution.

But given the large number of parties involved, the complexity and difficulty of the underlying issues and the resulting uncertainty of achieving a potential global resolution, we continue to litigate and prepare for trial in the cases that have been filed and we intend to continue to vigorously defend ourselves in those cases.

And so, accordingly, we haven't recognized the liability related to the potential framework as of September 30. And the company will continue to evaluate our accounting position based on the facts and circumstances as they develop.

Steve Collis

Yes, I mean, if I could just add that, we see the merits of the potential global framework which reflects I think sincerely intense negotiations and significant concessions and commitment from our industry, not only to financial settlement, but also to innovative regulatory solutions and to free product disposal and which we think others could potentially join in.

And so, it's a really good framework we think to settle really unproductive endeavor which is a lot of litigation. So, I just look at that.

Kevin Galindo

Thank you.

Operator

Our next question comes from the line of Charles Rhyee with Cowen. Please go ahead.

Charles Rhyee

Yes, thanks for taking the question, guys. I just want to follow-up really quickly on that opioids. The fact that you guys are discussing it today, along with your peers over this earnings season. Since October 21, is it fair to think that you are more optimistic now of reaching sort of a global settlement here.

And can we read into the fact that you guys are at least kind of discussing it more openly versus how you guys kind of discussing maybe in previous quarters that you feel good progress has been made?

Steve Collis

We are continuing to litigate. We settled that in two counties in Ohio. The weekend before the trial was going to start and we think that, particularly the settlement that was announced on October 21st is a very good stepping stone and a bridge to what could be a global settlements and we negotiated with those four attorney generals.

I think just previously characterized that as intense negotiations and with significant concessions from our industry to try to be productive and a reflection of what is been a very serious societal issue and an attempt to allow business to focus on more productive endeavors. So, as I said earlier.

Charles Rhyee

All right. Thanks. And Jim, maybe one for you. CapEx guidance here is about $400 million. Obviously, you talked about investments to expand capacity. So, is this sort of a good runrate we should think about going forward afterwards or do you think maybe these are sort of one-time projects to kind of expand capacity and will come back to a more normalized rate? Thank you.

Jim Cleary

Yes. So, as I said before, we always get the best returns by investing in our business. We are expecting $400 million approximately in fiscal year 2020, up from fiscal year 2019. It's probably a little bit higher because we have so many productive projects going on doing some systems implementations in our really successful specialty businesses.

And so, I would say, it's little bit higher due to the fact that we just have so many productive projects to invest in. But I'd expect – while we are only doing fiscal year 2020 guidance, kind of expect that, kind of in a level that we are in fiscal year 2019 and 2020 to be a normalized level.

Charles Rhyee

Great. Thank you.

Operator

Our next question comes from the line of George Hill with Deutsche Bank. Please go ahead.

Lee Lueder

Hi thanks. This is Lee Lueder on for George. So, last quarter you mentioned that the audit inspections of the two open PharMEDium facilities were a key input into an assessment of a future work plan to reopen the Memphis facility. So now that those two inspections are done, can you give an update on the reopening of Memphis?

Steve Collis

Yes, we are happy with the progress that Memphis is making. We were happy that the two facilities remained open. We are complying with the terms of the consent decree and completing initial third-party inspections.

We had meaningful milestones which we are monitoring very closely and we are going to get important input into the assessment of a work plan which will allow us to reopen that Memphis. And as we have updated at our material or different from that, we will certainly keep you informed, because we know that, that is important to our investors and important to operations. So Jim, anything you could add?

Jim Cleary

Steve, I think that that really covers it and it was discussed earlier, we don’t expect PharMEDium to be a financial headwind in fiscal year 2019 compared to fiscal year 2020. We will continue to remediate and optimize the operations as we continue to evaluate appropriate next steps.

Lee Lueder

Okay. Thank you.

Bennett Murphy

And operator, we have time for one more question and then, we’ll make a closing remark.

Operator

Okay. The last question will come from the line of Ricky Goldwasser with Morgan Stanley. Please go ahead.

Ricky Goldwasser

Yes, hi. Thank you for taking my question. So, my question is around the onboarding of the Cigna business. But then also, and if you see the impact from off-boarding the income. So, can you just kind of explain us the dynamics there?

That's first. And second of all is as we think about your improvement given on the incremental Cigna business. Should we think about it as mail and what's the contribution between specialty and routine rights. But then more importantly, should we just think about as incremental volume, that's coming in just at a large client type of margin.

Steve Collis

Yes. Again this is a kind of a – sort of a organic development within one of our established customer relationships and it's a benefit here. We got – we lost of course some of the Genix business in Genix RX business.

But this is – it would be about a quarter of the growth that we will experience next year that we budget it all. And typically, mail order business, it is a lower margin business for us, because of the fewer sites heavy balance of specialty drugs and but it's another example of how strong Express Scripts relationship. And of course now, some of they are strong Cigna relationships.

So, very detail …

Ricky Goldwasser

So overall - just a quick follow up. So overall incremental to your EBIT growth next year from a dollar value.

Steve Collis

Yes, it is – it does – it is an operating income contributor. That's of course, slightly delighted the - like there is the big expression of this business but good top-line and of course, our second largest customer by large measure. And so, I know that there were some quality difficulties with AT&T and we apologize for that.

In fact, our line was even dropped for a minute. So, I don't think we ever had that before. But I hope that you all join me and being very proud of this fiscal year in this quarter that AmerisourceBergen produced for our shareholders. Our pharmaceutical strength and strategy and expertise has us well positioned to continue to create long-term shareholder value in pursuit of our purpose.

And we just feel that we have to get this lining here because Dennis loves us. I am going to conclude by saying ABC has 2020 vision for how we can execute and grow well in our upcoming fiscal year. So, thanks, everybody.

Operator

Okay. Ladies and gentlemen, this does conclude today's conference. I want to thank you for your participation. You may now disconnect.