Q2 FY21 Cardinal Health, Inc. Earnings Conference Call

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Operator: Good day, and welcome to the Cardinal Health, Inc. Second Quarter Fiscal Year 2021 Earnings Conference Call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Kevin Moran, Vice President of Investor Relations. Please go ahead.

Kevin Moran: Good morning, and welcome. Today, we will discuss Cardinal Health's second quarter fiscal 2021 results along with an update to our FY21 outlook. You can find today's press release and presentation on the IR section of our website at ir.cardinalhealth.com.

Joining me today are Mike Kaufmann, Chief Executive Officer; and Jason Hollar, Chief Financial Officer. During the call, we will be making forward-looking statements. The matters addressed in the statements are subject to the risks and uncertainties that could cause actual results to differ materially from those projected or implied. Please refer to our SEC filings and the forward-looking statement slide at the beginning of our presentation for a description of these risks and uncertainties.

Please note that during the discussion today, our comments will be on a non-GAAP basis unless they are specifically called out as GAAP. GAAP to non-GAAP reconciliations for all relevant periods can be found in the schedules attached to our press release.

During the Q&A portion of today's call, we please ask that you try and limit yourself to one question so that we can try and give everyone an opportunity. With that, I'll now turn the call over to Mike.

Mike Kaufmann: Thanks, Kevin, and good morning, everyone. I'll start our discussion with a few high-level thoughts on our progress so far this year, and then Jason will review our second quarter results and our updated FY21 outlook. I'll close by sharing updates regarding our growth areas.

We continue to make progress on our strategic plan as we navigate the rapidly changing global environment. Overall, second quarter operating results came in better than our expectations, led by the Medical segment. In addition, we saw some favorability, including timing below the operating line, enabling us to deliver EPS growth of 14% in the quarter.

Due to our solid first half performance and our improved visibility into the remainder of the fiscal year, we are increasing and narrowing our EPS guidance to a range of $5.85 to $6.10 per share.

In the second quarter, we saw varying effects of the pandemic on our business. Our Medical segment saw a net positive impact related to COVID-19 as our lab business and PPE products continued to experience strong demand. And in Pharma, although the pandemic continued to adversely impact volumes, mainly in generics and nuclear imaging, areas like Specialty and consumer health are recovering and performing very well.

Across the company, we remain focused on doing our part to support ongoing pandemic relief efforts. In Pharma, we partnered with the CDC to act as a network administrator, enabling retail independent, small chain and long-term care pharmacy customers to participate in the vaccination effort. And in Medical, we partnered with the state of Ohio to support vaccine distribution through our OptiFreight Logistics business.

Regarding PPE, we are utilizing our supply assurance program to manage costs for our customers and provide consistent, long-range supply in key product categories. We are seeing improving supply in some of these product categories such as gowns and masks, but continue to see a challenging market with exam gloves.

Looking ahead, we remain committed to supporting our customers, patients, government and communities through the ongoing challenges of the pandemic, and we are ready and willing to help in any way possible.

Before I provide some updates on our strategic growth areas, I'll turn it over to Jason to share more details on our second quarter and outlook for the year.

Jason Hollar: Thanks, Mike, and good morning, everyone. Beginning with total company results, second quarter EPS was $1.74, reflecting a 14% increase driven by discrete tax items and strong Medical results. Total second quarter revenue increased 5% to $41.5 billion, driven primarily by sales growth from existing customers. Total gross margin was flat at $1.8 billion. SG&A increased 2% to $1.1 billion due to IT investments. The net result for the quarter was consolidated operating earnings of $628 million, a decrease of 3%, which reflects a modest net negative impact for the enterprise from COVID-19.

The Pharma segment was adversely affected by COVID-19 during the quarter, and this was partially offset by a net positive impact in Medical. I will discuss these segment impacts shortly.

Interest and other expense decreased 33% versus the prior year to $34 million, driven primarily by lower interest expense as a result of prior year debt reduction, as well as an increase in the value of our company's deferred compensation plan investments. Our non-GAAP effective tax rate for the quarter was 13%, which reflects the impact of certain discrete items.

Now, a quick note on the GAAP tax impact during the quarter. Primarily due to a self-insurance loss on our FY20 federal tax return, we will carry back and recover previously paid federal taxes at rates that were in effect at that time. As such, in the quarter, we recorded a net GAAP tax benefit of $420 million associated with the recovery of prior taxes. Additionally, we have recorded a corresponding receivable of approximately $1 billion, which we expect to receive within the next 12 months.

Turning to cash flow and the balance sheet. We generated robust operating cash flow of $1.2 billion during the quarter. As a reminder, the day of the week in which the quarter ends affects point-in-time cash flows. We ended the second quarter with a cash balance of $3.7 billion and no outstanding borrowings under our credit facilities.

We remain focused on taking appropriate action to maintain our investment-grade balance sheet. Our next debt maturity is in June 2022 with approximately $1.4 billion coming due. By the end of FY22, we intend to reduce long-term debt by that amount, though the exact timing and method may vary as we continue to evaluate the economics associated with early retirement of debt.

Now turning to the segments, beginning with Medical on slide 5. Medical revenue increased 7% in the second quarter to $4.3 billion, driven by a net positive revenue impact from COVID-19 and solid execution by our team. As we have previously discussed, we saw higher selling prices and volumes regarding PPE and higher volumes in our lab business, partially offset by reduced surgical products demand resulting from deferred and cancelled elective procedures.

Segment profit increased 21% to $236 million, driven by a net positive impact from COVID-19 and cost savings, which includes global manufacturing efficiencies. The net positive segment profit impact from COVID-19 was primarily due to higher lab volumes as well as increased contributions from PPE that were offset by the previously-mentioned elective procedure impacts.

As it relates to lab, we continue to experience a tailwind from increased demand for COVID-19 testing products. While difficult to predict, we expect this demand to remain elevated for at least the balance of fiscal 21.

Regarding PPE, we saw both higher volumes and timing favorability related to our cost mitigation efforts. As previously mentioned, we have incurred significantly higher procurement costs for select PPE products during the pandemic, and we expect the timing of selling the higher cost products to vary as we continue to manage our supply assurance program for our customers.

On electives, although procedure volumes continue to be choppy and still below prior year levels, second quarter volumes were generally consistent with our first quarter exit rate, down mid-single digits versus our pre-COVID-19 baseline.

Finally, as in the first quarter, we continue to see savings resulting from cost containment measures during the pandemic. And outside of COVID-19 impacts, we continue to realize benefits from our efficiency initiatives like our global manufacturing and supply chain transformation, which we expect will continue to deliver strong savings.

Transitioning to the Pharma segment on slide 6. Revenue increased 4% to $37.2 billion, driven by sales growth from Pharmaceutical Distribution and Specialty Solutions customers. Pharma segment profit decreased 11% to $413 million. This was driven by COVID-19-related volume declines in our generics program and Nuclear business and was partially offset by a higher contribution from brand sales mix in the quarter.

Our Specialty Solutions business continues to demonstrate resilience, both downstream with providers and upstream with biopharma manufacturers and again achieved strong overall growth in the quarter. Also, our generics program, when excluding the previously mentioned volume impact of COVID-19, continued to see generally consistent market dynamics.

Next, on slide 8, I will review the updates to our fiscal 21 outlook. Due to our solid first half performance and better visibility into the back half of fiscal 21, we are raising and narrowing our EPS guidance range to $5.85 to $6.10 per share, which at the midpoint, represents 10% year-over-year EPS growth. This improvement is driven by strong performance in our Medical segment as well as updates below the operating line.

Regarding updates to other corporate assumptions. We now expect interest and other in the range of $165 million to $185 million, with the improvement primarily driven by the impact of our deferred compensation plan adjustments. As a reminder, deferred compensation adjustments are fully offset in corporate SG&A and net neutral to our bottom line.

We are lowering our non-GAAP ETR range for the year to 23% to 25%, which reflects our year-to-date effective tax rate of 18% and higher expected effective tax rates in the back half of the fiscal year due to the timing of discrete items.

We also now expect dilutive weighted average shares outstanding to finish the year in the range of 294 million to 295 million.

Regarding the segment outlooks on slide 9. For Medical, due to the previously discussed drivers, we now expect segment profit percentage growth in the low to mid-20s and revenue growth for the year in the range of high-single to low-double digits.

Regarding the Pharma segment, we are maintaining our current guidance ranges of mid-single digit revenue growth and low-single digit profit growth.

To conclude, some comments on our enterprise COVID-19 assumptions for the back half of the fiscal year as we begin to lap the initial impact of the pandemic in the prior year. We continue to expect utilization to be choppy and to exit the fiscal year at or near pre-pandemic levels. And for the enterprise in fiscal 21, we continue to expect a year-over-year net negative impact from COVID-19, though less than originally anticipated due to improved medical expectations.

I'll now turn it back over to Mike.

Mike Kaufmann: Thanks, Jason. I'd now like to take a moment to elaborate on how this unprecedented time has reinforced our critical role in health care and how we see this role evolving as we look toward and beyond the second half of the fiscal year.

I said last quarter that we aspire to be health care's most trusted partner and create the greatest value for our customers, shareholders, communities and employees. We create this value by efficiently operating resilient business models, deploying capital with discipline and investing for growth, all while prioritizing the health, safety and development of our teams.

First, as we've seen throughout the pandemic, we operate resilient business models that can address today's challenges and adapt for the future. For example, as Jason highlighted, our lab business continues to enhance its offerings throughout the pandemic. Through our Cardinal Health brand portfolio and our distribution relationships, we supply instrumentation, reagents and consumables, enabling both independent and acute laboratories to support the health of patients.

We are also enhancing our core Medical and Pharmaceutical distribution and product capabilities as we continue to adapt these models for the future. We are making strong progress in both segments on our supply chain workstreams and generating near and long-term efficiencies.

For example, we began work this quarter on a new 1 million square foot Medical segment replenishment center near Chicago that we expect to be operational in the fourth quarter. This facility is the second of its kind in the last year and is part of our multiyear plan to improve the customer experience, consolidate our network and increase capacity to meet customer requests for pandemic storage.

We are also making strategic investments in our IT infrastructure to enhance our customer experience and digital capabilities. At the same time, we are investing in our differentiated portfolio to drive strategic, long-term growth in key areas and not only support, but also anticipate our customers' needs.

Our investments in the areas of Specialty, at-Home, Medical Services, Nuclear and Connected Care will enable us to capture benefits from favorable industry trends and to develop specialized customer solutions, utilizing our breadth and scale. Recall, I noted at a recent conference that these five businesses represent $25 billion in total revenue. And together, they have a double-digit historical three-year revenue CAGR.

Let me highlight a few of these areas in greater detail. In Medical Services, which includes our OptiFreight Logistics and WaveMark businesses, we are investing in technologies to drive continued innovation that will meet the evolving needs of our customers. For example, with our recently announced TotalVue Analytics tool in our OptiFreight business, we are using data to help our customers drive insights and savings in their health care supply chain logistics management.

And in WaveMark, which, as a reminder, is a software-as-a-service platform, optimizing supply chain and clinical workflow processes for acute care, we have seen growth in both our installations and our pipeline as we continue to go live with additional customers. WaveMark has also recently initiated partnership opportunities to explore solutions to help lab managers and supply chain leaders manage the increased demand for critical test kits and lab supplies.

As our Nuclear business continues its recovery related to the pandemic, our team remains focused on long-term plans to further strengthen our leading industry position. We continue to build out our Center for Theranostics Advancements in Indianapolis and are excited about the pharmaceutical innovators coming on board. From supporting manufacture development of radiopharmaceuticals to commercialization and distribution, we are working together to change the way patient care is delivered.

In addition, our recent customer loyalty survey results were excellent, showcasing our differentiated value proposition in the market. Our efforts over the past six years to transform our selling model, strengthen our world-class service levels and launch new products and services are deeply appreciated by our customers, and we are excited about the mid to long-term future of this business.

And finally, in Connected Care, we are making additional investments in technology solutions and actionable data tools to take advantage of the double-digit growth we are seeing and to enable more meaningful, cost-effective and outcomes-driven connections between payers, manufacturers, pharmacists and patients. Demand for these solutions continues to increase with our services currently reaching 60,000 pharmacies, 23 million patients and 60 payers.

We are sending more than 400 million texts annually to support medication management. And in the last quarter, we have designed, developed and implemented tools to help our pharmacy customers administer the COVID-19 vaccine with more than 2,500 locations already engaged. We will continue to share progress in each of these growth areas and in our core capability initiatives as they materialize over the coming year.

Before I close, I want to thank the team here at Cardinal Health, who continue to do a tremendous job adapting and responding to the changing needs of our customers as we navigate the pandemic.

Finally, I will reiterate that what we do matters, to our customers, shareholders, employees and communities. As we move forward, we are using our breadth, scale and expertise to provide products and solutions that create value and improve lives.

With that, I'll pause to open it up for questions.

Operator: (Operator Instructions) We'll take our first question from Michael Cherny of Bank of America.

Michael Cherny: If I can dive a little bit into the Pharma headwinds. As you think about the outlook for the rest of the year, how do you think about the trajectory and the visibility on Nuclear and then also the headwinds on generics and when they could recover for you?

Mike Kaufmann: Yes. Thanks for the question, Michael. Appreciate it. I guess, really a couple of things to keep in mind. We're really pleased with the resiliency of our Pharma segment both in the Pharma Distribution, as well as Specialty and the Nuclear business.

We do continue to see really COVID-19 being the main driver of any headwinds we're seeing there. It's good so far that a lot of the things that might affect the segments such as brand inflation, that's kind of off the table from what we've seen in January. We feel like we're executing really well on all our initiatives. And also, from a cost saving standpoint, we're on track. And then generics, which is always one of the -- could be one of the swing factors, we're not seeing anything inconsistent there from what we've seen in prior quarters.

So a lot of those swing factors are really off the table when we look at the rest of the year for Pharma. But what we really see is COVID being the main swing factor.

The things I would say there is that we saw a lot of choppiness in the quarter. We would expect it to continue to be choppy for the second half of the year. But we still are expecting to exit at or near pre-COVID levels. And as we said, our guidance continues to be low single-digit growth for the segment.

Jason Hollar: And if I could just add one point, Michael, this is Jason. In your point about Nuclear, we did see the headwind year-over-year be a little bit less than what we saw in the first quarter. So kind of follows -- continues to follow a little bit of what we're seeing with electives, a little bit more than other elements of the underlying volume. So not a lot of new news there, but a slight improvement sequentially.

Operator: Thank you. We'll take our next question from Robert Jones with Goldman Sachs.

Robert Jones: Maybe on the Medical business, I think we all understand that COVID is having significant impact across the segment. But I was hoping maybe you could help us with what you're assuming in the back half in Medical, particularly on the EBIT line. It just seems, based on the results to date and the updated guidance, you have to see kind of mid-20 declines in the back half versus the front half.

And I know there's a lot of moving pieces related to COVID. But -- and I think at a high level, Mike, I would think as you maybe see some of the drivers of the front half potentially fade, you would obviously see the legacy kind of surgery recovery product lines pick up.

Just trying to get a better sense of what you're assuming that could really drive this kind of back half decline versus what you've seen in the front half.

Jason Hollar: Yes. This is Jason. Let me start it off. Yes, like you said, we're really pleased with our first half performance. Certainly, two good quarters here now as well as on top of last year's double-digit growth as well. And then, still guiding to low to mid-20s for the year we feel very good about.

To the point about the trends, first half versus second half. As we stated in the remarks, we did see some Q2 favorability as it relates to our cost mitigation efforts on certain PPE products. So that's an element that was a component in addition to the volume strength that we saw in lab and the volume strength that we saw in PPE that drove Medical to actually have a net tailwind associated with COVID in the quarter. And so that's just one thing that will continue to vary quarter-to-quarter as we go forward.

The other item that we talked about last quarter as well is that we continue to be very aggressive with our cost control over the first half of the year here, a lot of uncertainty in the underlying volumes. And so we wanted to make certain that we had a lot of flexibility going into the second half of the year.

And then the third point I'd make is just that we do continue to make long-term investments in our business. As we've highlighted as our number one capital deployment priority is to invest in our strong pipeline of organic growth opportunities. And so we always trade off our level of spend in that regard as well.

Operator: Thank you. We'll take our next question from Jailendra Singh with Credit Suisse.

Jailendra Singh: You mentioned a few things you're doing to help with the vaccine rollout. I realize these programs, in and of themselves, aren't going to move the needle for the overall company. But just curious as to how this work might set the company up for future opportunities for you guys to participate in future phases of vaccine distribution.

Mike Kaufmann: Thanks. Appreciate the question. Yes, we've been -- continue to be involved and staying up-to-date in everything as it relates to the vaccine. As we've said, we are working with the state of Ohio, helping them distribute the vaccine, and we're also a partner with the CDC acting as a network administrator. And so we continue to do that. And there are some other areas where we are having some small touch in that area.

At the end of the day, I believe that -- our belief is that this is the -- one of the most important events in the country's history in that bringing the full scale of the distribution capabilities of all the distributors to the market is going to make the most sense over the long term to be able to effectively distribute and get the vaccines to folks. And so we continue to make sure that we're doing all the things to make ourselves ready to be able to participate and help out however we can.

Operator: We'll take our next question from Eric Percher with Nephron Research.

Eric Percher: Can we dig into the PPE price dynamics a little bit? I think last quarter, you talked about the ability to pass on pricing. In this quarter, I expect that we were going to see some input cost increases. So can you help square that with the pull forward you just mentioned? And maybe more broadly, it's price versus COGS Q1 to Q2 and then what's assumed second half?

Jason Hollar: Sure. Yes. Thanks for the question. And let me just kind of step back and talk about PPE in general and try to loop in that piece as well. Because certainly, the overall demand dynamic here, obviously, continues to be quite strong. And we are seeing certain components get a little bit more in balance between supply and demand.

But certainly, cost remains elevated across all categories. It's probably even more extreme in terms of that supply and demand imbalance remaining in exam gloves. So we continue to see that demand just far outstripping that supply, which has created some -- just some supply chain inconsistencies. Not only -- so now we're dealing with just the timing of supply, but we're also dealing with all the different timing elements of the cost increases and price increases. So it just becomes a bit of an uncertain combination of different influences that have driven some of these cost increases to be delayed then until later quarters.

So overall, our key objective remains the same, to make sure we're mitigating all these cost increases and working with our customers with the supply assurance program. But the timing is going to vary, as we said last quarter, and we'll continue to manage that as appropriate.

Mike Kaufmann: Yes. The only thing I would add is that while the PPE is clearly a driver, our lab business really was a big driver for us this quarter in the Medical segment, and we continue to be excited about its' growth and its' ability to continue to maintain that growth, at least for the remainder of FY21, is our current assumption.

Operator: Thank you. We'll go next to Lisa Gill, JPMorgan.

Lisa Gill: Mike, I just wanted to get an understanding of how you're thinking about utilization as we go into the back half of the fiscal year. One, are you seeing an impact with less cough, cold and flu?

And then secondly, you talked about the Rx segment in the quarter having an impact due to generics. What are you seeing? Is it more of a trend? You said branding. What kind of came in line or was that positive? Is it that new prescription volumes continue to be down, at least based on the data we see with IQVIA? Is there anything going on with your buying group?

Just how do we think about utilization and any other comments you can give us around how to think about the Pharma Distribution component of your business in the back half?

Mike Kaufmann: Yes. Thanks, Lisa. A couple of things I would say. I guess, first of all, it's important to know that sequentially, there's really not a lot of difference between what we saw in volumes between Q1 and Q2 for our Pharma business. And also, I would say that all the impact that we're seeing on volumes in generics is really, from our view, just related to COVID-19. So we're not seeing any other dynamics such as buying groups or other challenges like that impacting our generics program. It's really just the volumes as it relates to COVID-19.

So -- and as we said, we expect that to continue to be choppy. We saw a lot of up and down over the last six months. We would expect that for the second half of the year, but do expect to still get back to at or near pre-COVID levels by the end of the year.

As it relates to flu, as you know, this has become less and less of a driver in general for us. It can be a small driver. And as far as the flu goes, we've hardly seen much at all. So in terms of vaccine distribution, it has been a little higher. But all of the other type of ancillary products, such as the Tamiflus and those types of things, they have been down, obviously. But again, it's an incredibly tiny driver for us and was not something that is driving any of the concern or any challenges that we might be looking at in Pharma, which, again, we just are focused on COVID.

Operator: Thank you. We'll go next to Glen Santangelo with Guggenheim.

Glen Santangelo: Jason, I just wanted to ask a quick question about your share count guidance and your interest expense guidance. It looks like you raised the share count guidance but you lowered the interest expense guidance. And I appreciate the comments you made with respect to the deferred comp adjustments. But I was just curious if you're changing at all your capital deployment priorities in the near term? And secondly to that, is a potential opioid settlement at all in consideration in your capital deployment priorities for the balance of the year?

Jason Hollar: Okay, great. So in terms of interest, let's start there. Yes, you're right. As consistent with my comments, it's the deferred comp element that is driving the guidance change. And as I highlighted, that's entirely a flip-flop between interest and other and corporate SG&A. So there's no net EPS change associated with that. And of course, interest rates, although low, we have a substantial part of our capital structure fixed. So we just don't see a lot of variation as it relates to where rates have been.

And so then -- I'm sorry, there are three parts. What was the second part? Share count. Okay. So the share count, we're still within the guidance range of what we had before. It is slightly at the high end, to your point. As you can see, in the first quarter, we didn't do any share repo. We didn't do any in the second quarter as well. But the high end of that share count would imply no repo. The low end of this new range would be a modest amount of repo. So that's what's baked within that assumption.

As it relates to the capital deployment, certainly, we haven't changed our priorities. Of course, we work within those priorities. And just to reinforce that, we continue to invest in our business, first and foremost, as we are really confident with that strong pipeline of organic growth opportunities. And you saw that this quarter with the Medical global manufacturing and supply chain work. We're making some great progress there, and we want to continue to feed those activities.

The other point that I referenced in my commentary is consistent with the second priority, which is to maintain our strong investment-grade balance sheet. So I did highlight that we intend to reduce our debt by about $1.4 billion as it comes due at the end of our fiscal 22. And we think that's consistent with that priority. And then, of course, we return the cash to shareholders primarily through the dividend as our third priority.

After that, it is repo and other bolt-on strategic M&A. But we'll continue to look at that opportunistically as we get more confidence on variables such as opioids is certainly one of the elements we look at all the time. And as our confidence increases and we make more progress, understanding it, what the framing of that looks like. Then we'll continue to evaluate if we can be more aggressive on any of those other components. But we continue to balance all those each and every day.

Operator: Thank you. We'll take our next question from George Hill with Deutsche Bank.

George Hill: I kind of wanted to go back to Eric's topic a little bit on PPE pricing. I was wondering if you guys would be willing to kind of call out the positive impact of pricing in the first half of the year?

And Mike, I guess, I'd be interested in your commentary on how long pricing stays elevated. Do we think this is the new normal or at some point in the future are we going to have to worry about PPE price deflation?

Jason Hollar: Yes. So let me start, at least with the first part. We're not going to break out explicitly the pricing separately. First of all, it's just really important to highlight that the pricing is meant to cover that cost increase. And so that's what we're balancing there.

We did, however, say, in our last guidance update in Q1, that the vast majority of that revenue guidance increase for Medical was due to pricing, which was due to that cost that was increasing. With this update, it's definitely more balanced, more weighted towards volume increases in the lab business as well as volume increases in PPE and then to a lesser extent, any type of price changes. I would just go back to the last guidance increase, and it gives you a better understanding of what that PPE pricing dynamic is being driven by.

Mike Kaufmann: Yes. The only thing I would emphasize, just to make sure that it's clear, is that as the cost of the PPE comes down, our revenue will come down. But again, our goal has always been to maintain margin dollars and work with our customers on an assurance program. And so you shouldn't think about declining PPE costs necessarily being a headwind for us other than revenue. And as Jason said, but the timing of when you have the actual sale price and the cost as they flow through, that can create a little bit of lumpiness in the recognition.

Operator: Thank you. We'll go next to Ricky Goldwasser with Morgan Stanley.

Ricky Goldwasser: So two questions here. One on the Pharma Distribution segment. When we look at the implied growth for second half, EBIT is growing faster than revenue. Now clearly, there's some easy year-over-year comps versus the same period last year. But as we think -- and I know it's too early to think about 2022.

But really, if we think about the different drivers, that expectation that generic volumes are going to come back, and Nuclear, which is higher margin. Is it sustainable for us to think that we'll be able to model EBIT continuing to grow faster than revenues for the [Pharma] distribution segment? And my other question was just if you can give us a quick update on opioids and where we stand?

Mike Kaufmann: Sure. As far as -- I'll just cover the opioids quickly. As I've said in the past, it continues to be, as you know, complex negotiations, a lot of moving parts, but we're continuing to make progress there.

As far as on the Pharma guidance goes or thoughts there. We -- obviously, we can't talk about it at this time, fiscal 22. But you're right on those components. First of all, we would expect, if we exit at or near pre-COVID levels, that our Nuclear business would continue to improve sequentially as it goes forward. And we have a lot of confidence in that business. As you know, I highlighted it in my comments, around not only how they're performing well in the current situation, but also the investments we've made to be able to see growth in that business over the mid and long term in the theranostics space.

And then again, as far as generics go, yes, the main reason that we have seen that our generic volumes are off is because of COVID. And so rest of the program continues to be as we expected, we continue to see that program, all the various components that we have in it are essentially working as we expected with just COVID being the driver. So again, as COVID begins to be less and less of an impact, we would expect to see our volumes on our generics program grow.

Jason Hollar: Yes. The other thing I'll add is relative to the Nuclear comment, Ricky, as it relates to the revenue and margin balance here. I think you're on the right point that, as we talked, especially in Q4 of last year, when the volumes were declining quickly. Nuclear is a high-margin business. It is also a high fixed cost business.

So it creates a very high contribution margins that we saw certainly create a headwind in that fourth quarter. And so as we anniversary that in this fourth quarter, especially if our guidance is accurate with the at or near pre-COVID levels.

By the time we exit the fiscal year, then you would expect there to be -- for that piece of it, an improvement in earnings relative to revenue as one of the key components that probably needs to be plugged into your model to make that whole thing make sense.

Operator: Thank you. We'll take our next question from Charles Rhyee with Cowen.

Charles Rhyee: Just on the Pharma side, can you talk about biosimilars and to the extent that they've had an impact? Commentary from some of your peers would suggest that it's starting to become a more meaningful contributor. I just wanted to get a sense within -- in the Pharma segment, how much that's having an impact? And then -- yes, that's basically it.

Mike Kaufmann: Yes. Biosimilars continues to be an area we're also excited about. We are seeing positive contributions from biosimilars. It just doesn't -- it's not at the level to be calling it out as necessarily a driver at this point in time, but it's something that we do continue to participate in.

We're very well positioned to be able to help manufacturers and customers with biosimilars, and we do see that as something that should be a tailwind for us as we look forward, going forward.

Operator: Thank you. We'll take our next question from Steven Valiquette with Barclays.

Steven Valiquette: I think in the Pharma segment, we're all just kind of looking at the trend line where the segment operating profit grew 1% year-over-year back in the fiscal first quarter, but then they were down 11% here in fiscal 2Q. And you mentioned that the Nuclear Pharmacy headwind was actually a little bit less in the December quarter. And I think you said in the Q&A that for the generics, you're not seeing anything inconsistent there from what you saw in the prior quarter despite the COVID impact on generics.

I guess just the question is, is there anything else you'd call out that may have gotten a little bit worse sequentially in that segment? Or is it just maybe there was something else that made the comp a little bit tougher in the December quarter that we overlooked? Just wanted to get more color on the decline in profits in fiscal 2Q versus the fiscal 1Q?

Jason Hollar: Yes. As Mike mentioned earlier, we saw very consistent type of performance in a number of categories sequentially, Q1 to Q2 when we talked about the COVID impacts, we talked about generics in general, the consistent market dynamics.

So you do need to go back to look at the Q2 of the prior year, where that's where the generics program overall was fairly strong, and we talked at that point about not only volume but some mix impacts that were going on at that time. So I think it's very much a comp as well as consistency in the quarter-to-quarter sequential.

Operator: Thank you. We'll take our next question from Elizabeth Anderson with Evercore.

Elizabeth Anderson: I just want to ask about the different -- in terms of your home health business, can you talk about how that has been performing in the quarter? And then maybe sort of your expectations as we like move through the rest of COVID and beyond?

Mike Kaufmann: Yes, we continue to be very pleased with our at-Home business. We're continuing to see growth in overall number of customers that we're serving, the types of product lines that we're working with and driving our mix, all of those types of things, getting after our cost structure.

We are making some large investments in our IT systems that will be going online here. So a little increased SG&A as we drive to improve our systems there to be able to improve the customer experience, and as we grow, be able to do it more effectively. But it's a business that we continue to remain very positive on. We believe the trends continue to be in our favor in that business. And being one of the leaders in that space, I think, enables us to invest in various activities and opportunities to continue to grow that business.

Operator: Thank you. We'll take our next question from Eugene Kim, Wolfe Research.

Eugene Kim: I would like to get some color on cost savings benefit in the Medical segment. And can you maybe quantify the benefit you saw for the quarter and share how much of the savings are more temporary in nature? And also if you are expecting those temporary savings to come back in the back half?

Jason Hollar: Yes. So within the quarter, we called out two key items. One is this topic, cost savings as well as the COVID impacts. And they were both the most significant items that are driving our year-over-year performance. So in terms of the order of magnitude, you should think of that as a large driver of this performance and consistent with that other driver.

How we break out our cost savings is that they would, by their nature, be largely permanent. Anything that's temporary and only because of COVID or COVID-related matters, we would put into the COVID bucket. So we do see this as a continuous improvement and deep into our DNA and that we aren't just squeezing out costs temporarily, but truly transformational foundational elements. It's within our SG&A expense, it's within our global manufacturing and our supply chain. And as such, we'd expect it to be permanent.

Mike Kaufmann: Yes. And the only thing I would add to that is, as Jason mentioned earlier, remember that because of some of the strong performance we've had in Medical and in the business in the first half, there are some areas in Medical expenses where we are investing in the business, as we've talked about from a capital standpoint.

I just mentioned the IT systems in at-Home, and we're also looking at some other areas. So we are ramping up some of our expenses that -- in the area of making investments in growing the business over the mid to short term. So we would expect them to be a little higher in the second half. But to our $500 million five-year goal, those are seen as permanent expenses that come out. But what we're talking about is ramping back up the type of investments based on how we feel strongly about the performance of the business for the full year.

Operator: Thank you. We'll take our next question from Eric Coldwell with Baird.

Eric Coldwell: We've been hearing a lot about stockpile-as-a-service or storage-as-a-service in medical and perhaps even in certain areas of pharma or therapeutics, mission-critical items that are often in short supply.

I'm just curious, it sounds like you're doing some similar things here. And I'm curious what the model looks like with that business. Is this more like a 3PL fee? Or how exactly does that work? When does the customer buy the product from you? How are you compensated for the facilities, the capital costs, the storage, et cetera?

Mike Kaufmann: I think a couple of things. First of all, the last thing you said is important is that we would intend to be properly compensated for that, as with any investment, we’re working with customers to make sure that the services that we provide, we're getting compensated for not only from an income statement, but appropriately looking at our balance sheet and the return. So that's important to note.

To give you specifically on how it would work, that's a little more complicated because I think it's -- we're going to see inventory changes across the entire supply chain.

I think you're obviously, one, going to see supply changes in the way that probably the manufacturers work and the amount of inventory they're carrying to be able to get through these types of things; the location of our supply chain and where we -- the percentage of what we self-manufacture versus what we source, we continue to increase our capacity, for instance, to manufacture our own drapes and gowns. And so the ability to ramp that up, store inventory and managing it that way would be one.

And then as I mentioned, we are building some larger distribution centers so we have the capacity to do that on our end, both to make sure our service levels are where our customers expect them to be, but also, in certain cases, carry that inventory for customers.

But I also believe that customers are looking at what they warehouse and don't warehouse and that mix of what they warehouse may be more towards these PPE-related items versus other ones. And that can create some different opportunities for us to work with them.

So I do think the entire supply chain will adjust over the next couple of years as it relates to inventory. But the important thing to note is that as we work with our customers on this, we would -- and suppliers, we would expect to get compensated from both in order to provide that type of service.

Operator: Thank you. And we will take our final question from Brian Tanquilut with Jefferies.

Brian Tanquilut: Mike, just a question on the vaccine distribution side. I know you said you're taking care of small chain pharmacies and the independents. So is there any sort of sizing that you can put there or in terms of like what your clients are thinking in terms of the percentage of overall vaccinations that they will get as a group?

Mike Kaufmann: Yes. At this point in time, it's -- as you know, it's state by state, it changes on a weekly basis. So I don't really have any good insights on to how to help you on that. I would tell you that we continue to be there for our customers. We're going to continue to help them be ready to do it. It's not a driver at all for our financial statements one way or the other. So from a financial driver, it's not material. But it'd be really hard for me to even give you anything there because of the choppiness of the amount of vaccines that we're seeing state by state.

Operator: That will conclude our question-and-answer session. At this time, I'd like to turn the call back over to Mike Kaufmann for any additional or closing remarks.

Mike Kaufmann: Yes, I really want to thank everybody for joining us this morning. And on behalf of all of us at Cardinal Health, I hope you and your families are safe and well, and we look forward to speaking to all of you again soon.

Operator: Thank you. That concludes today's call. We appreciate your participation.