Q3 FY23 Cardinal Health, Inc. Earnings Conference Call

May 4, 2023, 8:30AM Eastern

Operator: Hello, and welcome to the Third Quarter Fiscal Year 2023 Cardinal Health Incorporated Earnings Conference Call. My name is George, I'll be your coordinator for today's event. Please note, this conference is being recorded and for the duration of the call, your lines will be in a listen-only mode. However, you will have the opportunity to ask questions at the end of the presentation. This can be done by pressing star one on your telephone keypad to register a question. If you require any assistance during the presentation please press star zero and you will be connected to an operartor. I would now like to hand the call over to your host today, Mr. Kevin Moran, Vice President of Investor Relations to begin today's conference. Please, go ahead, sir.

Kevin Moran: Good morning. Today we will discuss Cardinal Health's Third-Quarter Fiscal 2023 results along with updates to our full year outlook. You can find today's press release and earnings presentation on the IR section of our website at ir.cardinalhealth.com. Joining me today are Jason Hollar, our Chief Executive Officer, and Aaron Alt, our Chief Financial Officer.

During the call we will be making forward-looking statements. The matters addressed in the statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected or implied. Please refer to our SEC filings and the forward-looking statement slide at the beginning of our presentation for a full 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.

For the Q&A portion of today's call, we kindly ask to limit yourself to one question, so that we can try and give everyone in the queue an opportunity. With that, I will now turn the call over the Jason.

Jason Hollar: Thanks, Kevin. Good morning, everyone.

Overall, we're pleased to deliver another quarter demonstrating progress against our plans, with our Q3 results led by continued momentum and growth in the Pharma segment.

With the strong overall performance in the quarter and our increased confidence in the rest of the year, we are raising and narrowing our fiscal '23 EPS and adjusted free cash flow guidance.

Our Pharma business is a resilient and growing business, where we're well-positioned given our critical role in the pharmaceutical supply chain and strong and diverse customer base.

We've seen ongoing stability in the underlying fundamentals of the business, including consistent market dynamics in our generics program. We've also seen continued broad based strength in pharmaceutical demand spanning across product categories and classes of trade.

Our Pharma team is executing our plans to build upon this growth, both in our core distribution operations and in Specialty where we're focused on capturing the increasing demand for Specialty products and services.

In short, we're pleased with the resiliency and strength of the business and to be able to raise our Pharma outlook for fiscal '23.

In Medical, we remain confident in our Medical Improvement Plan target of at least $650 million dollars of segment profit by fiscal '25, driven by our inflation mitigation and growth initiatives.

While we are making progress, with the second consecutive quarter of positive segment profit, we remain focused on taking actions to drive more predictable financial performance in-line with this business's underlying potential.

For several quarters now, we've seen the demand for our higher-margin Cardinal Health Brand products remain generally stagnant, which we've reflected in our updated fiscal '23 outlook.

We continue to achieve progress with inflation mitigation, the number one key to returning the business to a more normalized level of profitability.

Across enterprise, we are operating with urgency to drive our businesses forward. We're collectively focused on our three key strategic priorities of executing on the Medical Improvement Plan, building on the growth and resiliency of the Pharmaceutical segment, and maintaining a relentless focus on maximizing shareholder value.

I'll provide some further updates on our continued progress shortly, but first, let me turn it over to Aaron to review our results and updated outlook.

Aaron Alt: Thank you, Jason. I am pleased to join you this morning on my first call since assuming the CFO role with nearly 90 days now under my belt. What I could see from the outside has proven to be true on the inside – Cardinal Health is a business with a strong leadership team, an engaged board, a defined strategy, a strong balance sheet and plenty of operational opportunities to promote value creation for our stakeholders.

I'll begin today with the enterprise's strong results for the third quarter.

Total revenue increased 13% to $50.5 billion dollars and gross margin increased 6% to $1.8 billion, dollars both driven by the Pharma segment.

Consolidated SG&A increased 4% to $1.2 billion dollars, primarily reflecting inflationary supply chain costs, which were offset in part by our comprehensive enterprise-wide cost savings initiatives.

Operating earnings of $606 million dollars were 11% higher than the third quarter of last year, driven by significant Pharma segment profit growth, with opportunities remaining for us to achieve Medical segment profit increases in future quarters.

Moving below the line, Interest and Other decreased 32% to $28 million dollars, driven primarily by increased interest income from cash and equivalents. As a reminder, our debt is largely fixed rate, resulting in a net benefit from rising interest rates.

Our third quarter Effective Tax Rate finished at 22.4%, slightly lower than we had expected, reflecting some positive discrete items in the quarter.

Diluted weighted average shares were $258 million, 7% lower than a year ago, due to continued share repurchase actions.

The net result of the progress against our strategy was adjusted Earnings Per Share of $1.74 in the third quarter, growth of 20% versus the prior year.

Now, turning to the balance sheet.

We ended the quarter with strong liquidity, with $4 billion dollars of cash on hand. The business generated robust adjusted free cash flow of $1.3 billion dollars in the third quarter. Year to date adjusted free cash flow is $2.1 billion dollars. Given our cash balances, we ended the period with no outstanding borrowings on our credit facilities.

And in further support of our strong investment grade rating, during the quarter, we paid down $550 million dollars of maturing March 2023 notes with cash on hand, consistent with our plans. We also extended our $2 billion dollar revolver of back-up liquidity until February of 2028.

Earlier in my remarks I referenced return of capital to shareholders. During the quarter, we returned $378 million dollars to shareholders, through a $250 million dollar Accelerated Share Repurchase program and payment of our long-standing dividend. Year-to-date we have returned $1.5 billion dollars through share repurchase and made nearly $400 million dollars in dividend payments.

Now, I will cover our segment performance, beginning with Pharma on slide 5.

Third-quarter revenue increased 14% to $47 billion dollars, driven by brand and specialty pharmaceutical sales growth from existing customers. We saw strong broad-based pharmaceutical demand, particularly from our largest customers. GLP-1 medications also provided a revenue tailwind in the quarter.

Pharma segment profit increased 23% to $600 million dollars. We were pleased to see that this progress was driven by both positive generics program results, including volume and mix, and by a higher contribution from brand and specialty products.

Within our generics program, we continued to see ‘consistent market dynamics’ and strong performance from Red Oak Sourcing.

With regards to branded and specialty products, the higher contribution reflects a modest benefit from manufacturer price increases. As a reminder, while over 95% of our overall branded margin is derived from fixed fee-for-service agreements, the contingent portion is highly concentrated in our fiscal third quarter.

Moving to the key growth area of Specialty, we've seen strong double-digit growth across Specialty Distribution, along with our upstream Manufacturer Services.

Our Nuclear business, which is tracking ahead of plan, continued its double-digit growth, including benefiting from recent launches of novel theranostics.

Within our pharmaceutical supply chain, we continue to effectively manage through the incremental inflationary cost pressures seen industry-wide, and in the third quarter, these net impacts were not material on a year-over-year basis.

Finally, in the quarter we lapped more significant opioid-related legal costs and higher costs related to the now completed ERP technology enhancements.

Now, turning to Medical on slide 6.

Third-quarter revenue decreased 5% to $3.7 billion dollars driven by lower Products and Distribution sales, primarily due to expected PPE volume and pricing declines.

Medical segment profit decreased 66% versus prior year to $20 million dollars, primarily due to lower Products and Distribution volumes and unfavorable sales mix.

Additionally, these results reflect both net unfavorable non-recurring adjustments, including simplification actions, and some modest year-over-year improvement in PPE margins. Similar to Q2, we observed normalized PPE margins in the third quarter.

Regarding the demand environment, we've previously discussed some overall volume softness in our Products and Distribution business, including Cardinal Health Brand. In the quarter, volumes for our Cardinal Health Brand products were roughly flat sequentially.

We achieved inflation mitigation of over 40% during the quarter, driven by our continued efforts. We also saw benefits from our ongoing cost saving initiatives, such as in our manufacturing and supply chain.

Now, for our updated fiscal '23 outlook, beginning on slide 8.

Our team is working hard and we are seeing positive results in key parts of our portfolio. As we move into the final quarter of the year, we are narrowing and raising our non-GAAP EPS guidance range from $5.20 to $5.50 to a new range of $5.60 to $5.80. At the mid-point, this represents a $0.35 and 13% year-over-year growth.

This update primarily reflects an improved outlook for the Pharmaceutical segment for the year, as well as a more modest short-term outlook for Medical. While we will save commentary or updates on long-term segment guidance for our upcoming Investor Day on June 8, we are sharing today that we are reaffirming the long-term financial guidance in the Medical Improvement Plan for the Medical segment.

We are also updating some key enterprise-wide assumptions, as seen on slide 8.

Based on year-to-date performance, we now expect Interest and Other in the range of $95 to $105 million dollars, a non-GAAP ETR of approximately 22 to 23% for the year and adjusted free cash flow generation of $2 to $2.3 billion dollars for the year.

We expect diluted weighted average shares outstanding in the range of $262 to $263 million, reflecting our year-to-date repurchase activity and continued expectation of $1.5 to $2 billion dollars in total share repurchases in fiscal '23.

Finally, we now expect capital expenditures of approximately $450 million dollars, reflecting the timing of our continued investments to drive organic growth.

Turning to the segments on slide 9.

In Pharma, with the strong pharmaceutical demand and performance that we've seen to date.

We now expect full year revenue growth in the range of 14 to 15% and segment profit growth between 10.5 to 12% growth.

We are extremely pleased with the ongoing resiliency and strength of the business and our plans to drive double-digit profit growth in fiscal year '23. Yet, when looking at the more normalized performance of the Pharma business, it's important to note our fiscal '23 outlook includes two non-recurring year-over-year tailwinds.

First, as noted, we experienced a modest benefit from branded manufacturer price increases in fiscal year '23 that we assume is unlikely to repeat in future years.

Additionally, relative to the prior year comparisons, our prior fiscal year '23 guidance assumed offsetting year-over-year impacts in total between several non-recurring drivers: higher than usual inflationary supply chain costs, lower opioid-related legal costs and lower costs for technology enhancements compared to fiscal year '22. However, we now expect the in-year comparison to fiscal year '22 for these items to produce a modest year-over-year tailwind unique to fiscal year '23.

We will provide insights into our long-term targets for Pharma during our Investor Day, including some early guidance for fiscal year '24.

Turning to Medical, we now expect a revenue decline of approximately 6% and a segment profit decline of approximately 50% for the year.

This updated outlook reflects three key changes:

First, third quarter actual results, as I've already discussed.

Second, updated assumptions around Cardinal Health Brand volumes, namely that we will see relatively consistent demand patterns for the remainder of the fiscal year.

Third, delayed realization of lower costs which we have previously incurred, primarily related to international freight. Based on our updated volume expectations, we now expect some of the previously-anticipated fourth quarter improvements in the P&L to shift into fiscal '24.

As a reminder, on the cost side we have seen significant improvement in incurred international freight costs, which are capitalized into inventory on our balance sheet. These costs are then recognized in our P&L results on a delay as we sell through the products. We continue to have strong line of sight into this eventual benefit, however, due to timing, the impact to our fourth quarter results will be more modest than previously assumed.

Importantly, we continue to expect to exit the year offsetting at least 50% of the gross impact from inflation.

Looking ahead to the fourth quarter, the approximate $60 million dollar sequential improvement in Medical segment profit embedded in our guidance primarily reflects the combination of three items: First, the normalization for the non-recurring adjustments from Q3. Second, continued improvement and progress on our mitigation initiatives, including the benefit from the previously incurred international freight costs. Third, and to a lesser extent, normal seasonality improvements in the fourth quarter.

So, in financial summary, an excellent financial quarter overall, a raise to guidance, with opportunity still in front of us.

With that, I'll now turn it back over to Jason.

Jason Hollar: Thanks Aaron. Now, a few key updates on our 3 strategic priorities for fiscal '23.

First, executing our Medical Improvement Plan initiatives.

We remain on track with our mitigation actions for inflation and global supply chain constraints, and I'm pleased with our continued incremental progress on this critical front.

We've now mitigated over 40% of the gross impact to our business through our mitigation initiatives. This includes widespread temporary price increases across nearly all of our Cardinal Health brand product categories, supplier distribution fee increases to offset higher transportation, labor, and fuel costs and our focus on other offset opportunities, such as additional sourcing efficiencies.

We continue to work collaboratively with our industry partners to make pricing adjustments that are reflective of current market conditions on our path to fully mitigating this headwind by the time we exit fiscal '24 through these collective actions.

By taking a transparent approach, we are also advancing our re-contracting efforts, successfully adjusting long-term product contracts as they renew and including language that allows for greater future flexibility.

While costs generally remain significantly elevated relative to pre-pandemic levels, we've seen a stabilization across most areas, along with improvement in international freight. We believe we are now past peak overall cost levels, as the improved international freight costs will begin to be reflected in our fourth quarter results. We remain committed to our mitigation efforts as highlighted earlier.

To drive growth outside of our mitigation actions, we are focused on optimizing and growing our Cardinal Health Brand portfolio, accelerating our growth businesses and driving simplification and continued cost optimization.

As Aaron indicated, demand for our Cardinal Health Brand products has remained generally stagnant over the first three quarters of fiscal '23. We believe market demand will improve in fiscal '24 and '25, coinciding with our ongoing initiatives to increase product availability, drive new product innovation and implement other commercial improvements. As an example of product innovation, we recently unveiled the new Kangaroo OMNI™ Enteral Feeding platform at the ASPEN Congress. OMNI™ is the only enteral pump cleared to accurately deliver thick formula and is designed to meet enteral feeding needs, from the hospital to home, infancy to end of life. OMNI™ has received very positive feedback from both clinicians and patients generating excitement for the launch in early fiscal '24.

Outside of U.S. Products and Distribution, we're driving growth in our other key areas of the segment, at-Home Solutions, Medical Services, including OptiFreight® Logistics and WaveMark™, and International Products and Distribution.

For example, in at-Home Solutions, we are expanding our footprint to match the sustained growth of home healthcare we are seeing in the industry and our business. Our new, central Ohio distribution center is now operational. This new location is the next step in supporting our growth strategy and will be equipped with systems and automation capabilities to improve safety, service and operational efficiencies. A new automated storage and retrieval system will increase throughput and capacity; an ideal technology for at-Home Solutions' facilities that are primarily focused on direct-to-patient fulfillment.

In OptiFreight® Logistics, we are accelerating our growth as a leader in tech-enabled logistics management by driving best-in-class customer experience and continually diversifying our product offerings.

And, we continue to take action to drive simplification across our Medical business by optimizing our distribution and global supply chain network and through our active approach to product lifecycle management.

Next, in Pharma, we're building upon the growth and the resiliency of the business.

We are privileged to serve and partner with a broad customer base providing essential healthcare services in their respective communities, including leaders in retail pharmacy, mail order, grocery, and health systems, among the many classes of trade.

We support our customers by bringing significant scale and leading offerings to market, including our comprehensive generics program, anchored by the capabilities of Red Oak Sourcing.

To keep pace with the strong and resilient demand we are seeing from our customers, we continue to focus on strengthening our core operations by continually developing customer-focused solutions and investing in new technologies across our supply chain. Our goal is to continue providing innovative tools that address the unique challenges of our customers, while unlocking value and further efficiencies across our distribution supply chain.

We're also prioritizing the area of Specialty through our actions and investments. Our new organizational design is driving efficiencies and further effectiveness, enabling us to move quicker and better prioritize the needs of our customers and manufacturer partners.

Downstream, we've seen continued double-digit growth across Specialty Distribution, including in health systems and alternative care. And in the physician office channel, our acquisition of the Bendcare GPO and investment in their MSO continues to drive a differentiated engagement model for Rheumatologists through our expanded capabilities.

Upstream with biopharma manufacturers, we again saw double-digit growth from Manufacturer Services in the third quarter. Our leading Specialty 3PL continues to win new business, including in the area of cell and gene therapy. Through Q3, we've supported 27 product launches, with double-digit launches anticipated in the fourth quarter.

And in our Nuclear business, we're seeing a growing demand pipeline for our Center for Theranostics Advancement in Indianapolis. We've seen strong volumes from recent theranostic launches, such as radiopharmaceuticals supporting prostate-specific PET imaging. With the continued success of the business combined with the innovation that is occurring in the space, we continue to be excited about this very promising area.

And lastly, a brief update regarding our relentless focus on shareholder value creation.

We have placed a strong emphasis on responsible capital deployment, including the return of capital to shareholders. This is evident through our plans to return over $2 billion dollars to shareholders in fiscal '23 through dividends and share repurchases. We will continue to pursue opportunities for additional shareholder value creation.

Our management team has made significant progress in realigning our operations to drive focus and simplicity. Our work is ongoing, and we continue to work through a comprehensive review of our company's strategy, portfolio, capital allocation framework, and operations with the support of our Board and the Business Review Committee. Given the importance of this work, today we announced that the Board has extended the term of the Committee for an additional year, through July 15, 2024, and we have also extended the term of the Cooperation Agreement with Elliott.

We are very much looking forward to our upcoming Investor Day on June 8th in New York City and the opportunity to further articulate why we believe Cardinal Health is well-positioned for long-term success and our plans to maximize shareholder value. Among other topics, we plan to detail our growth strategies and provide updates on our long-term outlook, capital allocation framework and the ongoing business and portfolio review.

Before I conclude, I want to thank our Cardinal Health employees who are advancing our key strategic priorities and fulfilling our essential role in healthcare serving customers and their patients. While there’s still work to do, I am encouraged by our team’s continued progress and excited about our future opportunities.

With that, we will take your questions.

Operator: Thank you very much, sir. Ladies and gentlemen, once again please limit yourself to one question. Today's first question is coming from Michael Cherny calling from Bank of America. Please go ahead. Your line is open.

Michael Cherny: Good morning, and thanks for taking the question. Maybe, if I can just dig in on the Medical side and just get an understanding, especially given the bridge dynamics between where you're run rating versus the build to the $650 million in ’25. Is there any way you can go into more detail about what the quantitative and qualitative components of what led to the non-recurring piece that's been absorbed within the segment? And then, as you think about the dynamics behind that, how does that roll off over time as part of that build towards the longer-term multi-year targets?

Jason Hollar: Sure. Thanks, Michael. Yeah, let's break down the inflation into the components as a way of giving you the pieces I think you're asking for there. And we've given you enough of this that you can back into these numbers, but let me just be really explicit around the impact of inflation across the quarters in fiscal ‘23 and what that then implies for ‘24 and beyond and I think that will get at most of your questions. So the first half of the year, namely within Q2 – somewhere around Q1, Q2 – we saw the peak net impact of gross inflation net of the mitigation actions. And then, specifically in Q2, we had about $100 million dollars included in our reported Medical segment earnings.

Now, we have had improvements over the course of the last quarter. So, in Q3 we saw both the ongoing pricing dynamics as expected and the costs continue to be incurred at lower levels as expected. And what that did then was drove a P&L benefit related to those mitigation actions of $20 to $30 million dollars for the quarter. The difference in the quarter is that both Q3 as well as Q4, our volumes are now expected to be lower. So, what we see in the P&L is a little bit less than what we had anticipated. But what we're spending on those incurred costs are coming in as expected. So, again, that's Q2 to Q3, a $20 to $30 million dollar improvement in the net impact. And then, we expect pricing to continue to improve as we roll over more and more contracts into the new permanent structure and then we have ongoing – the international freight, especially continue to roll through our

P&L, again, at a slower pace than originally anticipated. But we still expect that benefit in the fourth quarter and that's another $20 to $30 million.

So, as you think about that Q2 to Q4 journey, that's $40 to $60 million or let's call it about $50 million dollars of benefit, just related to the mitigation actions. So again, the actions are entirely consistent with our expectations. It's just that volume component is effectively delaying the benefit of what we see until some of it spilling over into fiscal ’24 more than what we had anticipated. So, that's the biggest part of the bridge because our guidance implies an $80 million dollar-ish type of run rate in the fourth quarter, and so getting that Q2 to Q4 $50 million of that that kind of gets you there. Now, to your point, in Q3, there were some non-recurring items, some puts and takes that we don't anticipate will continue on into the Q4, let alone 2024 and 2025. So, that's kind of in and out, and not really something to think about so much in terms of that overall bridge.

Now, last part of this story then is, okay, so that gets you to the run rate of about $80 million in the fourth quarter. And as I said, we started with $100 million at the beginning of the year, Q2 impacted because of inflation. The $20 to $30 million each quarter takes you down to the $50 million in Q4. That implies that in that $80 million dollars of profit as we exit the year in our Q4 results, still includes $50 million dollars for the quarter related to the net impact of inflation. That's the opportunity that we remain committed to. Nothing we're talking about here is different than our expectations. I continue to expect us to fully mitigate through pricing of the ongoing renewals, as well as this cost will continue to come down in terms of what impacts our P&L. We do not anticipate significant further reductions in other commodity areas, but we do expect that international freight will stay at the low levels that it currently is at.

Next question, please.

Operator: Thank you, sir. Next question is coming from Lisa Gill of JPMorgan. Please go ahead.

Lisa Gill: Thanks very much and thanks for all the detail. Jason, I know you're going to talk about this at your Analyst Day around the portfolio review, but there's been some speculation around your nuclear business. Can you just talk about the contribution that that had maybe overall thus far this year and how you see that? Is that a core component of your business going forward, or is this something that you would think about when you think about your portfolio review? And any insights that you have around nuclear would be helpful.

Jason Hollar: As you would expect, Lisa, first of all, good morning. I'm not going to comment on any of the rumors or speculation. What I'll say is nuclear is a fantastic business. In our segment flip, we break out the revenue that's trending a little above $1 billion dollars. It did increase a bit here because of some rev-rec changes that's taking our revenue growth at well over 30%. But the kind of the normalized level of revenue growth has been in the low-double digit type of revenue growth. So, it's been growing nicely. We've never broken out the margin, but we have indicated it's a higher-than-average margin. So, it's a growing business. It's a strong business and a great secular area, and that's all that we're going to say about that. Next question, please.

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

Kevin Caliendo: Thanks. Thanks for taking my question. I appreciate all the color around the things that you can control on the Medical side. But it's a little confusing to understand why market demand has been stagnant the last couple of quarters for your products. Given what we hear from at least the public hospitals and the like who clearly are doing better. Is there a geographic issue? Is it a customer issue that you're not seeing increased demand? Is purchasing changing at the hospital level, or is it a product portfolio issue? Like, what's actually happening in the marketplace that's kind of kept your private portfolio stagnant?

Jason Hollar: Yeah, there's a few components I can provide some additional color on. First of all, we've highlighted some of the categories. So, PPE, we've highlighted the destocking situation still. So, we're not seeing anything new or different there. We have some other categories like our lab business, which is actually seeing a little bit of a headwind sequentially, nothing too significant. But it's certainly with COVID originally and then with flu testing, we had some pretty good volume over the last couple of years and that's getting more normalized. So, we have some headwinds like that.

For the other, non-PPE type of Cardinal Health brand categories that are important to us, especially from a margin perspective, what we have to go back to is just highlight that a couple of years ago, last year, we saw some very significant supply chain constraints. And at that time, we were not able to get our customers the products that they needed. Fortunately, we've been working very hard on that. Our product availability, our product health, our customer service levels are at levels we've not seen since before the pandemic. So, we're in really, really good shape now, but we were not getting all the products to our customers that they needed over that period of time and we lost some opportunities as a result of that. So, that's why we're not benefiting from as much of the growth right now. I do think that the underlying utilization is improving. We're not getting our fair share of that. And that's where we're very focused on further investments in our capacity, further investments in product innovation, but also just making certain that we keep our service levels ever increasing to levels that are really exciting our customers, so that they want to buy more and more of that product from us. And we're in the best position we've been in in years and have more confidence that we'll get there.

This is an important part of the Medical Improvement Plan, right? It's one of the four pillars of growth and so we are anticipating further improvements. It is about 20% of the actions necessary for us to hit the $650 million dollar plus target. That's why we're very focused on the other actions as well to see if we can overdeliver and derisk this. But we do believe that utilization will continue to improve overall for the market, and we are better positioned now than we've been in a long time to participate in that and I feel good about our prospects to see that growth, especially as we get into fiscal ‘24.

Kevin Caliendo: Thanks so much.

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

Elizabeth Anderson: Hi, guys. Thanks so much for the question. One, I was hoping – thanks for all the details on the Medical business. I was wondering if you could just help us on one more thing, and sort of exclusively tell us what the contribution of, or the hit from one-time items was in the quarter on Medical. And then, two, can you talk about the pushes and pulls on the Pharma operating profit in the fourth quarter? Because it seems like it could be a little bit conservative there, so I just want to make sure that we have all the dynamics down there. Thank you.

Jason Hollar: Okay. So, I'll make a comment on your first part of your question, I'll turn it over to Aaron for the second one. It's nothing that we've explicitly quantified, just wanted to highlight the words that we used, again, that it was a modest net negative impact in Q3. So, it's one component. It's a number of puts and takes within there. Did highlight that as an example, one of the types of items are some costs for further simplification actions and we had some of that in the first quarter as well. So, we're constantly looking at our portfolio and taking action to improve our ongoing profitability and that required us to take some further adjustments within the quarter, but nothing else to really highlight there, other than the key is that we just don't expect them to continue, certainly not to long-term or even into the rest of our guidance for fiscal '24. Aaron?

Aaron Alt: Good morning. Happy to talk about the Pharma business. First, just let me repeat a little bit of what I said in my prepared remarks, which is we are really pleased with the performance of the Pharma business and what the team is accomplishing in that core part of our business, the resiliency and the strength that they showed in Q3 based on the progress on the generics platform, as well as some strength in the brand portfolio and the double-digit growth in specialty allowed us to be able to lean forward and raise our guidance for the year for the Pharma business.

I want to highlight a couple of things as you think about Q4, which I think was the point of your question, which is, while we expect to see continued good news relative to the operational performance and a stable macro environment with the strong underlying fundamentals we laid out, it is important to note that Q4 last year was a strong quarter for us and so we're lapping a higher point. It's also the case that we'll have less benefit from some non-recurring items that we called out in our prepared remarks earlier as well. And so, overall, strong performance in Q3, looking forward to a good Q4. But, careful in our expectation setting.

Operator: Thanks so much, sir. We'll now move to Eric Percher of Nephron. Please go ahead.

Eric Percher: Thank you. Staying on the Pharma side, I wanted to ask whether the changes we're seeing to list prices around the insulin products and the potential for more changes in front of the AMP cap sunset next year is significant? I understand this is a change to fee-for-service economics and that gives you a right to renegotiate but, how would you characterize renegotiations of that type when they come up? And are you confident you can maintain absolute profit or something close to it?

Jason Hollar: Yes. In short, very confident and we'll continue to appropriately be compensated for our activity-based value. So, this is not any different than the various other types of adjustments we've had to make over the years, and it's something that I think we've demonstrated makes sense to make the appropriate adjustments.

The other thing I'd highlight is the starting point for a product like this is not real strong margins to start with. So, there's not a big profit pool from which to draw value from. So, we do expect to be compensated for the value that we provide, and we'll continue to monitor and follow this. One thing we had talked about in the past on this type of topic is where I have the most concern is when we don't have sufficient visibility to changes and that something would just kind of fall in our lap at the last minute. Because it does require some renegotiation, restructuring in some cases of how the arrangements are made. This one is a little bit more straightforward, and we feel like we can negotiate the appropriate outcome for it and we certainly have the time for it. But the distinction is, if there's ever any really short-term type of impact and that would be needed to be addressed separately.

Operator: Thank you very much, sir. Next question is coming from George Hill of Deutsche Bank. Please go ahead.

George Hill: Yeah. Good morning, guys and thanks for taking the question. I guess, first, as it relates to the Cardinal Health branded products in Medical, I guess, Jason, is there any way to evaluate whether or not you guys are losing wallet share with customers and that is impacting volumes? And I guess my quick follow-up on that would be, we know that you guys have historically forward bought commodity-based products. I guess, is there any way to provide any more color around the timing of when Medical in flex as it relates to kind of the forward buying and the commodity impact in the inflation mitigation? Just trying to think about kind of like when we see the inflection as it relates to these lower costs really pulling through.

Jason Hollar: Yeah. So as it relates to share, I think when you look back at our volume, we had a stepdown in volume in Q3 and Q4 of last year. And again, there was a lot of PPE that came out there. We clearly lost share there. It is a business that's a commodity business for us. It's important for our customers. We participate as needed. We source most of that product. So, it's a category that's not our priority. What's most important is that we take care of our customer needs.

In the non-Cardinal volume, we also saw some weakness there, as I mentioned before, the supply chain constraints. So, as other providers had capacity, then we would have had a lower share as a result of that. Again, I think there's been very little of that change since then. Our service levels and our product health have improved dramatically even over the course of fiscal ‘23. So, I do not believe that we have, everything that we're seeing from a new contracting perspective has been consistent with our expectations here this year, so I don't see anything new there. But we are dealing with some impacts that happened over the last couple of years, that part is the case.

Your second question, I think I answered it before in terms of the timing associated with the commodity impact is really the international freight is the big one that's reduced. And that reduced significantly six to nine months ago. And that's why right now we're on the cusp of having that hit our P&L favorably, or benefit our P&L, is because we typically have two to three quarters' worth of inventory. Why it's spilling over into ’24, is that our volumes have been lower than anticipated and so it's taking a little bit longer for us to recognize that benefit. I've not called out any significant movements on other commodities. There's clearly movement. There's some better. There's some that have not improved. Overall, it's consistent with our expectations. We expected a little bit of an improvement across the board, and we just haven't seen anything more than that outside of international freight. We do have some categories that are just staying very high like non-wovens, where there's a bit of a geopolitical impact on those types of costs and not just on raw input costs. And so that is something that may or may not change in the future. It's why we have to have the right structure in the contract if there's a further shock to be able to have more flexibility with our price adjustments. But overall, we're seeing the other commodities continue to be pretty stable, admittedly at fairly high levels, but they're not changing enough to really impact our overall message here.

And by the way, as those change, our pricing will change. Our objective is to offset this. We're not expecting to make a margin on this. But if those come down more quickly, then at some point I would imagine that those cost, those prices will adjust consistent with that. But right now, we are still absorbing $50 million, well $50 to $75 million right now, per quarter of those costs and that's why our prices do need to still keep increasing until those two lines converge, which we think will be again, closer to the end of fiscal ‘24.

Operator: Thank you very much, sir. Next question is coming from Eric Coldwell of Baird. Please go ahead, sir.

Eric Coldwell: Thank you. Most of might have been covered, but I did want to hit on the generics pricing topic. I know you've made some positive comments during the call, but also suggested that market dynamics are generally consistent. We've seen some generic pricing in our data, some generic pricing deflation improvement over the last few months. I'm curious if you're seeing the same thing. And what your outlook might be on that front moving forward? Thank you.

Jason Hollar: Thanks, Eric. We called out favorable volume and mix and consistent market dynamics. As we've highlighted many times before, it's important to look at the total of both sides, buy and sell, and we continue to think those overall dynamics are fairly well balanced. And there will be ongoing volatility on one direction or another, one side or the other, but it's the importance of Red Oak Sourcing and continue to deliver the best-in-class service levels, as well as cost. And we feel very good about our competitive positioning there and why we think the margin per unit will continue to be as expected, and that's as much a part of the story then as the volume and the mix.

Operator: Thank you very much, sir. Next question is going to come from Mr. Steven Valiquette calling from Barclays. Please go ahead.

Steven Valiquette: Hey, thanks. Good morning. You might have just touched on this a little bit, but I guess I was curious more just for the overall Pharma segment. You've had obviously a bunch of consecutive quarters now of double-digit top line growth, including 14% this quarter. And you talked about brand inflation, brand volume, generic specialty, all being strong. So, I guess my question was really..

Operator: Very sorry about that, ladies and gentlemen. The line appears to have dropped suddenly. Sir, if you’re back with us, please press star zero, star one again. We'll go with Daniel Grosslight with Ciit.

Jason Hollar: If I could, I think I might know where he's going with the question. I think he was leading us to – I'm guessing that he's leading us to were there any deviations from that. I mean, what we saw was really broad-based performance throughout our Pharma segment. I've answered questions about nuclear, nuclear was just like our other businesses this quarter. We referenced generics. We referenced brand. We referenced specialty. We saw a strong performance across the board, utilization is certainly strong across the board. I also wanted to highlight our performance on delivering this very strong volume was also positive. The one thing to may be add to this as well. We talked about a new customer that was onboarded Q3 of last year and they were onboarded in the prior year Q3, but there's always a ramp-up process there. So, we did see some benefit this quarter relative to last year in terms of this customer now being fully onboarded. So, we had a bit of a benefit there, not to the extent of what we saw in the last couple of quarters. And then the last piece that has been – was very robust this quarter as well. That was not the case in the prior year certainly were the GLP-1s that Aaron had mentioned. So, it was a combination of strength across customers, classes of trade, as well as an individual business unit.

All right. So, now you can ahead to the next question.

Operator: Thank you very much, sir. Sorry about that. Our next question is coming from Daniel Grosslight calling from Citi. Please go ahead.

Daniel Grosslight: Yeah. Thanks for taking the question. And I had a similar question, but more on the EBIT for Pharma. Nice raise obviously this quarter. But I'm curious if you can kind of break out for us the non-recurring items in a little more detail in the Pharma EBIT raise, and how much will be recurring in fiscal ‘24? Thanks.

Aaron Alt: Well, I think the benefit of them being non-recurring items is they won't recur into fiscal ‘24. If your question is more on Q4, I think the answer is similar in that way. For the Pharma segment, we saw strength across the board. It was a stable macro situation. We had the strong underlying fundamentals. We had the good operational performance as well. We did see some modest benefit from branded manufacturer price increases and this being the third quarter for us as well, which we don't predict are going to repeat as we carry forward. And so, I think the story for us for Pharma was a good year so far, a good quarter for Q3. We raised our guidance for the year, and we'll talk more about fiscal ‘24 and indeed our long-term expectations for the business during our Investor Day on June 8.

Jason Hollar: Yeah and I'll just add – the way Aaron put it was perfect as it relates to true non-recurring items. The only one that we could think of that way would have been – it depends on your assumption of what you think brand inflation will be next year, that was modest. The other part that we did call out that was a benefit from a growth rate perspective year-over-year is that we do see some of our costs related to opioid legal fees and our ERP implementation running a little bit lower than anticipated. Now, that's non-recurring, right? It just means that we have gotten to a bit more of a normalized level quicker than what we had anticipated. So, I do not expect there to be further significant improvements in the out periods, out years related to those costs going down even further. It will be something that we'll continue to evaluate and provide update if that's the case. But it's for those reasons why our implied growth rate in Q4 is more normalized. It's also why we're not communicating anything differently right now for our longer-term targets, and we'll certainly revisit that point when we come together at the Investor Day on June 8. But generally speaking, we're seeing the strength, whether it's the new customer, the brand inflation or some of these cost drivers trending in the right direction are all items that we think we are normalizing now on a go-forward basis and why you should expect more normalized margins from here on out.

Operator: Thank you very much, sir. Our next question is coming from Charles Rhyee calling from TD Cowen. Please go ahead, sir.

Charles Rhyee: Yeah. Thanks for taking the question. I just wanted to follow-up, I think it was Eric's question around – you were talking about in that specific instance about insulin pricing and sort of how you can kind of mitigate some of that? Can you just kind of go into, again, for us a little bit how your fee-for-service contracts are arranged generally? And maybe more specifically, with insulin perhaps ahead of with these changes occurring? Because I would have thought that a lot of the language is already built into your contracts that would automatically sort of adjudicate to maintain sort of to capture that service that you are providing. And then as a follow-up, you had talked earlier about sort of Red Oak and continuing to perform well in generics. Curious if any work in Red Oak is being done in terms of biosimilars and trying to get better economics on that side as well. Thanks.

Jason Hollar: Well, I'm not going to go into the mechanics of a product-level contracts and structure. Just go back and reiterate that we feel very confident about our process, our experience, our history with any type of change that comes any other product. Again, as a distributor, we play a role. We play the role of getting the product from the manufacturers to those who need it, and with that will always be changes in the structure and how we go about it. But nothing is different in today's environment than what's been present for the last 50 years of our existence when we'll have to continue to adapt and evolve with this and that's enough to be said there.

Aaron Alt: And then with respect to biosimilars, what we would say is that we are quite well-positioned to support the next phase of growth over the next several years in that expanding therapeutic area on the sites of care. We believe it's going to come prodominately from products with a greater retailer or a specialty pharmacy presence, which plays to our strength as well as new therapeutic areas such as immunology and ophthalmology. And so, our expectation is it will be a tailwind for us as we push ahead into the end of fiscal year ‘23 and beyond.

Operator: Thank you very much, sir.

Kevin Moran: Next question, please.

Operator: Thank you, sir. Next question is from A.J. Rice of Credit Suisse. Please go ahead.

Jonathan Yong: Hey, thanks. It's Jonathan Yong on for A.J. here. Just going back to Medical again, I appreciate the comments on the cost improvements that you're doing and how that's going to set up a good framework for ‘24. But I guess given some of the volume constraints that you're kind of seeing and not seeing the same flow through, how much of improvement related to the cost side, especially on the freight side is tied to actually improving that volume side, that you kind of need to flow through? Thanks.

Jason Hollar: Well, so it depends on the timeframe we're talking about. But for fiscal '25, our ultimate goal of the $650 million, that volume impact we're talking about will not materially impact at all the recognition of the inflation mitigation. That is something that does have some volatility quarter-to-quarter, which is exactly what we highlighted as one of the drivers in the guidance change for this year. But it's not something that will impact significantly the future quarters let alone when we get to fiscal '25. And so, when I think about volume, the volume component of – the order of magnitude of the impact and the benefit that we expect for growing this volume is that $75 million dollars that we have on one of the slides in the presentation, that volume pillar of growing Cardinal Health brand products, that is the order of magnitude we're talking about. And so, I do not believe long term that that spills over and impacts the mitigation and the cost side of that. So, you can think about those as independent as it relates to the longer term impacts. They are a bit more mixed in the terms of the short term and what that does to how quickly we recognize that, that lower cost, but that is very much just a short-term timing effect.

Operator: Thank you very much, sir. And our last question today is going to be coming from Brian Tanquilut calling from Jefferies. Please go ahead, sir.

Kristen Shuman: Hi, this is Kristen Shuman for Brian. And you might have mentioned this earlier, but I just want to clarify. So, could you just give some guidance around how much of the Pharma segment EBITDA guidance range is expected to recur in fiscal '24? Thank you.

Aaron Alt: Well, we have not provided fiscal year '24 guidance. We're pleased to report the strong performance in Q3 as we've talked about and indeed, we did raise our guidance overall for Pharma. For the year, we're now expecting the profit guidance to be 10.5% to 12% for the full year that's in contrast to our earlier guidance of low-single digit to mid-single digit. So, we are expecting a good finish to the year from this business, and we're excited to see you all on June 8 at our Investor Day presentation.

Operator: Thanks very much. Ladies and gentlemen, that will conclude today's Q&A session. I'd like to turn the call back over to Mr. Jason Hollar for any additional closing remarks.

Jason Hollar: Yeah, great. Thank you and thank you, everyone for joining us today. I know that we threw a lot out at you today, but we have a lot going on as an organization and just wanted to share the progress with you and give you more insights a lot of the key drivers. If I step back and just think about what we went through, certainly feel terrific about the progress that we're making across enterprise. Pharma has, of course, a fantastic quarter, a fantastic year, broad based as we talked. On the Medical side of the business, we have opportunity. We're very, very focused on driving the Medical Improvement Plan. Feel really good about the progress we made, or clearly making in three of those four pillars. We have work to do on the underlying volume. We'll have more confidence in where the market is going for that volume, also have confidence in the leading indicators that will take for us to get our fair share of that volume.

Of course, also, we're very pleased with the cash performance that we had and that we talked about today and that raising that guidance, narrowing the guidance as well. It highlights both the strong cash management that we have, but also the responsible capital deployment that's going along with that. So, just again, thank you for your time today and look forward to seeing all of you at the Investor Day on June 8.

Operator: Well, thank you very much, sir. Ladies and gentlemen, that will conclude today's conference you may now disconnect. Have a good day, and goodbye.