Q4 FY23 Cardinal Health, Inc. Earnings Conference Call

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Operator: Good day, and welcome to the Fourth-Quarter FY 2023 Cardinal Health, Inc. Earnings Conference Call. Please note, this conference is being recorded and for the duration of the call, your lines will be on listen-only. However, you will have the opportunity to ask questions at the end of the call. This can be done by pressing star one on your telephone keypad to register your question. I would now like to hand the call 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 Fourth-Quarter and Fiscal Year-End 2023 results along with our outlook for Fiscal Year 2024. 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 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 full description of these risks and uncertainties. Please note, that during the discussion today, all 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'll now turn the call over the Jason.

Jason Hollar: Thanks Kevin, and good morning, everyone.

Fiscal '23 was an inflection point for Cardinal Health, with improved performance, strong execution, and notable progress against both our short and long-term plans.

We delivered record financial performance, including our highest non-GAAP EPS ever, reflecting 14% growth from the prior year. We grew Pharma segment profit an impressive 13% and generated $2.8 billion dollars of adjusted free cash flow. And in Medical, we drove significant sequential improvement in operating performance, from a segment loss in the first quarter to over $80 million dollars of segment profit in Q4.

This year we took decisive action to advance our 3 strategic imperatives: building upon the resiliency of our Pharma segment, executing our Medical Improvement Plan and maximizing shareholder value creation. Consistent with what you heard at our June Investor Day, these results were achieved through our team's commitment to ruthlessly prioritize the core of our business, and to better serve our customers so they in turn, can focus on caring for patients.

We simplified how we operate by streamlining our organizational structure, exiting non-core product lines, and rationalizing our geographic and manufacturing footprints. We made key leadership changes and governance enhancements, adding talent in key positions across the enterprise and to our Board. We formed and extended the Business Review Committee tasked with evaluating our strategy, portfolio, operations and capital deployment.

On that note, we completed our review of the Pharma segment, including announcements at Investor Day to further invest in our Nuclear & Precision Health Solutions business and launch our new Navista™ Network supporting community oncologists, which I will discuss more later in my remarks. We recently closed our Outcomes™ merger with Blackrock's Transaction Data Systems, which we see as a big win for pharmacies and an important opportunity to accelerate the business's future growth. We also deployed capital responsibly, with a continued eye on maximizing value. And we are positioned with the financial flexibility to continue driving value for shareholders.

At Investor Day we provided preliminary guidance for fiscal '24. With the strong finish to the year and increased confidence as we look ahead, I am pleased that we can raise our fiscal '24 outlook.

Later in my remarks I will share further details on our 3 strategic priorities. But first, let me hand it over to Aaron to walk you through our financial results and guidance.

Aaron Alt: Thanks Jason, and good morning. I won't bury the lead, Q4 was a strong finish to a year in which, with Jason's guidance, the Cardinal team made significant progress against our strategic initiatives.

We delivered fourth-quarter EPS of $1.55, and $5.79 for the full year, at the high end of our guidance from Investor Day. For both Q4 and the year, our EPS results reached historical high points. We also delivered stronger-than-expected cash flow, something I will touch on more later.

Let's start with the Pharma segment on slide 6.

Fourth-quarter revenue increased 15% to $49.7 billion dollars, driven by brand and specialty pharmaceutical sales growth, from existing customers. We continued to see broad-based strength in pharmaceutical demand spanning across product categories: brand, specialty, consumer health, and generics, and from our largest customers. Similar to Q3, GLP-1 medications provided a revenue tailwind in the quarter.

Segment profit increased 12% to $504 million dollars in the fourth quarter, primarily driven by positive generics program performance. Within our generics program, we saw volume growth and consistent market dynamics, including strong performance from Red Oak.

Increased contributions from brand and specialty products, along with nuclear, were also a positive factor, partially offset by higher investment and operating expenses, including higher costs to support sales growth.

Turning to Medical on slide 7.

Fourth-quarter revenue was flat at $3.8 billion dollars, an improvement in trend. We saw a decrease in Products and Distribution sales related to lower PPE volumes and pricing, partially offset by inflationary impacts, including our mitigation initiatives. This decrease within Products and Distribution was offset by growth in at-Home Solutions.

In the fourth quarter we delivered Medical segment profit of $82 million dollars, a nearly $100 million dollar increase from the prior year loss. The results for the quarter were consistent with our Investor Day commentary, composed of approximately $60 million dollars of more core performance, driven in connection with the Medical Improvement Plan, and approximately $20 million dollars of both seasonality and net favorable one-time items.

As expected, we saw an improvement in net inflationary impacts, including our mitigation initiatives, and the normalization of PPE margins, which were impacted by unfavorable price-cost timing in the prior year. Of note, we achieved our target of exiting fiscal ‘23 with at least 50% inflation mitigation.

Consistent with the expectations communicated at Investor Day, we were encouraged to see early indicators of an improvement in trend with respect to our Cardinal Health Brand product sales. We also saw a positive overall contribution from our growth businesses, including at-Home Solutions and OptiFreight, and from our ongoing cost optimization measures.

So, with significant profit growth in both segments, we delivered total operating earnings of $560 million dollars, growth of 24%.

Moving below the line, Interest and Other decreased by $48 million dollars to $16 million dollars, due to increased interest income from cash and equivalents, and increased income from our company’s deferred compensation plan investments, which as a reminder is fully offset above the line in Corporate.

Our fourth-quarter effective tax rate finished at 27%, approximately 2 percentage points higher than the prior year, due to certain discrete items.

Fourth-quarter average diluted shares outstanding were $256 million, 7% lower than a year ago due to share repurchases, including a $500 million dollar accelerated share repurchase program initiated in the quarter, as we announced at Investor Day. The net result of all of this was fourth-quarter EPS of $1.55, growth of 48%.

Now, transitioning to our consolidated results for the year.

We surpassed the $200 billion dollar revenue mark for the first time. Fiscal ‘23 revenue increased 13% to $205 billion dollars, and gross margin increased 5% to $6.9 billion dollars, both driven by the Pharma segment.

Total company SG&A increased 6% to $4.8 billion dollars, primarily reflecting inflationary supply chain costs and higher investment and operating expenses, such as higher costs to support sales growth, which were partially offset by our comprehensive enterprise-wide cost-savings measures.

Operating earnings increased 3% to $2.1 billion dollars.

Interest and Other decreased 46% to $89 million dollars, primarily driven 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 in the near term.

Our annual effective tax rate finished at 23%.

The net result was, for fiscal '23 EPS, $5.79, growth of 14%.

As for the segment's full year results, beginning with Pharma on slide 10.

Pharma segment profit increased 13% to $2.0 billion dollars, driven by positive generics program performance and a higher contribution from brand and specialty products, partially offset by inflationary supply chain costs. Fiscal '23 year-over-year growth also included a modest benefit from branded manufacturer price increases, which we are assuming will not repeat in fiscal '24, as well as a favorable prior year comparison related to higher opioid-related legal costs and costs for technology enhancements in fiscal '22.

Moving to Medical on slide 11.

Segment profit decreased 49% to $111 million dollars, primarily due to lower Products and Distribution volumes and unfavorable sales mix and net inflationary impacts, including mitigation initiatives. This decline was partially offset by normalization of PPE margins.

But before I turn to fiscal '24, let's cover the balance sheet.

In fiscal '23, we generated robust adjusted free cash flow of $2.8 billion dollars, with particularly strong cash flow toward the end the year. We ended the year with $4 billion dollars of cash on hand.

At our Investor Day we highlighted that cash flow optimization was an area of go-forward focus for our teams, and the Cardinal Team delivered, across our businesses. This effort will continue in fiscal '24, notwithstanding that it is a tougher calendar from an inflow/outflow days of week perspective.

We remained focused on deploying capital in a balanced, disciplined, and shareholder-friendly manner.

In fiscal '23, we invested approximately $480 million dollars of capex back into the business to drive future growth. Paid down $550 million dollars in debt to reduce leverage and maintain our strong investment grade ratings. Returned over $2.5 billion dollars to shareholders, including through the dividend that our board increased in May, for the 34th year in a row, and $2 billion dollars of share repurchases.

Now, for our updated fiscal '24 guidance on slide 13.

Today, we are raising our fiscal ‘24 EPS guidance to a range of $6.50 to $6.75. This increase reflects the strong finish to fiscal ‘23, particularly within Pharma, where we are now entering the year at a higher jump-off point. We also are tightening our shares range to $250 million to $253 million, which reflects the recent share repurchases, as well as our continued expectation of $500 million dollars in base share repurchases over the course of fiscal ‘24.

As you will calculate, the mid-point of our newly raised fiscal ‘24 EPS guidance is 15% above our fiscal ‘23 EPS results. There are no changes to the other corporate guidance assumptions provided at Investor Day: Interest and Other between $110 to $130 million dollars, an effective tax rate in the range of 23 to 25% and adjusted free cash flow of approximately $2 billion dollars in fiscal ‘24.

Our segment outlooks for fiscal ‘24 are also unchanged, with one exception: a higher revenue range for Pharma, driven by the continued accelerations of GLP-1’s, which as a branded product category do not meaningfully contribute to segment profit.

Slide 14 shows our fiscal ‘24 outlook for Pharma, our build-and-grow business. We expect revenue growth in the range of 10 to 12% and segment profit growth in the range of 4 to 6%, which is now on a larger fiscal year ‘23 reference point due to our strong finish to the year.

We are reiterating our key assumptions provided at Investor Day. We expect growth from our generics program, with volume growth and consistent market dynamics, and positive operational execution against our organic Specialty efforts. We are not assuming outsized benefits from branded inflation, in contrast to some of the benefits that we did see in fiscal ‘23.

On the Pharma fiscal ‘24 cadence, we expect the year to follow typical seasonality patterns. As usual, we see our fiscal Q3 being the largest segment profit dollar quarter due to the usual timing of branded manufacturer price increases.

Turning to Medical, I want to recognize the progress that the Medical team made during fiscal ‘23, particularly in Q4 and also acknowledge that we still have blocking and tackling to do against the turnaround to both drive demand and improve our cost. For the full year, we are reiterating our assumptions of revenue growth of approximately 3% and segment profit of approximately $400 million dollars for the year, while providing some additional color.

Like fiscal ‘23, we anticipate segment profit to be significantly back-half weighted. We expect Q1 to be generally consistent with the core performance from Q4, with quarterly sequential improvement thereafter driven by our Medical Improvement Plan initiatives.

There are a couple of factors for why Q1 is the low point in the year. First, keep in mind that Q1 is the seasonal low point for our global Medical products and distribution business, due to timing of volume and cost recognition. Second, while we continue to expect to exit fiscal ‘24 offsetting the impact of gross inflation, those improvements are expected to grow over time making the impact greater over the course of the year. And finally, we continue to plan for slight Cardinal Health Brand volume growth, that will largely hit in the second half of the fiscal year.

So, in summary, for Medical for fiscal year ’24, continued work in front of us with each quarter improving from our Q1 launching point to get us to the approximately $400 million dollar guidance for the year.

Stepping back, we are pleased to see growth across our businesses continuing in fiscal ‘24. Consistent with our messaging from Investor Day, we are targeting a 12 to 14% EPS growth CAGR for fiscal ‘24 to ‘26, now from the higher fiscal ‘23 baseline of $5.79.

Now, regarding our intended deployment of cash, which is consistent with our disciplined capital allocation framework, as seen on slide 18. After investing approximately $500 million dollars back into the business to drive organic growth, making approximately $500 million dollars of litigation payments, including our 3rd payment under the national opioid settlement back in July, and our $1 billion dollar baseline return of capital, we expect to have strong flexibility as we assess further investments in the business, M&A and the possibility of incremental return of capital to shareholders. I want to reiterate that as we shared at Investor Day, neither our fiscal ‘24 guidance or our long-term targets reflect potential opportunistic deployment of capital, including M&A, which is difficult to predict in timing or magnitude, or additional share repurchases beyond our $500 million dollars of baseline repurchases each year. We will continue to evaluate both of these levers opportunistically to drive long-term value.

To close, the Cardinal Team has a lot of be proud of with respect to their accomplishments in fiscal ‘23. Jason and I are pleased with the progress our teams have made, we are confident in the plans we have in place, and we are excited for our team to realize the significant value creation opportunities still in front of Cardinal Health. With that, I will turn it back over to Jason.

Jason Hollar: Thanks, Aaron. Let’s now dive deeper into the actions we are taking to execute our 3 strategic priorities, beginning with priority number one, and building upon the resiliency of the Pharma segment.

In our largest, most significant business, the Pharma segment has been performing well by prioritizing what matters most: focusing on the core and delivering for our customers and their patients. The business is positioned at the forefront of favorable secular industry trends and has also benefited from our specific actions and performance. We were pleased to recently raise our long-term segment profit target to 4 to 6% growth, solidly in the mid-single digits and consistent with the segment profit growth we expect in fiscal ‘24. Our growth is enabled by a scaled, stable, and resilient core pharmaceutical distribution business, growing in the low-single digits, and double-digit growth from our higher margin Specialty and Nuclear businesses.

Within the core, our generics program remains a critical component of our overall offering and performance, enabled by Red Oak Sourcing. In addition to its leading scale, Red Oak’s proprietary analytical tools and deep industry expertise puts us in the best position possible whenever product shortages occur to continue servicing customers.

We’re committed to providing customer-focused solutions across our many classes of trade as we noted at Investor Day. More recently, we hosted our 31st annual Retail Business Conference, where we brought together nearly 4,500 attendees from across the country to celebrate the critical role independent pharmacies play in caring for their communities and showcase our commitment to our customers through our newest innovations. For example, we are offering modern payment solutions through our collaboration with Square to help independent pharmacies seamlessly manage business operations, integrate flexible payment options, and reduce payment processing costs.

We've conveyed that Specialty is our priority area of focus, and a key enabler to our long-term growth. We're continuing to invest to expand downstream across key therapeutic areas, such as Oncology, Rheumatology, and other emerging areas.

We're excited to build upon our existing capabilities with the recent launch of our Navista™ Network, a specific suite of offerings for community Oncologists, supporting their growth and desire to remain independent. To ensure the Navista™ Network's success and development, we've recently appointed new leadership with deep industry and clinical experience and continue to build out the organization with internal and external talent. We continue to seek input from customers and have created an Advisory Board. While still early innings, I'm pleased with the engagement from current and potential customers.

Upstream in Specialty, we're expecting continued double-digit growth from Manufacturer Services. In our leading 3PL, we're expanding our ambient and cold chain space to keep up with our business's strong growth. At Sonexus™ Access and Patient Support, we delivered on a record number of new client implementations and continue to launch new innovative products to streamline the patient journey.

We're also supporting the growth of pharmaceutical manufacturers in the cell and gene therapy space through our Advanced Therapy Solutions offerings. For example, we're partnering with TrakCel to bring visibility and tracking capabilities to biopharma companies by helping them navigate cell therapies through multiple stages of development and commercialization.

Overall in Specialty, we're confident that the connection between our downstream and upstream strategies, what we call our Specialty growth cycle, will drive double-digit growth well into the future.

Our Nuclear business, which is on track to double profits by fiscal '26 as of our fiscal '21 baseline, is strategically positioned for growth at the center of precision medicine. We're further investing in this space with a Phase 2 investment of $30 million dollars over the next several years to expand our Center for Theranostics Advancement and support our manufacturer partners' projects as they advance through the commercial development pipeline.

We're encouraged to see pharmaceutical innovation expanding the breadth of conditions that are being addressed with emerging therapies, such as cell and gene, and precision medicine. As the future of healthcare continues to evolve, our breadth of capabilities, from pharmaceutical and specialty distribution, radiopharmaceuticals and theranostics, to biopharma and manufacturer services, enables us to offer multiple touch points for manufacturers, providers, and patients to realize value from these promising new treatment options.

Now turning to Medical and priority number two.

When we introduced the Medical Improvement Plan last August, our immediate focus was turning around the performance in the core, Products and Distribution, where we've achieved tremendous progress over the past 12 months.

We are on track to address the impact of inflation and global supply chain constraints by the time we exit fiscal '24. This is the number one key to returning to a more normalized level of profitability, and we are now over halfway to our target.

We continue to execute our mitigation initiatives to offset elevated inflation and make progress with our commercial contracting efforts, and we are exploring other offsets with urgency, such as our manufacturing excellence and sourcing initiatives. While overall costs remain elevated, international freight has generally returned to pre-pandemic levels, and we expect this improvement to be reflected in our fiscal '24 results.

We're driving significant progress through our 5-point plan to grow Cardinal Health Brand volume and seeing improvements in our leading indicators. This includes better portfolio health for key product categories and higher service levels, Customer Loyalty Index scores and retention rates for distribution. We're driving enhanced customer experience through investments in product availability and automation, while optimizing costs.

At Investor Day we highlighted our two-pronged approach to portfolio lifecycle management, which has enabled us to completely exit our non-healthcare portfolio, and we are in the process of reducing over 2,000 SKUs across our Cardinal Health Branded product categories to simplify the business. We're focusing our investments in new product development and capacity expansion in key growth areas, such as compression, enteral feeding, and incontinence.

Within our products that are Core to Distribution, we've seen continued stabilization with PPE, a smaller part of our portfolio but a source of volatility during the pandemic, and growth in our Presource surgical kitting category.

In our Specialty products portfolio, comprised of clinically differentiated products and leading brands like Kangaroo, Kendall and Protexis, we're investing in innovation to meet customers' needs and drive sustainable growth. For example, the launch of our new Kangaroo OMNI™ enteral feeding system this month.

As a result of our combined efforts, commercial momentum is accelerating. During Q4 we renewed several key distribution customers and saw positive net new wins during the quarter. These leading indicators give us confidence that moving forward, we'll participate in the growth from an overall improving Medical utilization environment.

Outside of the core, we're on track to accelerate our growth businesses. In at-Home Solutions, we're investing in DC network expansion to keep pace with increased demand as care continues to shift into the home. For example, we recently began construction for a new 350 thousand square foot

Greenville, South Carolina DC. This facility, the 11th in our national network, will be fully operational in 18-24 months and equipped with advanced automation technology and robotics to drive operational efficiencies. In OptiFreight, we provide premier logistics management powered by our technology capabilities and expertise. We're continuing to invest in digital tools to support core volume growth and sustain our strong performance.

Finally, we're continuing to execute our simplification and cost savings initiatives, such as optimizing our global manufacturing and supply chain and our international footprint. For example, we exited four additional countries and two additional manufacturing sites this year.

In short, we are making progress with our Medical Improvement Plan. While there is still execution in front of us, I'm excited for the business to return to more significant profitability in fiscal '24.

Finally, priority number three, maximizing shareholder value creation. We're maximizing shareholder value creation through operational performance, robust cash flow generation and the responsible allocation of capital.

At Investor Day, Aaron detailed our new long-term capital allocation framework, which builds upon our long-standing priorities with some notable enhancements. We're pleased that with our strong cash flow profile and the significant progress we've made on our balance sheet, we have the flexibility for share repurchases each and every year. And, with the residual cash flow that we anticipate, we'll continue to opportunistically evaluate disciplined M&A in Specialty and potential additional share repurchases.

While our team has made significant progress over the past year, particularly in realigning our operations for focus and simplicity, there is still work and opportunity in front of us. We continue to evaluate additional value creation initiatives, including the progress we are making with our ongoing business and portfolio review.

To wrap up, I want to acknowledge our dedicated Cardinal Health employees, who are fulfilling our essential role in healthcare serving customers and their patients. Thank you for your determination in advancing our key priorities and moving healthcare forward. I am excited for the opportunities still to come.

With that, we will take your questions.

Operator: And as a reminder, if you do have a question, please signal by pressing star one on your telephone keypad. Our first question today comes from Lisa Gill of J.P. Morgan.

Lisa Gill: Thanks very much. Good morning, and congratulations on the quarter. I just really want to start with the GLP-1 comment. So, I understand you're raising revenue by 200 basis points. One, is that all GLP-1? And two, my understanding is that they are a lower margin, but they are contributory to overall margin dollars. Is that not the case when you're keeping the profit the same, and when I think about the Pharmaceutical segment for 2024?

Jason Hollar: Yeah. Good morning, Lisa. Thanks for the question. Yes, the primary reason for the raise in the guidance on the revenue is related to the GLP-1. So, we did not call out anything else. We saw a strong finish to the year as it relates to that. And looking forward, we see that there's nothing that we can foresee in the near-term that will change those trends. As a reminder, we did call out for the first time GLP-1 as a benefit to our revenue from a year-over-year growth perspective in the third quarter. So, we have kind of a -- there was growth before that, but not as significant. And so, it was more meaningful in Q3 and Q4. So, as you look forward to fiscal '24, you would expect that revenue growth to be stronger in the first half of the year as that's more of a contributor. Now of course, we don't know what that slope is going to look like into '24, but we would anticipate as you start to lap the second half of '23 that, that will be more muted in terms of the year-over-year benefit.

And I guess as it relates to your second part of your question, I would just reiterate that these are branded products. And as such, they're just not a meaningful contributor to segment profit and just leave it at that.

Kevin Moran: Next question please.

Operator: The next question comes from Eric Percher of Nephron Research.

Eric Percher: Thanks for all the commentary on Medical performance. I want to make sure we're kind of precise on the core performance and the stepping off point there would be around $60 million, not $82 million. And then, can you define seasonality and one-time benefits this quarter, and any expectation that those will recur as we look at that cadence for fiscal year '24?

Aaron Alt: Eric, good morning. Good to hear your voice, and happy to give you a little more context on that. Look, we were quite pleased with the results for Medical, as you can imagine, delivering that $82 million dollars of results. That was $60 million dollars of what we're referring to as core performance, and $20 million dollars in aggregate combined positive seasonality and one-time items in the fourth quarter. And I called, I call it out purposely that way because it does impact how we think through the cadence of quarters during fiscal '24.

Now before giving you a little more context on the quarterly guidance, I do want to go back and just observe that we are reiterating the $400 million dollar profit target for the Medical segment from the year. The Medical Improvement Plan, the key components, that remain unchanged from our description at the Investor Day as well. But we are providing a little more color relative to how we see the year playing out, given the number of moving pieces. The blocking and tackling as I referred to in my prepared remarks as we carry forward. So, look from a full year perspective, the way I would have you think about it is this. As I said at Investor Day, if you take $60 million dollars of core performance and multiply that by 4, that gets you to $240 million dollars of profit, right? If you add $100 million dollars of incremental inflation net on top of that, that gets you to $340 million in total. And as we talked about at Investor Day, that leaves about $60 million dollars of contribution from other elements across the year, the simplification of the Cardinal Health brand, et cetera. That's a full year view of how to think about it.

Now as we think about the cadence, though, we are being clear that the profit will be back-half weighted during the year just like it was in fiscal year ‘23. Our view is that Q1 will have similar core performance with Q4, with sequential performance thereafter. Q1 is the seasonal low point for the Med Products and Distribution business due to both the timing of volume, as well as our cost recognition. That's an important point. And similarly, we do expect that continued acceleration of inflation mitigation over the course of the year as well. So that will push the profit from a weighting perspective in the back-half. And then don't forget that while we were very pleased to call out a sign of change in trend in Cardinal Health Brand, we're also clear at Investor Day that the Cardinal Health Brand volume growth is largely back-half weighted. Hope that helps.

Kevin Moran: Next question, please.

Operator: The next question comes from Kevin Caliendo of UBS.

Kevin Caliendo: Thanks. Maybe to follow-up on that a little bit. So, if we're thinking about 82, the baseline is really 60, the first quarter is likely because of the $20 million in seasonals' and one-timers. The first quarter is likely to be down sequentially, and then grow off that base to get to the 400. I just want to make sure that, that's what you're committing to, or commenting on.

And then secondly, or incrementally, the new products or the Cardinal brand products, is that the increase in the back half of the year? Is that because of new product launches or manufacturing capabilities? Is it contractually like new contracts coming on that are higher-weighted? Can you just sort of explain the dynamics of the Cardinal brand products as well?

Aaron Alt: Well, I'll start, and then toss it over to Jason. You are correct in that the way we're thinking about this is that core performance Q4 to Q1 will be roughly in line. And if you interpret what I was just saying in response to an earlier question, we do have some negative seasonality in Q1 versus Q4. So that's why the jumping off point is core performance versus the Q4 results. Jason?

Jason Hollar: Yeah. I'd think about the Cardinal brand volume growth being back-half loaded through a couple of different lenses.

First of all, we do think that the underlying utilization will be, for the market will continue to be relatively consistent. So, we do see same-store sales growth out there, and we anticipate that, that will continue. And within our performance within that, we highlighted that our comparison point to the prior year is becoming easier as we did lose some business over the last 18 months or so that we now are lapping, and our 5-point plan is working. Our 5-point plan to improve, that includes improving the customer experience and importantly, that supply chain health.

We're seeing strong progress as it relates to service levels, CLI scores that gave us very good customer retention in the quarter, net new wins that were positive in the quarter. That gives us the foundation that gives us confidence that we'll grow with the underlying market, especially as we continue to lap that prior year impact, which we think will be more impactful in the second half of the year.

So, all the leading indicators are going as anticipated and consistent with how we laid it out at the Investor Day and gives us the visibility and the confidence that we'll be able to participate in that market growth that we anticipate that will be there over the course of this next year.

Kevin Moran: Next question, please.

Operator: The next question comes from George Hill of Deutsche Bank.

George Hill: Yeah. Good morning, guys, and thanks for taking my questions. I'll take it in a little bit different direction. Jason, I'd love to hear the kind of the progress that you guys have made on the Navista offering, since it was first announced at the Analyst Day. And I guess, given the growth and the size of the specialty market, particularly in oncology, I guess how should we think about the ramp of that business, maybe through fiscal '24 and beyond. So, just kind of progress in ramping contribution? Thank you.

Jason Hollar: Sure. Yeah, great. Thanks for the question, George. Yeah, so when we think about Navista, I think it's important to recognize that we had a foundation in place. We have a foundation in place, built off of our existing specialty business. We had plenty of programs and initiatives in place, platforms like our, Navista TS, where we are already providing capabilities to the community oncologists to help support their value-based care initiatives. Of course, other data and insights, clinical research support. So, we have a lot of the tools. What Navista™ Network is doing is, bringing that all together in the form of a business with new additional senior leadership brought in place. So that's one of the key things that's happened since the announcement a couple of months ago, is we have brought in additional leadership to bring on top of the strong team that we already had in place that were already serving these important customers and their patients. So, we are building that out further with both internal, as well as external talent. We also created an advisory board to ensure that we are working directly with both current and prospective customers, more than anything to make sure that they have a strong voice as to where we go next with the development of this platform in this business. We continue to listen and be out in the field doing a lot of research, but we're also building what were already notably to be some of the key attributes of this platform and this network that they're demanding. What's key and what we highlighted before is that these are, the 1,500 that we're focused on here, are very strongly interested in maintaining their independence. We're also hearing a strong desire for ongoing transparency, which as healthcare's most trusted partner we feel like we're really well positioned for. So, it's only been a couple of months since we rolled this out, but in that timeframe, we've got the team in place, better definition of what the platform needs to be built out with and continue to work with those prospective customers to make sure that their needs are met.

Kevin Moran: Next question, please.

Operator: Next question comes from Elizabeth Anderson of Evercore.

Elizabeth Anderson: Hey, guys. Thanks so much for the question. I don't know if you could comment on the corporate costs that you just discussed in Medical, the $60 million dollars. Is that something that you also expect to like ramp ratably over the course of the year? Is that something that has gone through, those cuts are going through, have gone through already, and are just annualizing? A little bit more help there would be very helpful.

And then secondarily, can you talk about what is different about getting this next 50% of the inflation offset this year that was not the same last year? We obviously know that you've been getting more [indiscernible] in your contracts, et cetera, but I'm just looking for any more additional commentary you can provide on what might be different about this remaining 50%. Thanks.

Jason Hollar: Okay. I think I caught the essence of at least part of that, so let me start. I believe part of the question was related to the next part of the inflation mitigation in the second half. I think the other question related to the corporate cost ramp. So, let me start with the second part and then throw it over to Aaron for the first part.

So, as you think about the inflation mitigation and the next piece, there's – it's really the same for the second 50% as it was the first 50%. So, in both cases, what we've seen is a moderation of the international freight. That spiked significantly about two years ago and started coming down about a year ago and got back down to pre-pandemic levels maybe six to nine months ago. So, that has started to benefit us as we especially exited fiscal ‘23. So, we did start to see that. It, of course, was inventoried into our inventory, capitalized those costs into our inventories. So, it took a little while for that to benefit our P&L as a cost reduce. And along the way, in parallel with that of course, we were pricing mainly on a temporary basis the first year for those increases as well as increases in other commodity costs and transportation, domestic transportation, increased labor and all those other costs. All those other costs have plateaued. They are not coming down. We don't see any signs of them coming down. And so, we have to price permanently for those items. We priced temporarily for the international freight. And as those costs on the international freight roll off, we need to maintain higher prices. And so we are continuing to price, and some of those temporary prices are now being rolled into the permanent prices. And so, we would expect that as those contracts renew that we'll continue to see more and more of that pricing recognized. Let me be very clear, we're not rolling back prices. We've not increased prices beyond the point of our costs. At the 50% level, we're still only being compensated for half of that overall growth impact that we've incurred. But over the course of this year, we do expect the international freight to come down. And by the time we exit fiscal ‘24, the prices will continue to increase as we go through the course of the year, as we get more of those contracts renewed permanently, and then that will cross over with the lower cost and then we'll exit in that manner at the end of the year. Aaron, on the first question?

Aaron Alt: Sure. I think I heard a couple of different things, and so I'm going to answer the question I think I heard, and it goes something like this. So, we did, I did comment earlier that in addition to the annualization of the core performance and indeed the inflation mitigation that Jason just touched on, that there was $60 million dollars of other benefit coming over the course of the year. Really driven by the three other pillars within the Med Improvement Plan: the contribution of the growth businesses, the simplification, and the Cardinal Health Brand work. As I was touching on, that work progresses over the course of the year, and we've seen more benefit towards the back half of the year. I want to emphasize the simplification efforts. Steve and the team are working really hard at that every day. We just see the benefit coming more in the back-half. The growth businesses are making good progress. They have some seasonality as well. They are certainly a strong contributor to the additional $60 million dollars over the course of the year. And then Jason has already touched on Cardinal Health Brand, so I won't go there.

Kevin Moran: Next question please, Operator.

Operator: The next question comes from Daniel Grosslight of Citi.

Daniel Grosslight: Hi. Thanks for taking the question. I just have one quick housekeeping question, and then I'll ask my real question. There was a slight change in the language around your inflation mitigation efforts from your I-Day presentation to your current presentation. You went from fully mitigating by the end of ’24 to just mitigating. Curious if there's been some change in how you're thinking about things? Or if it was kind of a simplification of the language?

And then my real question is around the generics business. It seems like you and your competitors have all benefited from a more favorable environment. And it seems like it might have accelerated towards the end of your fiscal year. So, I'm just curious to get your thoughts on the generics market, potential shortages and how you're thinking about the benefit or tailwind of generics in your fiscal ‘24 guidance vis-à-vis the strength you saw in fiscal ‘23. Thanks.

Jason Hollar: Sure. So, in terms of the language change for inflation mitigation, I think you said it best. It's a simplification language. The one thing I would highlight is similar to our disclosures with COVID, over time those became more difficult to precisely measure. So now we are, and this inflation mitigation was always focused on the incremental inflation because we had spikes, unusual dramatic spikes in inflation. Well, there's normal inflation as well. So, this is just a little bit broader language to recognize that over time it's becoming harder to differentiate between the two. We have a good understanding of the most significant impacts, like the international freight. But when you get into labor, what's normal, what's incremental, it becomes more challenging. And we just have a little bit broader language to recognize that it is going to be less precise than it was early on in our measurement. We're still doing as deep of analytics as possible to get a reasonable understanding of it. As it relates to well, I think the key takeaway with that is we are on track, right? Ultimately, the strategy makes sense. It should be pushed down to the final customer, the final user of the products and services, given the business model. And so, we believe that the basic tenets are absolutely unchanged. It's just reflecting the level of precision.

On your second question as it relates to generics, as I step back and think about performance for the Pharma segment this year, inclusive of generics, I think you can think about the overall segment as well as the generics business. There's a couple of things that have occurred. There is the overall market utilization has been very strong, and our performance has been very good within that. And it's at levels that, for all the reasons Aaron highlighted, is that a growth rate is a bit higher than what normal is and certainly higher than what our long-term growth targets are. And as I think forward to fiscal ‘24, we expect that to normalize. We expect it to still be favorable growth. We indicated during Investor Day in the 2 to 3% type of range from a unit volume growth, and we would expect to participate within that. And we expect our performance to continue with areas like Red Oak Sourcing, to continue to drive both the cost as well as to your other related point, the product shortages. They have a dual mandate to drive performance for both cost as well as service levels to customers.

So, while there are product shortages sporadic within the overall Pharmaceutical distribution supply chain, that's not a new phenomenon. There's various demand driven spikes and supply driven spikes. Our goal, of course, is to minimize those challenges within that to give our customers the best possible service. And what we saw, in fact, in fiscal ‘23, it was a little bit of a benefit by being able to supply products as a second distributor as not the primary distributor, but we had some opportunities where we were able to provide when others were short on product. So overall, that was a slight positive for us this year as well. And we expect those types of things to be more normalized in fiscal ‘24 and feel well-positioned to participate in that growth.

Aaron Alt: I would just add one thought, which is in Q4, we saw strong volume, as Jason highlighted, but overall consistent market dynamics. And indeed, as we look forward, Jason called out the unit growth, but we are also guiding to consistent market dynamics for the upcoming year as well.

Kevin Moran: Next question, please.

Operator: Next question today comes from A.J. Rice of Credit Suisse.

A.J. Rice: Thanks. Hi, everybody. I know on your Medical side, there's a lot going on, and you're a little more skewed toward inpatient than some of the others that have reported. But we've heard this discussion about an uptick in utilization from some of the providers. And I wondered if I peel back everything that's going on in Medical, did you see any change in behavior on the part of your customers to suggest that there was an uptick in utilization?

And then just on the PPE comment, you're calling it normalization of profits from here. Do you think sequentially from here, we're pretty steady? And as we return to a normal environment, is there any seasonality around that category to call out to remember when we get back to a normal environment?

Jason Hollar: Yeah. The utilization, we think, has been fairly consistent. I wouldn't call it an acceleration or anything. We're seeing pretty consistent underlying same-store sales type of growth. So, it's sufficient within our business model and where we laid it out from Investor Day, but I wouldn't call out anything unique there.

As it relates to PPE normalization, a couple of points. So, normalized is good for us. This is not a category that we've ever made a tremendous amount of money and value. It's an important category for our customers. And so, we do everything we can to satisfy their needs. So going forward, our objective is to ensure that we get customers the product they need and minimize the volatility that goes along with that. But I just don't see it being a material driver one way or the other. Recall that the challenges with PPE was that we had volatile price cost and volume all at once. What you have right now is a normalization that's been occurring over the last couple of years of both price and cost has been coming down somewhat steadily. And they've been staying in a relative type of spread close enough to one another that, that's been manageable. And it's that volume that's been a little bit more challenging. We've highlighted that it was destocking beginning about – well, over a year ago now in terms of the underlying volume there. But given the margins are relatively tight for this type of product, getting those margins right and relatively low margins, means that the volume volatility or the lack of volume growth is not much of an issue for us because it's just not a large contributor of incremental volume or incremental margins. So, we're at a level that I think it's fairly stable, and it's our objective to keep it that way.

Kevin Moran: Next question please, Operator.

Operator: Our final question today comes from Brian Tanquilut of Jefferies.

Brian Tanquilut: Good morning. This is [indiscernible] in for Brian. I had a question about your capital allocation priorities for the fiscal year 2024. Generated quite a bit of free cash flow this fiscal year. And I'm just curious if there's any specifics you can get into with regards to where you see capital allocation in the next fiscal year? Thank you.

Aaron Alt: Hey, great question. Thank you for putting it on the table for us. Look, we were very focused on our Investor Day in laying out the disciplined capital allocation decision matrix that we apply. And we were also very pleased to see the overall cash generation for fiscal ‘23 and Q4 in particular.

Here's the simple answer. We're going to do what we said we were going to do at Investor Day in that respect. And just as a quick reminder, there are a couple of things which are table stakes for us, which is first, we're going to invest back into the business to drive the organic growth. We spent $480 million in fiscal ‘23. We've guided, we're going to spend about $500 million dollars in CapEx against our business plans across the business.

Our second priority, of course, is maintaining our investment-grade balance sheet. And you'll recall from our Investor Day that we don't have short-term maturities. We have some bonds coming due at the end of the year that we will likely just refinance. But we're feeling good about our investment-grade balance sheet.

And then we've committed to a baseline of return of capital to shareholders, continuing to grow the dividend. We've raised it 34 years in a row. Similarly, we committed to buy back at least $500 million of shares during fiscal year ‘23. Those are the table stakes parts of how we're going to use our cash.

As we then move through the year, as we assess the opportunities in front of us, as we assess how the business is performing, we have two opportunistic levers that we will also be looking at. The first is active, disciplined, and targeted M&A largely in specialty, and we have opportunities there, that we're looking at as well. And then on top of that, we will also continue to look at incremental return of capital to shareholders. Nothing additional to announce today on either of those two levers, but we want to be clear that we are going to do what we said we were going to do with respect to our disciplined capital allocation strategy.

Operator: And that does conclude the question-and-answer session of today's call. I would now like to turn the call over to CEO, Jason Hollar, for any additional or closing remarks.

Jason Hollar: Okay, great. Thanks again for joining us this morning. To summarize, fiscal ‘23 was a great year. It was a year of inflection, and we are excited to continue this momentum into fiscal ‘24 and beyond. With that, thank you and have a great day.

Operator: And that does conclude the Fourth-Quarter Full-Year 2023 Cardinal Health, Inc. Earnings Conference Call. We thank you all for your participation and you may now disconnect.