Q1 FY24 Cardinal Health, Inc. Earnings Conference Call

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Operator: Good day, and welcome to today's First-Quarter Financial Year 2024 Cardinal Health, Inc. Earnings Conference Call. This meeting is being recorded. At this time, I would like to hand the call over to Matt Sims, Vice President of Investor Relations. Please, go ahead sir.

Matt Sims: Good morning, and thank you for joining us for Cardinal Health's First-Quarter Fiscal 2024 Earnings conference call. On the call with me today are Jason Hollar, Chief Executive Officer, and Aaron Alt, Chief Financial Officer.

You can find today's press release and earnings presentation on the IR section of our website at ir.cardinalhealth.com. As a reminder, 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 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 that you limit questions to one per participant, so that we can try and give everyone an opportunity. With that, I will now turn the call over to Jason.

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

Overall, it was a great start to our fiscal year. With strong first-quarter results and an improved outlook for the year, we are continuing our operating momentum into fiscal '24.

In the first quarter, we delivered significant profit growth in both segments.

In Pharma, the results were driven by the strength across our business, including continued positive performance from our generics program. We also benefitted from our role distributing the recently commercialized COVID-19 vaccines, which I'll elaborate on later in my remarks.

Macro trends in the core distribution business remain stable, and we continue to see strong pharmaceutical demand, including with GLP-1 medications. And both our higher-growth Specialty and Nuclear businesses tracked ahead of plan in the quarter.

In Medical, the first quarter was another proof point of the inflection we began to see last Q2 in this business. Recall the segment was unprofitable only a year ago. Overall, the results tracked slightly ahead of our expectations, and we continue to execute our Medical Improvement Plan initiatives to drive better and more predictable financial performance. In particular, we made notable progress on inflation mitigation in the quarter.

At an enterprise level, we realized notable operating leverage from our efforts to manage costs across the segments.

And below the operating line, our favorable capital structure and responsible capital deployment provided tailwinds, enabled by our strong cash flow generation.

In short, the broad-based performance to-date gives us confidence to raise fiscal '24 EPS guidance, only a quarter into the year.

Our team continues to prioritize focused execution to best serve our customers and create value for shareholders.

I will update you on our progress in advancing our 3 key strategic imperatives shortly, but first let me turn it over to Aaron to review our results and updated guidance in more detail.

Aaron Alt: Thanks Jason, and good morning.

Q1 delivered a strong financial start to the year with EPS of $1.73, surpassing our expectations in Pharma and Medical. The strength of our Pharma business, the progress on our Medical turnaround efforts and our disciplined approach to capital allocation contributed to new first quarter highs for the Enterprise on both revenue and EPS.

We also delivered strong cash flow and ended the quarter with $3.9 billion of cash.

Let's start with the consolidated enterprise results as seen on slide 4.

Total revenue increased 10% to $54.8 billion, driven by the Pharma segment.

Gross margin also increased 10% to $1.8 billion, driven by both the Medical and Pharma segments.

Consolidated SG&A was generally in-line with the prior year at $1.2 billion, reflecting our disciplined cost management across the enterprise.

With the significant profit growth in both segments, we delivered total operating earnings of $571 million, growth of 35%.

Moving below the line, interest and other decreased by $15 million to $12 million, due to 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 first quarter effective tax rate finished at 22.5%, an increase of approximately 5.5 percentage points. We saw positive discrete items in both the current and prior year periods, which were more beneficial a year ago.

First quarter average diluted shares outstanding were 250 million, 8% lower than a year ago due to share repurchases.

And as I mentioned earlier, the net result was first quarter EPS of $1.73, an all-time first quarter high point, reflecting growth of 44%.

Let’s turn to the Pharma segment on slide 5.

First-quarter revenue increased 11% to $51 billion, 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 trends last year, GLP-1 medications provided a revenue tailwind in the quarter.

Segment profit increased 18% to $507 million in the first quarter, driven by a higher contribution from brand and specialty products, including distribution of COVID-19 vaccines, which provided a modest contribution as customers stocked up in preparation for the fall vaccination season.

We also saw positive generics program performance, with continued volume growth and consistent market dynamics.

Turning to Medical on slide 6.

First-quarter revenue, at $3.8 billion, was largely flat to prior year and prior quarter.

In the first quarter, we saw lower PP&E volumes and pricing, including the impact from the prior year exit of our non-healthcare gloves portfolio, offset by growth in at-Home Solutions and inflationary impacts, including mitigation initiatives.

Medical slightly exceeded our expectations in Q1 and delivered segment profit of $71 million, which represents an approximate $80 million increase from the prior year’s first quarter loss.

Consistent with the expectations communicated at Investor Day and last quarter, we continue to be encouraged by indicators of improvement in trends with respect to our Cardinal Health Brand product sales. In Q1, we saw slight year-over-year volume growth.

As expected, we saw an improvement in net inflationary impacts, including our mitigation initiatives. We also continued to see normalized PP&E margins – which were impacted by unfavorable price-cost timing in the prior year.

In the quarter, we also recorded a $581 million non-cash, pre-tax goodwill impairment charge related to the Medical segment, which is excluded from our non-GAAP results. This Q1 accounting charge is due to an increase in the discount rate used in our goodwill impairment analysis.

Now, turning to the balance sheet.

As I alluded to earlier, in the first quarter, we generated robust adjusted free cash flow of $1 billion, and ended the quarter with $3.9 billion of cash on hand.

We remain focused on doing what we said we would, and deploying capital in a balanced, disciplined, and shareholder-friendly manner.

In the first quarter, we continued to invest against our highest priorities, including investing approximately $92 million of capex back into the businesses to drive organic growth. We made our third annual payment on our national opioid settlement obligation. We did not draw on our credit facilities and received a positive change to the outlook on our investment grade rating from Fitch, as well as from S&P in Q2. We returned over $630 million to shareholders, through payment of our quarterly dividend and the launch of a new $500M Accelerated Share Repurchase Program which completed in October.

Now, for our updated fiscal ‘24 guidance on slide 8.

Today, we are raising our fiscal ‘24 EPS guidance to a range of $6.75 to $7.00, the mid-point of which is 19% above our fiscal ‘23 EPS results. This $0.25 increase to our EPS range primarily reflects an improvement to our Pharma outlook, as well as some improvements below the line.

We are raising our Pharma segment profit guide to 7% to 9% growth for the year and are pleased with the momentum in the business. Our updated guidance reflects: the strong first quarter performance, higher than originally assumed contributions from COVID-19 vaccine distribution, which continued into October, the ongoing strength of our business consistent with a 4% to 6% growth trajectory for the segment on a normalized basis.

Finally, as a reminder on the Pharma quarterly cadence, we continue to assume Q3 branded inflation will not repeat at fiscal ‘23 levels.

In Medical, we are reiterating our outlook of $400 million of segment profit for the year. Recall that we previously guided that Medical segment profit would be significantly back-half weighted. That assumption remains unchanged. The first half-second half cadence continues to be driven by progress on Cardinal Health Brand volume growth, the cumulative impact of inflation mitigation, and some business-specific seasonality.

While we are encouraged that the business slightly over-performed relative to our expectation in Q1, due to execution against our plans and our cost management efforts, our expectation for Q2 segment profit is unchanged from our original guidance which reflected some seasonality in Q2 specific expenses like Health & Wellness. Altogether, Q2 segment profit should be slightly higher than Q1, which benefitted from over-delivery. We expect continued progress from our Medical Improvement Plan initiatives over the course of the year.

Below the line, Interest and Other is reduced to a range of $100 million to $120 million, while we are maintaining an effective tax rate in the range of 23% to 25%. We do expect the tax favorability we saw in the first quarter to be offset in Q2.

We also are lowering our shares outlook to approximately 249 million, which reflects the already-completed $500M of our baseline share repurchase.

I want to reiterate that as we shared at Investor Day, neither our fiscal '24 guidance nor our long-term targets reflect M&A, which is difficult to predict in timing or magnitude, or additional opportunistic deployment of capital to share repurchases beyond our baseline repurchase. We will continue to evaluate both opportunistically to drive long-term value.

So, an overall successful first quarter. The Cardinal Team has a lot of be proud of with respect to our accomplishments. 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 us. With that, I will turn it back over to Jason.

Jason Hollar: Thanks Aaron. Now, for a few updates regarding our recent progress on our three key strategic priorities, beginning with priority number one and building upon the resiliency of the Pharma segment.

The key enabler to the Pharma business's outstanding performance over a number of quarters now has been the team's consistent prioritization of what matters most, operational execution in the core. We're leveraging our scale, efficiency and breadth of essential products and service capabilities to deliver for our customers and their patients.

Within the core, our generics program remains a critical component. Our performance is anchored by Red Oak Sourcing, which continues to do a fantastic job fulfilling its dual mandate managing both cost and supply, to help maximize service delivery for customers.

I recently saw our customer-focused mindset on display when I visited our Specialty Pharmaceutical Distribution facility in LaVergne, Tennessee, where our team worked extensively to prepare for commercial distribution of COVID-19 vaccines, while maintaining their terrific service for our other Specialty products. Our team successfully navigated complex cold chain requirements for the vaccines, enabling us to quickly meet demand and begin making shipments immediately following FDA approval, in time for the fall immunization season. We're pleased to support our customers in this manner, which patients rely upon for care, convenience, and accessibility.

We're committed to supporting customers and manufacturers, and our Strategic Sourcing and Manufacturer Services team recently hosted hundreds of our supplier partners for our annual Business Partners Conference. It was energizing to hear the excitement around various industry opportunities, such as biosimilars and emerging areas like cell and gene. We are confident about our ability to continue to be a strategic partner for manufacturers investing in the important drugs being developed and commercialized in this space.

We've continued to see strong momentum across our Specialty business, both downstream and upstream, and have reiterated our focus on this space. We are very sizable today in Specialty with over $30 billion in fiscal '23 revenue, which we noted at Investor Day has grown at a 14% CAGR over the last 3 years.

We are making progress building out our Navista™ Network offerings, with investments in the platform that will scale over time. Our differentiated model in community oncology is focused on driving practice growth and sharing value, while maintaining practice independence. Our approach is being refined through engagement with clinicians and our customer advisory board. Overall, we are developing solutions strategically aligned to supporting the clinical and operational needs of community oncologists that drive long-term practice independence and allow physicians to focus on patient care.

In Nuclear, the business continues its double-digit growth trajectory, with strong performance across our core categories and Theranostics. We continue to experience increasing demand for our Center for Theranostics Advancement, with more than sixty projects at various stages in our pipeline with our pharmaceutical manufacturer partners. We're progressing on our Phase 2 investment that we announced at Investor Day. Our Innovation Center and Pre-Commercial Manufacturing Center are already highly utilized. We're underway and progressing according to plan with the expansions of our Central Pharmacy capability and our Commercial Manufacturing Center. With our strong foundation and continued investment, the Nuclear business is well on track to deliver its long-term target of doubling profits by fiscal '26, relative to our fiscal '21 baseline.

Now turning to Medical and priority number two.

The Medical business has now delivered back-to-back quarters of meaningfully improved profitability, and we expect more to come.

As part of our Medical Improvement Plan, we've been taking action to address the challenges in the core Products and Distribution business, with the #1 priority being mitigating supply chain inflation.

We remain on track to address the impact of inflation and global supply chain constraints by the time we exit fiscal '24, and we're pleased to note we are now over 70% to target.

On the cost side, while overall still elevated, we've seen lower international freight costs reflected in our results, as anticipated.

We continue to execute our mitigation initiatives to offset elevated inflation, are making progress with our commercial contracting efforts, and are seeing benefits from our additional actions, such as our sourcing initiatives.

Additionally, we have been taking action through our 5-point plan to grow Cardinal Health Brand volume, which has yielded improvements.

We are utilizing a balanced portfolio approach and have made important line extensions within our core products to fill portfolio gaps critical to our distribution offering.

We've also highlighted investments we're making in new product development and commercialization for our clinically-differentiated specialty medical products, which culminated in two notable product launches during the quarter.

We launched our anticipated Kangaroo OMNI™ Enteral Feeding Pump in the U.S., designed to help provide enteral feeding patients with more options to meet their nutritional needs throughout their enteral feeding journey, from hospital to home.

We also announced the launch of our next generation NTrainer™ System 2.0, a medical device designed to help premature and newborn infants develop the oral coordination skills to make the transition to independent feeding faster and help reduce their NICU length of stay.

I'm excited about what our products can do for patients and the progress we are making as we now turn to playing more offense to grow our Cardinal Health Brand portfolio.

We're continuing to see the results of our actions benefitting our leading indicators, such as our customer experience metrics and portfolio health for key categories, which gives us confidence that we'll be able to better participate in the growth from an overall improving Medical utilization environment moving forward. For example, we've seen further improvement in our Customer Loyalty Index score for U.S. distribution beyond the 13-point increase in the last two years that we noted at Investor Day. And we've seen a continued reduction in our product back-orders, which are now at a multi-year low and consistent with pre-pandemic levels.

Outside of Products and Distribution, we're continuing to accelerate our growth businesses. In at-Home Solutions, we continue to see strong demand as care increasingly shifts to the home. Our team's focus on operational efficiency is producing better operating leverage in this business, resulting in increased contributions to the bottom-line.

To wrap up in Medical, we're continuing to execute our simplification and cost savings initiatives across the segment, which contributed to the strong SG&A management in the quarter.

Finally, priority number three, maximizing shareholder value creation.

We're maximizing shareholder value creation through our improved operational performance, robust cash flow and responsible allocation of capital.

As Aaron detailed, our confidence in our cash flow generation enabled execution of our fiscal '24 baseline share repurchases, continued evidence of our willingness to return excess capital to shareholders and our value creation through capital deployment. With our financial flexibility, we'll continue to opportunistically evaluate disciplined M&A in Specialty and potential additional share repurchases. We continue to actively evaluate a range of potential partners or acquisition candidates for both the downstream and upstream elements of our Specialty strategy but have been clear that our long-term growth targets are not predicated on inorganic investment.

We are making progress with our ongoing business and portfolio review, focused on the Medical segment. While across the company, our team has made significant progress over the past year realigning our operations for focus and simplicity, there is still work and opportunity in front of us. We continue to work collaboratively with our Business Review Committee to evaluate additional value creation initiatives and expect to provide further updates in the coming quarters.

To close, we had a great first quarter and are excited to build upon last year's momentum. This was driven by our highly engaged and talented team, and I would like to thank them for all their efforts fulfilling our critical role as healthcare's most trusted partner.

With that, we will take your questions.

Operator: Thank you. As a reminder to ask a question, please signal by pressing star one. And our next question comes from Lisa Gill from JP Morgan. Please go ahead.

Lisa Gill: Thanks very much, and congratulations on the quarter. Jason, I just want to understand the COVID-19 vaccines. Can you maybe just talk about the economics of that? Is that substantially better than kind of traditional drug distribution? And I know you said it only goes through October, but are there other vaccine opportunities that that would be similar and incremental opportunities for Cardinal?

Jason Hollar: Yeah, thanks Lisa. How I think about the vaccines is, again we're not going to get into obviously product and customer level type of detail, but overall, it all comes down to the value that we provide. And so, when you think about COVID-19 vaccines and vaccines in general, you really have to understand what's the requirements. And so, with COVID and with some vaccines, it requires more complex distribution, cold chain capacity and capabilities. And of course, there's also the unique thing about vaccines is that you scale up and down quickly, and so you're spreading a lot of that cost over a pretty short period of time. So, there's not a one size fits all answer to your question. And we provided a little bit of color for you in Aaron's comments there, so you can get a general understanding of the benefit that we had.

And to go a little bit further, I can say that about one third of the growth for the Pharma segment this quarter was related to the vaccines. So, it was a component of it, but certainly not the majority of the driver of the business. The core part of the business remained very strong within the segment for the quarter. And our guidance that quarter to continue to be strong. We do expect the vaccine benefit to be a bit greater in the second quarter, because of course there's more volume in Q2 than in Q1. Just given the nature of the October most likely being the peak volume that we would expect to see for vaccine distribution. And then we'd expect that to ramp down as we get the pipeline. We've got the pipeline pretty full here as we exited October. And now the future volumes will be much more predicated on what the actual demand is, which of course, at this point in time is hard to anticipate.

Matt Sims: Next question, please.

Operator: We'll now move to our next question from Eric Percher from Nephron Research. Please go ahead.

Eric Percher: Thank you. A question on Medical, specifically the over-delivery this quarter or upside that you showed versus expectations. How much of that is core Medical and mitigation efforts? What will carry through to the future versus not? And then were there any one-time items in Q1 we should keep an eye on? Any update on factors driving Q2 to Q4, including the incremental oil price and commodity pressure of the last few months?

Aaron Alt: Good morning, Eric, it's Aaron. Look, we were really pleased to see Q1, the results slightly exceeding our external or rather our expectations. The results or result of the team doing what they had planned to do, as well as being good managers and always looking for optimization opportunities across the portfolio. And so, they did what they were expected to on the first part or first part of the year for the Medical Improvement Plan. And there were no notable one-time items, contrary to some earlier quarters that complicated the results. So, we were quite pleased with the results that we gave.

And we do expect that to continue. You will have noted from our guidance for the year that we do expect slight continued improvement quarter over quarter. We are not changing our guidance for the year on Medical. I want to emphasize that we've taken a balanced approach and believe that the $400 million profit number for the year is the right target or the right guidance for that business. And the plans also haven't changed, right? It's going to start with the continued execution of the Medical Improvement Plan, the inflation mitigation elements that we've been talking about. Jason highlighted that we had hit 70% plus in the quarter as well, and they're going to continue to optimize and grow the Cardinal Health Brand. We're continuing to focus on driving more out of at-Home and the other growth businesses as well as simplification and cost optimization. And so overall, a great quarter and good expectations for the year to come.

Jason Holler: Yeah. Another thing I'd add, Eric, I think the component of your question was just asking about commodities and if there's any impact there. There was not anything significant. So, I know we've all been on this long journey as it relates to the impacts of commodity. So let me just spend a moment on that. As I think about the commodity and just general inflation, let me answer the question that way. I put our work into a couple of key buckets. The international freight piece is the only component that we've seen a meaningful change. And of course, that started about a year ago, and it was a dramatic reduction. So that reduction is as expected and given the elongated supply chain we had at that time, it took some time for that to work through and hit our P&L, but we're now seeing the more significant benefits of that over the last couple of quarters. So that is certainly a key component of it.

What I would say about all the other commodities or all the other inflation, specifically the commodity impacts, whether it's the oil-based products, polypropylene, polyethylene or unwovens and wovens and other types of inputs which are varied. I would say that they are generally remain elevated. A little bit volatile here and there, but generally elevated and not real different than what we had anticipated. So certainly noise. But how I think about it going forward and what my anticipation is, we're just not seeing the volatility that we did back 18 months ago. So, there is volatility, no doubt there will always be volatility. But it's to a much lesser degree and much more balanced and kind of in a normal environment right now. And that's why you don't hear us talking about it is because it's just not meaningful in the context of everything else that we have going on.

Matt Sims: The next question, please.

Operator: Kevin Caliendo, UBS. Please go ahead. Your line is open.

Kevin Caliendo: Great. Thanks. I guess what we're trying to figure out is in the change in the Pharma guidance, how much of it was incrementally coming from the vaccine incremental versus what you had originally expected? If you don't want to give us that number specifically, maybe explain there was a five-basis point improvement in the Pharma margin year over year, how much of that was coming from vaccines? Or maybe you can just break out where the benefits came from? I assume GLP-1s were negative on the margin, so something had to be better on a year over year basis, I'd love to explore that.

Aaron Alt: We're happy to provide a little more context. Look, it was a strong start to the year, and we remain very encouraged about the runway for the Pharma business. And we did raise the guidance to 7 to 9%. And it was really a result of three factors. First was just the strong Q1, and as Jason alluded to, we did have a contribution from the COVID vaccine distribution. And it was higher. That contribution was higher than what we had assumed in our original plan, just based on the timing of when the approvals came through, and frankly, our team's ability to jump on it and execute the way they did. Third element though is just the ongoing strength of the business, other than the COVID vaccines which is really consistent from an outlook perspective with the 4 to 6% guidance that we gave previously on a normalized basis. And just to remind you on that, what we had guided previously is that we expected low single-digit profit growth from the core Pharma business. We're expecting stability from the generics business, consistent market dynamics. You often hear us say, we are expecting double-digit growth in the specialty and nuclear business. And Jason highlighted that progress in his comments earlier. And importantly, we are expecting brand inflation more in line with fiscal ‘22, not the modest benefit that we saw in fiscal ‘23, right? And so, look, we are early in the year as we have done. We'll continue to update as we push ahead, but we're pleased with the results so far and the raise to the guidance.

Operator: The next question comes from Erin Wright, from Morgan Stanley. Please go ahead.

Erin Wright: Hi, thanks. Another question on the Pharma business. You mentioned the consistent generics environment, but can you elaborate on that a little bit. I guess, can you speak to the generic drug pricing environment? Are you seeing easing deflationary dynamics across generics? And how material is that for you in terms of your guidance raised across that segment? And does consistent mean essentially a continuation of those favorable pricing trends going forward, I guess throughout the rest of the year? Thanks.

Jason Holler: Yeah. Thanks, Erin. It's very consistent to the prior messages. So, we're not seeing any change in the underlying market. And so, my comments are going to be very similar to what it's been in the past. So let me just start with just underlying utilization continues to be strong. We've seen in our commentary this morning, we made a number of comments around just the broad-base utilization being strong in the pharma industry, so we generally benefited from that. So, volume is absolutely a key component of that. The consistent market dynamics that Aaron just referenced again is an indication that the buy and sell side continues to be very balanced. So overall, as in the past, I'm not going to break apart all the different pieces. We think it's best to look at them on a net basis. And within that, what I will say though is we continue to have very strong performance with our Red Oak sourcing joint venture. So, we continue to have that team very focused on the dual mandate of a course, driving down the best cost. But also, as important and their mandate is to ensure that service levels are optimized as much as possible as well. So, we feel very good about their progress, both in controlling costs, but also in driving great service for our customers. So again, those should be very similar words we've said in the past, so that's why we use the phrase consistent market dynamics because we're not seeing any significant change in the underlying dynamics of this part of our business.

Matt Sims: Next question, please.

Operator: George Hill of Deutsche Bank. Please go ahead, your line is open.

George Hill: Yeah. Good morning, guys, and thanks for taking the questions. I think like a lot of the other people on the line here, I'm really intrigued by what seems to be going on in the generic drug business. You guys called out Red Oak. GLP-1s were really strong in the quarter, but they have to be significantly margin diluted. I guess Jason, I'd love if you could talk about like, if anything's changing on the contracting side. Are you seeing like increased rebates for purchasing compliance or supply compliance? Just kind of interested, any more color that you can provide on what's going on in the generic drug space as it relates to profitability would be super helpful.

Jason Holler: Yeah. So, it's a fair question, George. And there's always going to be an evolution, customer to customer contract to contract. The balance of brand versus generic, and then within brand and within generic, the mix always is ever evolving. And so over time, I would expect there to be more and more separation between some of these elements as the weighting of the products change. So even though this volume has been dramatic for the GLP-1s, it's also been over a pretty short period of time and probably still early in this journey. So, you used the phrase, and I think it was used earlier as significantly margin dilutive. I'm sure we've never said words like that because it's very rare you hear us talking about margin rate, which you hear us talking about is margin dollars. And I even joked about this at investor day. I'm not sure I've ever said the words out loud in my career about the margin rate not being the most important or a significant metric for us. And it's because of products like the GLP-1s, products that are incredibly important to that underlying patient, which means it's important to our customers, which means it's important to us. It is not the most profitable class of products for us today, but it's important for our patients and important for the industry. What we value more than anything else is innovation in the distribution channel in the industry. Innovation brings good things for us, maybe not in the short term, and maybe not for every single product, but innovation ultimately brings opportunities. Whether it's services, or whether it's when these products become other opportunities to contract, or other opportunities over time for them to go generic. There's just lots of different ways in which you can create economic value on a particular transaction, particular product. And so GLP-1s today, you hear us talk about it from revenue, it's not a meaningful contributor to our earnings. And so, we're not going to talk about it from earnings perspective. Contracting, back to your original question will continue to evolve underneath that dynamic. But ultimately, we are well protected customer by customer in certain corridors to ensure that we don't flip upside down on a particular customer. And so that needs to evolve over time as those concentrations evolve over time. But our model has proven very, very resilient over the years and decades because this is the latest mix challenge that there is, or mixed change I should say. But it's not the first time that there's been a mix change in her industry. And so, our model's proven to be resilient in that regard. So, it's unique in different product, but it's not unique in terms of impacts and influences that a particular product category has on the pharma distribution industry.

Operator: The next question comes from Elizabeth Anderson of Evercore. Please go ahead.

Elizabeth Anderson: Hi guys. Thanks for the questions or the comments about sort of the pacing of the year. One thing I was just kind of, I heard what you said about calling out the inflation and how that doesn't quite flow through the same way as it did last year. Can you speak to how you're thinking about sort of the first half of the year versus the second half of the year? Because obviously you had a [inaudible].

Operator: Sorry. I think we lost we lost the previous caller. And we'll move on to the next question from Daniel Grosslight from Citi. Please go ahead.

Daniel Grosslight: Hi, thanks for taking the question. Maybe we'll go back to the COVID vaccine for a second here. You mentioned that you're seeing stocking of vaccine ahead of the winter season. Are you also taking more share in vaccine distribution than perhaps your overall market share would suggest? And then as we think about therapeutics moving into the commercial channel in a couple months here, how is that factored in into your guidance? And then lastly, you've been operating well above your longer-term Pharma EBIT guidance of 4 to 6% for a few quarters here. I'm curious if there's been any change to how you're thinking longer term about the business and some of the secular tailwinds that might be driving growth higher than your longer term 4 to 6% guidance.

Jason Holler: Well, you're getting all the value out of your one question. So let me see if I can touch on each one. I think there's some connectivity between these. So overall for vaccines, I think the best way to think about vaccine distribution is more about it from the customer standpoint. So, I think what you'll see is that COVID-19 vaccines, like other vaccines, typically will follow the distribution network. So, the real question is, are our customers getting more than their fair share? And I don't necessarily want to talk about them from that perspective other than to say we are very happy with the customers we have. We've often used a phrase for other situations about 'winning with the winners' and we feel very well aligned with great customers. But I think that's how you should think about it in that it most likely the vast majority of the volume will follow the distribution network.

I think your second element of that question was on the COVID therapeutics. How I think about that, is a little bit differently than vaccines in terms of just the rollout. Where the vaccines were a bit of an obsolete old product, new product type of situation where all that government stockpile. When we were asked about vaccines nearly a year ago, when it was first communicated to be commercialized, that was part of our response as well. We didn't know the FDA approval date. We also didn't know what was going to happen with the in-stock inventory, which seems to not have been a relevant usage at this stage given the variant evolution.

As it relates to therapeutics, we don't have that same challenge, right? There's a lot of product out there still, and the rollout will be slower. And you're talking about an oral solid type of brand product, which typically does not carry the same type of specialization necessary in the distribution channel that does drive higher-margin products, like our specialty products.

And then the last question is on the long-term growth outlook. I think one of the key messages that is behind your question and behind how we think about it, and it's partly why we're calling out those elements that may be a little unusual. Again, just like with GLP-1s, COVID vaccines another form of innovation. We like innovation. It provides us new opportunities and new growth as an enterprise. And so, part of the answer to this question is, well, how did these innovative products evolve and transition over time? Is that a continued opportunity? Is it lumpy? Is this year maybe higher or lower than what that volume will be in the future? Those are all hard questions to answer, but what we saw here is a bit of an influx of innovation that we've been able to benefit from while using the same infrastructure. One thing that's really important to highlight about our performance this quarter, is that we had really nice gross margin growth, and we had very flat SG&A. I made the comment about the operating leverage in my comments. That's what I'm getting at, is that we were able to execute very efficiently this quarter. And whether we're talking about vaccines or other products, having that gross margin because it's an incremental product category for us because of course we did not participate in that volume last year, but we're able to leverage the same capacity, the same team. That's an efficient use of our distribution channel. And as we get more opportunities like that, then there's some opportunity. But one of the key things that Aaron highlighted in a number of his comments, whether it's his comments or his answers to the question, is that our underlying growth, we feel very good about that long-term target. And a lot of what we've seen here was the Q1 over performance, both from vaccines, but also just the core utilization being very strong. That's not the same level of strength that we have indicated we should be thinking about long-term. It's an opportunity for us, but that's not what we're expecting at this point in time, and it's not what we're guiding for the balance of the year in terms of the core growth. We'd expect that core growth to still be in that 4 to 6% range. But again, innovation can create some opportunities for us that's hard to see right now, but we're not planning for that.

Aaron Alt: So maybe if I can just wrap a bow around that from a guidance perspective, just to reiterate what our guidance is. Look for the, as we sit here today, the Medical segment guidance is $400 million of profit for this year, and we've talked about that extensively, leading to $650 million of profit in fiscal year ‘26.

While we are pleased with the progress on Pharma one quarter into the year and are raising our guidance for this year for Pharma, the 7 to 9% profit growth, our longer-term algorithm remains the 4 to 6% profit growth that we had called out at our Investor Day, leading to 12 to 14% adjusted EPS growth long-term as our overall guidance. We're not making changes to a long-term guidance as we sit here today.

Now some may ask, and I've seen in some of the headlines as well, you beat by a particular amount but your raise is a little bit less than what that amount is. And the short answer to maybe get ahead of the question is that we had above the line benefits for which we, and below the line benefits, relative to consensus or expectations. And the real difference between our raise and how you might do that math is just, we are not carrying forward the tax benefit that we saw in Q1 into the updated guidance for reasons I call out during my prepared remarks.

Operator: The next question comes from Charles Rhyee from TD Cowen. Please go ahead.

Charles Rhyee: Yeah. Thanks for taking the question. Jason, I wanted to follow up on your comments on commodity prices. And you said that you're seeing less volatility in pricing than before. Would you say that, when you look at sort of the increase in oil over the past six months or so, would you say that's within your expectations of volatility, or would you might expect to see that get reflected into freight, and/or some of your other input costs at some point? Thanks.

Jason Holler: Yeah. No, that's a great question. So, when I step back and think about 18 months ago, what the root issue was, of course we had the international freight that was driving up the cost of everything in a multiple that was crazy. But you also had these other commodities that were, okay, so there's some commodities that are oil based. So, you had the oil input cost, but then you had the supply demand factors going on too that I think over-emphasized that issue. Because we don't buy oil, we buy products that contain oil. And so, as oil goes up and down, that's often absorbed within the supply chain in a normal steady state unless it gets outside of a certain band. So, it did get outside that band, right? Oil went above a $100 per barrel, and then you had other demand factors that were driving those commodity costs well beyond what the input cost impacts were. So, you had a bit of a exponential increase in a number of commodities. So today, given that we're in a much more muted demand environment, as a broad industry because this is way outside of healthcare, right? It's a general economy not being as hot as it was at that point in time. When you see these types of input costs going up and down, it goes back to a bit more of a normal model, which is they're not being exaggerated and multiplied, they're just flowing through in a much more normalized, steady state. So that's the reason why that I would not expect this under this current environment to get outside of normal bounds. So, if you see the input costs going up and you see a heated economic environment that can further compound that impact, that's when we need to start worrying more about this. I know the importance of this will certainly be day to day, we certainly spend a lot of time on this, but we'll continue to provide any insight that we see going forward.

Of course, when we get into the very significant changes, that's the changes to our contracting structure that we've put into place that's never going to be perfect. It's never going to be a one for one offset, but it's meant to really be active and impactful when you have those more extraordinary types of impacts that really kind of compound these items like I just referenced, and not just the normal types of more muted movements.

Matt Sims: Next question, please.

Operator: The next question comes from Allen Lutz from Bank of America. Please go ahead.

Allen Lutz: Good morning and thank you for taking the questions. I want to go after the Pharma margin dynamic a little bit differently. So, they were up five bps year-over-year. It sounds like the vaccine benefit is going to peak in your fiscal 2Q. So, is the right way to think about the margin growth in the Pharma segment year-over-year is, it could peak or the growth could peak in 2Q and then kind of more of a normalized lower-margin trajectory in the back half? Just trying to get a sense of the seasonality there. Thanks.

Aaron Alt: We really haven't provided quarterly guidance at the margin level for the Pharma business. We were, we leaned in a bit in describing the impact to Q1 from the COVID vaccine distribution, as well as Jason's comments around the expectations for Q2. Beyond that, I think you just need to take into account what we typically say about our business, which is first that we expect the consistent market dynamics from a generic perspective, right? And we are not assuming some of the benefits from a brand perspective in Q3 that we have previously seen. That's how we're offering up today.

Operator: We'll now take our final question today from Elizabeth Anderson, Evercore. Please go ahead.

Elizabeth Anderson: Hi guys. Apologies about the audio issues before. My question was just on the non-operating items, it seems like both on interest expense and maybe on the share count based on the ASR that you talked about and the interest expense in the first quarter, that there's a little bit of conservatism int that number, in both of those numbers [inaudible].

Operator: And it seems we have lost her again.

Aaron Alt: I'm going to attempt to answer the, I'll answer the question I think she was seeking to ask. The question from what I heard was interest and other, are we being conservative as well as what's going on with our share count? And I guess I would offer the following: we were pleased to see continued benefit in the quarter from I&O driven by the fact that we have such high cash balances and the return we're receiving on those cash balances. We are of course also benefiting in the quarter from the fact that we are largely fixed rate. We have been now for several quarters and so we haven't been exposed to the interest rate increases that some other companies may be dealing with. And that's just driven by the good stewardship, previously.

We do have a maturity coming at the end of fiscal ‘24. It's about $750 million from recollection, and we've commented that we're likely to refinance that, haven't commented on the timing of that as we carry forward. And so, we believe the updated guide we've provided on I&O reflects the benefits and the various trade-offs in that.

With respect to the share count, I do think it's important to call out that as we have consistently said, we don't guide for share count changes beyond the baseline share repurchase. We made a commitment at fiscal, during our Investor Day in June that our baseline share repurchase was going to be $500 million during fiscal year ‘24. We completed that in the first quarter. That is the share repurchase we're talking about today. And our guide reflects the impact of the completion of that share repurchase program. It does not reflect any other changes to share repurchase over the course of year. As Jason called out earlier, we have the benefit of our cash balance and having invested, having the plans that we do to invest in the business, CapEx wise, $92 million in the first quarter targeting 500 million for the year, continuing to make progress on our investment grade rating. And the two positive outlook changes that we received during the quarter, having made our baseline share repurchase during Q1 as well as continuing to pay our dividends as we are, as a dividend aristocrat. And now we have the opportunity in support of the plans to take the resources we have available to us to invest back in the business with that specialty focus that Jason has called out several times to look at M&A in a disciplined manner as Jason called out. And then to also consider further opportunistic share of purchase in due time as we assess how the year is performing. I think that's where Elizabeth was going.

Operator: Thank you. With this, we conclude today's question and answer session. And now I'd like to hand the call back over to Jason Hollar for any additional or closing remarks. Over to you, sir.

Jason Hollar: Yeah, thanks again everyone for joining us this morning. As we said a few times, it was a great start to the year. We're pleased with our broad-based performance and to be in the position we are today to raise our guidance after just the first quarter. We look forward to certainly continuing to update you on our progress against these plans throughout the year. And with that, thank you and have a great day.

Operator: Thank you. This concludes today's conference call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.