Q1 FY22 Cardinal Health, Inc. Earnings Conference Call

November 9th, 2021 8:30AM Eastern

Operator: Good day, and welcome to the Cardinal Health, Inc. First Quarter Fiscal Year 2022 Earnings Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Kevin Moran, Vice President of Investor Relations. Please go ahead.

Kevin Moran: Good morning, and welcome. Today, we will discuss Cardinal Health's First Quarter Fiscal 2022 results. You can find today's press release and presentation on the IR section of our Website at ir.cardinalhealth.com. Joining me today are Mike Kaufmann, Chief Executive Officer; and Jason Hollar, Chief Financial Officer.

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

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

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

Mike Kaufmann: Thank you, Kevin, and good morning, everyone. Our first quarter results were in line with our expectations. As we continue to manage through the global pandemic, we're staying focused on the near-term priorities and long-term strategies to drive growth and momentum across our businesses.

In Pharma, we continue to see sequential volume improvement, and are encouraged by the profit growth that we saw in the first quarter. We believe our Pharma business -- inclusive of our strategic growth areas of Specialty, Nuclear and Outcomes -- is well positioned for growth in FY '22 and beyond.

Our Medical segment continued to be impacted by the disruptions in the global supply chain that we called out last quarter. Recently, these pressures have rapidly escalated, and we are experiencing significantly elevated product costs due to international freight and commodities. While we believe the majority of these elevated supply chain costs are temporary, we do not expect them to return to normalized levels this fiscal year. As a result, we are lowering our FY '22 outlook for Medical segment profit to adjust for these increased headwinds. We are taking action to mitigate these impacts across the enterprise, and we are reaffirming our FY '22 EPS guidance of $5.60 to $5.90 per share.

We have been on a journey to simplify our portfolio and strengthen our core businesses so we are positioned for broad-based, sustainable growth, as noted in the long-term targets we're announcing today. We are prioritizing investment in our strategic growth areas and in innovative solutions to meet our customers' needs, today and tomorrow. And with our improved balance sheet, commitment to our dividend, and now an additional $3 billion share repurchase authorization, we're positioned to return capital to shareholders. Looking ahead, we remain confident in our strategy.

Now, I'll turn it over to Jason to discuss our results.

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

I will review our first quarter results and updated expectations for fiscal '22 before closing with some comments on capital deployment.

Beginning with total company results, first quarter revenue increased 13% to $44 billion, driven by sales growth from existing customers. Total gross margin decreased 4% to $1.6 billion driven by the Cordis divestiture and the net impact of elevated supply chain costs in Medical.

As a reminder, the sale of Cordis was completed on August 2nd and impacted the quarter's results by approximately 2 months.

SG&A increased 1%, reflecting information technology investments and higher costs to support sales growth, partially offset by the Cordis divestiture and benefits from cost savings initiatives.

Overall, first quarter operating earnings tracked in line with our expectations, down 15%.

Moving below the line, Interest and Other decreased by $2 million, driven primarily by lower interest expense from continued debt reduction actions. During the first quarter, we exercised a make-whole call provision to redeem $572 million of outstanding June 2022 debt maturities. We continue to expect to repay the approximately $280 million of remaining June 2022 notes upon maturity.

Our first quarter effective tax rate was approximately 24%. Average diluted shares outstanding were 289 million, about 4 million shares fewer than the prior year. This reflects prior year share repurchases, as well as the $500 million share repurchase program initiated in the first quarter and recently completed.

The net result for the quarter was EPS of $1.29.

We ended the first quarter with a cash balance of $2.5 billion and no outstanding borrowings under our credit facilities. This cash balance also reflects our first annual settlement payment into escrow under the proposed opioid settlement agreement.

Now turning to the segments, beginning with Pharma on slide 5…

Revenue increased 13% to $40 billion, driven primarily by branded pharmaceutical sales growth from large Pharmaceutical Distribution and Specialty customers.

Segment profit grew 1% to $406 million, which reflects an improvement in volumes compared to the prior year quarter, which was adversely impacted by COVID-19. This was largely offset by investments in information technology enhancements.

As a reminder, last quarter we began deploying new technology platforms across our Pharmaceutical Distribution business as a part of a multi-year journey to enhance our IT infrastructure. This rollout is tracking according to plan, and we continue to expect incremental implementation and depreciation costs through the first three quarters of fiscal '22.

As Mike mentioned, during the quarter we saw broad-based sequential improvement in pharmaceutical demand, including generics. We continue to expect a recovery of generic volumes to pre-COVID levels by the end of the calendar year. Outside of volumes, our generics program continued to experience generally consistent market dynamics, along with strong performance from Red Oak.

And, during the quarter, Pharma saw double-digit contributions from our growth businesses: Specialty, Nuclear and Outcomes.

Transitioning to the Medical segment on slide 6…

Medical revenue increased 5% to $4.1 billion, driven primarily by PPE sales, partially offset by the Cordis divestiture. Segment profit decreased 46% to $123 million, primarily due to elevated supply chain costs. To a lesser extent, this also reflects the impact of the Cordis divestiture, as well as net favorability in the prior year attributed to COVID-19.

As Mike mentioned, Medical segment profit was negatively impacted by increased product costs due to significant inflationary pressures in our global supply chain, particularly in the areas of commodities and international freight. In commodities, we have seen spikes in some key resins, such as polypropylene, that are inputs into our self-manufactured and sourced products, with recent index prices nearly double where they were last year. And with international freight, we are seeing ocean container costs at roughly 8 to 10 times pre-COVID levels.

We believe the majority of these headwinds are temporary, but we do not expect them to abate this fiscal year. We are taking action, including through pricing and aggressive cost management. I will discuss these impacts to our full year Medical outlook shortly.

To wrap up the quarter, despite some impact from the Delta variant on elective procedure volumes, overall our customers continue to manage effectively and total elective volumes exited the quarter near 95% of pre-COVID levels. Additionally, Lab testing volumes remained significantly elevated above pre-COVID levels, but was not a material driver to the quarter due to the strong performance in the prior year.

Next, on slide 8, a few updates to our fiscal '22 outlook.

We are reiterating our EPS guidance range of $5.60 to $5.90 per share.

This reflects updated expectations for the Medical segment, as well as lower ranges for our tax rate and share count.We now expect our annual effective tax rate in the range of 23% to 25%. We also now expect diluted weighted average shares outstanding in the range of 280 million to 282 million.

As for the segment outlooks on slide 9…

First, we are adjusting our Pharma revenue outlook to low double-digit growth to reflect the strong branded pharmaceutical sales growth that we are seeing from large customers.

For Medical, we now expect fiscal '22 segment profit to be down mid-single to low double digits. This change is driven by the significant increases in supply chain cost inflation that I previously discussed, which is expected to result in an incremental net headwind of approximately $100 million to $125 million on the year. Given the anticipated timing of realizing these cost increases and our mitigating actions, as well as the timing of selling higher cost PPE, we expect a sequential decline in Medical segment profit in the second quarter.

Stepping back, the only large operational item that we see meaningfully different today compared to our original fiscal '22 guidance is the incremental impact of elevated supply chain costs in Medical. Notably, we do not anticipate any material net impact in Pharma from inflationary supply chain costs. And, as noted last quarter, we still expect the cadence of our EPS guidance to be significantly backhalf weighted.

Now to close, an update on capital deployment…

We are focused on deploying capital in a balanced, disciplined, and shareholder-friendly manner, and will continue to allocate capital through the lens of our priorities, which are unchanged.

We have been on a journey to improve our balance sheet and our portfolio and have made tremendous progress. As we look forward, we see our debt paydown beginning to moderate, which will provide an increased ability to be more opportunistic with our return of capital to shareholders.

On that note, two important updates:

Our Board recently approved a new, three-year authorization to repurchase up to an additional $3 billion of our common stock, expiring at the end of calendar year 2024. And, we now expect approximately $1 billion of share repurchases in fiscal '22, which includes the $500 million of share repurchases executed to date.We believe that capital deployment, along with the future growth that we expect in both our segments, will be a key driver to the double-digit combined EPS growth and dividend yield that we are targeting over the long term.

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

Mike Kaufmann: Thanks, Jason.Throughout the pandemic we have responded to challenges with resilience and agility, approaching every situation with a focus of delivering for our customers, so they can care for their patients. We are continually reviewing our business and seeking areas to improve as we navigate the dynamic macroeconomic environment.

We're taking action to mitigate elevated costs and manage through temporary supply chain disruptions in Medical. These actions include pricing adjustments, cutting additional costs throughout the organization and accelerating additional growth opportunities.

Outside of a continual focus on the customer, we are directing our efforts to 3 main areas that will support our long-term target of mid-single to high-single digit growth for the Medical segment.

First, we are simplifying our operating model.

We continue to take decisive action to reposition the business for growth. We divested the Cordis business and have begun significantly reducing our international commercial footprint. We have announced and are in the process of exiting 36 initial markets, which will allow us to focus on the markets where we have a competitive advantage. Additionally, we are further streamlining our Medical manufacturing footprint and modernizing our distribution facilities. We expect these simplification initiatives to contribute to our $750 million enterprise cost savings target and position us to generate sustained long-term growth.

Second, we are focused on driving mix through commercial excellence.

Our Cardinal brand portfolio has significant breadth, with leading brands and clinically differentiated products such as Kendall™ compression, Kangaroo™ enteral feeding, and Protexis™ surgical gloves, among others.

While we have made important changes to align our commercial organization’s structure and incentives, we recognize that we are under-penetrated in Cardinal Health brand mix relative to our potential. An increase in private label penetration across our U.S. and in-channel customer base represents a significant profit opportunity, with even further opportunities out of channel and internationally. As we move past the pandemic, we see this as a significant opportunity to both deliver savings for our customers and grow our business over the mid to long term.

And third, we're fueling our Medical segment growth businesses – at-Home Solutions and Medical Services, which includes OptiFreight Logistics and WaveMark.

These growth businesses are aligned with industry trends and positioned to capture market share and grow double-digits in FY '22 and beyond. We continue to invest in technology enhancements and innovative solutions that give our businesses a competitive edge.

In OptiFreight, we continue to expand our customer base and offerings.

And in at-Home Solutions, which is now a $2.2 billion business, we continue to see volume growth as care is rapidly shifting to the home. We are investing in new technologies to drive operational efficiencies and enhanced data visibility.

Moving to Pharma. We have 2 primary objectives to achieve our long-term guidance of low-to-mid-single digit segment growth: continuing to strengthen our core Pharma Distribution business, and fueling our growth businesses: Specialty, Nuclear, and Outcomes.

We will continue to strengthen our core business by focusing in 3 primary areas:

First, supporting our diverse customer base. Over 50 years, we've honed our distribution expertise and developed a strong customer base across multiple classes of trade, with leaders in chain pharmacy, direct mail order, grocery, and retail independent customers, all of whom play critical roles in providing healthcare access to their local communities. Along those lines, during the quarter we extended our distribution agreements with CVS Health through FY '27.

Second, we're managing our generics program to ensure consistent dynamics, which we continue to see and expect. Our generics program is anchored by the scale and expertise of Red Oak Sourcing – a partnership we also recently extended, through FY '29.

Third, we've been investing heavily in our technology to enhance customer experience and drive efficiencies. We are approaching the end of a multi-year investment journey to modernize our IT infrastructure, which will yield meaningful working capital improvements and operational efficiencies.

As for our second overall Pharma objective, fueling our growth businesses, we continue to expect these 3 businesses to realize double-digit growth over the next several years. And, as these businesses grow, they will become a bigger portion of the overall Pharma segment.

In Specialty, key downstream and upstream initiatives will enable our growth. In Oncology, we are competing differently downstream by transforming from a distribution-led orientation to a focus on supporting independent oncology practices with solutions to thrive in a value-based care environment.We are seeing commercial momentum with Navista TS, our technology platform that helps oncology practices improve their performance in value-based care.

We have a strong presence in other therapeutic areas, such as Rheumatology, which today is a $4 billion distribution market growing double-digits.

We are also encouraged by the anticipated growth in biosimilars as more products come to market, such as the FDA's approval for the first interchangeable biosimilar insulin product. We're well positioned to support the next phase of biosimilar growth as adoption increases in areas outside of oncology.

Upstream, we are expecting strong growth from higher-margin services supporting biopharma manufacturers. We operate a leading 3PL supporting hundreds of manufacturers that continues to see wins and support new products coming to market, such as in the area of cell and gene therapy.

In Nuclear, we are expecting continued double digit profit growth, resulting in a doubling of our profits in this business by FY ’26. We continue to build out our multimillion-dollar Center for Theranostics Advancement in Indianapolis and are investing to expand our PET capabilities. We’re partnering with several companies to grow the pipeline of novel theranostics.

For example, through our agreement with TerraPower, we will produce and distribute Actinium-225, a radionuclide involved in creating targeted therapies for several cancer types.

And in Outcomes, we continue to see and expect strong growth. This business has added new payers and PBMs and is expanding clinical solutions for both independent pharmacies and retail chains to include solutions for medical billing, point of care testing and other clinical capabilities.

With respect to the Enterprise, we continue to aggressively review our cost structure as we work to streamline, simplify and strengthen our operations and execute our digital transformation. As I mentioned earlier, we recently increased our total cost reduction goal to $750 million by FY '23, and we are on track to deliver those savings.

We're pairing cost reduction efforts with balanced, disciplined, and shareholder-friendly capital allocation with a focus on investing in the business, maintaining a strong balance sheet and returning cash to shareholders. Long term, we're targeting a double-digit combined EPS growth and dividend yield. These expectations are driven by our growth targets for our segments, our commitment to our dividend, and our new $3 billion share repurchase authorization.

Now, let me provide an update on the proposed opioid settlement agreement and settlement process. In September, we announced that enough states agreed to settle to proceed to the next phase, and each participating state is offering its political subdivisions the opportunity to participate in the settlement for an additional 120-day period, which ends on January 2, 2022. At that point, each of the distributors and the states will have the opportunity to determine whether there is a sufficient participation to proceed with the agreement. If all conditions are satisfied, this agreement would result in the settlement of a substantial majority of opioid lawsuits filed by the state and local governmental entities. This is an important step forward for our company. As we've consistently said, we remain committed to being part of the solution to the U.S. opioid epidemic and believe that settlement would provide relief for our communities and certainty for our shareholders.

Turning to ESG – these priorities remain critical to achieving a healthier, more sustainable world. We recently announced goals to reduce Scope 1 and Scope 2 greenhouse gas emissions by 50% by 2030, and increase minority representation in our global workforce by 2030.

In closing, what we do matters, and it is our privilege to serve our customers, their patients, and their communities around the world.

And now, Jason and I will take your questions.

Operator: Thank you. And if you would like to ask a question, please signal by pressing “star,” “1” on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, everyone, to ask a question, press “star,” “1” on your telephone keypad. We’ll pause for a moment to assemble the queue.

And our first question will come from Lisa Gill with J.P. Morgan.

Lisa Gill: Thanks very much. Thank you for all the comments. Mike, I just want to go back to your comments around simplifying the operating model on the medical supply side, and where you talked about driving the mix of Cardinal-branded products. One, can you remind us what percentage of sales today are Cardinal-branded products? And then two, can you talk about the margin differential on those products? And then my third and last question would just be that now that you have the divestiture of Cordis behind you – the sale of Cordis behind you – are there other assets within Medical that would make sense to divest?

Mike Kaufmann: Thanks, Lisa. Thanks for the questions. Tough questions to answer because these aren't things we have historically given. Obviously, I can say this. We believe there is plenty of room to grow. Some of our accounts were significantly penetrated in and others obviously were less penetrated in, so we do have good targets by account that we are going after. So we think there's plenty of opportunity there. It's one of the key reasons we believe in our longer-term guidance for Medical is the fact that we can do that.

As far as margin rates go, generally, they are much more higher as a percentage and dollars than national brand. There are times in certain preferred brand programs, which is why we have them, that we do prefer national brand. But in general, as a rule of thumb, our margin rates are much more significant on our Cardinal-sourced or Cardinal-manufactured products.

And then, lastly, around Cordis, we're always looking at our entire portfolio of businesses to make sure we have the right type of businesses where we are positioned to win. There's nothing that sticks out to me in terms of a certain product category or that, but we are as I mentioned in my prepared remarks, that we are exiting 36 countries. So not only do we look at products, but we look at products by country and countries, and where we don't believe we have significant growth opportunity, where there might be too much risk versus benefit, et cetera. We have made real conscious decisions to aggressively manage the number of countries in, which is why we are exiting 36 countries to help simplify the model.

Operator: Alright, and up next, we will take a question from Charles Rhyee with Cowen. Please go ahead.

Charles Rhyee: Thanks for taking the question. Mike and Jason, want to just talk a little bit about the long-term growth targets a little bit here. I guess first is when we're starting the jump-off point for these – for the earnings growth – are you starting from fiscal '22? And is that a 5-year target that we should be thinking about? Or are we jumping off from fiscal '21 as sort of the baseline year? And then secondly, within that, can you just remind us again sort of what the – obviously, the earnings this year are back half-weighted – just remind us what the tailwinds that we should be considering as we build out our model for the remainder of this fiscal year? And then, lastly, those higher freight and shipping costs, do you assume those go away after this year as we think about it in relation to the long-term targets? Thanks.

Jason Hollar: Okay, hi. Good morning. Yes, this is Jason, I'll try to capture all those points. Your question is certainly fair as it relates to trying to define the baseline for those longer-term targets.

As we indicated in the remarks today, we do anticipate this additional $100 million to $125 million related to the inflationary environment as temporary. It's difficult certainly to define exactly if that's short term, medium term, or longer term. And at the current moment, we would expect those to revert back to some normalized level in a time frame that is relatively short to medium term. And so when we talk about these longer-term targets, we are not presuming that type of tailwind, right? So it is in a more normalized state when we provide those targets. You referenced 5 years, I'd say 3 to 5 years is a reasonable type of time frame for average types of performance levels to get a broad perspective on the ins and the outs. But we would not expect big shocks associated with items like that, divestitures and acquisitions, things of that nature would also be normalized out of that so that we're getting at that core type of performance.

And then as it relates to more specifics around the elevated supply chain costs. We highlighted within our remarks that it's really just 2 key areas: the international freight and the commodities. In both cases, the reason we believe that they're temporary is that they are at multiple levels higher than what we've historically seen on international freight, which is essentially the cost of getting a shipping container shipped from overseas locations, such as Asia to the United States. We're seeing that cost up 8 to 10 times versus pre-COVID levels. Certainly, we would expect that to be significantly lower at some point in the future. And on the commodities, we're talking about a lot of different types of polymers, such as polypropylene. Those levels are more like 2x what we've seen historically. So again, we would expect those to get back to a more normalized state at some point in the future. But again, those are not tailwinds to get us to these targets, those targets are more normalized.

And in terms of the second half, different cadence of our results for the various businesses, we did indicate that – well, with Pharma, we would expect the second half to continue to improve steadily versus where we're at today just as it relates to getting back to more normalized state for underlying generic volume. So that continues to be as expected. And also as expected, our investments in our technology investments we indicated would be front-end loaded, especially with the first three quarters. Primarily as it relates to that fourth quarter, we started to implement those cost increases in the final implementation last Q4. So we start to get the full year effect of that as we exit the third quarter here.

On the Medical side, we did indicate a sequential decline from Q1 to Q2 and that's just related to the timing of realizing the supply chain costs I was just walking through, and all the mitigating actions that go along with that. And then also recall that we cited the COVID favorability in Q2 of last year, that is not expected to repeat. In fact, we expect that to be a headwind this 2Q, primarily as a result of the PPE price and cost timing. So we have that Q1 to Q2 cadence. And then of course, in the fourth quarter of this fiscal year, we'd expect a significant COVID tailwind associated with the comparison benefit from the PPE in the prior year. And then in all of our businesses, we expect ongoing stronger contributions from our growth businesses as we see the effects of various initiatives and investments that have been put in place over the course of last year. Next question.

Operator: The next question will come from Eric Percher with Nephron Research.

Eric Percher: Thank you. Appreciate the supply chain commentary. I'd like to get a little bit deeper here. We used to have guidance on commodity impact, so I think anything you can provide relative to $17 million of revenue or the cost that you incur to give us some sense there. And then thinking about commodity and freight, what is clearly passed along versus what represents a decision that has to be made? And what I'm really looking for is $100 million to $125 million of increased expense, what does that represent relative to the total expense that you're seeing pass through?

Mike Kaufmann: Yes, thanks for the question. So let me see if I could help. First of all, we, as you know, called out in our fourth quarter of last year that we did expect elevated supply chain cost. So in our guidance for this year for the Medical segment, we already assumed a certain amount of elevated supply chain cost, some of which we had planned already to offset through cost reductions, pricing actions and those types of things, and that was originally built in.

What we saw during the quarter, particularly as the quarter went on, was a significant increase in those supply chain costs, most notably in international freight high containers that we talked about as well as commodities. And those, we feel, will create an incremental $100 million to $125 million of cost for us. Roughly, I would say that $100 million to $125 million is split relatively evenly between the impact of commodities and the impact of freight cost. So they were both very, very significant. We saw other minor ones in other areas, but those were the really 2 big ones, both of which we believe are temporary because, one, as Jason said earlier, they're at all-time highs for the most part, significantly higher than where they were and we believe that over time, the market will adjust and those will be able to come back down.

So what are we doing about that? That is a net number, the $100 million to $125 million, obviously, since we called that out as the adjustment to Medical guidance, is that we are getting after it through pricing actions, passing some of it through. It's hard to really talk about exactly which ones you can pass through or not. The market is very complicated. There are contracts that we have to work through. We have to work with our partners, both the hospitals and the GPOs. We have to understand the supply and demand dynamics of each item in the environment. And so, we are working through and understanding all of those factors, but there is some additional pricing action built into that number.

And then obviously, since we maintain guidance for the entire company, we are taking aggressive cost actions across the company. We are leveraging our improved balance sheet, and we are also focusing on our growth businesses and pushing our teams to do more, faster there. So those are some, I hope, some helpful comments.

Jason Hollar: Yes. And the only thing I'd add is that this increase is not – it's related to 2 parts. It's a greater increase in both of these areas of international freight and commodities, but it's also a longer expected duration. We had anticipated that they would come back to more normalized levels a bit earlier, so we saw a higher spike and a longer duration.

And in terms of just how you model it through on revenue, I'd like to just draw a little bit of distinction. With PPE, we saw many, many times higher total impact on that product cost. And so we saw a much more significant number of dollars in both cost and revenue that came through. While this is still significant, it's much less meaningful from a revenue perspective and it's not moving that needle nearly as much. Next question.

Operator: And next, we'll hear from Kevin Caliendo with UBS.

Kevin Caliendo: Thanks. Thanks for taking my question. So if I'm doing the math right, it appears the bad guy, that is the incremental supply chain cost, is larger than the good guy of the lower share count and perhaps a lower tax rate. Am I doing – am I thinking about that right in the fact that you didn't guidance? Is that just you're still within the range, but maybe it's the lower end of the range or you're just giving yourself a little room? How should we think about that?

Jason Hollar: Yes. I think your math is accurate for the items that we typically provide in guidance. One area that's not explicitly called out, but is implied, is just the underlying other corporate expenses. And as we referenced a few times already in Mike's specific comments, there's broad-based cost reductions. The $750 million program, which we increased by $250 million last quarter is enterprise-wide and that includes the corporate function. So we have identified additional corporate cost reduction actions that are not included in either of the segments, but do fall through to the bottom line, the total segment profit as well as our earnings per share.

Kevin Moran: Next question, please.

Operator: And next we'll hear from Michael Cherny with Bank of America. Please go ahead.

Michael Cherny: Good morning. I want to dive a little bit more into some of the long-term guidance and compare and contrast it with the dynamics you're seeing right now in terms of the supply chain. I know that a lot of these are out of your control, and clearly, some companies in the space are seeing similar approaches. That being said, as you think about the ways you're interacting with your customers now, interacting with your partners and supplier partners, are there any ways that you can continue to evolve your business so that maybe we don't see ever spikes like this, but some of the fluctuations and volatility that you have seen in the supply chain in the past. And I'm thinking in particular on some of the raw material cost spikes that do come up from time to time, are ways that can be mitigated in a more systematic fashion going forward, so we don't have this level of volatility and level of surprise for stuff that, as I mentioned, a lot of it tends to be out of your control.

Mike Kaufmann: Yes. I really appreciate the question. It's a really good one. So let me step back and hit a couple of different pieces, and I'll finish with your question on Medical, but I'll take a shot here to emphasize a few others. So there's really, I would say, 3 obviously components to our long-term target, which our long-term target we're talking about is having a double-digit combined EPS growth and dividend yield on average, as Jason mentioned.

In Pharma, the – to your point, we don't really see those fluctuations in commodities and costs affecting that business generally because if it does, it generally happens in the form of the drugs having increases, which in that model, are able to be passed on and worked through the model. And so our goal of low single-digit to mid-single-digit growth in Pharma is really focused on strengthening that core PD balance. Getting that right mix of generics, making sure we're managing the balancing through our margin initiative and all that as well as then driving our growth businesses, especially Nuclear and Outcomes, and we gave some color on those that hopefully you found helpful and exciting. For instance, Nuclear doubling in the next 5 years, Specialty continuing, and Outcomes continuing with double-digit growth. So we believe the combination of getting that PD business stabilized, which we're seeing and then seeing the growth there is really what's going to drive that. And then, of course, we mentioned the use of capital being able to – having our debt lower commitment to our dividend and then the share repurchases.

On Medical, as you mentioned, it's a couple of different things. It's simplifying our operating model, focusing on driving mix, and fueling our growth businesses. I won't go into those details because we did it in the comments, but to your question on what kind of changes can we make that help, it's really – one of the things we are working on with customers right now is how do we change our contracts with our customers to give us more flexibility when there is sudden significant changes in the supply chain, that there is some ability to raise price.

Our discussions with our customers are being very transparent. We want to be able to make sure that if we're able to do that, we're very willing to tie those things to indexes and things, so they understand that, as they come back down. We're not – we're willing to pass lower costs back on to them. Because we don't want to look at this as a – necessarily a chance to improve our margins – we'd like to do that through driving mix and launching more products, not on the backs of our customers during a supply chain. So, we are working with them to create contracting methods that will allow us to be able to pass those on as well as help them understand what are the metrics we will do to be able to know for them when they changed the other direction, too.

Operator: All right. And our next question will come from Jailendra Singh with Credit Suisse. Please go ahead.

Adam Heussner: Hi, this is Adam on for Jailendra today. Thanks for taking the question. Going back to your long-term growth target, just wondering if you take into account the capital allocated to the anticipated opioid fulfillment payments? Or how we should be thinking about that potential impact as it relates to being able to invest across some of your growth and higher-margin businesses?

Jason Hollar: Yes. Good morning, Adam. This is Jason. Yes, so that would incorporate that. As we think about the capital deployment side of that, we have for quite some time now included in an expectation of what those payments would be. That's all based upon our current set of assumptions, of course. And if that would change materially, then that would change the answer. But based upon what we know now, that would be the baseline. For example, the $3 billion share repurchase authorization that we have just completed is inclusive of that as well. So part of the capital outlay that we would expect over that period of time and this would be the available capital beyond that. Next question.

Operator: And up next, we'll take a question from Steven Valiquette with Barclays. Please go ahead.

Steven Valiquette: Hi, thanks. Good morning everybody. So just a question on the Medical segment. You mentioned that despite some impact from the Delta variant that the total elective volumes exited the quarter near 95% of pre-COVID levels. I guess I'm curious if there's any updates on your assumptions for the pace of return of procedures for the remainder of fiscal '22? And is this also a positive factor that helps to offset some of the negatives that you discussed within the Medical segment? Thanks.

Jason Hollar: Yes. The – there was a little bit of a reduction in that base – in that level of elective procedures in the first quarter. We started the quarter at close to pre-COVID levels. And as we indicated, we exited and then back at about 95%. And we think that's primarily attributed to the Delta variant. So we see that trending in the right direction. And with the pace of the virus since then, we feel that will continue to improve. And importantly, what we saw in the quarter is we saw an improvement in our lab business that effectively offset that modest deterioration in the amount of elective procedures.

So what we're seeing right now, is that those two items tend to generally offset both good and bad, depending upon the pace of the virus. So it's nothing significant that we saw in the quarter. And as a result, we don't anticipate there being wild fluctuations going forward. Next question.

Operator: And next, we will take a question from Stuart Hill with Deutsche Bank.

George Hill: Hi, good morning guys. And this is the second time this earnings season I've been Stuart. Jason and Mike, just kind of a quick question on the long-term guide, which is, I guess, over the long term, how do you think about the underlying operating earnings growth contribution versus the capital deployment or inorganic growth contribution?

Mike Kaufmann: Well, I think if you know as you break down the long-term targets, when we were really talking about Pharma being low single digits to mid-single-digit growth, we're really talking about the operating earnings of that segment being in the low single to mid-single, Medical being in mid-single to high single digit. And then the rest of it would come from our dividend yield as well as capital deployment around repo to get to the double-digit combined EPS growth and dividend yield. So the guidance on Medical and Pharma was really about operating earnings. And I would also say that M&A is not a top priority in this. That may occur. And we may have some of that here and there, and that is one option with capital deployment. But this is really more focused on what we talked about, operating earnings growth, as well as dividend yield and opportunistic repo. Next question..

Operator: And our last question will come from Ricky Goldwasser with Morgan Stanley. Please go ahead.

Ricky Goldwasser: Yes, hi. Good morning. So on the long-term double-digit growth, I know we talked about the growth rate being sort of on a normalized basis. So, should we take that long-term double-digit growth back out from 2022 guidance – sort of the abnormal costs that you're seeing, normalize for them and then apply that growth rate to get to 2023? So that's the first part of the question.

And then secondly, as we think about these sort of transitory costs in nature, you talk about $100 million to $125 million costs related to the supply chain. What's the contribution of labor cost to that headwind? Because when we think about labor costs, we think about it as potentially more structural because once you raised someone's salaries, it's difficult to bring it back down. So how should we think about that component within the additional cost?

Jason Hollar: Sure. Good morning, Ricky. This is Jason, I'll start. As we talk about our long-term targets, it's not expected or intended to be each and every year. There's a reason that we do highlight that as an average over that period of time. So we are not providing fiscal '23 guidance with the statement.

With that said, we think that there are, over these longer periods of time, that these would be the primary drivers and expectations we would have for our businesses. And – but how you described it about the normalized level, as an example, that $100 million to $125 million, we're – we indicated that we anticipate these costs remain elevated for the balance of fiscal '22. We are not taking a position at this point as to how much, if any, carries over into fiscal '23. That is a terrific example of an important element of fiscal '23 guidance that we will provide in the future. That is not, at this point, something that we feel comfortable being able to identify.

And then your question about labor is a great one. We did not call it out because it is very consistent with what we had last quarter. So, while labor inflation and those pressures are very real for us like the whole industry, we are not seeing anything new and unique this quarter versus last quarter and so we're not adding in any additional costs for that.

But I would also highlight that even what was included in the original guidance was not nearly as substantial as the cost that we're referencing for what was included before for commodities and international freight. Those are clearly the most significant items that drive that fluctuation. And items like labor as well as more domestic-related costs such as, domestic transportation and other fuel, are all relatively low compared to those other two primary items of international freight and commodities.

Operator: And that concludes our Q&A session for today. I *will* turn the call back over to CEO, Mike Kaufmann, for closing remarks.

Mike Kaufmann: I want to thank everybody for taking the time to be on the call today and for all of your questions. I like to conclude with just a few thoughts. I know the elevated product costs within the Medical segment incurred a lot of attention here today, but I want to just reiterate that, one, we do believe a majority of these costs are temporary; two, that we are taking aggressive enterprise-wide actions to help mitigate; and three, we did reaffirm our non-GAAP EPS guidance.

Additionally, in Pharma, we're encouraged by the profit growth we saw in the quarter, and the ongoing resiliency in this business. With an additional $3 billion share repurchase authorization and our commitment to our dividend, we are positioned to return capital to shareholders while prioritizing investment in our growth businesses, simplifying our operating model and strengthening our core businesses.

And together, this gives us confidence in achieving the new long-term growth targets that we provided. With that, thank you again. We hope you all have a good day.

Operator: And this concludes today's call. We thank you again for your participation. You may now disconnect.