

Cardinal Health Inc. (CAH)

\$58.26 (As of 02/06/20)

Price Target (6-12 Months): **\$61.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/11/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:A

Value: A

Growth: C

Momentum: A

Summary

Cardinal Health exited the fiscal second quarter on a strong note, wherein both earnings and revenues outpaced the consensus mark. Cardinal Health's Pharmaceutical segment witnessed solid growth in Pharmaceutical Distribution and Specialty Solutions customers. Apart from these, the company's extension of agreements with CVS Health, collaboration with PANTHERx Specialty Pharmacy and buyout of mscrisps instill optimism. Shares of Cardinal Health outperformed the industry in a year's time. Meanwhile, contraction in gross margin remains a woe. Huge investments in Pharmaceutical IT platform and lackluster generics performance are likely to limit the company's operational efficiencies in the upcoming quarters. Intense competition and customer concentration are other concerns.

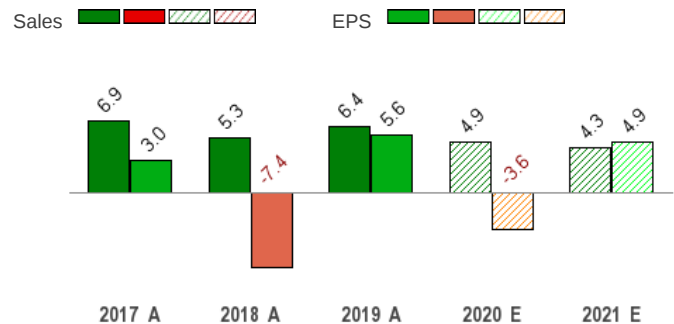
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$59.80 - \$41.03
20 Day Average Volume (sh)	3,069,320
Market Cap	\$17.0 B
YTD Price Change	15.2%
Beta	1.36
Dividend / Div Yld	\$1.92 / 3.3%
Industry	Medical - Dental Supplies
Zacks Industry Rank	Top 34% (87 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	25.6%
Last Sales Surprise	0.6%
EPS F1 Est- 4 week change	6.1%
Expected Report Date	05/14/2020
Earnings ESP	0.2%
P/E TTM	10.6
P/E F1	11.5
PEG F1	1.9
P/S TTM	0.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	38,985 E	41,018 E	38,521 E	40,788 E	159,263 E
2020	37,341 A	39,735 A	36,952 E	39,027 E	152,670 E
2019	35,213 A	37,740 A	35,228 A	37,353 A	145,534 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.28 E	\$1.26 E	\$1.52 E	\$1.23 E	\$5.34 E
2020	\$1.27 A	\$1.52 A	\$1.44 E	\$1.13 E	\$5.09 E
2019	\$1.29 A	\$1.29 A	\$1.59 A	\$1.11 A	\$5.28 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/06/2020. The reports text is as of 02/07/2020.

Overview

Headquartered in Dublin, OH, Cardinal Health Inc. is a nation-wide drug distributor and provider of services to pharmacies, healthcare providers and manufacturers. The company has two reporting segments – Pharmaceutical and Medical.

The Pharmaceutical segment is the second largest pharmaceutical distributor in the United States and the largest nuclear pharmacy. Its products and services include pharmaceutical distribution, manufacturer and specialty services, and nuclear and pharmacy services. This segment also offers “specialty pharmaceutical products and services”, which supplies (1) oncology, rheumatology, urology and other pharmaceutical products to physician offices; (2) human plasma products and specialty pharmaceutical products to hospitals and other healthcare providers; (3) consulting and other services to pharmaceutical manufacturers, third party payors and healthcare providers.

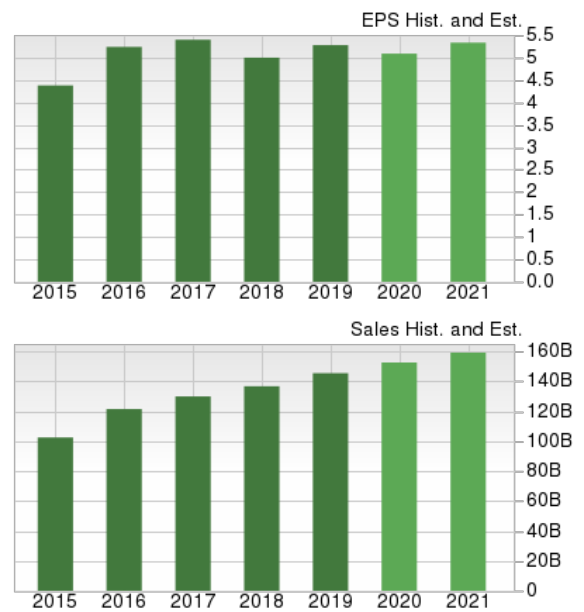
The Medical segment manufactures products such as single-use surgical drapes, gowns and apparel; exam and surgical gloves; and fluid suction and collection systems and offers sterile and non-sterile procedure kits. These products are sold directly or distributed via third-party sources in the U.S., Canada, Europe, South America and the Asia/Pacific.

FY19 at a Glance

In fiscal 2019, Cardinal Health registered adjusted earnings of \$5.28 per share, up 5.6% on a year-over-year basis. Revenues increased 6.4% on a year-over-year basis to a record \$145.53 billion. Delving deeper into the segmental revenue details, Pharmaceutical (89.3% of net revenues) increased 7.2% to \$129.92 billion in fiscal 2019. Medical revenues (10.7% of net revenues) rose 0.3% on a year-over-year basis to \$15.63 billion.

Important Acquisitions & Divestments

On Feb 1, 2018, Cardinal Health announced the divestiture of its Cardinal Health China business to Shanghai Pharmaceuticals Holding Co., Ltd. for \$1.2 billion.



Reasons To Buy:

▲ **Share Price Movement:** Over the past year, shares of Cardinal Health gained 7.4%, against the industry's decline of 1%. Meanwhile, the S&P 500 Index rallied 22.1% over the same timeframe. Pharmaceutical segment, broad product portfolio and prudent acquisitions continue to favor the stock.

▲ **Cost Savings:** In terms of costs, Cardinal Health announced in fourth-quarter fiscal 2019 earnings call that it anticipates incremental cost savings of \$130 million associated with actions intended to optimize and simplify its operating model and cost structure. In the fiscal first quarter, the company reaffirmed the same. In fact, in the fiscal second quarter, the company anticipates to meet or exceed its \$130 million commitment for the year primarily on the back of selling, general and administrative activities. It is expected that the benefits from this and additional actions will continue to improve through the balance of 2020. This is likely to aid the company's margins in the days ahead.

▲ **Pharmaceutical Segment to Drive Growth:** Cardinal Health's Pharmaceutical segment is the second largest pharmaceutical distributor in the United States. The segment's products and services comprise pharmaceutical distribution, manufacturer and specialty services, and nuclear and pharmacy services, which are expected to majorly drive the quarters ahead. In the fiscal second quarter, pharmaceutical revenues improved 5.9% to \$35.71 billion on a year-over-year basis. The upside can be attributed to sales growth from Pharmaceutical Distribution and Specialty Solutions customers.

Moreover, Pharmaceutical witnessed an improvement of 4.3% in profits to \$462 million owing to positive performance in the company's generics program and Specialty Solutions business. However, an adverse impact of Pharmaceutical Distribution customer contract renewals partially offset the upside.

▲ **Diversified Product Portfolio:** Cardinal Health's Medical and Pharmaceutical offerings provide the company with a competitive edge in the niche space. The company offers industry expertise and an expanding portfolio of safe products. For example, Cardinal Health's Bathroom Safety, Mobility, and Exam Room Equipment products are exclusively designed for both patients and care givers. With a variety of products ranging from wheelchairs and crutches to exam room tables and commodes, Cardinal Health offers the right mix of medical equipment. Cardinal Health's ECG Monitoring Electrodes offer quality performance and are neoprene-free, lead-free and mercury-free. These are not made with natural rubber latex, and are highly exclusive in the markets.

Per management, for the fiscal year 2019, Specialty business finished strongly around \$19 billion in sales, driven by uniqueness of its product profile. Specialty once again delivered excellent revenues and profits on the back of higher volumes and mix in the fiscal second quarter. Management continues to expect this business to sustain growth.

In April 2019, Cardinal Health Specialty Solutions announced collaboration with PANTHERx Specialty Pharmacy that has been created to cater to growing needs of the market and bolster its cell and gene therapy ability.

▲ **Acquisition Drives Growth:** Cardinal Health follows an acquisition-driven strategy and continues to focus on investment in key growth businesses to gain market traction and boost profits. In recent past, Clayton, Dubilier & Rice and Cardinal Health jointly invested in Brentwood, Tennessee-based naviHealth. Cardinal Health sold a 55 percent stake in naviHealth to the New York City-based private equity firm Clayton Dubilier & Rice (CD&R). naviHealth has always been a strong performer for Cardinal Health. Management at Cardinal Health announced that the company is likely to have a competitive edge in the MedTech space with CD&R as a partner.

In April 2019, Cardinal Health acquired mscripts, a company that specializes in delivering patient adherence and engagement solutions via an innovative, user-friendly mobile and web-based health management platform.

▲ **Cushioned Against Macroeconomic Sluggishness:** Large-cap, diversified healthcare distributors such as Cardinal Health are relatively insulated from macroeconomic uncertainty and a weak economy. Cardinal Health is one of the largest distributors of pharmaceuticals and medical supplies. It has a diversified product portfolio, which is a hedge against the risk of sales shortfall in testing times. In fiscal 2019, Cardinal Health's focused on taking the necessary steps to address the changing industry dynamics to position the pharma distribution business for a long-term growth.

The company's generics business continues to show healthy growth, supported by a solid customer base, significant scale of operation and the competence to source products from a complex and global supply network. Cardinal Health has rationalized the number of generic suppliers. In addition, the company has expanded relationships with generic manufacturers that include several benefits like higher service levels, greater clarity on generic cost of goods sold, and a more consistent product supply with fewer disruptions.

▲ **Long-term Supply Agreements Buoy Optimism:** Cardinal Health is also pursuing growth via joint ventures and long-term supply agreements with several firms. The company entered a long-term strategic agreement with Henry Schein, under which the latter purchased Cardinal Health's medical supplies for physician practices. The collaboration is expected to drive core sales and prove accretive to Cardinal Health's earnings in the long term.

Fred's Inc. also signed a multi-year agreement for Cardinal Health to be the primary supplier of branded and generic pharmaceutical products to all of Fred's more than 360 in-store pharmacies and EIRIS Health Services in the United States in the past.

The signing of a 15-year agreement with Bayer Healthcare for the contract manufacturing of Xofigo is significantly positive. In our opinion, this will help the company leverage its expertise in the nuclear pharmacy industry to expand access to a therapeutic agent and increase the use of radiopharmaceuticals in the U.S. and Canada. The Red Oak Sourcing joint venture with CVS Health, which will negotiate generic pharmaceutical supply contracts on behalf of both companies, also holds significant long-term prospects for Cardinal Health. Cardinal Health extended agreements with CVS Health to distribute pharmaceuticals to retail pharmacies and distribution centers through Jun 30, 2023. In fact, with the recent renewals of CVS Health and Kroger, Cardinal Health now has contracts with three of its largest customers for the next

Cardinal Health's diversified portfolio represent significant long-term opportunities. Further, the company follows an acquisition-driven strategy.

four years.

▲ **Good Client Retention:** The performance of Cardinal Health's Pharmaceutical segment has been facilitated by good client retention, with the loss of only a few key customers (Walgreens and Express Scripts). Cardinal Health has already renewed many of its chain customer contracts for subsequent years. The concentration of suppliers has also been well managed by the company. At the end of third-quarter fiscal 2019, management at Cardinal Health confirmed that its new platforms like at-Home distribution services have witnessed solid client uptake with double digit growth in the quarter. Moreover, both at-Home distribution services, and national brand and services exhibited a solid performance in the fiscal first quarter.

Reasons To Sell:

- ▼ **Weak Trends:** In the fiscal second quarter, as a percentage of revenues, gross margin was 4.3%, down 30 bps on a year-over-year basis. Distribution, selling, general and administrative expenses totaled \$1.16 billion, up 9.3% year over year.

The company reported operating income of \$3.34 billion in the quarter under review, down 33.7% from the year-ago quarter. As a percentage of revenues, operating margin in the reported quarter was 0.8%, down 50 bps on a year-over-year basis.

- ▼ **Probabilities of Loss of a Major Customer:** Cardinal Health faces the risk of losing considerable business in case of loss of a major customer, which in turn will severely impair its revenues in the future. In this regard, post the establishment of a generic sourcing joint venture with CVS Caremark in 2014, Cardinal Health largely depends on the former for over 20% of its revenues. Collectively, five of Cardinal Health's main customers, including CVS, accounted for as much as 40% of its revenues.
- ▼ **Group Purchasing Organizations:** Cardinal Health derives a significant quantum of revenues through agreements with group purchasing organizations (GPOs). These organizations act as agents that negotiate vendor contracts on behalf of their members. The company's largest GPO agents are Asembia, HealthTrust, Innovatix, Intalere, Premier Purchasing Partners, and six more. These GPOs accounted for a significant amount of Cardinal Health's revenues. Loss of relationship with either of these agents will severely affect the company's sales. In addition, some GPOs sell products that compete with distributors.
- ▼ **Integration Risks:** Cardinal Health continues to acquire a large number of companies. While this improves the company's revenue opportunities, it adds to integration risks. The Cordis acquisition was financed through a combination of debt and cash and the \$1 billion debt financing increased leverage in the near term.
- ▼ **Cutthroat Competition in MedTech Space:** Cardinal Health faces tough competition in each of its business segments. For example, its pharmaceutical supply chain business faces competition from McKesson and AmerisourceBergen as well as several smaller medical-surgical distributors such as Henry Schein and Owens & Minor. Moreover, the medical device market is a mature one compared to Cardinal Health's pharmaceutical business. Although Cordis has significant brand presence, we believe growing competition will hurt Cardinal Health's medical segment's margins in the near term.

Cardinal Health has been facing sluggishness in the exam-gloves unit lately. Further, cutthroat competition in the niche space is a headwind.

Last Earnings Report

Cardinal Health Q2 Earnings & Revenues Top Estimates

Cardinal Health, Inc. reported second-quarter fiscal 2020 adjusted earnings of \$1.52 per share, which surpassed the Zacks Consensus Estimate of \$1.21 by 25.6%. Further, the reported figure improved 17.8% year over year.

Revenues increased 5.3% on a year-over-year basis to \$39.74 billion. The figure also beat the Zacks Consensus Estimate by 0.6%.

Quarter Ending **12/2019**

Report Date	Feb 06, 2020
Sales Surprise	0.64%
EPS Surprise	25.62%
Quarterly EPS	1.52
Annual EPS (TTM)	5.49

Segmental Analysis

Pharmaceutical Segment

In the fiscal second quarter, pharmaceutical revenues improved 5.9% to \$35.71 billion on a year-over-year basis. The upside can be attributed to sales growth from Pharmaceutical Distribution and Specialty Solutions customers.

Pharmaceutical witnessed an improvement of 4.3% in profits to \$462 million owing to positive performance in the company's generics program and Specialty Solutions business. However, an adverse impact of Pharmaceutical Distribution customer contract renewals partially offset the upside.

Medical Segment

In the quarter under review, revenues at this segment rose 0.4% to \$4.02 billion on account of growth in Cardinal Health at Home. However, decline in products and distribution partially negated the upside.

Medical segment profit improved 3.7% to \$195 million owing to benefits from cost savings initiatives. However, a decline in products and distribution partially offset the upside.

Margin Analysis

Gross profit dipped 0.9% year over year to \$1.74 billion.

As a percentage of revenues, gross margin in the reported quarter was 4.3%, down 30 basis points (bps) on a year-over-year basis.

Distribution, selling, general and administrative expenses totaled \$1.16 billion, up 9.3% year over year. Adjusted operating income totaled \$646 million, up 1.4% from the year-ago quarter.

The company reported operating income of \$3.34 billion in the quarter under review, down 33.7% from the year-ago quarter. As a percentage of revenues, operating margin in the reported quarter was 0.8%, down 50 bps on a year-over-year basis.

Financial Update

As of Dec 31, 2019, cash and cash equivalents amounted to \$1.21 billion, up 36.9% sequentially.

Cumulative cash from operating activities totaled \$697 million at end of the fiscal second quarter, compared with \$372 million in the year-ago quarter.

2020 Guidance Raised

The company has raised fiscal 2020 adjusted earnings per share, which will now range between \$5.20 and \$5.40 (up from the previously guided range of \$4.85-\$5.10). The Zacks Consensus Estimate is pegged at \$5.06 per share.

Valuation

Cardinal Health's shares are up 15.2% and 10.6% in the year-to-date period and the trailing 12-month periods, respectively. Stocks in the Zacks sub-industry and the Zacks Medical sector are up 6.1% and 2.9% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 1.1% and 5.3%, respectively.

The S&P 500 index is up 3.4% in the year-to-date period and 22.1% in the past year.

The stock is currently trading at 11.19X Forward 12-months earnings, which compares to 18.27X for the Zacks sub-industry, 21.56X for the Zacks sector and 19.09X for the S&P 500 index.

Over the past five years, the stock has traded as high as 19.47X and as low as 8.12X, with a 5-year median of 12.95X.

Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$61 price target reflects 11.71X forward 12-months earnings.

The table below shows summary valuation data for CAH.

Valuation Multiples - CAH					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	11.19	18.27	21.56	19.09
	5-Year High	19.47	19.99	21.56	19.34
	5-Year Low	8.12	13.7	15.84	15.18
	5-Year Median	12.95	16.63	18.9	17.46
P/S F12M	Current	0.11	0.37	2.89	3.54
	5-Year High	0.29	0.37	3.82	3.54
	5-Year Low	0.08	0.23	2.44	2.54
	5-Year Median	0.16	0.28	2.95	3
P/B TTM	Current	18.87	4.69	4.64	4.54
	5-Year High	18.87	4.93	5.03	4.54
	5-Year Low	1.97	2.53	3.43	2.85
	5-Year Median	3.58	3.45	4.3	3.62

As of 02/06/2020

Industry Analysis Zacks Industry Rank: Top 34% (87 out of 255)



Top Peers

Owens & Minor, Inc. (OMI)	Outperform
AmerisourceBergen Corporation (ABC)	Neutral
Becton, Dickinson and Company (BDX)	Neutral
Herbalife LTD. (HLF)	Neutral
Henry Schein, Inc. (HSIC)	Neutral
McKesson Corporation (MCK)	Neutral
Nu Skin Enterprises, Inc. (NUS)	Neutral
Thermo Fisher Scientific Inc. (TMO)	Neutral

Industry Comparison Industry: Medical - Dental Supplies				Industry Peers		
	CAH Neutral	X Industry	S&P 500	MCK Neutral	OMI Outperform	TMO Neutral
VGM Score	A	-	-	A	A	C
Market Cap	17.04 B	1.46 B	24.40 B	28.01 B	401.62 M	133.13 B
# of Analysts	8	5	13	7	2	9
Dividend Yield	3.30%	0.00%	1.75%	1.04%	0.16%	0.23%
Value Score	A	-	-	A	A	C
Cash/Price	0.08	0.06	0.04	0.05	0.25	0.02
EV/EBITDA	7.41	11.73	14.17	9.01	13.78	21.05
PEG Ratio	1.85	1.92	2.05	1.52	NA	1.76
Price/Book (P/B)	17.01	4.08	3.31	4.39	0.82	4.49
Price/Cash Flow (P/CF)	6.71	12.84	13.63	5.33	0.65	18.36
P/E (F1)	11.45	21.30	19.08	10.73	9.00	24.40
Price/Sales (P/S)	0.11	1.58	2.67	0.12	0.04	5.21
Earnings Yield	8.74%	3.63%	5.24%	9.32%	11.11%	4.10%
Debt/Equity	6.73	0.32	0.71	1.33	3.57	0.58
Cash Flow (\$/share)	8.69	1.80	6.89	29.73	9.83	18.08
Growth Score	C	-	-	B	A	B
Hist. EPS Growth (3-5 yrs)	3.56%	8.88%	10.80%	4.30%	-20.73%	13.63%
Proj. EPS Growth (F1/F0)	-3.60%	10.76%	7.23%	8.76%	29.09%	10.19%
Curr. Cash Flow Growth	-0.80%	9.29%	9.51%	-1.89%	289.83%	6.99%
Hist. Cash Flow Growth (3-5 yrs)	7.74%	12.65%	8.55%	16.28%	29.15%	10.08%
Current Ratio	1.03	1.70	1.20	0.98	1.74	1.91
Debt/Capital	87.06%	26.85%	42.90%	60.82%	78.11%	36.53%
Net Margin	-2.81%	4.08%	11.76%	-0.41%	-2.88%	14.47%
Return on Equity	45.21%	15.72%	16.98%	36.40%	4.89%	17.24%
Sales/Assets	3.70	1.02	0.54	3.73	2.60	0.45
Proj. Sales Growth (F1/F0)	4.90%	5.42%	4.15%	6.52%	-1.26%	5.40%
Momentum Score	A	-	-	C	A	F
Daily Price Chg	10.59%	0.00%	-0.11%	4.06%	3.06%	-0.15%
1 Week Price Chg	-4.85%	-1.10%	-2.60%	-6.56%	-0.16%	-6.14%
4 Week Price Chg	15.82%	4.98%	1.51%	12.05%	27.55%	0.73%
12 Week Price Chg	6.41%	7.37%	5.63%	9.45%	-2.89%	10.36%
52 Week Price Chg	7.39%	7.79%	17.01%	21.23%	-15.48%	36.68%
20 Day Average Volume	3,069,320	318,989	1,961,054	1,350,476	1,716,107	1,486,702
(F1) EPS Est 1 week change	5.98%	0.00%	0.00%	0.25%	0.00%	-0.01%
(F1) EPS Est 4 week change	6.11%	0.00%	-0.00%	2.18%	3.33%	0.15%
(F1) EPS Est 12 week change	6.40%	0.00%	-0.16%	2.20%	3.33%	-0.03%
(Q1) EPS Est Mthly Chg	-1.00%	0.00%	0.00%	1.00%	7.69%	-4.27%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	C
Momentum Score	A
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.