



COMPANY SPOTLIGHT:

Cardinal Health Inc.

COMPANY DESCRIPTION

Headquartered in Dublin, OH, Cardinal Health is a pharmaceutical distribution and medical device company. The company provides its services to healthcare providers, pharmacies, and pharmaceutical manufacturers.

With the company since 1990, Mike Kaufmann became CEO on January 1, 2018.

COMPANY HIGHLIGHTS AND FINANCIALS

Cardinal Health is the third largest pharmaceutical distribution company by revenue behind McKesson and AmerisourceBergen. The company is the largest supplier to CVS pharmacies. In 2014, the two companies started a joint venture for generic drug sourcing and distribution, forming the largest generic drug sourcing entity in the US. The high barriers to entry in this space allows Cardinal Health to produce consistent and stable operating results as their large distribution network would be hard to emulate for a new company entering the market. In recent years, the company

has expanded into medical device manufacturing and distribution via internal development and acquisition of Medtronic's patient recovery business (professional products for patient care). This 2017 acquisition furthers their focus on higher margin medical products and distribution, generating roughly \$2.4 billion in additional sales. The acquisition will complement the company's strong supply chain management and large customer relationships allowing them to generate significant cash flows even in a low margin business.

VALUATION AND RISKS

Cardinal Health is trading at a discount compared to its historical valuations and below fair value based on scenario analysis of free cash flow growth. Cardinal Health has a dividend yield of 2.75% and generates over \$1.5 billion in free cash flow to give them the flexibility to continue to raise their dividend over time. On a free cash flow basis, we expect the company to grow cash flow at 3.0% annually over the next decade. This is below its historical

KEY POINTS

- :: A leader in pharmaceutical distribution services.
- :: High barriers to entry allows for consistent cash flow generation and high operational efficiency.
- :: Good financial health with over \$1.2 billion in cash and net debt to capital of 50%.
- :: Compelling upside as valuations and growth remain attractive.
- :: Consistent and growing dividend with a yield of 2.75%.

growth rate due to higher pricing pressure on pharmaceuticals and high revenue concentration. Modeling our conservative assumption places a price of \$80 on shares, which is almost a 21% premium, based on the price as of the date of this report. If our conservative assumptions turn out to be overly optimistic, we feel there is a margin of safety built into the current price based on the company's high returns on capital and strong cash flow generation.

Though Cardinal Health has only two main competitors in the pharmaceutical distribution business, it is a highly competitive environment. We would like to see continued discipline in regard to capital spending while continuing to grow their dividend. Continued focus on the company's revenue breakdown, along with integration among its recent acquisition, will be areas to monitor closely.

Weighing the potential rewards and risks, we are optimistic that Cardinal Health will be a good long-term investment.

—Patrick Mason, Investment Analyst, Cairn Investment Group



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