



Cardinal Health Inc. (CAH)

Updated August 8th, 2019 by Eli Inkrot

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|---------------------------------|-------|
| Current Price: | \$44 | 5 Year CAGR Estimate: | 15.8% | Volatility Percentile: | 79.5% |
| Fair Value Price: | \$60 | 5 Year Growth Estimate: | 5.0% | Momentum Percentile: | 36.0% |
| % Fair Value: | 73% | 5 Year Valuation Multiple Estimate: | 6.4% | Growth Percentile: | 37.6% |
| Dividend Yield: | 4.4% | 5 Year Price Target | \$76 | Valuation Percentile: | 90.9% |
| Dividend Risk Score: | A | Retirement Suitability Score: | A | Total Return Percentile: | 87.4% |

Overview & Current Events

Dublin, Ohio-based Cardinal Health is one of the “Big 3” drug distribution companies along with McKesson (MCK) and AmerisourceBergen (ABC). Cardinal Health serves over 24,000 United States pharmacies and more than 85% of the country’s hospitals. The company has operations in 46 countries with approximately 50,000 employees. With 32 years of consecutive dividend increases, the \$13 billion market cap company is a member of the Dividend Aristocrats Index.

On August 8th, 2019 Cardinal Health released Q4 and full year fiscal 2019 results for the period ending June 30th, 2019. For the quarter Cardinal Health reported revenue of \$37.4 billion, representing a 5.9% increase compared to the \$35.3 billion posted in Q4 of fiscal year 2018. On the bottom line adjusted net income equaled \$334 million or \$1.11 per share compared to \$315 million or \$1.01 per share in the year ago period, increases of 6% and 9.9% respectively. For the year Cardinal Health reported \$145.5 billion in revenue, representing a 6.4% increase compared to the \$136.8 billion generated in fiscal year 2018. This year adjusted net income totaled \$1.6 billion or \$5.28 per share compared to \$1.6 billion or \$5.00 per share last year, helped by a significantly lower share count.

Cardinal Health operates in two segments: pharmaceutical and medical. The pharmaceutical segment makes up the lion’s share of revenues (~89%), but the medical segment remains important due to its higher margins and growth potential. The pharmaceutical segment reported \$129.9 billion in revenue and \$1.8 billion in profit for the year, while the medical segment generated \$15.6 billion in sales and \$576 million in profit.

Cardinal Health also provided a new fiscal year 2020 outlook. The company expects adjusted earnings-per-share to come in between \$4.85 and \$5.10 for the year.

Growth on a Per-Share Basis

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|---------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| EPS | \$2.22 | \$2.67 | \$3.21 | \$3.73 | \$3.84 | \$4.38 | \$5.24 | \$5.40 | \$5.00 | \$5.28 | \$4.98 | \$6.36 |
| DPS | \$0.74 | \$0.82 | \$0.88 | \$1.09 | \$1.25 | \$1.41 | \$1.61 | \$1.81 | \$1.86 | \$1.91 | \$1.92 | \$2.22 |
| Shares | 356 | 351 | 343 | 340 | 337 | 328 | 322 | 316 | 309 | 301 | 295 | 275 |

Note that Cardinal Health’s financial results around 2009 / 2010 were *materially* impacted by its spinoff of CareFusion Corporation, which was completed on September 1, 2009. Despite this spinoff, the company’s segment revenues, segment earnings and dividend continued to grow during this time. In addition, adjusted earnings are used above.

Since 2010 the company has compounded both earnings-per-share and its dividend by a double-digit rate. Moving forward we do not anticipate this sort of growth, especially considering the slowdown in earnings improvement as of late. Instead we have assumed 5% intermediate-term earnings growth with a payout ratio under 40% over the next 5 years. This view could very well turn out to be conservative, especially with the company’s penchant for share repurchases, but given the firm’s recent earnings performance and hot-topic drug pricing environment we are cautious for now.



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Valuation Analysis

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Now | 2025 |
|-----------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| Avg. P/E | 15.1 | 17.0 | 13.1 | 12.7 | 17.9 | 19.1 | 14.9 | 14.4 | 14.6 | 9.5 | 8.8 | 12.0 |
| Avg. Yld. | 2.1% | 1.8% | 2.1% | 2.3% | 1.8% | 1.7% | 2.1% | 2.3% | 2.9% | 3.8% | 4.4% | 2.9% |

Cardinal Health has traded hands with an average P/E ratio of about 14 or 15 times earnings dating back to 2010. However, this was during a time when growth was much more robust. We have used a multiple of 12 times earnings as a starting place for fair value in recognition of our lower anticipated growth rate. Even so, it appears that there is ample valuation improvement potential from this point.

The dividend yield has now eclipsed 4% due partly to an expanding payout ratio, but mostly as a result of a lower share price. While the pace of dividend growth has slowed, the starting yield is solid.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|--------|------|------|------|------|------|------|------|------|------|------|------------|------------|
| Payout | 33% | 31% | 27% | 29% | 33% | 32% | 31% | 34% | 37% | 36% | 39% | 35% |

Collectively the three major pharmaceutical wholesalers have a competitive advantage in the industry. Competition is held at bay by the massive scale already in place and the exceptionally low margins.

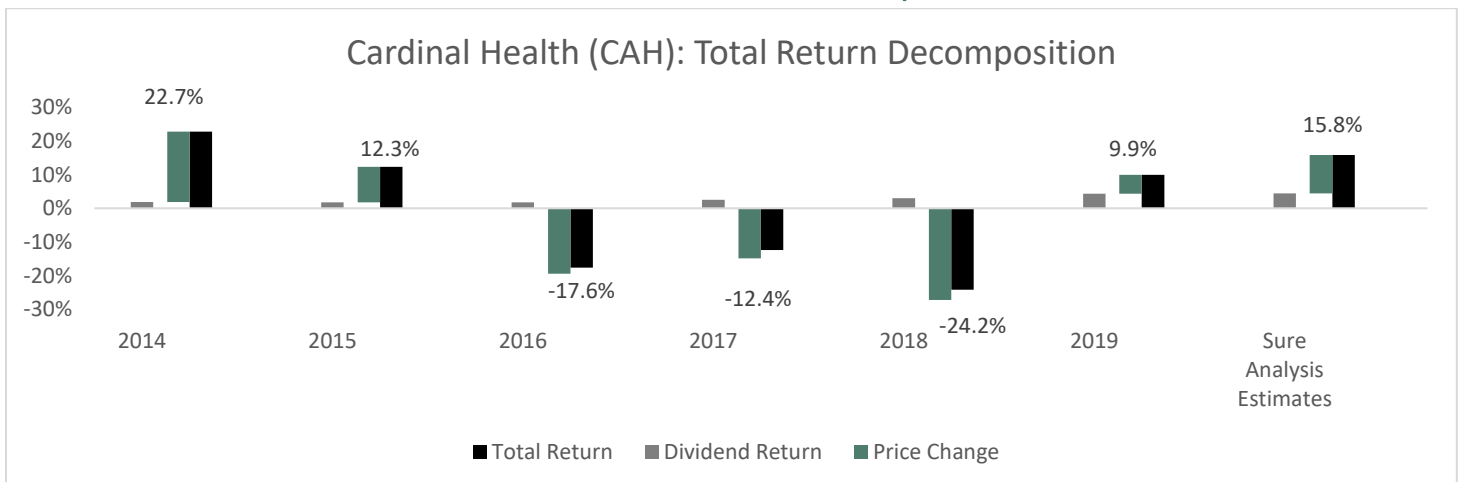
Cardinal Health has proven itself to be a solid operator in many ways – strong earnings for the past decade, a growing dividend and ample interest coverage. The dividend payout ratio has ticked up slightly, but it still represents less than 40% of profits. In turn, the company has the ability to repurchase a meaningful amount of shares.

As of the most recent report the company held \$2.5 billion in cash, \$25.7 billion in current assets and \$40.9 billion in total assets (29% of which is goodwill) against \$24.1 billion in current liabilities and \$34.6 billion in total liabilities. Long-term obligations stood at \$7.6 billion against underlying annual earnings power of ~\$1.5 billion.

Final Thoughts & Recommendation

Shares are down 6% since our last update. We see total return potential of 15.8% per annum stemming from a 5% growth rate, 4.4% dividend yield and 6.4% valuation tailwind. While there are risks – namely political pressure and the low margin business – the dividend is well covered and the balance sheet is in reasonable shape. We believe shares are offering an attractive value proposition and therefore shares earn a buy rating at the current quotation.

Total Return Breakdown by Year



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Disclosure: This analyst is long the security discussed in this research report.



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Income Statement Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-------------------------|------|------|------|------|------|------|------|------|------|------|
| Revenue (\$B) | 95 | 99 | 103 | 108 | 101 | 91 | 103 | 122 | 130 | 137 |
| Gross Profit | 3748 | 3781 | 4162 | 4541 | 4921 | 5161 | 5712 | 6543 | 6544 | 7181 |
| Gross Margin | 3.9% | 3.8% | 4.1% | 4.2% | 4.9% | 5.7% | 5.6% | 5.4% | 5.0% | 5.2% |
| SG&A Exp. | 2334 | 2397 | 2528 | 2677 | 2875 | 3028 | 3240 | 3648 | 3775 | 4596 |
| D&A Exp. | 226 | 254 | 313 | 325 | 397 | 459 | 451 | 641 | 717 | 1032 |
| Operating Profit | 1414 | 1365 | 1544 | 1831 | 1888 | 1910 | 2191 | 2436 | 2242 | 1878 |
| Operating Margin | 1.5% | 1.4% | 1.5% | 1.7% | 1.9% | 2.1% | 2.1% | 2.0% | 1.7% | 1.4% |
| Net Profit | 1152 | 642 | 959 | 1069 | 334 | 1166 | 1215 | 1427 | 1288 | 256 |
| Net Margin | 1.2% | 0.7% | 0.9% | 1.0% | 0.3% | 1.3% | 1.2% | 1.2% | 1.0% | 0.2% |
| Free Cash Flow | 1016 | 1874 | 1104 | 916 | 1532 | 2275 | 2240 | 2506 | 797 | 2384 |
| Income Tax | 402 | 625 | 552 | 628 | 553 | 635 | 755 | 845 | 630 | -487 |

Balance Sheet Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets | 25119 | 19990 | 22846 | 24260 | 25819 | 26033 | 30142 | 34122 | 40112 | 39951 |
| Cash & Equivalents | 1222 | 2755 | 1929 | 2274 | 1901 | 2865 | 4616 | 2356 | 6879 | 1763 |
| Acc. Receivable | 5215 | 5171 | 6156 | 6355 | 6304 | 5380 | 6523 | 7405 | 8048 | 7800 |
| Inventories | 6833 | 6356 | 7334 | 7864 | 8373 | 8266 | 9211 | 10615 | 11301 | 12308 |
| Goodwill & Int. | 2267 | 2253 | 4259 | 4392 | 5574 | 5870 | 6018 | 9426 | 9207 | 12229 |
| Total Liabilities | 16394 | 14714 | 16997 | 18016 | 19844 | 19632 | 23886 | 27551 | 33284 | 33892 |
| Accounts Payable | 9042 | 9495 | 11332 | 11726 | 12295 | 12149 | 14368 | 17306 | 17906 | 19677 |
| Long-Term Debt | 366 | 2129 | 2502 | 2894 | 3854 | 3972 | 5492 | 5539 | 10395 | 9013 |
| Total Equity | 8725 | 5276 | 5849 | 6244 | 5975 | 6401 | 6256 | 6554 | 6808 | 6059 |
| D/E Ratio | 0.04 | 0.40 | 0.43 | 0.46 | 0.65 | 0.62 | 0.88 | 0.85 | 1.53 | 1.49 |

Profitability & Per Share Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Return on Assets | 4.7% | 2.8% | 4.5% | 4.5% | 1.3% | 4.5% | 4.3% | 4.4% | 3.5% | 0.6% |
| Return on Equity | 14.0% | 9.2% | 17.2% | 17.7% | 5.5% | 18.8% | 19.2% | 22.3% | 19.3% | 4.0% |
| ROIC | 11.1% | 7.8% | 12.2% | 12.2% | 3.5% | 11.5% | 11.0% | 12.0% | 8.8% | 1.6% |
| Shares Out. | 356 | 351 | 343 | 340 | 337 | 328 | 322 | 316 | 309 | 301 |
| Revenue/Share | 265.54 | 272.86 | 290.78 | 308.17 | 293.88 | 264.01 | 306.06 | 368.32 | 406.18 | 434.31 |
| FCF/Share | 2.81 | 5.19 | 3.13 | 2.62 | 4.45 | 6.59 | 6.69 | 7.59 | 2.49 | 7.57 |

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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