



Cardinal Health Inc. (CAH)

Updated February 7th, 2020 by Eli Inkrot

Key Metrics

Current Price:	\$59	5 Year CAGR Estimate:	5.0%	Market Cap:	\$17.3B
Fair Value Price:	\$53	5 Year Growth Estimate:	4.0%	Ex-Dividend Date¹:	03/29/20
% Fair Value:	111%	5 Year Valuation Multiple Estimate:	-2.0%	Dividend Payment Date¹:	04/15/20
Dividend Yield:	3.3%	5 Year Price Target	\$64	Years Of Dividend Growth:	32
Dividend Risk Score:	A	Retirement Suitability Score:	A	Last Dividend Increase:	1.0%

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 \$17 billion market cap company is a member of the Dividend Aristocrats Index.

On February 6th, 2020 Cardinal Health released Q2 fiscal year 2020 results for the period ending December 31st, 2019. (Cardinal Health’s fiscal year ends June 30th.) For the quarter Cardinal Health reported revenue of \$39.7 billion, representing a 5% increase compared to the \$37.7 billion posted in Q2 fiscal year 2019. Operating income equaled \$334 million compared to \$504 million previously, which included a -\$96 million charge related to surgical gown recalls. Adjusted earnings equaled \$448 million or \$1.52 per share compared to \$385 million or \$1.29 per share prior.

Cardinal Health operates in two segments: pharmaceutical and medical. The pharmaceutical segment makes up the lion’s share of revenues (~90%), but the medical segment remains important due to its higher margins and growth potential. The pharmaceutical segment reported \$35.7 billion in revenue (+6%) and \$462 million in profit (+4%) for the quarter, while the medical segment generated \$4.0 billion in sales (+0%) and \$195 million in adjusted profit (+4%).

Cardinal Health also updated its fiscal year 2020 outlook, expecting EPS of \$5.20 to \$5.40 (from \$4.85 - \$5.10).

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	\$5.30	\$6.45
DPS	\$0.74	\$0.82	\$0.88	\$1.09	\$1.25	\$1.41	\$1.61	\$1.81	\$1.86	\$1.91	\$1.92	\$2.28
Shares²	356	351	343	340	337	328	322	316	309	298	294	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 4% intermediate-term earnings growth. 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, opioid litigation and hot-topic drug pricing environment we are cautious for now.

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	11.1	10.0
Avg. Yld.	2.1%	1.8%	2.1%	2.3%	1.8%	1.7%	2.1%	2.3%	2.9%	3.8%	3.3%	3.5%

¹ Estimate

² In millions.

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



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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 10 times earnings as a starting place for fair value in recognition of our lower anticipated growth rate and risks in the industry. Given the current valuation of 11.1 times our estimate of this year's earnings, this implies a small valuation headwind.

The dividend yield is now fairly robust partly due to an expanding payout ratio, but mostly as a result of a lower share price in the last few years. 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%	36%	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.

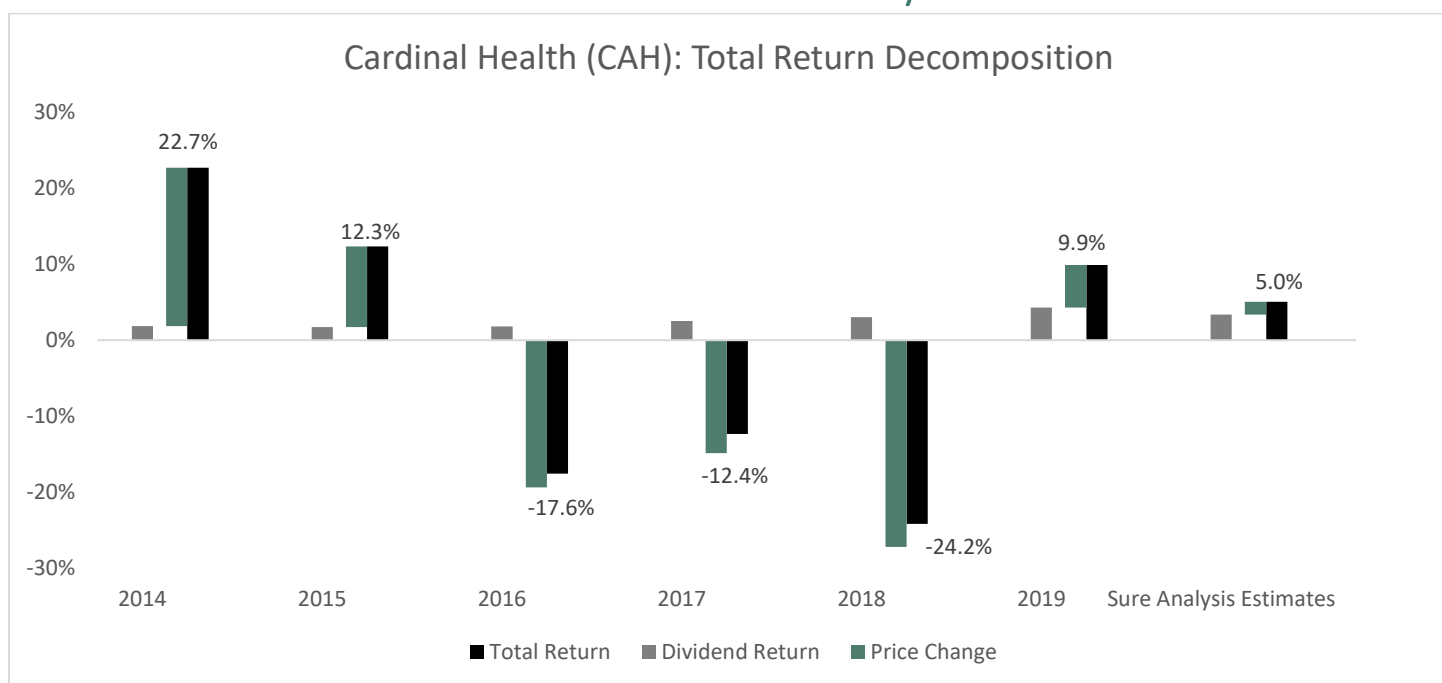
Cardinal Health has proven itself to be a solid operator in many ways – strong earnings for the past decade, a growing dividend and ample interest coverage. The dividend payout ratio has ticked up slightly, but it still represents less than 40% of profits. In turn, the company has the ability to repurchase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

As of the most recent report the company held \$1.7 billion in cash, \$25.7 billion in current assets and \$41.0 billion in total assets (28% of which is goodwill) against \$24.9 billion in current liabilities and \$40.0 billion in total liabilities. Long-term obligations stood at \$6.7 billion against underlying annual earnings power of ~\$1.5 billion.

Final Thoughts & Recommendation

Shares are up 9% since our last report. Total return potential comes in at 5.0% per annum, stemming from a 4% growth rate and 3.3% dividend yield offset by a small valuation headwind. There are risks to the business - namely political pressure, opioid litigation and the low margin business – but the dividend is well covered, and the balance sheet is in reasonable shape. Due to the current valuation, we are reiterating our hold rating.

Total Return Breakdown by Year



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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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