

# Cardinal Health Inc. (CAH)

Updated August 6<sup>th</sup>, 2020 by Eli Inkrot

## Key Metrics

<b>Current Price:</b>	\$53	<b>5 Year CAGR Estimate:</b>	7.6%	<b>Market Cap:</b>	\$16 B
<b>Fair Value Price:</b>	\$55	<b>5 Year Growth Estimate:</b>	4.0%	<b>Ex-Dividend Date<sup>1</sup>:</b>	09/30/20
<b>% Fair Value:</b>	98%	<b>5 Year Valuation Multiple Estimate:</b>	0.4%	<b>Dividend Payment Date<sup>1</sup>:</b>	10/15/20
<b>Dividend Yield:</b>	3.6%	<b>5 Year Price Target</b>	\$66	<b>Years Of Dividend Growth:</b>	33
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	A	<b>Last Dividend Increase:</b>	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 33 years of consecutive dividend increases, the \$16 billion market cap company is a member of the Dividend Aristocrats Index.

On August 6<sup>th</sup>, 2020 Cardinal Health released Q4 and full year fiscal 2020 results for the period ending June 30<sup>th</sup>, 2020. For the quarter Cardinal Health reported revenue of \$36.7 billion, representing a -2% decline compared to the \$37.4 billion posted in Q4 fiscal year 2019. Adjusted earnings equaled \$305 million or \$1.04 per share compared to \$334 million or \$1.11 per share in Q4 2019. For the year the company reported revenue of \$152.9 billion, a 5% increase compared to the \$145.5 billion posted in fiscal 2019. Adjusted earnings equaled \$1.6 billion or \$5.45 per share (above prior guidance of \$5.20 to \$5.40) compared to \$5.28 last year.

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. For the quarter the Pharmaceutical segment reported \$33.2 billion in revenue (flat) and \$359 million in profit (-20%), while the Medical segment generated \$3.5 billion in sales (-13%) and \$120 million in profit (+24%). For the year the Pharmaceutical segment reported \$137.5 billion in sales (+6%) and \$1.8 billion in profit (-4%), while the Medical segment generated \$15.4 billion in sales (-1%) and \$663 million in profit (+15%).

Cardinal Health also provided a fiscal year 2021 outlook. The company expects \$5.25 to \$5.65 in adjusted earnings-per-share, \$190 million to \$215 million in interest, 292 million to 296 million outstanding shares and \$400 million to \$450 million in capital expenditures. We have initiated our forecast accordingly.

## Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
<b>EPS</b>	\$2.67	\$3.21	\$3.73	\$3.84	\$4.38	\$5.24	\$5.40	\$5.00	\$5.28	\$5.45	<b>\$5.45</b>	<b>\$6.63</b>
<b>DPS</b>	\$0.82	\$0.88	\$1.09	\$1.25	\$1.41	\$1.61	\$1.81	\$1.86	\$1.91	\$1.92	<b>\$1.94</b>	<b>\$2.30</b>
<b>Shares<sup>2</sup></b>	351	343	340	337	328	322	316	309	298	294	<b>294</b>	<b>290</b>

Since 2010 Cardinal Health has compounded both earnings-per-share and its dividend by about 10% annually. 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, from management’s midpoint of flat guidance for fiscal year 2021. This view could very well turn out to be conservative, especially with the company’s penchant for share repurchases. However, given the firm’s recent earnings performance, opioid litigation and hot-topic drug pricing environment we are cautious for now. In addition, while the COVID-19 pandemic has helped results in the short-term, the long-term outlook remains quite uncertain. That being said, we are encouraged by management comments related to elective procedures coming back and a material increase in personal protective equipment (PPE) demand.

<sup>1</sup> Estimate

<sup>2</sup> In millions.

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

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## Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	17.0	13.1	12.7	17.9	19.1	14.9	14.4	14.6	9.5	9.2	9.8	10.0
Avg. Yld.	1.8%	2.1%	2.3%	1.8%	1.7%	2.1%	2.3%	2.9%	3.8%	3.8%	3.6%	3.5%

Cardinal Health has traded hands with an average P/E ratio of about 14 times earnings dating back to 2011. 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 near 10 times our estimate of this year's earnings, this implies little impact from the valuation.

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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	31%	27%	29%	33%	32%	31%	34%	37%	36%	35%	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.

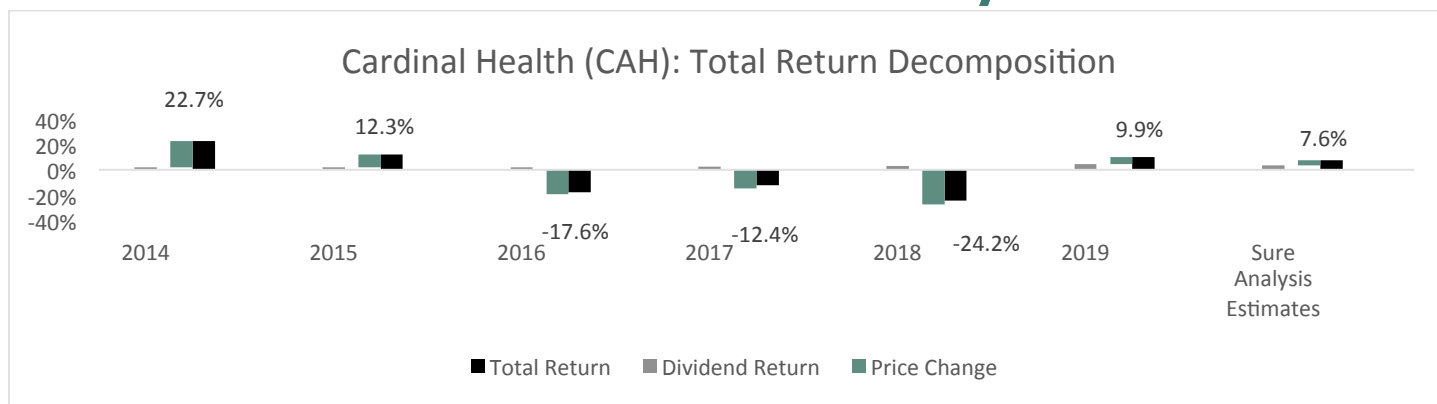
Cardinal Health has proven itself to be a solid operator in many ways – strong earnings for the past decade, a growing dividend and ample interest coverage. The dividend payout ratio has ticked up slightly, but it still represents less than 40% of profits. In turn, the company has the ability to repurchase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

As of the most recent report the company held \$2.8 billion in cash, \$25.9 billion in current assets and \$40.8 billion in total assets (28% of which is goodwill) against \$23.6 billion in current liabilities and \$39.0 billion in total liabilities. Long-term obligations stood at \$6.8 billion against underlying annual earnings power of ~\$1.6 billion.

## Final Thoughts & Recommendation

Shares are up marginally since our last report. Total return potential comes in at 7.6% per annum, stemming from a 4% growth rate, a 3.6% dividend yield and a small valuation tailwind. There are risks to the business - namely political pressure, opioid litigation, the ongoing COVID-19 pandemic 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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue (\$B)	99	103	108	101	91	103	122	130	137	
Gross Profit	3781	4162	4541	4921	5161	5712	6543	6544	7181	
Gross Margin	3.8%	4.1%	4.2%	4.9%	5.7%	5.6%	5.4%	5.0%	5.2%	
SG&A Exp.	2397	2528	2677	2875	3028	3240	3648	3775	4596	
D&A Exp.	254	313	325	397	459	451	641	717	1032	
Operating Profit	1365	1544	1831	1888	1910	2191	2436	2242	1878	
Operating Margin	1.4%	1.5%	1.7%	1.9%	2.1%	2.1%	2.0%	1.7%	1.4%	
Net Profit	642	959	1069	334	1166	1215	1427	1288	256	
Net Margin	0.7%	0.9%	1.0%	0.3%	1.3%	1.2%	1.2%	1.0%	0.2%	
Free Cash Flow	1874	1104	916	1532	2275	2240	2506	797	2384	
Income Tax	625	552	628	553	635	755	845	630	-487	

## Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	19990	22846	24260	25819	26033	30142	34122	40112	39951	
Cash & Equivalents	2755	1929	2274	1901	2865	4616	2356	6879	1763	
Acc. Receivable	5171	6156	6355	6304	5380	6523	7405	8048	7800	
Inventories	6356	7334	7864	8373	8266	9211	10615	11301	12308	
Goodwill & Int.	2253	4259	4392	5574	5870	6018	9426	9207	12229	
Total Liabilities	14714	16997	18016	19844	19632	23886	27551	33284	33892	
Accounts Payable	9495	11332	11726	12295	12149	14368	17306	17906	19677	
Long-Term Debt	2129	2502	2894	3854	3972	5492	5539	10395	9013	
Total Equity	5276	5849	6244	5975	6401	6256	6554	6808	6059	
D/E Ratio	0.40	0.43	0.46	0.65	0.62	0.88	0.85	1.53	1.49	

## Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	2.8%	4.5%	4.5%	1.3%	4.5%	4.3%	4.4%	3.5%	0.6%	
Return on Equity	9.2%	17.2%	17.7%	5.5%	18.8%	19.2%	22.3%	19.3%	4.0%	
ROIC	7.8%	12.2%	12.2%	3.5%	11.5%	11.0%	12.0%	8.8%	1.6%	
Shares Out.	351	343	340	337	328	322	316	309	301	
Revenue/Share	272.86	290.78	308.17	293.88	264.01	306.06	368.32	406.18	434.31	
FCF/Share	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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