



Cardinal Health Inc. (CAH)

Updated November 5th, 2020 by Eli Inkrot

Key Metrics

Current Price:	\$53	5 Year CAGR Estimate:	7.9%	Market Cap:	\$16 B
Fair Value Price:	\$58	5 Year Growth Estimate:	3.0%	Ex-Dividend Date¹:	12/31/20
% Fair Value:	92%	5 Year Valuation Multiple Estimate:	1.7%	Dividend Payment Date¹:	01/15/21
Dividend Yield:	3.6%	5 Year Price Target	\$67	Years Of Dividend Growth:	33
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 33 years of consecutive dividend increases, the \$16 billion market cap company is a member of the Dividend Aristocrats Index.

On November 5th, 2020 Cardinal Health released Q1 fiscal year 2021 results for the period ending September 30th, 2020. (Cardinal Health’s fiscal year ends June 30th.) For the quarter the company reported revenue of \$39.1 billion, representing a 5% increase compared to Q1 2020. Cardinal Health reported a net loss of -\$624 million for the quarter, however this included -\$1.0 billion in charges related to the opioid litigation settlement. On an adjusted basis the company posted earnings of \$445 million or \$1.51 per share compared to \$378 million or \$1.27 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. For the quarter the Pharmaceutical segment reported \$35.1 billion in revenue (up 5%) and \$402 million in profit (up 1%), while the Medical segment generated \$4.0 billion in sales (+1%) and \$230 million in profit (+36%).

Cardinal Health also updated its fiscal year 2021 outlook. The company now expects \$5.65 to \$5.95 in adjusted earnings-per-share, compared to \$5.25 to \$5.65 previously. The increased guidance reflects a combination of lower than expected COVID-19 headwinds and cost savings. We have updated our forecast accordingly.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$2.67	\$3.21	\$3.73	\$3.84	\$4.38	\$5.24	\$5.40	\$5.00	\$5.28	\$5.45	\$5.80	\$6.72
DPS	\$0.82	\$0.88	\$1.09	\$1.25	\$1.41	\$1.61	\$1.81	\$1.86	\$1.91	\$1.92	\$1.94	\$2.30
Shares²	351	343	340	337	328	322	316	309	298	294	293	280

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 in the last few years; although recent guidance has been more encouraging.

We are forecasting 3% intermediate-term earnings growth, from management’s new midpoint guidance of 6.4% growth compared to fiscal year 2020. Our subdued growth rate view could turn out to be conservative, especially with the company’s penchant for share repurchases. However, given the company’s earnings performance in 2016 - 2020, ongoing 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. Cardinal Health is holding up well in the pandemic.

¹ Estimate

² 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	9.2	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%	3.4%

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 9 times our estimate of this year's earnings, this implies the possibility of a small valuation tailwind.

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%	33%	34%

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.

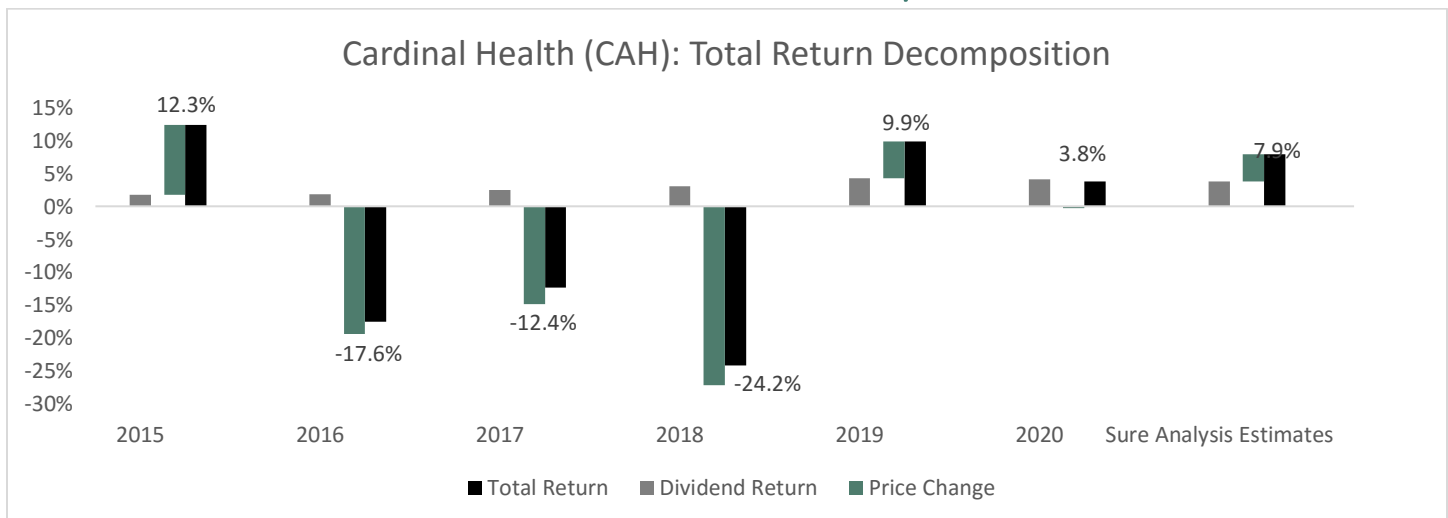
Cardinal Health has proven itself to be a solid operator in many ways – strong earnings for the past decade, a growing dividend and ample interest coverage. The dividend payout ratio has ticked up slightly, but it still represents less than 40% of profits. In turn, the company has the ability to repurchase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

As of the most recent report the company held \$2.7 billion in cash, \$27.0 billion in current assets and \$41.7 billion in total assets (27% of which is goodwill) against \$24.0 billion in current liabilities and \$40.3 billion in total liabilities. Long-term obligations stood at \$6.7 billion against underlying annual earnings power of ~\$1.7 billion.

Final Thoughts & Recommendation

Shares are more or less unchanged since our last report. Total return potential comes in at 7.9% per annum, stemming from a 3% 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. 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)	102.6	107.5	101.1	91.18	102.5	121.5	130.0	136.8	145.5	152.9
Gross Profit	4162	4541	4921	5161	5712	6543	6544	7181	6834	6868
Gross Margin	4.1%	4.2%	4.9%	5.7%	5.6%	5.4%	5.0%	5.2%	4.7%	4.5%
SG&A Exp.	2528	2677	2875	3028	3240	3648	3775	4596	4480	4572
D&A Exp.	313	325	397	459	451	641	717	1032	1000	913
Operating Profit	1544	1831	1888	1910	2191	2436	2242	1878	1733	1772
Operating Margin	1.5%	1.7%	1.9%	2.1%	2.1%	2.0%	1.7%	1.4%	1.2%	1.2%
Net Profit	959	1069	334	1166	1215	1427	1288	256	1363	-3696
Net Margin	0.9%	1.0%	0.3%	1.3%	1.2%	1.2%	1.0%	0.2%	0.9%	-2.4%
Free Cash Flow	1104	916	1532	2275	2240	2506	797	2384	2394	1585
Income Tax	552	628	553	635	755	845	630	-487	386	-79

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	22846	24260	25819	26033	30142	34122	40112	39951	40963	40766
Cash & Equivalents	1929	2274	1901	2865	4616	2356	6879	1763	2531	2771
Acc. Receivable	6156	6355	6304	5380	6523	7405	8048	7800	8448	8264
Inventories	7334	7864	8373	8266	9211	10615	11301	12308	12822	13198
Goodwill & Int.	4259	4392	5574	5870	6018	9426	9207	12229	11808	11275
Total Liabilities	16997	18016	19844	19632	23886	27551	33284	33892	34633	38974
Accounts Payable	11332	11726	12295	12149	14368	17306	17906	19677	21535	21374
Long-Term Debt	2502	2894	3854	3972	5492	5539	10395	9013	8031	6775
Total Equity	5849	6244	5975	6401	6256	6554	6808	6059	6328	1789
D/E Ratio	0.43	0.46	0.65	0.62	0.88	0.85	1.53	1.49	1.27	3.79

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	4.5%	4.5%	1.3%	4.5%	4.3%	4.4%	3.5%	0.6%	3.4%	-9.0%
Return on Equity	17.2%	17.7%	5.5%	18.8%	19.2%	22.3%	19.3%	4.0%	22.0%	-91.1%
ROIC	12.2%	12.2%	3.5%	11.5%	11.0%	12.0%	8.8%	1.6%	9.3%	-32.2%
Shares Out.	353	349	344	345	335	330	320	315	301	293
Revenue/Share	290.78	308.17	293.88	264.01	306.06	368.32	406.18	434.31	483.50	521.92
FCF/Share	3.13	2.62	4.45	6.59	6.69	7.59	2.49	7.57	7.95	5.41

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

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