

FINAL TRANSCRIPT

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CAH - Cardinal Health, Inc. at JPMorgan Healthcare Conference - Q&A

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CORPORATE PARTICIPANTS

George Barrett

Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

Jeff Henderson

Cardinal Health, Inc. - CFO

QUESTIONS AND ANSWERS

Unidentified Audience Member

(Inaudible question-microphone inaccessible)

George Barrett - *Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services*

Okay. Great. So I've been asked to repeat the question. I gather there's some issues in making sure everyone can hear. So I'll try to do that. So the question was really about our announcement last week, when we revised our guidance, and during that announcement we also said that our health safe -- healthcare supply chain business was largely unchanged and on track. And so, there were a couple of questions about the environment that we're competing in right now. Lisa, I'm trying to remember what else you asked --.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

George Barrett - *Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services*

A little bit about Pfizer price increase, etcetera. Okay. So business is holding up pretty nicely, which for a business that has been challenging, as you guys know in recent years, we're excited about. There are, for us, some good signs. I mentioned earlier that we seem to be showing some signs of life in our independent business, our direct store business -- our DSD business. We're thrilled to have gotten through the DEA issues, which will certainly enable us to go be more of a player geared to growth rather than defending.

The environment certainly feels intense as it relates to the overall economy, and yet we seem to be holding up pretty nicely. We're not seeing a huge impact on the economy to our customer base, although certainly every one of them, I'm sure, is feeling the stress as everyone is. But today, we see no signs of reduced volume, for us on the pharmaceutical distribution side.

Our credit situation with our customers looks pretty good, particularly on the pharmaceutical distribution. We are -- Jeff, and his team have done a great job in managing receivables. We're actually doing as well as we ever have in the management of our receivables. We've seen some sign of stress among the hospitals, primarily the smallest and most vulnerable, largely doctor-driven hospitals. And probably our bankruptcy rate has been a little bit higher in the past six months than it would have been in a normal six month period.

Jeff, it was --.

Jeff Henderson - *Cardinal Health, Inc. - CFO*

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George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

Yes. About 11, small, bankruptcies compared to a typical period that might have three or four. This is not something that you'd necessarily notice in our numbers. These were very small units. We're talking about 11 out of 5,000, 6,000 accounts, but something we're watching very carefully.

So right now I'm very pleased at where we are. I feel like the generic programs, as I mentioned earlier, are getting better. Our independent pharmacy position is getting better. We're doing some things in our medical business that are giving us good signs. We've reduced inventory SKUs by somewhere between 2,000 and 3,000 in med-surge and that's helping us get a little bit more focus, a little less complex, a little bit more efficient.

Nuclear medicine is doing really well at the moment. Probably the one business where we're experiencing a little bit of challenge right now is on our Kitting business, but again, I think we're doing the right things in terms of our operational excellence focus and focus on lean to reduce, not just inventory, but also reduce cycle time. And I think we're going to get better in that business as well.

As it relates to Pfizer increase, it's probably not a huge mover of the needle for us, but we're pleased that they've moved forward with price increases as has historically been the case. People ask me, and I've been asked many times over the last day or two, what we're going to see going forward. It's so hard to predict that. I think some companies are taking a more cautious approach in the current climate, and then those are taking probably a more opportunistic approach in the current climate. And so net-net, I'm not sure that we're seeing anything that's a dramatic change there.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

The question is really about our generics, and given my history in generics, am I seeing any unique opportunities relating to the way we buy. That's the question.

I have to say Cardinal has been a pretty good buyer of generic products over the years, often driving me crazy on the other side of it, but nonetheless, a very efficient buyer, very knowledgeable. The team knows what they're doing. They know how to identify high quality suppliers from those that maybe they would be less enthusiastic about.

What I've tried to bring to it is a little bit more of a focus on longer strategic relationships with key players. I think the generic is going to be a consolidating market of suppliers and I want to make sure that we are well connected to those who I think are going to create the most value.

Having said that, we also work with a lot of players who need access to the market and we're one of the ways those companies gain access. But I'd probably try to bring a little bit less of a transactional orientation to it, if that makes any sense, and a little bit more of a longer strategic perspective to the way we're doing our generics.

And I think it's going to pay dividends for us. I want to make sure that whatever's happening in the market, we're seen as sort of a go-to-player by the manufacturers as well as the customers. And I think the direction we're on makes it more likely that's going to happen.

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Unidentified Audience Member

(Inaudible question - microphone inaccessible)

George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

Yes. We are -- our inventory systems are pretty demand sensitive. So they're driven off models that are coming directly from demand. So we haven't had a specific corporate-wide approach that says we're going to reduce inventory because of the economic climate. Rather, we're actually working our inventory management from the demand as we see it.

When I speak very specifically about our surgical kitting business, that's a little bit of a different story. That's a business where we're -- actually have a very long lead time to get -- or a relatively long lead time from the inception of a kit, where a surgeon says this is exactly what I'd like in my kit to the point where we can actually deliver that selection of instruments in the exact configuration.

And we've been working very hard at reducing that cycle time. It just allows us to be so much more agile. And in some cases, we reduce our cycle time from about 11 weeks down to about five. So that would -- ultimately, if we can do that in a more broader sense, it would allow us to reduce inventory.

Jeff Henderson - Cardinal Health, Inc. - CFO

Just a further word on inventory management. I think we've made great strides over the past couple of years on the pharmaceutical distribution side of the business. Now that initially started with the transition from buy and hold model to the fee for service model, but I would say over the past couple of years, we've continued to work to take days or two days a year out of the system.

We continue to focus on that. We continue to make good progress. It gets harder and harder every year because this is sort of the hard operational excellence type work that is required, but we still feel there's opportunities to take more inventory out of the system.

On the med surg side, if you sort of divide it into the manufacturing piece and the distribution piece -- on the manufacturing fees, we've been able to cut our days of inventory from well over 100 to, I think, something in the 70s, in one year, which is a remarkable reduction. And on the med-surge side, there's also opportunities there.

Although that is as much about SKU management as George referred to earlier, as anything. When you carry a huge number of SKUs, it increases complexity, it increases just the sheer inventory levels, it increases the dead inventory that you're carrying. And so, really the focus there has to be on continuing to rationalize the SKUs. But we've -- it's definitely been identified as an opportunity and we're focused on it.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

Jeff Henderson - Cardinal Health, Inc. - CFO

It -- well, it will reduce the amount of inventory that we're carrying, if we do that because you need a safety stock for all your SKUs. Right? And if you're carrying 15 of one item, if you can eliminate three of those items, you don't necessarily replace it with other items. You can bring the inventory down.

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So generally, as we take SKUs out, the inventory is going to come down. And the complexity and cost of our systems is going to come down.

George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

I'd like to just give an example of a way -- I'm going to exaggerate for the purpose of making a point, but the way that we think about how improving the SKU mix can improve our numbers. We might carry, today, something called a three-inch bandaid. We might carry a three-inch latex strip. We might have a Barney three-inch bandaid. We might have a Miss Piggy three-inch bandaid. And we, all done, you have 40 or 50 things that actually look very similar.

And so, one of the things that we've probably done as a business is sort of carry all that because that's what we had an order for or a vendor wants us to supply, when in fact there's some linked things. And at some point, you say, look, we're going to offer six different types. There's the child's bandaid. There's the skin colored bandaid. And you start to steer, you start to steer the direction of the business a little bit more than just sort of letting it carry you.

And so I exaggerate just for the point of making the argument, but it's not so far off. That's the thing that can happen as you start to respond to every single customer demand and every single vendor demand. And yet, some point you have to take control of your business a little bit more and we're trying to do that.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

So the question is really about our nuclear business and about our -- or my statement that we have both a cardio light and a Myoview product and some kind of low-cost alternative that might get private label.

We will probably continue our program to move our own manufactured product, which may or may not bring to the finish line or proceed with -- to the finish line. But I think what we've been able to do, and I think because of the strength of our distribution channel and our footprint, we've been able to work out an arrangement that gives us a lot of economics of ownership.

And to quote my former colleague at Teva who is a CFO he used to say you don't always have to own the cow to get the milk. And it's a good quote. And I think this is a case where we're working to take advantage of the strength that we have in the distribution channel to gain the economies that we might have had with our own product. And so, we're pretty enthusiastic about where we are.

I have to say our Nuclear business is really good. We do very consistent voice of the customer surveys these days to try to get a sense for where we are. And when we do this in our Nuclear business, we get incredibly high marks from our customers. We're doing a very good job for our customers.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

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Jeff Henderson - Cardinal Health, Inc. - CFO

Yes. For competitive reasons, I don't want to get into the specifics. I'd say on a dollar basis, it's -- can be more attractive, particularly during a certain period of time. And that's what makes it attractive for us to pursue. And I think what also makes this a little bit different than a general generic situation is when you just sort of have a retail drug where it very quickly it goes down to a relatively low level of pricing in the market.

In this particular area, this is a product that's sold as a bundle of products and services, where we're providing a lot of the value-added for the hospital or for the imaging center. And really, the product is one component of a bundle of products and services, so there is an opportunity to drive more margin there and maintain margin over a longer period of time than a typical sort of retail generic.

George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

That's a good caution for everyone here is that this -- the dynamic here will look different than what you'd see in a traditional retail generic launch.

Yes?

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

So the question is about major contract renewals among our retail customers -- I assume, is the focus of the question. And as most of you probably know, we are due for -- our contract with CVS is one of our major customers, expires in the summer in front of us and there was a question as to whether or not we would be -- what do we expect? How should you all think about it? Will we renew early?

It's hard to say exactly how that will play out. I've said a few things publicly about this and I'll repeat those. I would certainly never promise you that you're not going to have a price reduction in a negotiated contract, it's certainly the nature of life. My hope and my expectation here is that this a newer contract and we feel like we are at market. And so, our hope would be that whatever adjustments needed to take place are tolerable -- not what we've been through.

As you may remember, we went through a 12-month period where we repriced Kroger, Walgreen and Target all within a very small period of time and that -- and Kmart, excuse me, not Target. Kmart, Walgreen and Kroger. And that had a significant impact on us. And so, our hope here is that we are in a much more market-based moment, and whatever changes will take place are ones that are going to be less dramatic.

As to whether or not we'd renew early, it's hard to say. It would be wonderful for me to say to you tomorrow, this is all out of the way and done. And the question is, at what cost? There is sometimes a cost to moving out of something earlier. And it's just one that we'd have to think about carefully.

So I'm prepared for this to go its normal course. If the opportunity came and it came at a reasonable, comfortable place for us to try to resolve this early, it would be great. I'd love to be spinning off the business in June or July or August, whenever it may happen and tell you it's all behind us, but -- or earlier, but we'll see how it plays out.

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Unidentified Audience Member

(Inaudible question - microphone inaccessible)

George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

We all -- look, I'm going to say something, and I'll let Jeff jump in. One of the interesting questions, as we were One Cardinal Health, with a med-tech business that had certain characteristics and a healthcare supply chain business that had other characteristics, is how you use your cash. Actually, you could do it very differently depending on which seat you sat in.

As we look at a business without Dave's business back there, without our business, we are a significant cash generator. We think that dividends are certainly important to us and to our shareholders. They may have a different perspective on what is best for a business with a different profile. But we're -- right now, we're in the thinking mode and listening mode.

So we are certainly listening to what you all have to say and how you think about it. But I would say from our standpoint, we do believe that it's important for a business like this to be returning something to our shareholders and we certainly see dividends as part of that. And would you like to add to that, something?

Jeff Henderson - Cardinal Health, Inc. - CFO

Yes, the thing I'll add is obviously, particularly in this environment, but I would say in any environment, for a business like us -- like ours, that has very large working capital swings, ensuring that we have the appropriate access to liquidity is very important both in terms of the cash balance, but also the commercial paper and accounts receivables lines that we have.

So that clears that first priority, to make sure that we have the liquidity to run the business. And then as George said, returning an appropriate level of capital to shareholders is clearly something we understand. It's clearly what investors in this business expect. And as George said, we're sort of going through analysis right now of how much of that's going to be in dividend versus other forms.

While we're talking about capital structure and related subjects, why don't I just sort of give you a little bit more of an update on the spin-off, just in terms of its status. And the punch line is we're on track. We had said that our goal is to complete it sometime during the summer of this calendar year and we're very much on track to do that.

We filed our private letter ruling request for the IRS in the prior quarter. We will be filing the Form 10 with the SEC this quarter. A lot of the organizational realignment that we needed to in terms of getting business people allocated to -- and staff people allocated to the respective businesses has been done.

And in fact, we accelerated that, so people would know where they're going and it would eliminate sort of the distraction impact as we pursued through that. So most of our top four levels of management are now effectively placed in the company that they're going to be with going forward.

The commercial agreements that need to be put in place between the two entities are either done or being completed as we speak. And a lot of the IT separation work, which for those of you may have gone through this in your lives, know that's sort of the tedious technical part of this and, again, that's very much on track.

So all the things that we needed to do to work towards a summer spin are very much on track. The one external factor that we're watching very closely is the state of the credit markets. In order to split up the debt between the two entities, the SpinCo does need to issue a certain amount into the credit markets and -- that will be approximately an amount of about \$1.5 billion

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that they will need to issue. So clearly the state of the credit markets, particularly for strong BBB companies is of great interest to us.

I think the great news is over the past month we've seen a tremendous loosening of those markets in a positive direction. BBB deals are being done in size right now. They're being over subscribed. And although credit spreads are relatively -- are pretty high by almost any standard, treasuries are very low, so we actually look at the coupon rates. They're not that bad by historical standards, so we actually feel quite good about the state of the credit markets and our ability to complete the spin at this point as we look forward to the summer.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

Jeff Henderson - Cardinal Health, Inc. - CFO

First of all, we're committed to maintaining a strong investment grade rating and we know -- we've -- are saying that publicly, we've got the rating agencies and told them that that is our strong commitment as well.

Well, basically, this is the way that the spin will work, just to get a little bit into the logistics of it. SpinCo would borrow money -- let's just pick the \$1.5 billion number that I referenced earlier. They would then transfer that -- those funds to the parent company. The parent company would then use most or all of those funds to pay down existing debt.

So when all's said and done, if you look at right now, Cardinal Health has about \$3.5 billion of long-term debt on its balance sheet. When the spin is done, SpinCo will have about \$1.5 billion and the RemainCo will have a little over \$2 billion. So that's effectively how we've split it up. So, long answer to your question, but no, we do plan on paying down some of the debt and to maintain a strong BBB credit rating.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

The question is about our interest in the ambulatory markets that I reference in our meeting in the big room, and whether or not we might see acquisition opportunities there.

The answer is maybe. We feel pretty confident that we can grow organically. The question is, do we still move the needle enough at the size that we're at, which is relatively small. So we'll look at that and take a pretty disciplined approach to balancing the organic potential versus what we see through acquisition.

At the moment, there's no specific plans, at least for any acquisition. And we are building our plans around an organic growth opportunity, but we'll continue to look at ways to jump start businesses. If we think there's an important opportunity that we can get to scale and change economics because it'll scale quickly, we'll certainly look at those opportunities.

I want to sort of get back -- there was a question earlier about generics and I think I -- I realize as I -- we finished, I probably answered part of it, which was around the buying side and I probably didn't answer the selling side. And I think the opportunity for us on the selling side is interesting.

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There's a part of the market that buys generics directly. And while there's some movement among players who occasionally flip back and forth, by and large, the largest of the players buy their generics directly and were enormous customers for me in my last life.

Having said that, there is a significant part of the system that just has a very difficult time dealing with the complexity of the generic system. There are huge numbers of products, there's all the complications of patent cases and whether you're going to have products and for how long and I think it represents an opportunity for us.

I think the other thing that's happening is that there have been a lot of middle market players in generic drug manufacturing and that has been a difficult place to be in the last couple of years. And I'm not sure if it's going to get a lot easier. That's really a place for us to step in; where those players or the large players use us to access other parts of the market.

And I think we can be a very effective partner in getting to those parts of the system that don't really want to build their own infrastructure. Through generics, we can aggregate demand very efficiently and really move share for the suppliers and solve a lot of problems for the customers downstream.

So I think the generic opportunity continues to be robust for us, but a lot of it has to do, as well, with improving our mix of business to give us more of those customers that actually would buy our generics. And so, that's something I wanted to make sure I cover from a prior question.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

Yes, I don't know if I'm ready. The question is about the specialty market and our strategies. And I'm not sure I'm ready to answer it, actually. I'm not sure I'm ready to answer it. I can say that there's no doubt that the specialty area is, at least in dollar sense, a growth area if you look at the number of NDAs or BLAs coming through the system. There's no question that a high preponderance of our products are specialty.

Having said that, it's a complex area. You have to be careful. And I've lived on this from the other side in my days at -- with Teva Neuroscience, that the channels can be different. There are some unique attributes about different specialty businesses, as Jeff brings some of the Lilly experience as well, and we want to make sure that if we make moves there, we're not doing something we're going to regret.

In some cases, the target customer base is very small and there's going to be a direct relationship between that target customer case and the biotech company. So we're going to be looking very hard at this area, but probably very careful about making moves. I think the wrong move could be painful, so we're going to [be] careful here.

Unidentified Speaker

(inaudible)

George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

I'm sorry?

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Unidentified Speaker

One more question.

George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

One more question? Great.

Unidentified Speaker

If there is one.

George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO, Healthcare Supply Chain Services

Oh, if there is one. Anybody? Thank you for your time.

Jeff Henderson - Cardinal Health, Inc. - CFO

Thank you.

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