

FINAL TRANSCRIPT

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CAH - Cardinal Health, Inc. at JPMorgan Healthcare Conference

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PRESENTATION

Lisa Gill - *JPMorgan - analyst*

Good afternoon. My name is Lisa Gill, and I am the Healthcare Distribution and Technology analyst for JPMorgan. Thanks for joining us this afternoon.

We're very happy to have actually two presentations this afternoon by Cardinal Health. The first presentation will be about their supply chain management business, which is now run by George Barrett. I think many of you know George from Teva, who joined Cardinal about 10 months ago. So, he'll walk us through the opportunities around this business.

With us also this afternoon is Jeff Henderson, CFO. Jeff will be participating in the Q&A. And with that, I'm going to turn it over to George and ask you to hold your questions until after the presentation in the Borgia Room across the hall. George?

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

Thank you, Lisa. It's great to be here. [This is] everyone. As you just heard, we have announced, several months ago, that we will be spinning off a part of our Cardinal business, our medtech business, which we have been calling CMP over the years. And Dave Schlotterbeck is here and will present after me.

So I'll try to give you a quick overview of what we're calling the new Cardinal Health. Let me first make sure that you read this disclaimer about our forward-looking statements, please.

So what is the new Cardinal Health look like after the spin-off? As some of you know, the spin-off is not a complete clear cut between what used to be our HSCS business, our supply chain business, and our CMP business. There are a few businesses that are moving over from what was a Clinical and Medical Products and back to the original Cardinal. And I'll try to walk us through that as we go.

But as we describe the business today -- Cardinal coming under the blocks will be a leading provider of products and services across the health system. We'll have an extensive footprint across multiple channels with a very customer-centric focused model, serving over 50,000 customers with really a renewed focus. And when we look at the spin-off, many have asked us about what the spin-off is all about. And in many ways, it's really about focus. And I'm sure we'll get some questions on that when we go to the breakout room.

We will bring an experienced management team from Cardinal with diverse experiences. And I'll talk to you a little bit about some of our leadership as we go. With revenues in excess of \$90 million, about 30,000 employees with direct operations in 11 countries, and a history of solid cash flow generation and what we expect to continue going forward.

Before I talk a little bit about the future, I'd like to spend just a couple of minutes on the past. Cardinal, as you know, has been through some challenging times; these last 10 months or so, since I've been there, are certainly no different. And when I first

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joined, I tried to take some time with all of you to talk a little bit about the things that we needed to do to turn this business around.

We focused on a couple of key priorities for us. I'd like to just very quickly touch on those priorities, give you a sense on how we are progressing.

Key issues for us were as follows -- one is to sweeten the mix, to improve our mix, both in terms of customer mix and product mix; to improve our customer loyalty -- we've been a business that has been through challenges in retaining customers, and we needed to turn that around. At the heart of that was our ability to execute flawlessly in a business that is all about execution; the blocking and tackling in a business like ours is critical.

And finally, rebuilding a culture about winning. Cardinal has a long and proud tradition; many years as a market leader. And these past couple of years have been challenging for everyone. And we know that turning the business in the right direction is also partly about turning that culture.

Very important issue for us, as you probably know, a little over a year ago, Cardinal started having some challenges in its management of our controlled drugs. And with that, we temporarily lost the licenses to distribute controlled drugs from a couple of our facilities. This has been a huge issue for us. It's impaired our ability to go forward in a positive way as a business, making us feel very much like we're on the defensive.

Thankfully, we have continued to invest heavily in this area, and in the past few months, have actually regained back all of our licenses as it relates to the controlled drugs. As I said, this is enormously important for us, particularly as it relates to the second issue, which is regaining our business with our independent retail customers.

We lost a considerable amount of business during the time that we were unable to ship controlled drugs. And regaining those licenses has been really a building block in our ability to regain that. I'm pleased to say that we are making some progress. As I look at our independent wins and losses in term of customers and dollars, after coming through a very rough period in the spring and summer, starting in late September, every month since then has actually been very positive. We've had improvement in our customer win/loss ratio every month progressively.

We've continued to focus on the customer; I'm actually making some organizational changes -- not the least of which was announcing, not that long ago, a Chief Customer Officer to make sure that the voice of the customer was present in our executive suite.

We've enhanced our generic programs to make them more clear and transparent, making the value proposition a little more dramatic and clear for our customers. And I'll talk about that in a moment.

We have moved our nuclear pharmacy business forward significantly in the last six months, solidifying our leadership in that field, and working through what we describe as the post-generic Cardiolite event. I'll talk about that as well.

We focused on efficiency gains and our inventory management and rationalizing our SKUs. I had felt since the I arrived at Cardinal that in our medical businesses, we have a tendency to make things extremely complex. And we've lost some of the advantage that we gained from scale from some of the disadvantages of scope. And we've been trying to work at that to simplify the business and reduce complexity.

And finally, we're seeing very good growth in our ambulatory business, clinic and surgery suites, and in our lab and hospital businesses.

We will operate under the new Cardinal with two groups of businesses in two segments. One, the pharmaceutical segment, led by Mike Kaufmann, who some of you know, and one led by Mike Lynch.

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Just a quick word about these executives. They come with long histories. Mike really, for many years at Cardinal, having been head of sales, head of -- CFO of our pharmaceutical distribution business for a number of years -- very well regarded, both by our suppliers and our customers on the downstream side.

Mike Lynch brings over 20 years with a long history from American Hospital Supply, and Baxter, and Allegiance. They bring tremendous leadership to our organization. We're really excited to have them leading these businesses.

On the pharmaceutical side, our largest business is pharmaceutical distribution; nuclear pharmacy is included among those business, and our manufacturing service business is also in there, including our 3PL business, which is primarily directed at smaller Biotech companies.

On the medical side, we have a med/surg business, medicals -- a distribution business, which includes our scientific products business, which is a lab distribution business, and our ambulatory business, as well as traditional med/surg.

We have an infection prevention business that -- this was one of the organizations that was part of our CMP business and is now returned to Cardinal. That business is really focused on the operating room very heavily -- involved in gowns, drapes, other products that are used in infection prevention. And then as you can see down below, we describe these products -- fluid management products, products for use in the operating room.

I'm going to back up for one second. An important part on this slide that I want to highlight, we have felt all along that our value across these two businesses remains strong. And you can see, as we describe, shared customers, integrated sales programs, and operating efficiencies that we believe, as we go particularly into the hospital market, that our business across both the pharmaceutical distribution as well as the medical businesses, creates for us a unique footprint in the market. And we believe that being able to go to market with a highly integrated selling organization that works across both the pharmaceutical and the medical side into the hospitals is important for us.

In addition, we're focusing very heavily on finding the synergies that we can take on a back office basis between these two businesses. And I think we're going to -- that's going to allow us to gain additional efficiencies.

Our businesses are really about matching an extremely -- extremely -- fragmented system for demand, customer system, with a very complex supply system. People have a tendency to understand what we do in terms of moving boxes in the distribution, but in fact, our business is much more than that. And it's really about various aspects of doing this matchmaking in the system.

Distribution inventory management, logistics support -- we work in creation of formularies and product selection. We are essentially a financial go-between between these customers and the suppliers, and very involved in risk management, a critical issue today.

At the heart of all of this with our business is a basic mission, which is that when we do our job incredibly well, pharmacists and doctors, surgeons, nurses, can devote their energies to delivering patient care. We essentially try to take the back engine of their activities, the operational aspects off their plate.

To look very quickly at the pharmaceutical segment, I mentioned the businesses that are part of this. We create value for our market both upstream and downstream. To our supplier partners, we're very critical to them in smoothing out demand, making sure that there's an efficient supply into the system. We're doing contract and credit collection and management for them; next day delivery to over 30,000 locations.

And really, in some places, actually moving share, particularly in generics. That is a place where, particularly in independents, in regional chains, and mass merchants and grocery, we're actually influencing share. And that's an important part of our business.

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We're also a significant provider of data to our upstream partners. On the downstream side, again, we can deliver next day delivery, access to more than 2,000 suppliers, which for them would just be catastrophic if they had to deal with this in any other way. We manage working capital management for them and a number of value-added services; essentially, again, enabling them to focus their time on serving the patients.

Generics are an important part of our business. In our pharmaceutical distribution business, we have worked very hard at rebuilding the quality of that generic program. And today, I really am pleased that we're making progress. Some of you know from my past life I was very involved in this area. It's critical to be able to launch products at huge scale and very quickly.

We have increased our capacity and changed our systems. We're using ParMed, one of our distribution operations, for these quick launches. And we bring enormous value to the market by being able to do almost an instantaneous launch, and very significant value for our supplier partners.

We've got the broadest portfolio in the industry; somewhere in the range of 4,000 products in our program. We've tried to be very flexible and tailored in our offerings to our customers. We try to let them hit the ball where it's pitched. Every customer has unique needs as it relates to their generic programs. And I think we're getting better and better at listening to customers and serving them with programs that meet their needs.

We can manage supply risk. This is an industry in which it is not uncommon that there are disturbances in supply. We had one recently this year with a company that had some significant regulatory activities. Our customers, were they buying those products directly, would be scrambling to find a source of supply. For us, it took virtually minutes for us to re-supply with backup vendors, and we were able to manage that risk.

And we've really gone out of our way to strengthen our strategic supply relationships. Obviously, I bring some history from this world, and it was relatively straightforward for us to begin to really change the way we approached some of our strategic partners.

We've continued to drive our independent business. As I mentioned to you, that that's an important part of our turnaround. I won't go into enormous detail, there's a lot on this slide. But essentially, what we enable our independents to do is to compete effectively with the giants down the street. It is a very difficult environment for independent pharmacy. And we essentially allow them the tools that allow them to focus on their patients.

So, we're managing their operational efficiencies with inventory management tools and then cash flow tools. We work with them on managing a very complex reimbursement system in the payor system. We're able to aggregate demand among a number of independents and work with them on programs.

Leader is our major program for doing this. And this is a network of pharmacies that work under a single banner; again, several thousand pharmacies that work under the Leader brand. We can do two things -- one is allow them to compete day-to-day with the company down the street; and two, improve their net operating income, as we work these programs.

I mentioned nuclear pharmacy is an important part of our business, and cardiac imaging is the place we reside here, both in hospitals and in cardiac imaging clinics.

It's been an interesting year in nuclear pharmacy. We saw the first generic entrant on Cardiolite, one of the key nuclear medicine products. Cardinal had, several years ago, invested in its own manufacturing operations to develop this product. And with the sell-off of our manufacturing businesses, that program got a little bit off course. We've been working very hard to make sure that we are in a position to compete effectively when Cardiolite does, in fact, go generic.

And we've done a couple of things during these last six months that have really strengthened our position. Number one, we have developed a relationship with GE, which is very important to us -- valuable to us and valuable to GE -- that allows us to be

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a distributor of their Myoview product. We've continued to sell Cardiolite and it's doing very well, but we've also been able to negotiate some terms that allow us to compete very effectively, once the generic product entered.

As we go through the spring and next summer, we've actually done some things in our relationship with our existing vendors, which will allow us to compete even more efficiently with a low-cost alternative. So we'll be the company with a huge footprint -- nearly 170 nuclear pharmacies; distributing Myoview, Cardiolite, and a low-cost alternative. In addition, we're continuing to work on our development of our PET business. It is small but growing nicely, and we continue to work on projects with both academic institutions and other businesses to develop products that will allow us to grow our PET franchise.

Our medical business is really an important one for us, and it often gets too little attention. And one of the things I love about this business -- and we were describing this to people this morning -- it's a business in which our value proposition, I think, is very clear. Our customers really need us.

Hospitals are very complex systems. They were designed to deliver care and not necessarily to be business enterprises. And one of the things we can do very effectively is to take some of that transactional and managerial administration of running the operations behind the scene, off their shoulders. And it's a business that I think has been in some ways, underappreciated and in some ways, underperformed in recent years.

The good news for me is that a business that creates this much value is a business that, for me, has potential. We know the things that we need to do to change this business. At the heart of it is reducing complexity, as I mentioned to you earlier. We probably carry too many products and too many SKUs and try to do it in too many ways. And I think simplifying the business model here will be very important for our med/surg business.

One of the things that we think is an important aspect of this business is a place where we actually can move share. And like generics, on the pharmaceutical side, the ability to move share is the ability to create margin for us. And we can do that both on branded products that go into the medical segment, as well as private label products.

We are present throughout the continuum on the medical care side. So we're in the hospitals; we're in surgery suites; we're in colonoscopy centers; we're in ambulatory centers across the spectrum. And we like having a footprint that works across the system.

Our role here is not just in the logistics management, but it really is very consultative. So, again, our role, as we look at our medical business, is both advisor and administrator of operational activities. As is true with our business in pharmaceuticals, we create a lot of value both downstream and upstream for customers.

One of the businesses that, as I mentioned to you, moved over from CMP is our infection prevention business. This is really one of the businesses where we were able to achieve some vertical benefit. We're a manufacturer of surgeon gloves and exam gloves; drapes, gowns; the other barrier products that are used in an operating room. We have a significant presence there, as we do in surgical kitting, which is a very high-touch business for us and a very important business in terms of creating openings for this business.

We are actually reorganizing a little bit on our operations side to try to take advantage of this vertical footprint. And if you imagine that many of the products that we distribute might be products that we could source or manufacture ourselves, and think private label generics, this would be a potential area of growth for us and one that we're devoting some energy to.

I mentioned our growth in the ambulatory markets. This is a substantial market. It's a \$16 billion market. We know that as our system evolves, that care is moving out of the acute care centers into centers that the system pays less for -- and very specialized centers. You know that there are ambulatory centers that do orthopedic surgery, as I mentioned, colonoscopy and endoscopy; general surgery centers; doctor's offices. Our presence is growing in these areas, but we're still relatively small. And we see this as a tremendous growth opportunity for us.

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We will continue to focus on this business. And one of the things that we need to do -- and this is one of the areas where we have focused some of our attention in terms of our IT strategy and RT investment -- is to improve our customer facing with these ambulatory centers.

Each of the centers has unique kinds of needs in terms of products and services. We've had a tendency to go to these businesses with a very large, almost hospital portfolio, and then asking them to do the work to select out what they need.

The reality is each of these kinds of businesses is very different. They may have 150 or 200 or 250 products that are critical to their day-to-day activities. And what we need to do is to create the IT infrastructure that allows that interface to be simple, so that they're looking at the products that they use and need every day. And we're working very hard right now to do that. I would say those programs on the IT side are well underway and moving through nicely.

Our lab and scientific products market has been exciting for us. We've got a significant position in the acute care centers, a leading position there. It's a business that actually has been growing very nicely. Some of you know that we lost, a couple of years ago, one of our largest customers. If we correct for that, that loss, we're showing really significant growth in this business. And even with the loss of that customer, we're still showing some growth, which has really been great for us.

We are still relatively underpenetrated in the clinical and research laboratories, which represents for us an opportunity. But again, this is a place where we can use our breadth as a company, our cross-selling opportunities, to extend our reach in the lab supply business.

It would be hard for me to stand up here without saying just a few words about health care reform. This is an extraordinary environment. It is clear that the system as we know it is going to go through some changes, and all of us are speculating on what that's going to look like.

What I've tried to do is identify a few of the forces at work along the left here, and some of the things that we are hearing consistently, thematically, as the direction of reform. I don't have to give you a long speech about the demographics and the rising costs; it's very clear.

We have an extraordinary number of uninsured or underinsured people in the US. We know also among those who are uninsured, that the care that they're getting is less significant in terms of overall availability. They're getting care, but not at the same rate or type that those who are insured are getting.

It's also an incredibly fragmented system. And that has been part of the challenge for all of us in getting control of the health care costs. And we know that we're going to see more of an emphasis on quality. What's the outcome that we're looking for and what are we willing to pay for it?

This has some implications for us as we look at health care reform. There's, I think, no question that we're going to see coverage, universal coverage, in some form -- expanded coverage across the system. How we're going to pay for it is the question. But I think we do see the likelihood of that.

We also see a comparative effectiveness continuing to be discussed. And while that happens overnight, which is unlikely, or it happens over time, there will be a continued focus on quality.

This all really plays to our strengths. We are a very, very low-cost, high-value-added part of the system. And the efficiency of what we do, I think, will contribute to a system that is going to need to be able to serve more patients with less cost. We know that the focus on quality and comparative effectiveness is going to play to our consultative role and our ability to work along the safety and the quality spectrum.

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We do believe we're going to see some kind of program that is some hybrid between a private system and a public system. There are various proposals out there. Those of you who have read Daschle's book or Max Baucus's work and his proposals, are seeing some common themes that we're going to see fairly consistently throughout.

It's also important, as we look at the fragmented nature of our system -- important for us that we have a footprint in all of the parts of this system in order to connect the cost and the value. So, one of the things I'm really excited about with our business is our ability to operate across the health care system.

We have -- are an enormous player in retail pharmacy in the acute care centers and surgery centers and ambulatory; in cardiac imaging, and the operating room. And the ability to work across the continuum of care, I think for us, present opportunities as the system unfolds.

And finally, as I said, we've focused very heavily on safety, on quality, and on prevention. We have a business unit that's dedicated to that effort. And I think that will play very helpfully for us as we go forward.

So, we believe we've got a business position to lead in a health care system that is going to evolve, and a landscape that is going to look probably a lot different over the coming years than it has today. We're a leading provider of products and services across the system and across the supply chain. We are deeply customer-focused. Our organization is particularly energized. And I have to say -- we talked -- I talked in my opening slide about culture. The spin-off alone has created an energy for our organization that probably would be hard to do without doing it -- without announcing that spin-off.

It's a sense for a new time for the Cardinal people; for a new chance for us to take control of our own business and to add value, and to be particularly focused on where the customers are going and where the system is evolving.

We've got an experienced management team. We've got robust cash flow, excellent liquidity, and huge scale and efficiency. We expect to expand in some of these growing markets, like I mentioned, in ambulatory and reference labs.

We'll deepen our penetration with our existing channels and with our existing customers. We'll drive leadership in a growing generic business. We know that the incentives to drive generics will only increase.

We will expand our value-added services to enable our customers to operate efficiently and to focus on delivering patient care. And we'll leverage our manufacturing capabilities and our sourcing capabilities to drive value through essentially what is a portal to this system -- a very large portal to the health system that we operate in.

So, in summary, just give you a quick sense of our leadership. We are pharmaceutical distribution, national leaders; leaders in distribution hospitals, in nuclear pharmacy services; med/surg products and distribution; operating room products; surgery centers; clinical acute labs; surgery kits.

On a global basis, we're active in surgeons gloves, and clinical and patient Medicare -- patient protection products; in fluid management, products that are used in the operating room; med/surg products that are used throughout Canada and have now extended our reach into Puerto Rico, and we'll be moving increasingly in that space.

With that, we have about 20 seconds and I'll say thank you.

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