

FINAL TRANSCRIPT

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CAH - Cardinal Health, Inc. Conference Call

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PRESENTATION

Operator

Good day ladies and gentlemen, and welcome to the Cardinal Health Incorporated conference call. My name is Kawanda, and I will be your coordinator for today. (OPERATOR INSTRUCTIONS). (technical difficulty). As a reminder, this conference is being recorded for replay purposes. I would now like to turn the call over to Mr. Jason Strohm, Vice President Investor Relations for Cardinal Health. Please proceed sir.

Jason Strohm - Cardinal Health, Inc. - VP IR

Good morning everybody. On today's call we will discuss Cardinal Health's plan to sell its Pharmaceutical Technologies and Service segment, which we disclosed in our press release earlier today. If any of you have not yet received a copy of this press release, you may access it over the Internet at our investor page at, www.cardinalhealth.com. Additionally, our updated fiscal year 2007 financial targets and goals slide can also be found on the website.

Speaking on our call today will be Kerry Clark, President and CEO. After Kerry's formal remarks we will open up the phone lines for your questions.

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During the course of the call we will make forward-looking statements. These statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected. Please see our press release and other SEC filings for a full discussion of the risk factors associated with them.

In addition, we will reference non-GAAP financial measures governed by Regulation G. A reconciliation of these measures is included in the press release and financial targets and goals slide on our website. At this time I would like to turn the call over to Kerry Clark, Cardinal Health's President and CEO.

Kerry Clark - *Cardinal Health, Inc. - President, CEO*

Good morning everybody. Jeff Henderson is also with us today. Thank you for joining us on such short notice. I want to take a few minutes to discuss the strategic rationale for the decision we announced this morning. We plan to allow time for a few questions at the end of the call, but please understand that we won't have all the answers today. Our goal is to communicate our rationale and what we know today and to provide you with updates when other material developments occur.

As you read in the news release we issued this morning, we have made the decision to divest our PTS business, the leading contract manufacturing and service provider for the pharmaceutical industry. This segment, with more than 30 facilities and 10,000 employees worldwide, generates \$1.8 billion in revenue annually.

The divestiture is a strategic choice to allow us to focus our capabilities and resources on better serving providers of health care and expanding the health care supply chain services and the clinical and medical products manufacturing businesses, both domestically and internationally. These segments align with Cardinal Health's core competencies and offers significant opportunities for future growth.

As we continue our journey to becoming a truly integrated operating Company, we will put our resources behind organic growth initiatives in our four remaining segments, leveraging our scale to reduce costs and substantially improving our return on capital. For the past year you have seen us take a number of steps to optimize our portfolio through divestiture and what we call tuck-in acquisitions like [Doughman], MedMined and Care Fusion. I believe that making strategic choices like the one we announced today will allow us to be more successful with other core initiatives within our business, such as international expansion, medication management, infection prevention and new supply chain services.

Today's announcement is a good example of the focus we are driving across Cardinal Health. We absolutely believe in the strong potential of PTS, but through a rigorous review we determined it was not a strategic fit with Cardinal's long-term strategy to help health care providers improve safety and productivity.

Over the past several months we have operated PTS on two parallel paths. One path had us accelerating the operational excellence initiatives that are strengthening our operations, particularly in sterile manufacturing. Progress has been made with our North Raleigh and Brussels facilities. Woodstock remains a solid facility, and operational excellence initiatives are beginning to deliver results in Albuquerque. Overall we have a strong customer demand for our offerings.

The other path had us exploring the longer-term strategic fit of PTS within our provider oriented strategy. We were able to share some of this thinking at our analyst meeting in September, but clearly we had not made a decision to divest the business at that time.

We will retain two of the segment's businesses, the Martindale generic business and the Beckloff Associates regulatory consulting unit, both of which are strategic to the Company's generic pharmaceutical interests. Martindale develops generic injectables that are complementary to Cardinal Health's hospital business and generic strategy. And Beckloff provides regulatory consulting services, including for Cardinal Health generic products. These two businesses will be included in our health care supply chain services pharmaceutical segment financial results going forward.

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To give you a perspective on the relative size of these operations, in fiscal 2006 combined these two businesses generated revenues of approximately \$100 million and operating earnings of just over \$30 million.

Most of you know that PTS was formed through multiple acquisitions, and today is the leading provider of contract manufacturing development and packaging services for the pharmaceutical and biotechnology industries. As a stand-alone company, excluding Martindale and Beckloff, we estimate these businesses would generate in excess of \$300 million in earnings before interest, taxes, depreciation and amortization. Key businesses include oral technologies, sterile technologies, packaging and printing services, clinical supply and analytical services. The net book value of these businesses, excluding Martindale and Beckloff, is approximately \$2 billion today.

Now, regarding use of proceeds, we expect to use the proceeds to repurchase Cardinal Health shares. In anticipation of the sale, our Board has initially authorized an additional \$1 billion, bringing the Company's total repurchase authorization to \$3 billion for fiscal 2007 and fiscal 2008. We expect to have completed \$1.5 billion of repurchases under this authorization by the end of fiscal 2007, including the \$500 million completed to date this year. This compares to our previous plan of approximately \$1 billion of purchases by the end of fiscal 2007. Also for our base capital plan we will continue to invest in organic growth and tuck-in acquisitions to strengthen existing product and service offerings.

We know you are interested also in how this change will affect our fiscal 2007 and long-term guidance. Let me start with fiscal 2007. Had we not made today's announcement, our EPS guidance for fiscal 2007 would have remained unchanged from previous communications. However, based on the decision to separate PTS we will begin treating this segment as discontinued operations in our financial statements. Therefore we have issued new consolidated earnings guidance for fiscal 2007 with non-GAAP diluted EPS from continuing operations expected to be in the range of \$3.25 to \$3.40.

Our earnings goals for the four remaining segments are unchanged from our previous communications on the Q1 earnings call. The only other change relates to our capital deployment plan as I outlined earlier with regards to share repurchase. Our updated fiscal 2007 financial targets and goals are available on our website, as indicated in today's news release.

Now, let me address our long-term guidance. Excluding the impact of any proceeds from the PTS divestiture, we reaffirm our long-term financial goals for the consolidated Company of 12% to 15% non-GAAP EPS growth, and expect to be within that range for fiscal 2008. Within fiscal 2008 we expect each of our four remaining segments to perform within or above previously announced longer-term earnings goals for each segment. And we also reaffirm our longer-term capital deployment plan to return 50% of our operating cash flow to shareholders.

Depending on the actual timing of the divestiture, the proceeds from the transaction should further add materially to fiscal 2008's EPS. Although the exact amount of the proceeds is not known at this point, we would expect fair value for a business that is expected to generate EBITDA in excess of \$300 million. And we would expect the transaction to close around mid calendar year 2007.

As most of you know, we are also very focused on return on invested capital, and expect the divestiture of PTS will be substantially accretive to ROIC beginning next year. It's also my expectation that sometime during our fiscal third quarter we will provide an 8-K filing with restated historical results, both consolidated and at a segment level, as we work to finalize the impact of corporate expenses and other items associated with this segment.

Our remaining four segments will be slightly impacted by the allocation of additional corporate costs that were previously absorbed by the PTS segment. However, as I have just indicated, this will have no impact on our segments' operating earnings growth targets, both long-term and for fiscal 2007.

So just to summarize the key points. Number one, today's announcement highlights our strategic commitment to the provider market, and our intent to be very focused on serving that market exceedingly well.

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Two, we expect to repurchase a significant number of shares with the proceeds from the sale of PTS, and have already increased our total authorization to \$3 billion for fiscal 2007 and fiscal 2008. And third, we are reaffirmed our long-term guidance of 12% to 15% non-GAAP EPS growth, and that we expect our four remaining segments to perform within or above the previously announced longer-term earnings goals in fiscal 2008.

Now, we will open up for a few questions. But as I said earlier, we won't have all the answers today, but our goal is to communicate what we know now and provide you with updates when other material developments occur.

Operator, I think we're ready for the first question.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). [Adrienne Calova] on behalf of Christopher McFadden with Goldman Sachs.

Adrienne Calova - Goldman Sachs - Analyst

I'm calling on behalf of Christopher McFadden from Goldman Sachs. We actually have a couple of questions. The first is regarding the DSO expense, and how do you allocate DSO expense, and what portion of it was allocated to the PTS business? And what portion of it is allocated to the other parts of the business? And was the DSO expense included in that \$300 million EBITDA that you provided in the press release?

Jeff Henderson - Cardinal Health, Inc. - CFO

You mentioned several questions. I assume they were both in there. But first of all, we allocated approximately \$95 million of corporate expense to the PTS segment. And in the EBITDA of \$300 million that we referenced, we actually adjusted for that. Actually just to help you get to the \$300 million, we have a reconciliation at the back of our earnings release as well. But, if you take the expected reported operating earnings for PTS in fiscal 2007 of somewhere in the \$190 million to \$200 million range, if you then back out Martindale and Beckloff, and then adjust for the fact that they will have to take on certain of those corporate allocated costs as a stand-alone unit, and add back about \$100 million of annual depreciation, that's how you get to the \$300 million.

Adrienne Calova - Goldman Sachs - Analyst

My other question is, did you guys announce when you are planning on closing the transaction? I heard something you mentioned mid 2007. Is this correct?

Kerry Clark - Cardinal Health, Inc. - President, CEO

This is Kerry. That is our -- an expected range. Obviously we have a lot of work to do that, including completing a transaction with a buyer, so our expectation is that we could get this done around the summer.

Adrienne Calova - Goldman Sachs - Analyst

Around the summer. Will that have any implications for the second half of 2007 EPS?

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Kerry Clark - Cardinal Health, Inc. - President, CEO

I don't think so.

Adrienne Calova - Goldman Sachs - Analyst

Just out of curiosity, have you already been approached by any buyers?

Jeff Henderson - Cardinal Health, Inc. - CFO

This is Jeff. We are obviously just starting the process now. We don't want to comment on any discussions, but obviously, that process will start in earnest now that we have made a public announcement. Thank you very much. Next question, operator.

Operator

Robert Willoughby, Banc of America Securities.

John Wood - Banc of America Securities - Analyst

It's John Wood. You had \$2 billion in cash on the balance sheet as of the most recent period, and a pretty conservative capital structure in our view. What is precluding you from completing the share repurchases in a more accelerated fashion?

Jeff Henderson - Cardinal Health, Inc. - CFO

It's Jeff. Well, first of all, in our view this is an acceleration because we had originally planned on about \$1 billion of repurchases for 2007, which is in line with our commitment to do about 50% of our operating cash flow. So we are actually increasing it by 50% based on really an expectation that the transaction will close within a reasonable period.

Obviously the transaction hasn't closed, and we don't know when it's going to be. So it would be a little premature at this point to pull too much further ahead based on that expectation. That all said, we will continue to assess our capital structure and operating cash flow and other inputs on a regular basis, and make decisions under that \$3 billion authorization as management sees fit over time.

John Wood - Banc of America Securities - Analyst

One quick one. Any balance sheet metrics you can offer for the PTS business?

Jeff Henderson - Cardinal Health, Inc. - CFO

Well, it's got a net book value of \$2.1 billion. It has relatively little debt as a stand-alone unit right now -- a little debt internationally, and has some cash internationally as well. But both of those are relatively immaterial to the overall balance sheet.

Operator

Lisa Gill, J.P. Morgan.

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Alfred Bahemin - *J.P. Morgan - Analyst*

It's [Alfred Bahemin] for Lisa. We noticed in the process that this has been a significant use of management resources. With PTS now out of the way, where would you see management attention focused on going forward in terms of your four remaining segments, or anything else that you might see? And then I have a follow-up on the buyback too.

Kerry Clark - *Cardinal Health, Inc. - President, CEO*

This is Kerry. Obviously we are going to make sure we are focused on really driving the business hard in the four remaining segments. We have lots of wonderful opportunities in CTS, medical products manufacturing, opportunities in med search, and there's a lot going on in the generic space and in our pharmaceutical distribution business. So we have lots of opportunities that we are focused on, and it is going to give us a chance to work on those things.

Alfred Bahemin - *J.P. Morgan - Analyst*

Anything on the international front? You've talked about that a little bit in the past.

Kerry Clark - *Cardinal Health, Inc. - President, CEO*

Well, you know, it's interesting. This one to some degree, the divestiture of PTS, is a -- PTS is our most international business of our businesses today. On the other hand, this now gives us the real opportunity to focus on our med search businesses, primarily in the UK, Canada, France, and Germany, which are the key focus markets that we have identified before. So I think that we are going to continue to work there, but at the moment that's what our plan is.

Alfred Bahemin - *J.P. Morgan - Analyst*

Okay then just on the buyback here, you are increasing your target for fiscal 2007 by about \$0.5 billion, and any idea of whether that's going to be more weighted towards the end of fiscal 2007, because we would expect some accretion from that if it is being done earlier? Just any clarity you can give us on the timing there.

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

I think for general modeling purposes I would assume it's relatively spread over the remaining seven months of the year. But given the current stock price, we do view it as a relatively attractive buying opportunity, so it wouldn't surprise me if some of that was front loaded. But I would say generally it's going to be spread over the course of the year as the operating cash flow comes into the business.

Operator

Steve Halper, Thomas Weisel.

Steve Halper - *Thomas Weisel Partners - Analyst*

Just to clarify, on the divestiture, would you consider divesting individual pieces within PTS, or is it going to be divested all in one transaction?

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Kerry Clark - Cardinal Health, Inc. - President, CEO

Our goal is to divest it in all in one transaction.

Steve Halper - Thomas Weisel Partners - Analyst

But are you open to all different sorts of structures if that is beneficial to maximizing the value?

Kerry Clark - Cardinal Health, Inc. - President, CEO

Yes.

Operator

Terri Powers, Robert W. Baird.

Terri Powers - Robert W. Baird - Analyst

This is Terry in for Eric Caldwell. This question is both for Kerry and Jeff. You guys have been completing a series of divestitures over the last year as you've looked at portfolio optimization. And I realize that the overall business is always under review, but can you give us an update on terms of your thoughts about the overall portfolio today? Do you still see other opportunities for exfoliation, or are we largely done with this process, or some thoughts on that please?

Kerry Clark - Cardinal Health, Inc. - President, CEO

We actually hadn't thought it as exfoliation. But I would say that we are substantially complete, but we continue to look at all of our businesses, but I would say we are substantially complete with the process.

Terri Powers - Robert W. Baird - Analyst

Then just a follow-up. Can you just talk about the pharmaceutical development capabilities? Are those still retained, or what is going on with those?

Kerry Clark - Cardinal Health, Inc. - President, CEO

Well I would maybe break it into two parts here. There is the pharmaceutical work that's being done in PTS, but we -- and that of course is going with PTS. But we continue to be reasonably active in generic and generic sourcing, and we are retaining all the capability for that. And we also have capabilities to develop and work with generic manufacturers. particularly in our Martindale facility. And the Beckloff group that we mentioned earlier has a particularly good capability in regulatory clearance, which will help us as we look to expand our generic portfolio over time.

Terri Powers - Robert W. Baird - Analyst

May I ask one more question please? This was a capital intensive business, the PTS unit. Do you have any change to longer-term CapEx expectations due to this planned divestiture?

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Jeff Henderson - Cardinal Health, Inc. - CFO

This is Jeff. PTS absorbed about \$100 million, give or take, of capital expenditure each year over the past couple of years. More than that in previous years, but it had started to wind down over the last year or so. We've said publicly that we expect to spend about 25% of our operating cash flow on capital expenditures. I would say generally that target holds intact, maybe a little bit lower because PTS had a greater proportion generally, but I don't think you would see a material difference from that.

Operator

Larry Marsh, Lehman Brothers.

Steven Postal - Lehman Brothers - Analyst

This is Steven Postal for Larry. Jeff, you mentioned the -- I guess you mentioned the book value of the business and the balance sheet. I'm just wondering if you could provide any context to potential tax implications for the sale of the business?

Jeff Henderson - Cardinal Health, Inc. - CFO

Obviously it depends on the final form of the transaction, but we estimate our current tax basis to be approximately \$2.5 billion for the entities we are looking to divest.

Steven Postal - Lehman Brothers - Analyst

Okay, and then just one other question. You mentioned I guess the CapEx. What about the working capital needs for the business?

Jeff Henderson - Cardinal Health, Inc. - CFO

PTS was not a particularly working capital intensive business, so I don't think it's really a material part of the overall cash flow for the business, quite frankly. Because just to comment on that. Most of the raw materials that they were manufacturing were consigned by the pharmaceutical companies, so that they didn't have to purchase those materials prior to the manufacturing.

Operator

[Mia Levi] on behalf of Ricky Goldwasser with UBS.

Mia Levi - UBS - Analyst

Just two questions for you. The first one is in regards to guidance. If the share repurchases -- with new share repurchases of \$1.5 billion, you are saying that the guidance would have remained the same assuming that PTS would not have been taken out. So would that have impacted guidance as far as if -- should we assume that guidance would have been down if it would've remained at the \$1 billion?

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Jeff Henderson - Cardinal Health, Inc. - CFO

No. Actually my -- the comment about it being the same, we likely wouldn't have increased to \$1.5 billion absent this announcement. So all the original assumptions, including about \$1 billion repurchase, would have stayed intact. So, no, the guidance would have stayed the same.

Mia Levi - UBS - Analyst

So you think guidance would have remained the same, even if you would have upped your share repurchases?

Jeff Henderson - Cardinal Health, Inc. - CFO

No, what I'm saying is guidance would have stayed the same under the original assumptions of the \$1 billion repurchase. I should point out, though, that because a lot of this additional \$500 million will happen toward the latter part of the year, even if we had reflected it, when you offset the lost interest expense and the fact that you have only got a partial year impacted by the reduced number of diluted shares, the impact in 2007 probably would've been relatively tiny -- \$0.01 or so quite honestly.

Mia Levi - UBS - Analyst

And the other question is, just in regards to the new generic piece that you guys continue to retain, can you just talk a little bit more about that? Do you plan to fill that out more so? And how do you plan to incorporate that more so into your generic strategy?

Kerry Clark - Cardinal Health, Inc. - President, CEO

This is Kerry. I think if you look at what's happening in the generic market, this is an area where generics are going to continue to be expanding and be an important part of the pharmaceutical industry. And Cardinal is continuing to look for ways to meet its customer needs by providing a portfolio of well-priced generic product. And so we are very interested in identifying and leveraging sourcing opportunities for us that allow us to bring the lowest cost products to the marketplace for our customers. And as part of that, we are looking at expanding our sourcing of generic drugs through different locations and different capabilities and different suppliers. And so in that context, having the regulatory capability is helpful. But it is all about expanding our source of supply and being able to bring good value products to the marketplace.

Operator

(Operator Instructions). [Glen Lucas], Citigroup.

Glen Lucas - Citigroup - Analyst

I'm not sure if I missed it, but did you guys comment on what the expected sales price for the PTS business might be, or maybe you can give us more color on the valuation multiples for this same type of business?

Kerry Clark - Cardinal Health, Inc. - President, CEO

Well, the answer is no, because we don't know exactly what we're going to sell it for. We've tried to provide enough information on the EBITDA earnings of \$300 million. And I think we all have to use our judgment in looking at that, and what sort of multiple you think that business could attract. But I think there's some -- you guys have access to those multiples as well as we do. But

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that's the best advice that I could like to give you is what we think the earnings are, and then you can apply what multiples you think are appropriate for this type of transaction.

Glen Lucas - Citigroup - Analyst

One last thing. Can you comment on the percent tax -- what percent tax can we use for long-term gain?

Kerry Clark - Cardinal Health, Inc. - President, CEO

On the transaction?

Glen Lucas - Citigroup - Analyst

On the transaction, (indiscernible).

Jeff Henderson - Cardinal Health, Inc. - CFO

Until the transaction is structured, I really can't comment on that. So I think, again, for the purpose of your own assumption, I would just use the normal statutory rates.

Kerry Clark - Cardinal Health, Inc. - President, CEO

I think we're going to wrap it up here. I turn it back to you, Jason. Any further comments?

Jason Strohm - Cardinal Health, Inc. - VP IR

No. I think that's it. Thanks everybody for joining us. And that's it, thank you.

Operator

Ladies and gentlemen, this concludes the presentation. You may now disconnect, and have a great day.

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