

FINAL TRANSCRIPT

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CAH - Cardinal Health, Inc. Conference Call

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PRESENTATION

Operator

Great day, ladies and gentlemen, and welcome to the Cardinal Health, Incorporated, conference call. My name is Katina and I will be your coordinator for today. At this time, all participants are in a listen-only mode. We will conduct a question-and-answer session towards the end of this presentation. (Operator Instructions) As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the presentation over to your host for today's call, Ms. Sally Curley, Senior Vice President, Investor Relations. Please proceed.

Sally Curley - *Cardinal Health, Inc. - VP IR*

Thank you very much and welcome to today's call to discuss the Clinical and Medical Products segment and our revised guidance this morning. The call this morning will be brief; it will be 30 minutes. But we did want to provide you with some more color on our CMP business.

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I would remind everyone on the call that as we have not reported our second-quarter earnings yet, we will do so on February 5. We will be limited as to how much we can discuss today. We did, however, want to provide you with some additional perspective on this morning's announcement.

We will be making forward-looking statements today. The matters addressed in these statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected or implied. Please refer to our SEC filings and the cautions concerning forward-looking statements at the end of today's press release; and also they can be found on our investor page of our website.

In addition, we will reference non-GAAP financial measures; and information about these measures is included at the end of the release as well as on our website. You may also find a transcript of today's call on our website.

With that out of the way, I would like to turn the call over to Cardinal Health Chairman and CEO, Mr. Kerry Clark. Kerry?

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

Thanks, Sally, and good morning, everybody, and welcome to this morning's call. George, Dave, and Jeff are with me here today. We will all be available for Q&As, but Dave will be making some specific comments about Clinical and Medical Products. So let me just begin with some comments on overall context.

Of course, we are disappointed we have had to revise the fiscal year '09 guidance from \$3.50 -- to \$3.50 to \$3.60 over the year. But we feel that we just have to do that, given the current credit climate and its impact on hospital capital spending.

In many ways, we feel this is a strange environment to have to adjust guidance, because we don't believe there is any fundamental change to long-term demand, and we believe we are experiencing simply a deferral in capital spending. Dave will explain this to you in a moment or two.

On the positive side, though, I am very pleased with the growth we have seen in Q2 and with our ability to demonstrate operating strength here, leading us to provide Q2 guidance of at least \$0.90 non-GAAP EPS. And importantly, our segment guidance for HSCS has not changed, and we expect to report a solid Q2 and first half. We are encouraged by our progress and are looking forward to a stronger second half.

On a total Company basis, we have taken and are taking appropriate steps to cut spending in an effort to mitigate the impact of the hospital capital spending delay without jeopardizing our long-range plans.

Now let me turn it over to Dave for some specific comments on Clinical and Medical Products. Dave?

Dave Schlotterbeck - Cardinal Health, Inc. - Vice Chairman, CEO of CMP

Thanks, Kerry. As Kerry mentioned, we are disappointed to be revising our guidance, but it is necessary given what we are seeing in the market. I want to provide you with more information about this delay in hospital capital spending and what we have done to mitigate its effect on our business.

First, it is important to note that we are primarily seeing the slowing in the capital equipment side of our business. And even there, it is concentrated in a couple of segments.

Capital equipment orders are the strongest in the third month of the quarter, so it's not unusual to see a strong pipeline with modest order rates during the first two months of any given quarter. This was our experience in October and November.

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We saw some early indications of slowing capital equipment sales, which I noted to you during our Q1 call at the end of October. During November, we heard more from customers, particularly in our respiratory business, that they were delaying their purchases as the credit markets tightened. It wasn't until recently that it became clear we would be affected across our capital equipment businesses.

Now that brings me to the second important point I want to make. Customers have been clear they are only delaying their spending. In other words, we are not seeing any fundamental change in the competitive landscape. We are not losing business to competitors. Customers are telling us that they are pausing for the credit markets to improve and to develop more certainty in their own outlooks. The underlying demand is still there, and it will return as the credit markets continue to thaw.

We are seeing the effect of the delay more in our infusion business, which we now expect to be down in committed contracts by about 20% to 25% from last year. Of our four major capital equipment lines, we see much less of an impact on our medication dispensing products; and our respiratory business is in the best shape of all versus the prior year.

This is not to say that any of these product lines are meeting expectations that we had at the beginning of the year. However, I do want you to have some perspective on the most and least affected areas of the business.

Which leads me to my third point. We continue to see stability in our businesses that are linked to procedures and admissions. These are primarily our disposables products, those dedicated to our equipment and those not dedicated to our equipment, that in total comprise more than 40% of our business.

We continue to see strong contributions from our infection prevention products, including ChloroPrep from last year's acquisition of Enturia, and our surgical instrument lines.

Finally, we are taking steps Company-wide to mitigate the effect of the slowdown. Specifically, in CMP we have already taken steps to rightsize our manufacturing operations to bring them in line with the lower demand levels we've seen in this environment. We have made significant reductions in our infrastructure costs and discretionary spend to bring it more in line with our current views on full-year profit growth.

While we are looking at all operating expenses, we are working to maintain our core R&D spend, because it really is the lifeblood for Clinical and Medical Products. Additionally, we have instituted hiring freezes and travel restrictions.

Taking all of this into account, we now expect CMP segment profit for the fiscal year to be flat or better than last fiscal year. I will provide another update when we announce our Q2 results in early February. I think we have a handle on the current environment, and we are taking the right steps to deliver as strong of a year as possible.

Now I think we have time for a few questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Lisa Gill, JPMorgan.

Lisa Gill - JPMorgan - Analyst

Good morning. Dave, I was wondering if you can just talk about if this will change any of your plans around the potential spin of the CMP business.

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Then secondly, as you talk about taking out the cost, I'm just wondering how quickly you have been able to take out those costs. Is this something that we will start to see the costs come down over time over the next couple of quarters? Or are these things that you have been able to take out already?

Dave Schlotterbeck - Cardinal Health, Inc. - Vice Chairman, CEO of CMP

Well, to your second question, Lisa, we have already taken nearly 90% of the actions that we needed to, to remove costs. And so we are living with a lower spend rate at this very moment.

I apologize; I need you to repeat the first part of your question.

Lisa Gill - JPMorgan - Analyst

Yes.

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

Lisa, this is Kerry. Let me take the first part of your question, which is how it affects us. I just want to assure everybody that we are continuing to proceed forward. We do expect to file the SEC Form 10 by the end of this quarter. We will be ready to proceed by this coming summer.

In fact, we are feeling optimistic because of the unfreezing in the credit markets continues to keep us fairly optimistic that we are going to be able to execute as planned.

Lisa Gill - JPMorgan - Analyst

Okay, great. Then just one follow-on. I know Dave talked about the fact that the consumable portion of the business is not being impacted very much. But I am just wondering, on the Allegiance side of the business, are you seeing any changes in admission trends? Are you seeing any changes on that side of your business due to what is going on in the hospital environment?

Dave Schlotterbeck - Cardinal Health, Inc. - Vice Chairman, CEO of CMP

Well, we have seen of course a number of independent reports that indicate that admissions are down, most commonly 3% to 4%. It really has had no meaningful effect on that side of the business, Lisa.

Lisa Gill - JPMorgan - Analyst

Okay, great. I look forward to seeing you next week.

Operator

Ross Muken, Deutsche Bank.

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Ross Muken - Deutsche Bank - Analyst

Good morning. I was just interested in the disparity in the declines in infusion and dispensing, in terms of the magnitude. Are you sort of surprised by that? Is it a price point issue? Is there another sort of particular kind of driver of the fairly wide gap in terms of performance you are seeing there?

Dave Schlotterbeck - Cardinal Health, Inc. - Vice Chairman, CEO of CMP

Well, actually as I think it through, Ross, I am not surprised in the disparity. As I look at the infusion business, nearly every hospital in the United States, for example, purchases one infusion device per bed. So they have got a lot of them already installed. To make a decision to put off a spend to do replacements by six months is something that they are very capable of doing.

When I consider the dispensing side of the business, if a hospital already is a dispensing customer, they are already leasing equipment. So this is baked into their normal operating expense on a monthly basis, and it's really a much easier decision to continue to make the payments so that you can keep the equipment.

Then on the respiratory side of the business, these are life-saving devices. They do have a finite useful life, and there is, I would say, a much less likely pattern of hospitals putting off buying life-saving equipment. If you need that, you just have to have it.

They also have a much smaller number of respiratory devices in their institutions. So for example, a 300-bed hospital would likely have 300 or more infusion devices; and in respiratory devices they may only have 20 to 40.

Ross Muken - Deutsche Bank - Analyst

I see. Just quickly in terms of where you think we are in the hospital CapEx cycle, typically it has taken them quite a while to kind of readjust their budgets once they've begun the cutting process. They have been at times somewhat reticent to reaccelerate until we saw recovery in volumes or they started to see better interest income, et cetera.

So where do you think we are in that process? Is the magnitude of change you are seeing here similar or different to what we've seen in prior cycles when there was a fairly significant pullback?

Dave Schlotterbeck - Cardinal Health, Inc. - Vice Chairman, CEO of CMP

Well, I only know of one other prior cycle where hospitals really tightened their belts, and that was in the early '90s. That cycle lasted about a year, and that is in fact what we are planning for -- that this cycle would go through pretty much the end of 2009 calendar.

Ross Muken - Deutsche Bank - Analyst

Great. Thank you, guys.

Operator

Ricky Goldwasser, UBS.

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Ricky Goldwasser - UBS - Analyst

Good morning. A couple of follow-up questions. First of all, can you just give us the tax rate for the fourth quarter? I know you said the tax rate was lower.

Then secondly, what are the assumptions factored in the lower end of the revised guidance? Are you assuming any slowdown in disposables at this \$3.50 level? What are the other operating assumptions at the low end of guidance? Thank you.

Jeff Henderson - Cardinal Health, Inc. - CFO

Good morning, Ricky. It's Jeff. Let me try to address both of those, and then I will let Dave and George come in on the second piece of it.

First of all, with respect to the tax rate, when you said Q4, I assume you meant our Q2. We have previously said that the tax rate would be around 36%. That was based on an assumption related to the installation of a new state tax software system that we are putting in place in Q2. A very preliminary estimate was that that was going to increase our state deferred tax rate accruals for the quarter.

In fact, once we put the system in place and it was up and running, it turns out it didn't have a significant impact on the deferred tax rate. So we now expect our tax rate for Q2 to be in the 33% to 34% range versus the 36% that I cited earlier. That 33% to 34% is much more in line with the overall tax rate we expect for the full year.

So if you look at our expected overperformance versus our internal expectations and versus many of the expectations that I know you guys had, I would say about half of it is due to the improvement in the tax rate and the other half is due to some very solid operating performance that we had in Q2.

With respect to your second question, really the bring-down for the year, Ricky, is almost exclusively related to the changing capital equipment -- or the deferral in capital equipment ordering that we are seeing within CMP. We really haven't seen a material slowdown in the admissions-based or procedure-based part of the business, either within CMP or within HSCS. So our projections for the year in that regard are relatively consistent with where we started out.

To that regard, HSCS continues to be very much on track for the full year, for Q2, and for the second half of the year, which is obviously very positive for us. I will let Dave and George comment further.

Dave Schlotterbeck - Cardinal Health, Inc. - Vice Chairman, CEO of CMP

I would echo Jeff's comments. We have actually seen growth in disposables, and our guidance includes that growth continuing through the balance of the fiscal year. So we feel pretty good about that part of the business.

George Barrett - Cardinal Health, Inc. - Vice Chairman, CEO of HSCS

Ricky, it's George. As Jeff said, we have really not changed our expectations on the HSCS side. There was a question earlier about the former Allegiance businesses; and part of that is in Dave's world, part is in mine. And I would echo Dave's comments there, which is, while there is external data that reflects lower admissions rates, our old Allegiance businesses or the med surg parts of the businesses are holding up pretty nicely.

So, we have not made any changes to our expectations as we go to the back half of the year.

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Ricky Goldwasser - UBS - Analyst

Okay. Jeff, just following up on the benefit for the fourth quarter. You said half is from the tax rate, half is from the strong operating results. The strong operating results are coming from which side of the business?

Jeff Henderson - Cardinal Health, Inc. - CFO

I don't want to get into too many details because we actually haven't finished closing our books, and we've got our Q2 release on February 5. But I would say they are coming from both sides of the business, Ricky.

We have been very happy with the results that we have seen so far for our Q2, based on what we have been able to gather from the quarter.

Ricky Goldwasser - UBS - Analyst

Okay, thank you.

Operator

Eric Coldwell, Baird.

Eric Coldwell - Robert W. Baird - Analyst

Thanks. Most of my questions, frankly, have been asked and answered, but I just wanted to check. It sounds like you are not seeing any change in the competitive landscape or dynamics of your competitors in terms of their market behavior.

But I just wanted to verify that you are not seeing pricing come down or any kind of a market response from some of the competitors, whether it be in infusion or respiratory or other. Any comments on that would be helpful.

Dave Schlotterbeck - Cardinal Health, Inc. - Vice Chairman, CEO of CMP

Eric, that is absolutely right. We have seen no change in the competitive landscape at all across each one of these businesses.

I happen to believe that our respiratory business is the least affected, while we know that certain competitors have had significant effects on their business. I think that that is the result of having superior products.

We are not losing deals to competitors. So my view is that this is something that is much more across the board from the demand standpoint as opposed to supply.

Eric Coldwell - Robert W. Baird - Analyst

Dave, at the -- I think it was the June Med Tech Day that we attended in San Diego, you were showing off a new respiratory line, the Enve product. I am curious if we could get an update on how that launch -- I assume it is launched at this point -- how this that has gone in this environment.

Then just as a follow-up, I believe at that day you said you that you planned to launch 45 to 50 new products by the end of calendar 2009. I'm just curious whether any of the market dynamics that have been addressed today would be changing your outlook for launching new products or changing your experience with how those launches are proceeding.

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Dave Schlotterbeck - Cardinal Health, Inc. - Vice Chairman, CEO of CMP

Well, first on the new Enve ventilator, that is scheduled for a full product release this summer, and it is on track for that.

The balance of the 45 to 50 new products are also remaining on track. In fact, we just introduced at ASHP in December five of those products. Those were primarily targeting the dispensing business.

So I feel very good about the product pipeline and the impact that they will have on the business in a positive way.

Eric Coldwell - Robert W. Baird - Analyst

Great. The last question, and appreciate your time, during your prepared comments you said that you looked at the four capital equipment lines of CMP. Am I to assume that you are separating pharmaceutical dispensing equipment from med surg dispensing equipment at Pyxis? Was that one of the differentiations?

Dave Schlotterbeck - Cardinal Health, Inc. - Vice Chairman, CEO of CMP

That is exactly right, Eric.

Eric Coldwell - Robert W. Baird - Analyst

If so, could you give us -- just to be clear -- the exact rank order of where you are seeing the most impact on the slowdown to the least? I wasn't clear on whether prescription dispensing was worse, for example, then med surg.

Dave Schlotterbeck - Cardinal Health, Inc. - Vice Chairman, CEO of CMP

Okay. The most is, as I said, infusion; then would be the med surg dispensing; then med dispensing; and the least would be the respiratory business.

Eric Coldwell - Robert W. Baird - Analyst

Thank you very much.

Operator

Charles Rhyee, Oppenheimer.

Charles Rhyee - Oppenheimer - Analyst

Thanks for taking the question here. Just had one follow-up here. I think, Dave, you mentioned that in addition to the disposal business, the Enturia acquisition that you made is showing good progress. Would you say that --? I just want to get a sense on -- obviously some of your other businesses aren't necessarily meeting expectations, though they are not as impacted.

Is the same true here? Or is this still meeting expectations relative to when you made the acquisition last year?

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Dave Schlotterbeck - Cardinal Health, Inc. - Vice Chairman, CEO of CMP

Well, let me say if every business were behaving like Enturia, we wouldn't be having this call. I have been extremely pleased with Enturia's performance. They are performing ahead of our expectations and ahead of our deal model. I just feel really, really positive about where that product line is going.

Charles Rhyee - Oppenheimer - Analyst

Okay, great. That's it. Thanks a lot.

Operator

Robert Willoughby, Banc of America Securities.

Robert Willoughby - Banc of America Securities - Analyst

Jeff, do you have a quick update, perhaps, on just FX impact in the quarter, what you are seeing going forward?

Jeff Henderson - Cardinal Health, Inc. - CFO

Yes, you know, it was a very interesting quarter actually from an FX standpoint. Because during the early part of the quarter, the US dollar had strengthened almost 20% from the sort of weighted average rate that we had seen in the summer. Then it gained a lot of that back in the last three or four weeks.

Net-net I think the foreign exchange impact will still probably be slightly negative for the quarter, although we are still working through all that. But not nearly as severe as it could have been if rates would have stayed where they were in early November.

Robert Willoughby - Banc of America Securities - Analyst

And the guidance going forward reflects just an ongoing deterioration then?

Jeff Henderson - Cardinal Health, Inc. - CFO

Yes, it reflects a reasonable range of possible outcomes for the dollar based on where it is right now, and a range for possible scenarios through the end of the year.

Robert Willoughby - Banc of America Securities - Analyst

Was there any update at all in terms of the businesses that you have called out under Other? Is that portfolio still intact, or have we seen any action there in terms of divestitures?

Jeff Henderson - Cardinal Health, Inc. - CFO

As you know, we sold Tecomet and MedSystems at the end of Q1. With respect to Medicine Shoppe and Pharmacy Services, the status remains the same. We continue to conduct a strategic analysis of those businesses and are still going through the process of making a determination of where they best fit in the future. So no change.

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Robert Willoughby - *Banc of America Securities - Analyst*

Great. Thank you.

Sally Curley - *Cardinal Health, Inc. - VP IR*

Operator, I think I apologize in the interest of time, I think we have time for one more question.

Operator

Larry Marsh, Barclays Capital.

Larry Marsh - *Barclays Capital - Analyst*

Thanks. Good morning and I will be quick. Just wanted to clarify, today you are saying that the December quarter is in line with expectations; a little bit lower tax rate, Jeff, as you had mentioned. But anecdotally, you're saying the hospital spending environment is getting worse, especially on the infusion business, Dave.

So, relative to when you gave that outlook back in October, it seems like the environment has gotten much worse. I am still unclear why you wouldn't have seen more of an impact in the December quarter, given the challenges you are seeing. Because it doesn't sound like there is any shortfall in CMP in the December quarter.

Is that right? And why wouldn't there have been more of a shortfall?

Dave Schlotterbeck - *Cardinal Health, Inc. - Vice Chairman, CEO of CMP*

Well, that's a very insightful question, Larry, and it all has to do with the order-to-installation cycles of each one of these businesses. So what we convert from our backlog in the second quarter was actually booked either the fourth quarter of the prior fiscal year or, in some cases, the first quarter of the current fiscal year.

So, we actually have some running room when we begin to see a slowdown, which delays the actual effect of the slowdown.

Larry Marsh - *Barclays Capital - Analyst*

So that lag will be a quarter or two, it sounds like.

Dave Schlotterbeck - *Cardinal Health, Inc. - Vice Chairman, CEO of CMP*

Yes.

Larry Marsh - *Barclays Capital - Analyst*

Okay, all right. That's all I had. Thanks.

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Jeff Henderson - Cardinal Health, Inc. - CFO

Larry, it's Jeff. Just to clarify, you used the term in line with expectations. Actually, our term was better than expectations in the quarter. That is for the reasons that Dave said, also due to tax rate, but also due to solid performance within HSCS.

And I think finally some of the impacts of the restraint in spending that we have put in place for the year obviously are starting to flow through in Q2 and will continue for the rest of the year.

Larry Marsh - Barclays Capital - Analyst

Okay. Very good, thanks.

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

Everybody, thank you very much. This is Kerry. I think we have really run up to the top of the hour. I apologize we ran out of time. We will be presenting at the upcoming conference, and so we will have a chance to talk to more folks there.

But, today, of course, please feel free to call Sally or Jon with any follow-up questions; and if you need to contact anybody else, Sally and Jon can arrange that. So we will be very available throughout the day to finish up with any questions that didn't get covered today.

And thanks for joining us and being part of this. I appreciate it. Thank you.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes your presentation. You may now disconnect. Good day.

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