FINAL TRANSCRIPT

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CAH - Q4 2008 Cardinal Health, Inc. Earnings Conference Call

Event Date/Time: Aug. 07. 2008 / 8:30AM ET

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the fourth quarter 2008 Cardinal Health Inc. earnings conference call. My name is Erica, and I will be your coordinator for today. At this time all participants are in a listen-only mode. We will be facilitating a question and answer session towards the end of this conference. (OPERATOR INSTRUCTIONS) I would now like to turn the presentation over to your host for today's call, Ms. Sally Curley, Senior VP of Investor Relations, please proceed, ma'am.

Sally Curly - *Cardinal Health, Inc. - SVP IR*

Thank you, Erica, and welcome to today's call, everyone. In today's call we will actually be slightly extending it to 10 a.m. in order to accommodate as many of your questions as possible. If for some reason we run out of time prior to answering all of your questions, I would invite you to call investor relations and we will be happy to accommodate. Also today we will be making forward-looking statements. These statements also include assumptions around fiscal 2009 forecast and longer term goals and objectives. 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 forward-looking statement slide at the beginning of the presentation for a description of those risks and uncertainties. We will reference non-GAAP financial measures and information about non-GAAP financial measures is included at the end of the slide presentation. Both a transcript of today's call and a set of recap financials, as well as the slide presentation are available on our investor web page at www.cardinalhealth.com. Now I'd like it turn the call over to Cardinal Health Chairman and CEO, Kerry Clark.

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

Thank you, Sally, good morning, everybody. I want to start off today by putting some of our recent organization changes in context and addressing today's news that we are considering a spinoff of all or part of our clinical and medical products segment. Going back, you may recall that in late fiscal year '07 we sold our pharmaceutical technologies and service businesses and established two sectors, Healthcare Supply Chain Services and Clinical and Medical Products. We felt this structure simplified Cardinal Health, allowing us to create scale in each sector and to create better focus on our core businesses. Last month in the beginning of our fiscal year '09 we took another step in this direction by establishing these two sectors as two separate operating and reporting segments led by George Barrett and Dave Schlotterbeck.

Each segment has been designed to be closer to its customer, to be more innovative, to reach decisions faster and to have a best in class cost structure. With that behind us, we now think we should explore whether or not to take another step by spinning off all or part of the CMP segment, thereby creating two publicly traded companies in a tax free manner. We expect to make a decision by our next earnings call in October. But whatever the outcome, please note that the current Cardinal Health, that which you see today, will be the Cardinal that you should follow through most of fiscal 2009. Regardless of our decision, our goal is simple, to allow each business to become the best it can be in meeting the needs of our customers, our investors and our employees.

As Cardinal Health's portfolio has continued to evolve, we believe it is important to keep reviewing whether we are designed in the best way to deliver value to all of our stakeholders. For example, CMP has matured and grown, especially with the VIASYS and Enturia acquisitions. It now has sales of approximately $4.6 billion. It's growing rapidly and it has very attractive margins. We are increasing our investments in growing the pipeline of talent, products and innovation. The changes now underway are designed to simplify the organization and create more synergy across the previous CTS and MPT portfolios. Our Healthcare Supply Chain Service segment has been challenged over the past year, particularly in pharma distribution. We need to focus on executing the basics with excellence, with the right programs in the right channels at the right cost and the right profitability.

This is the major single-minded focus of all Cardinal Health management and it will require investments in customer facing IT to reach our long-term goals. George will provide you with more specifics on our programs in a moment. But I'm pleased to say that we are forecasting the segment will return to growth in the second half of fiscal '09 and we believe that is an important milestone. Decisions about the future design of Cardinal Health will be based on what we believe is best for the long-term. This review process is underway and we expect to announce a decision before the next earnings call. While the timing is uncertain in these matters, should a decision be made to spin-off all or a portion of CMP it could take us around 12 months before it takes effect. Now, before Jeff takes us through the fiscal year '08 actuals and fiscal year '09 guidance, I want to make a few other comments.

First, as we have said over the past two quarters, our CMP and medical surgical distribution businesses have been performing as we forecasted, although there has been some quarter by quarter fluctuation. These businesses are healthy and we are looking forward to continued progress in fiscal year '09. Our challenge has been in pharmaceutical distribution. As we have said, the factors that have been affecting the second half of fiscal '08 will continue to impact the first half of fiscal '09. As we said before, these factors are -- first, the previously discussed repricing of some major contracts; second, the loss of customers, particularly retail independents, due to anti-diversion challenges; and third, volatility around the nuclear pharmacy business as Cardiolite goes generic.

As we have also been suggesting, we do not expect these issues to be as much of a problem in the second half of fiscal 2009, so we are forecasting our return to growth in segment profit in the March and June quarters and that is great news. But, when we add the full year together for pharmaceutical distribution, with a decline in the first half and growth in the second half, overall fiscal '09 profits HSCS will be flat to down 5% from last year, despite reasonable growth in revenue. There are also some other nonoperating factors that will provide headwinds to our fiscal '09 results, including a higher tax rate and an increase in interest expense, which Jeff will cover in more detail. I also should point out that in the light of the strategic options we are considering for the Company, we will likely be significantly downsizing our share repurchase program for fiscal '09, which will affect shares outstanding.

In addition, and very importantly, we will also be making significant investments in R&D in CMP and IT in HSCS. We are choosing to make these investments to help each segment prepare for the longer term future. In many ways we see fiscal '09 as a transitional year for Cardinal Health, where we put the foundation for future growth under both segments. We are very optimistic about the future for both of these businesses. As you know, these two segments are very different. They have different business models and key factors for success. But both need to refresh their models to be well positioned for future growth and we will be making those investments this fiscal year. For these reasons we believe that the guidance of $3.80 to $3.95 per share represents an achievable realistic forecast based upon what we know today. George and Dave will shortly provide you with more details around each of their segments, but first let me turn it over to Jeff for a recap of fiscal '08 and our fiscal '09 forecast. Jeff.

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

Thanks, Kerry, and good morning all. Today I'd like to provide you with high level comments on both FY '08 and FY '09. You can see the detail in both the news release as well as in the slide presentation, which are available to you on our website at www.cardinalhealth.com. I'll keep my FY '08 comments brief and just highlight a few key items and trends there. Then I will spend most of my time discussing FY '09 and our forecast assumptions. A quick recap on our past year. I won't comment specifically on slides five through 11, but will just give some overall comments. We posted non-GAAP operating earnings from continuing operations of $568 million for Q4 and $2.2 billion for FY '08. Non-GAAP EPS was $0.97 for the quarter and $3.80 for the year. Our non-GAAP tax rate for the year was about 32.6% and our operating cash flow was $1.6 billion.

We executed $1.1 billion in share purchases under our programs in FY '08 and for the year averaged approximately 364 million fully diluted shares outstanding. For the quarter and the year we had approximately $35 million and $123 million in special item charges respectively. This netted against impairment gains of $10 million in the quarter and $32 million for the year. All these were primarily related to restructuring and acquisition charges, as well as a sale of a few of our businesses. But now a few general comments about the year. Both of our CMP businesses, CTS and MPT, had very strong years and continue to bolster the prospects of the future. We are ahead of schedule with the VIASYS integration and we began the integration of Enturia, which strengthens our presence in the infection prevention area.

Within HSCS medical, we delivered what we set out to, we turned around our US med-surge distribution business and to make some key operational improvements within our Presource kitting business. One final comment I would like to make about pharma distribution relates to the decline in our DSD revenue in Q4, which as mentioned in the news release was down about 5%. There's a few apples and oranges here that I would like to point out that skewed the year to year comparison. First, there was a change in the form of our sales to a large customer in Q4 '07 which resulted in a onetime revenue increase of $200 million for that quarter. And in Q4 of '08 there was a movement of business from one of our largest customers from DSD to bulk, which is worth about $450 million in revenue. In addition, the loss of retail independent business associated with our anti-diversion activities had an impact as well, as George will cover.

Now let's jump to slide 11 and our key financial drivers. I'm quite proud of some of the items we accomplished in a challenging year. Specifically, we reduced inventory by three days in the quarter versus last year, increased our dividend by 17% to $0.14 per quarter per share, and ended Q4 at 33% debt to capital ratio, which is within our CA goal. The net result of all these activities is a non-GAAP return equity of approximately 18.4% in Q4 of '08 versus 17.3% in Q4 of '07 and 19% for this fiscal year versus less than 17% in the prior fiscal year, a considerable improvement. This leads us to our FY '09 discussion. I want to start with rationale for our new guidance structure, as well as some assurances for you that we will continue to try to be transparent. You can refer to slides 13 to 17 as I walk through the guidance.

The new guidance structure is more streamlined, fits more with our new structure as announced July 8, and is consistent with both others in this industry and overall market practices. Based upon what we see, we currently are projecting achievable realistic guidance of $3.80 to $3.95 per share for FY '09. This is based upon total revenue projections of 6% to 7%, HSCS segment profit flat to down 5%, and CMP profit growing greater than 20%. We know that our FY '09 guidance may come as a disappointment to many of you. However, let me take a moment to highlight the overall trends, as well as our forecast assumptions and why we believe that this is realistic given what we know now. Our assumptions are split into two categories, our overall corporate perspective found on slide 14 and our segment related assumptions found on slide 15 and 16. I'll start with some overall corporate assumptions.

First, and probably most importantly, both of our segments are making significant investments in FY '09 to further improve our competitive position. As Kerry mentioned, much of our incremental strategic spending in FY '09 will be focused on product R&D and needed IT improvements, both of which will best position our respective businesses for the future. In fact, compared to last fiscal year we are budgeting up to $100 million worth of incremental strategic investments and that is reflected in our guidance range. We expected higher overall corporate tax rate of about 34%, which reflects anticipated shift in income from lower to higher tax regions, as well as the impact of some expiring international special rates. Interest in other is estimated to be approximately $180 million to $190 million, which is higher than FY '08 due primarily to some FX gains we experienced last year.

We are estimating average diluted shares outstanding for FY '09 in the range of 361 million to 362 million. In light of today's announcement about the strategic options we are considering, this share forecast incorporates a relatively conservative view of share repurchase, size and timing. It is clearly an assumption that will be revisited when we have reached a decision regarding exploration of the spinoff of CMP. And I should point out that the previous board authorization in this area stays intact. When compared to FY '08, the impact of these three items, increased tax rate, higher interest expense and shares outstanding, account for about $0.05 of incremental headwind. A few other items of note which affect our consolidated projections. Related to our recently announced restructuring program, we have forecasted cost savings in the range of $80 million to $90 million, which are built into our numbers and a significant portion of which will be used to offset the rising cost of oil and oil related commodities.

In fact with respect to this, while we are not immune to increases, we believe we have budgeted for them appropriately this year and is reflected in today's guidance. To date we have taken on the majority of the increase cost burden, but we are working closely with our partners to ask that they share in this responsibility. We anticipate operating cash flow to be in the range of what we experienced in FY '08. Finally just a few comments regarding the balance sheet. Our goal is to maintain our strong investment grade rating and our debt levels at about what we have seen in FY '08. We anticipate capital expenditures to be in the mid $400 million range, with much of that devoted to IT investments. Regarding divestitures, we are assuming that Tecomet and Med Systems are not in our '09 guidance. In fact to that end, we have signed a definitive agreement to sell Tecomet to Charlesbank Capital Partners (corrected by company after the call) and Tecomet Management.

That's it for the overall corporate assumptions. Let me move into the segments assumptions now. I'm not going to go over each one, but will try to highlight just a few. On the distribution side we anticipate that our DSD margins will stabilize as we get into 2009. However, on an overall margin basis we would not expect it to be enough to offset the mix impact of the faster growing bulk business. Our assumptions also include that we will be able to settle with the DEA in the first half of the year, that Borschow is accretive, and that we will not participate as a manufacturer of generic sestamibi. George will elaborate a little bit more on this last point in a moment. Our assumptions for CMP is that we will see a year of continued growth. As previously mentioned, we will be increasing R&D expense and anticipate approximately 50 new products or product enhancements to be launched during the next 18 months. Dave will discuss that in more detail in a moment.

Finally I want to talk a little bit about our financial reporting format for this year. Many of you have asked about this. Specifically, how we will be reporting next fiscal year, or this fiscal year and what visibility you will have into the businesses, particularly CMP as it involves products with despair industry growth rates. We will obviously start with reporting revenue and segment profit for our two new reporting segments. In our SEC filings we will supplement that with our anticipated reporting product categories for revenue as shown on slide 17. This may change slightly, but our goal is to provide you with the appropriate level of detail so you can best understand the business and make your own assessments. As a final word, although we don't want to get in the habit of providing quarterly guidance, I do want to make a comment on Q1given its somewhat atypical outlook.

The numbers for Q1 FY '09 will be relatively weak, around $0.70 per share, due to challenges which still persist in the pharmaceutical distribution area, unfavorable comparisons to the prior year based on strong Q1 FY '08 branded inflation contribution, and the fact that the impact of some of our new efforts won't take hold until the second half of FY '09. As a result, the comparison for this year's Q1 versus last will be challenging before we get back on track for the rest of the year. You look at our full fiscal 2009 forecast, I recognize that some of you have higher EPS estimates for the year. Compared to some of the estimates we have seen published, I suspect that our assumptions for tax rate, shares outstanding and interest in other accounts for about $0.14 to $0.15 of difference.

Majority of the remainder of the differential is really based on the additional significant investments we have chosen to spend this fiscal year to better position the Company for the future from a competitive standpoint. I hope this provides you with some color around our historical financials, as well as our FY '09 forecast. I'm happy to answer any additional questions during Q&A. But now I would like to turn the call over to George for some comments on the HSCS segment.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

Thanks Jeff, and good morning, everyone. For those of you following the slide presentation, slide 19 and 20 will provide you with some additional background on my comments here. It has been a year of some challenges for HSCS, but we finished the year as we forecast. As we anticipated, growth in our combined medical businesses was positive for the second half. Although our surgical kitting business continued to battle some price pressures and the impact of its effort to reduce inventories and create a leaner operation, our medical distribution businesses, which includes lab, ambulatory and hospital supply, had very strong years. Hospital supply had its strongest performance in years. Additionally, our lab business managed to grow year-over-year in spite of the previously announced loss of its largest customer. Our ambulatory business, although small, grew nicely and shows great promise.

Across our medical businesses we were awarded some key contracts late in the year and we expect these to benefit us in the latter half of '09. The addition of Mike Duffy, our former EVP of Operations, to oversee the medical leadership team will help us bring new alignment between our operational units and customer facing activities. Mike and his team will be very focused on matching the right SKU mix to the right customer need and in driving operational efficiencies, improved service levels, reduce cycle times and a more profitable customer and product mix. On the pharmaceutical side, our nuclear pharmacy business maintained its very strong market position and customer loyalty, but also experienced challenges heavily influenced by increasing cost of raw materials. We have expanded our product line to include both Cardiolite and Myoview and remain committed to offering the entire range of nuclear pharmacy products used in cardiac imaging, including a low cost alternative.

As Jeff mentioned, we have forecast 2009 with the conservative assumption that we will not be offering our own manufactured (inaudible) during this year. We have, however, made provisions with existing suppliers to allow us to compete more effectively should a generic product hit the market. And I should let you know we have assumed that a generic product will, in fact, be introduced. Also in nuclear we announced mid-June that we will open three additional positron emission tomography, or PET, radio pharmaceutical manufacturing facilities near our existing nuclear pharmacy locations this year, bringing the total number of cyclotron to 25. We are able to distribute our PET products through nearly half of our more than 150 US nuclear pharmacy locations, which is needed due to the short half-life of the PET imaging agents used to diagnose disease. This is not a large business for us today, but one that we believe could demonstrate rapid growth.

Finally, our largest business, our pharmaceutical distribution business, had one of its toughest years. I want to reinforce driving improvement in this business is our highest priority. In my first opportunity to address you on our third quarter call, I highlighted some of the areas which I believed would be important in improving the performance of our pharmaceutical distribution business. I highlighted the importance of focus and in particular a focus on execution. I discussed our need to more effectively segment our business so that we could target the right opportunities. I stressed the necessity of improving and simplifying our generic programs and to better integrate them into our overall offerings. And I told you that we would revisit and reinvigorate our value proposition. Although it is not immediately apparent from our financial results, I am confident that we are making progress on all fronts.

And I'd like to give you a brief update on these efforts. Our organization is indeed more focused on execution. Our anti-diversion issues need to be the starting point. We have fully committed our organization to the necessary improvements and the management of controlled drugs. We have put in place new procedures, both automated and manual, to improve our controls. We have conducted over a hundred training programs, which have included over 2500 Cardinal associates. And I can say that we are in constructive settlement discussions with the DEA. From an overall operational execution standpoint, we are seeing improvement in our service levels, as evidenced by our key customer service metrics, first time fill rate and delinquency days outstanding, both of which are ahead of last year and ahead of our internal goals.

In our segmentation work we have recommitted to growing our direct store door, or DSD business. Our anti-diversion programs have hurt our DSD business and made growth more challenging. Despite this, we are seeing some good signs. We are (inaudible) programs specifically targeting these non-bulk customers. We are focused on increasing our share of wallet with our existing accounts, that is capturing a greater share of their purchases, and we are focused on recapturing business lost during this past year. We are doing this by improving the quality and the value of our offerings which help our customers to compete in the marketplace. For example, we have focused our Leader service offerings around four key areas of a retail independent pharmacy, reimbursement support, streamlining operations, creating alternate revenue streams and increasing market share.

Our Leader pharmacy partners now have access to more front-end offerings, we well as medical equipment in high demand from our aging population. I just returned from our 19th annual retail business conference, which brings together thousands of retail pharmacists. This was the best attended conference in our history and the feedback on our services and products and in particular our leader offerings was very positive. Just as an example of the impact a program like this can have, we recently completed an overhaul of a retail independent in south Florida that implemented all of ur front end programs and saw its front of store sales increase from 3% to more than 10% of its total sales. That equated to approximately $200,000 more in annual sales for this particular pharmacy.

As we look across all our classes of trade, we are getting very good feedback on our generic programs, our managed care and reimbursement support services, and are automated as on calling tool which helps pharmacies remind patients that their medications need refilling. We've had several recent new customer wins, including Prime Therapeutics which was announced last week, each of these is a small step forward, but helps to validate our efforts, the benefit of which we should begin to feel in the latter half of the year. Our generic program, like our other programs, has been handicapped by our anti-diversion issues. Our new generic programs are simpler, more transparent and more tightly aligned with our interest in growing our overall retail business. Again, the data from a recent retail business conference indicated that this was the most successful program we have ever had for our generic business.

Our recent launches of three generics, the generic equivalence of Risperdal, Lamical and Yasmin, helped to highlight that we were getting very good at executing very fast, high volume, generic launches, a critical success factor in this business. Finally, we are making reaffirmation of our value proposition for HSCS an actionable item. We are approaching all of our contract discussions with a conviction that our value is meaningful and we are working hard to demonstrate this in economic terms to our customers in all segments and to vendors in our DSA discussions. While I would love to say that our pharma distribution business will turn around overnight, I realize this will take some time and some investment to help us reposition, but we are putting the building blocks in place.

We expect 2009 to be a transition year, one in which we will begin to feel the benefits of the work done in recent months and a year in which we expect margin erosion to moderate. Let me take just a moment to elaborate on margins. We divide our pharma distribution business between bulk and non-bulk, or DSD business, each having different operating and margin characteristics. As I'm sure you know, our bulk business, which we define as shipments to customers warehouses and mail order facilities, is lower margin but requires limited sales and marketing support and lower operating costs. This is profitable business, business in which we very efficiently manage our working capital and which is experiencing significant revenue growth led by our largest business partners. We have come through a difficult period in this business in terms of margin, particularly as we have repriced some major contracts.

As we look toward FY '09, with most of these major repricings behind us, we do see moderating of this erosion. Our non-bulk, or DSD business, has different characteristics. Our margins are better in this group, but our costs to serve are higher. We did see some DSD margin pressure in FY '08, but we expect a relatively stable DSD margin in FY '09. An important point here, because of the size of our bulk business and its expected growth in FY '09, revenue growth in FY '09, it is likely from a sheer math perspective that our overall margin could slightly decline in spite of the fact that we will improve the health of both of these parts of our business. Before I turn the call over to Dave, I want to make one final comment. We recently announced the acquisition of Borschow Medical and Hospital Supplies. Borschow, a drug and medical distributor, has a unique and powerful position in the Puerto Rican market.

John Borschow and his team have built over many years the kind of deep customer relationships, both in the retail and the hospital channel, that all of us envy and we're thrilled to have them on board. In summary, we feel very good about the progress we're making. I'll be providing you with updates during the year on some of the areas that I believe represent leading indicators of progress in our business. First, resolution of our anti-diversion issues at the DEA. Second, growth in our DSD business. Third, a return to meaningful growth in our generic source program. And finally, continuing momentum in our medical distribution business, with a particular focus on our lean transformation activities and the development of our private label offering to hospitals. Now I'd like to turn the call over to Dave for his comments about CMP.

Dave Schlotterbeck - *Clinical & Medical Products - Vice Chairman & CEO*

Thanks George. I wanted to first take the opportunity to provide you with a broad overview of how I view clinical and medical products. I'll be loosely referring to slides 22 and 23 in the presentation. First, we are extremely well positioned in the area of patient safety, particularly medication management and infection prevention, and we have strong competitive advantages. We are a global leader in medication safety and infusion systems. We have the largest U.S. hospital footprint in dispensing systems and are the largest acute care respiratory Company in the world. We are the leading provider of disposables used in the surgical suite. We have the industry's only enterprise-wide medication management solution. We're a leader in positive patient identification and the prevention of hospital acquired infections.

In fact, I'm sure you've heard by now that the centers for Medicaid and Medicare services, or CMS, included an additional three preventable conditions beyond the nine for this fall for which it would no longer pay. With our focus on infection prevention I feel we are well positioned to assist hospitals in improving outcomes. We believe we have a winning vision that insures our strategies align with key customers' concerns. At the same time we do have a few items on our plate that need addressing. First, we need to complete the remediation of the Alaris recalls on time and on budget and we are on track to do this. Second, while we will continue to use our core businesses as foundations for future growth, we will complete the integration of VIASYS to meet our financial commitments. In addition, we are increasing our investment significantly in innovation, both in new products and potential break through offerings.

We are capitalizing on our overall capabilities to develop and launch approximately 50 new offerings during the next 18 months, both in product enhancements and new products. More than 10 of these new products or enhancements are planned for release in our infection prevention business, independent of Enturia. We have more than 20 new products over the next 18 months in the VIASYS and respiratory marketplace alone. Most notable is the Enve Palmtop ventilator, what we believe to be the smallest and most versatile ventilator in the world. In the infusion area we plan to introduce version 10 of our operating system for Alaris after the first of the year and we're excited about the opportunity this brings with respect to new clinical applications to help our hospital partners improve clinical care. In dispensing the MedStation 4000 will be introduced with many new safety features. So all in all, we're looking for a solid year of more than 20% segment profit growth. That's why we are so keen to insure that we invest appropriately in R&D to continue to feed our pipeline beyond FY '09. With that I'll turn it back to Kerry.

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

Thanks Dave, George, and Jeff. Let me just briefly close by just quickly topping the key priorities we're making for this year. We covered a lot of them in the last two presentations, let me just hit the key points. First of all, we're very focused on returning supply chain services to steady growth, including making the right IT investments to provide for the future success of this business. Second, we're continuing to invest in CMP for a long-term growth. We will be focusing on completing the integration of Viasys, Enturia and Borschow with excellence. We're going to be focused on resolving any outstanding regulatory issues and further strengthening our compliance and quality infrastructure.

Of course, we will also be reviewing whether a spinoff of all or part of our clinical and medical product segments is the right next step. We believe very strongly that now is the time to insure both our segments are positioned properly for the long-term. And we're going to do this with an eye on our mission, which is to continue to innovate services and products that reduce medical errors, increase patient safety and enhance productivity across the broad healthcare spectrum. We're looking forward to updating you by our next quarterly earnings call at the end of October and thank you for your time and interest today. And we are now open for questions.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS) Our first question comes from the line of Glen Santangelo with Credit Suisse, please proceed.

Glen Santangelo - *Credit Suisse - Analyst*

Yes, thanks. I just had a quick question on the drug distribution business. George, can you help me understand, it sounds like the DEA issue seems like it's coming to a close somewhere in fiscal '09. It seems like you have lost a lot of sales along the way. Have these independent customers have they gone to your competitors to source product and, assuming you do ultimately wrap up the DEA issue, what makes you so sure that ultimately all these sales come back to Cardinal Health.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

Yes, thanks for the question. As it relates to the DEA, as you can imagine since we are actually in constructive conversations now, I probably should not add more to that statement. But we will leave it at that. As it relates to, we did lose a fair amount of business. If you look at this on an annualized basis, it's roughly $1 billion of lost sales. So we had a significant impact from this. And yes, the business went somewhere, I would say not to a single place. Certainly business has been spread around the industry. Our sense is this, we are working very hard at regaining, obviously, the products as we work through the DEA issues, of course, but also the trust of those independents. And non-independents as well, this affected all of our classes of trade. I'm feeling pretty good that there are a good number of customers who will come back to us, but certainly there are many who we will have to earn back. And that's why I said, I wish this would be a flip the switch overnight kind of story, but we will have to do this in a hard and well earned way but we know what we have to do in front of us and we're prepared to do it.

Glen Santangelo - *Credit Suisse - Analyst*

George, maybe just one follow-up question on the margins. You sort of are expecting slight margin contraction in drug distribution, is that because, I think I heard you say, that the bulk sales will accelerate and the DSD sales will remain flat or so. Its just the mix component that's driving the margin down year-over-year.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

It really is. The rate of erosion that we have experienced in our bulk business is beginning to slow and we have relatively stable margins in DSD. But the growth on a revenue basis of that bulk business is so substantial that the math just works against you.

Glen Santangelo - *Credit Suisse - Analyst*

Then my last financial question for Jeff. Jeff, is the $23 million reserve that you set aside for the DEA is that embedded within your guidance that you're putting out today or is that separate.

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

First of all that $23 million is reflected in our Q4 numbers.

Glen Santangelo - *Credit Suisse - Analyst*

Okay, so that has nothing to do with the guidance for next year.

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

It was captured in special items for Q4 of FY '08. Yes, you're correct, it has nothing to do with guidance for next year or this year.

Glen Santangelo - *Credit Suisse - Analyst*

Okay, thanks for the comments.

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

Thanks, Glen.

Operator

Our next question comes from the line of Ross Muken with Deutsche Bank, please proceed.

Ross Muken - *Deutsche Bank - Analyst*

Good morning, gentlemen.

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

Morning Russ.

Ross Muken - *Deutsche Bank - Analyst*

In terms of the new decision to look at potentially spinning off the CMP business, can you talk a bit sort of -- I know you went through the time line of what has happened in terms of the overall Cardinal Health, but can you talk about sort of the whether the sort of key considerations you're looking at when you're thinking about whether or not this makes sense in terms of creating shareholder value and is there anything in terms of the timing today of why this is probably, possibly more of a strategic decision today than it was say 12 months ago.

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

Ross, Kerry, here. Let me try address it. First of all, obviously why we would like to tell you lot more about the process we're in right now to (inaudible) situation just really isn't appropriate to go through a lot of details. What I would just step back a bit and say, looking at what we did on our July 8th announcement where we really established the two reporting segments, we really did that through a good understanding of what are the key, what counts factors in each of those businesses to make sure that we were simplifying and flattening the organization to get synergies, developing organizations that were closer to customers, more focused and faster decision making. And that July 8th was a very sort of natural evolution of the program we really began two years ago when we created the sector structure.

As we became very comfortable with what we were doing on July 8th and feeling very good about what that unlocked for us, it just simply became appropriate once that was out the door to step back and say so now with that behind us, really should we consider additional steps that could unlock shareholder value. And so we really sort of see these as very discrete events. We're very happy with what we did in July 8th, that is going to really underscore the business and support it through fiscal year '09. Anything that we're talking about in terms of next possible steps, should any decision be made, is still a longer term decision. So what happened on July 8th really was affecting this fiscal year. What we're talking about reviewing now is probably something that would not be imminent until somewhere around the next 12 months.

I guess arguably it is possible it could affect Q4 this year or around the first quarter next year, but it's really hard to tell. And it is a longer term issue. So the July 8th announcement and what we're doing now, the timetables on how either of those could impact the business are quite significant and therefore quite different in our view.

Ross Muken - *Deutsche Bank - Analyst*

And maybe just turning specifically to the CTS segment. Maybe Dave, you could go through some of the trends we're seeing maybe back order or backlog or order trends on the Pyxis business, then sort of from a competitive standpoint anything changing in terms of Alaris and sort of the potential for increased competition in '09 if competitor product came back to market.

Dave Schlotterbeck - *Clinical & Medical Products - Vice Chairman & CEO*

Right. Well, we continue to show a great deal of strength in both our Alaris and our Pyxis back logs. As I had mentioned earlier, I believe on our Q3 call we did have a very tough compare within CTS against Q4 of last year. I was pleased that we did beat that by an 8% increase in our operating margins. On the competitive front, Pyxis continues to gain strength and hold, if not gain market share. In the case of Alaris, when I look at the fourth quarter of the accounts where Alaris was the incumbent, I only know of one that we lost to a competitor, which was Hospira. And so I remain very bullish on this business going forward. I'd also like to say that the VIASYS businesses that were acquired a bit over a year ago continue to perform and have exceeded our expectations.

Ross Muken - *Deutsche Bank - Analyst*

And one final just question quickly maybe for George. In terms of the IT investment on the pharma supply chain side of the business, is that being driven sort of as a result of what happened sort of with DEA in terms of the control issues or are we talking about sort of the legacy system that's currently being implemented across the organization as kind of not up to par with kind of what you would think a modern distribution organization would be running.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

It is a yes to all. Just a little more color. We certainly have some work that we needed to do, much of which has been done on the controls side. But there are things that we're facing, for example the serialization requirements for pedigree require ongoing investment. We have got significant infrastructure issues that we want to really bolster, particularly on our customer facing. If we look at our medical businesses, for example, in ambulatory care we need to provide a much more effective user interface for this somewhat unique class of trade. On the retail side, we're going to be working very hard on the customer facing activities, which have to do with speeding order processing, creating better visibility for customers and in particular improving our Cardinal inventory management program, which is Cardinal Inventory Manager, as we call it CIM, which drives efficiency for our customers and is a really critical link and increases stickiness with our customers. So it's a combination of infrastructure and also what we think of as key customer facing investments to drive our value proposition.

Ross Muken - *Deutsche Bank - Analyst*

Great, thanks guys.

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

Thanks Russ.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

You're welcome.

Operator

Our next question comes from the line of Lisa Gill with JPMorgan, please proceed.

Lisa Gill - *JPMorgan - Analyst*

Thanks very much and good morning. Over the years as Cardinal's made many of these acquisitions there's been the argument, Kerry, by management team previous to yourself but there were a lot of synergies from across [el] perspective and one Cardinal especially in the hospital arena. I'm just wondering, as you think about now spinning out the companies can you talk about any potential loss of synergies going forward and have you started to have conversations with some of your larger customers, especially on the hospital side where this would be more impacted. And then secondly, George, I was wondering if maybe you could just talk a little bit about the generic source opportunity. I think that some of your other competitors have done a good job of selling generics into the channel, especially on the independent side, and it seems that Cardinal has been a little bit behind, maybe if you could talk about that opportunity.

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

Lisa, hi, it is Kerry here. Let me try to take a top line on the hospital and clearly as we are just announcing this process, obviously, we still have a lot of analysis and work to be done. So again I'll reference my comments in terms of where we are today. You're absolutely right. We have talked a lot about our ability to sell our products across hospital and the hospital space is clearly an important part of Cardinal's mix. Our hospital organization is really a combination of what I will call generalists and customer account folks, but we also have enormous amounts of product line experts which are aligned with the businesses we have. And in fact, the most recent organization we did in July 8 really further reinforces that in the sense that we have our product line experts, the product experts, are very much aligned today along George's businesses and Dave's business in the hospital.

So it is that combination of, if you will, for of a series of pillars by product line with a group across the top. Secondly, there still is an enormous amount of synergy in the hospital supply piece and the pharmaceutical piece, obviously the capital equipment business in Dave's organization is a little bit different. But still I think going forward we will obviously be looking hard at our ability to execute well in the hospital market. I will just say that today as of July 8 we have structured our organization so that still is very modular and very supportive of the segment structure we have today.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

Lisa, maybe I will touch on your generic question. We give our competitors good marks for having good generic programs. As it relates to ours, I think we actually making very good progress. I think I mentioned this when I first met with all of you. If you looked at the data from the end of calendar '07 you would have seen actually nice growth rates exceeding the market in our generic business. I would say our anti-diversion activities really made that much more challenging and very disruptive to our customers. That's one issue that certainly has had an impact on us. The other thing that's probably worth noting is our unique mix. We have a very large bulk component to our customers and as you probably know most of those customers buy their generics directly. We're working with a little bit of a different subset.

Having said that, we are seeing some really good signs in the generic program right now. We have a very strong team, they're extremely knowledgeable. As you know, I come from a lot of years here and these guys know what they're doing. I'm really pleased by what they're doing and we have done some things to really improve what I would say is the transparency of the program, make it easier for our DSD customers to see the value in what we're offering. I think we're much faster and much more agile than we were. We're focusing heavily on first launch capabilities. I think there's real runway here. But as I said, we are going to have to get it over time but I'm feeling optimistic about where we are right now.

Lisa Gill - *JPMorgan - Analyst*

George, can you -- granted I know you don't want to give us specific numbers around this, bit aside from the big bulk business and understanding that they buy direct, we think about the independents in the hospitals, can you maybe talk about from a percentage perspective how penetrated you are today and where you think you can go. Is is where they could buy 70% or 80%, or 100% of generics from you and today it's less than 50%, can you bucket it for us so we can see what the opportunity is.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

I can give you general color, but I don't think I'm comfortable giving specific buckets other than to say this. I would say our general compliance with are existing base of customers is not as high as it should be. And as I said, particular that's hurt us during this last year because there are those who have moved their narcotic purchase elsewhere. I would say our share of wallet, as I described earlier, is sub-optimal and there's runway there, which we're excited about going after. I think the hospital market represents a really interesting opportunity for us. We are effective, we have got a very strong reach into the channel, but I think we can actually be more effective there. I don't know if I can quantify this for you exactly other than to say we should be able to experience upside from taking a larger share of the purchases of our existing customers as well as, of course, looking for new customers.

Lisa Gill - *JPMorgan - Analyst*

Okay, great, thank you for the comment.

Operator

Our next question comes from the line of Tom Gallucci with Merrill Lynch, please proceed.

Tom Gallucci - *Merrill Lynch - Analyst*

Thank you, good morning. I guess a few questions in the drug distribution area primarily. First, clearly looking for that ramp in the second half. I'm curious, George, as you look at, at the way things play out, how much of the improvement that you expect is simply due to the anniversary of certain issues that were mentioned on the call versus the need to further execute better in that timeframe.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

Again I don't know if I can breakout exactly the components of this. Clearly, the lapping of these repricings will create a benefit for us as we come out of that. So that's not inconsequential. But I would also say we have invested a lot and we continue to invest a lot in growing our business and in growing our capabilities to manage these anti- diversion issues. We're feeling like we're on the right path in these things. We know that we picked up some business recently, two of which are piece of business in which we will get the generics, one starts in December, one starts in late September. So we just know that some of this will play out over time and it's sort of a building process for us.

Tom Gallucci - *Merrill Lynch - Analyst*

Okay and then just on the repricings. I guess one of your big customers, I think, is still up for renewal early next year, or sometime next year, so how do we think about that in the face of the idea that you're getting better stabilization on that front.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

Well again I think it probably dangerously for me to speculate too much about what could happen with a negotiation that is scheduled for next summer. We have a good strong relationship, this is reference to CVS, and ongoing dialogue about the value each one of us creates for one another. So I'm feeling optimistic that we will work our way through this, but I would not speculate on what the exact economics of it look like.

Tom Gallucci - *Merrill Lynch - Analyst*

Sure. Okay, fair enough there.

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

Tom, this is Kerry, let me add one little bit of color. Compared to all the previous contracts which we have done that we're coming off long-term contracts, we did have a contract renewal with CVS in summer '07. So-- which is very closely market linked and was also sort of at the same time there was the contract with McKesson was renewed. So I think in terms of how far was the old contract from market, that was a bigger issue in the older contracts we renewed. I would just point out that we are -- have a much more recent renewal with CVS and so the difference between then and now is not as great as the then and now in the previous contracts.

Tom Gallucci - *Merrill Lynch - Analyst*

Right, that's helpful. In the Nuclear business, I think you mentioned that you expect to be a distributor but not a manufacturer, so can you just remind us what the issues that you're facing on the manufacturing side are.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

Yes.

Tom Gallucci - *Merrill Lynch - Analyst*

And then also what the timing of that generic you anticipate in the guidance.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

Right. So there are things that we can and can't say here, but yes there are a number of moving parts as it relates to the generic Cardiolite sestimibi issue. So let's say number one, we are a manufacturer or had filed a manufactured product of a generic sestimibi. I can't provide you additional information on that other than that we do not believe that approval of our own product is imminent and we have decided the assumption that we ought to put for our '09 forecast is that we will not be our own manufacturer. As some of you know who follow this area the pediatric extension to the patent expired at the end of July and there was one Company sitting with a tentative approval. That tentative did not convert to a final approval after the 29th of July because there is a citizens petition that had been, that had been sent.

It appears, and we have probably no more insights than this, it appears that the agency has not yet responded to do that citizens petition, which certainly could have an impact. We have made the assumption in our numbers, and you should know this, that a generic product will launch. Our expectation is the way we modeled this earlier rather than later. But we will have to see how this plays out. As I mentioned in my comments earlier, we have tried to make some provisions should a product launch generically and we're not ready with our manufactured product to be in a better and more competitive position. And we will provide color as soon as we get more information for you.

Tom Gallucci - *Merrill Lynch - Analyst*

Okay. My final question for Jeff. Just in terms of the R&D and the IT spend, the extra $100 million, would we expect that to ramp down then in the forward fiscal year or is this sort of a sustainably higher rate, thanks.

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

Good question Tom. We have actually done a fair amount of benchmarking in both these areas in Dave's world. We have taken a look at what an appropriate R&D spend at the percent of sales is for a vibrant competitive Company in that space. And we think the increase investment we will be making in FY '09 really gets us to the more competitive levels we need in order to maintain our competitive position going forward. I would say in the IT space within George's area, somewhat similar story. Might be seeing a bit of a bolus in '09 as we launch some of these projects. But again as we looked at the benchmarking of our IT spend versus world class competitors, this allows us to get our IT infrastructure and run rates to a competitive level. Did that answer your question Tom?

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

Thank you.

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

Thanks. Thanks Tom.

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

Next question.

Operator

Our next question comes from the line of Randall Stanicky with Goldman Sachs, please proceed.

Randall Stanicky - *Goldman Sachs - Analyst*

Great, thanks for taking the question. Just a follow up to the last one. Jeff, can you just help us calibrate. You've talked for the last couple years about the One Cardinal Health plan and the cost reduction strategy, now we're sort of reversing and talking about incremental spend in some of the infrastructure. So I guess two questions, one how much cost flexibility do you have going forward. And then just even more specifically to the last question, is that $100 million that we're going to add to FY '09, does that $100 million continue or is there any ramp down at all once there's some initial investment. And can you help us think about maybe the quarterly variation or quarterly distribution of that investment.

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

Sure, thanks, Randall. First of all let me make a comment on One Cardinal Health and maybe it goes a little bit back to Lisa's question as well a few moments ago. I think a logical question that we receive even after the July 8th announcement was sort of going to these two defined operating segments, does that somehow undo everything that you accomplished through One Cardinal Health. And my answer both externally and internally is absolutely not. Just for some historical perspective, One Cardinal Health was more than bringing together two segments. It was bringing together 40 to 50 very disparate businesses that had largely been not integrated over a period of years. So yes, it was about One Cardinal Health, but it was also about taking 40 to 50 businesses and bringing them to a common standard in terms of back office processes and approach to customer and technology.

So the going to two segments, whether part of Cardinal Health now or perhaps two vibrant businesses going forward, if the board ultimately decides that we want to split up the Company, does that undo it, I don't really think so, because I think we have achieved a lot of the advances we need to get these two businesses where they need to be today. So I would say the benefit to One Cardinal Health remain intact and will continue to benefit us as one Company or potentially two companies in the future. Let me also point out that One Cardinal Health was largely about getting common back office systems, achieving synergies in back offices, about one approach to customer. What we're talking about now in terms of these $100 million investments is on the CMP side, bringing our R&D spend to a level that we think is necessary to be competitive the next five, 10, 15 years, a very different proposition than One Cardinal Health.

Then on the HSCS side I would say it reflects that technology continues to advance, customer expectations continue to advance, and in order to meet our customers needs, we need to make the types of investments that they're asking for and that we need to be competitive. I would also say the regulatory environment has changed as well with pedigree and the anti-diversion controls they put in place. These are all moving goal posts that we have to be flexible about in moving along with. In terms of your second question, I think that was somewhat similar to the question that Tom asked.

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

Mr Jeff, would you mind if I just stopped, because this is a really at the heart of some of our thinking here, Randall. It's a really good question to raise. First of all I just really want to underscore what Jeff said. For quite sometime now the approach of Cardinal has been bringing, if you will allow me to use this expression, a certain amount of order out of chaos. Out of a number of various businesses how do bring some order, how do you pick some focus, how do you create some scale. And the last couple of years we have concluded that contract manufacturing for the pharmaceutical industry was a business we didn't want. Then fundamentally having got over that part, it really did allow us to start seeing our businesses largely bucketing into, again, a painting that is very broad, but largely bucketing into distribution base companies and medical product manufacturing companies.

And if you think about those two businesses, as Jeff said, I think the company has done a heck of a job in getting to common shared services and IT, HR, financial services, our ability to manage across the enterprise has been very dramatically improved. But that's a different subject than how do you grow. How do you grow, how do you be competitive, how do you become best in class. When you look at mostly the manufacturing businesses, again speaking very broadly, this is about creating products, its about inventing for the future, it's about technology, it's about software, it's about electrical engineering, it's about mechanical engineering and this business needs very unique type of support to support its personality and to support its growth area. So when we look at Dave's business, we do look at in that competitive space what are successful companies spending in R&D.

What is the type of funnel you have to have in developing products to provide an output that can support the growth of the enterprise. And that review is done not just in a vacuum but we go out, we take a look at end products in companies that are competitive to Dave's sphere. What is the type of R&D spend. What is sort of from a long-term investment, what sort of investment do you have to have in there. It became very clear to us that we were falling on the other side. Now, flip it over to George's spot. There the R&D and the delivery of differentiation doesn't come as much from creating products, but it's through services, through interfaces, how do we support the customer. How do we execute what we do in a world class way, best in class way. And again, these aren't the things that come out of shared services, these are unique and specific discrete business investments that in looking at the concept of we are broadly in the distributing products to customers what do we need to do to be the best in class in each of those areas. Again this is an exercise that's not undertaken in a vacuum.

We do a lot of external benchmarking, we do a lot of discussion with the customers. As we reviewed our future growth plan and saying, and this is important, we believe in the future of these business. We believe very much in the long-term growth capability of both these businesses. But they will both need to be supported in different ways and different services. And to get to the future, we're going to have to pick up the pace in product research and development, in George's place, we are not where we need to be in IT -- sorry in Dave's place and George's place. And so we come to these conclusions after really what I will say over the last couple of years with the new management team, as we have been looking and trying to understand how do we launch these businesses into high trajectory growth for the future that meet your needs, meet our customers needs, meet our employees needs, we concluded that we were coming up short and we didn't have all the individual support activities, we are going to do that way.

This has nothing to do with shared services, which works great. It has nothing to do with the things we have done on shared services in hospitals. Bear in mind, most of George's customers are really in the retail drug space, if you were to do a weighted balance. So we have retail customers out there, which are different than hospital customers. So I feel strongly about it and that's why I am talking a few more minutes. It's always tough to eventually stop and say, wait a minute, are we spending what we need to be competitive in the future. Are we really setting up for growth. And you know what, we concluded this is the year we have got to stop doing what we're doing and start planning for the future, not just one year but two, three, four, five years down. This process has becoming clearer and clearer to us as we got the scale and focus and alignment in the segments or the sectors which became reporting segments and we see the opportunities there. So it is a change in our thinking, but it is a change for the future and it is a change for deciding we're going to win and be successful in the places we're playing.

Dave Schlotterbeck - *Clinical & Medical Products - Vice Chairman & CEO*

I just want to emphasize that if you recall at the opening of my remarks, I think you have to look long and hard across the landscape at any other organization that has the kind of market presence that you can find in every business within CMP. And this investment intensity is all about maintaining if not growing that presence. And so in my view this is exactly the right thing to do for shareholders.

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

Randall let me just answer your final question, then we can move on, regarding (inaudible). If this helps you out I would say that generally our rate of growth of SG&A expense will be higher in the first half of the year than the second half, which I think give you an idea that we are -- some of these things we want to get done as quickly as possible because they're critical to our future.

Randall Stanicky - *Goldman Sachs - Analyst*

Jeff, just to be clear, you guys have ruled out a sale of CMP, is that fair?

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

Randall, as we have said, right now we're going through the exploration process for a potential spin and until we get through that process it's premature to comment on anything else.

Randall Stanicky - *Goldman Sachs - Analyst*

Okay. Thanks for the color.

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

Thanks. Next question please.

Operator

Our next question comes from the line of Ricky Goldwasser with UBS, please proceed.

Ricky Goldwasser - *UBS - Analyst*

Good morning. One question for George and one for David. George, as far as outlook for fiscal year '09, what are the embedded expectations for branded price inflation for fiscal year '09. And then in particularly for September. And then for David, who do you think are your -- the appropriate comps that we should use to look at CMP, who do you view as kind of like your closest competitors.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

Ricky, it's George, I'll take the first part. We have assumed mid-single digit inflation rate for our '09 numbers.

Ricky Goldwasser - *UBS - Analyst*

And for September?

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

I'm sorry.

Ricky Goldwasser - *UBS - Analyst*

For the September quarter.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

I don't think we will comment on the breakdown by quarter.

Ricky Goldwasser - *UBS - Analyst*

Okay. But do you, but just kind of like a big picture do you think that we are going to see kind of like a slow down ahead of the election or you just assuming kind of like steady rate.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

It's very difficult to try to outguess what's going to happen during an election year. So I think at this point we make arguments on both sides of what will happen. So we have sort of come down the middle on it and said we will just give you a broad expectation of mid-single digit.

Dave Schlotterbeck - *Clinical & Medical Products - Vice Chairman & CEO*

Ricky, good morning. Let me give you a list of those folks that I think that would be the most appropriate comps. I would start with Providian, Hospira, Omnicell, getting into a certain extent Baxter. Okay?

Sally Curly - *Cardinal Health, Inc. - SVP IR*

Next question operator.

Operator

Our next question comes from the line of Larry Marsh with Lehman Brothers, please proceed.

Larry Marsh - *Lehman Brothers - Analyst*

Thanks, good morning, thanks for all the details. I guess the question to me is -- I know it is early on in the exploration, but as you think about it what might keep the Company and the board from pursuing a tax free spend. In other words, what could come up that would cause this process to be put on hold that we're not thinking about, because it seems like it's pretty logical. And then when you make that announcement, assume you go forward, will you be making specific management team announcements at that time, say this next quarter or is that going to be something further down the road.

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

Hi Larry, good morning. Well, first of all, I know that I can comment on the internal part of your question. Obviously, as you say, there's some logical to this, which is why we're studying it, but I think I just would leave it at that. But I will tell you yes, it is giving myself just one sort of caveat, it is highly probable that if we make a decision to do this and when we make an announcement, that yes, it is usually customary when companies do this to identify one or two of the top leadership team for each of the new ventures So yes, you could look forward to seeing something about that should we make a decision on that topic.

Larry Marsh - *Lehman Brothers - Analyst*

And should we think of -- is there any surprises in that, or it is just sort of based on where we are now. Is it sort of a logical sort of furtherance of what we have already been hearing about management teams.

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

Larry I have a great management team here. I don't know what would be a surprise to you, but we have a great team here and we're putting a lot of -- a lot of people will be -- the same people that are with the business today, are running the business today, I can't speculate, but we're happy with the team we have today.

Larry Marsh - *Lehman Brothers - Analyst*

Great. Just a clarification then on the share repurchase, I think, Jeff, you'd said you're moderating your views, looks like about $400 million of share repurchases this year. But sort of once you make the decision one way or the other just structurally I know you have said in the past you were sort of obligated to give a certain amount of capital back to shareholders, is that sort of going to be moderated or is there something else we should be thinking about that would keep you from being as active in repurchase in the next year or so.

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

Yes, good question Larry. Obviously it's ultimately up to our board as we go through this analysis period, first of all it will be very difficult for us to even access the market. We're in a bit of wait and see mode as we go through this assessment period. The ultimate decision is business status quo, is it quite possible that the board will decide that we will continue with our normal capital deployment plan and repurchases that are originally targeted for the year, I think that's quite likely. Alternatively, if the board ultimately decides that some other structural option is appropriate, I think we have to reconsider the whole capital deployment plan at that point.

Larry Marsh - *Lehman Brothers - Analyst*

Okay. Just clarification, your other category, which you highlight, made about $101 million in operating profit in fiscal '08. Did you say you're communicating a general range of expectations there. I know you have already sold two of the businesses or announced you're selling them, but how should we think of that. Then do we think of the pharmacy services and medicine shop as, again, as ongoing business or just wait and see.

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

Pharmacy services and medicine shop are in our guidance assumptions for the full fiscal '09, Larry. Tecomet and MedSystems are not, we're assuming that they will be sold. As we have said previously with respect to pharmacy services and medicine shop, we're going to continue our evaluation of the strategic options with respect to them and, you know, as we sort those out we will make decisions regarding the future of both of those entities. Regarding the guidance for other really, I didn't get into that specific level of detail, but let me say this. Tecomet and MedSystems contributed probably a little less than $15 million of EBIT last year that won't be in FY '09. So quite likely I think we will see a decline in other driven primarily by that removal of those businesses for the year.

Larry Marsh - *Lehman Brothers - Analyst*

But just a part from those two, are you saying the other two businesses would be kind of roughly flat, down or down more.

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

I don't want to comment specifically on those, Larry, other than to say that they're both profitable businesses and as long as they're in the Cardinal family they will continue to contribute in a meaningful way and we will continue to assess them.

Larry Marsh - *Lehman Brothers - Analyst*

Okay. And then finally just the -- I just want to make sure I am hearing this correctly, the $100 million of incremental spending with Dave and George's businesses, did you say how that's going to be split specifically between the two. Is it about half and half or no.

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

Yes, actually it is. And not just because we split it down the middle, but because we looked at specific R&D needs within CNP and specific IT needs HSCS and it just happened for both to be just under $50 million and I do want to re-emphasize that that spend is reflected in both of the segment guidance numbers that we gave for CMP and HSCS.

Larry Marsh - *Lehman Brothers - Analyst*

Right, okay, right. One final quick clarification then, George you said nuclear and Tom talked about that, but your message is really with the incremental cost in nuclear, you're thinking that division, that piece of distribution will be down a good bit again this year, is that right.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

I think we have to say there are moving parts that could really alter the dynamics here. So an example, if it turns out we do get our manufactured product earlier, that would be good news to us. If no generic launches throughout the year, it will be more difficult for us to offset some of the cost increases. So this has got some binary aspects to it and we will just have to keep watching.

Larry Marsh - *Lehman Brothers - Analyst*

Great, okay, very good thanks.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

You're welcome.

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

Next question, operator.

Operator

Our next question comes from the line of Charles Boorady with Citigroup, please proceed.

Charles Boorady - *Citigroup - Analyst*

Thanks, good morning. In terms of exploring a spinoff, I'm just curious why sale is not also being contemplated or maybe one is. If there's any tax or other considerations in looking at a sale versus a spin.

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

Good morning, Charles, Kerry here. I mean I think of course sale transaction has tax implications of course. So obviously we need to -- whatever course we take has to be in the best interest of Cardinal shareholders. And our current thinking is that we will be creating two publicly traded companies in a tax free manner is how we're thinking about it. But it's possible other alternatives. But we need to make sure that it is the right choice for our investors.

Charles Boorady - *Citigroup - Analyst*

What's the approximate book value of the CMP business.

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

Let me get back to you in a second with that.

Charles Boorady - *Citigroup - Analyst*

Okay. Just related question, under a spin scenario, what's the opportune -- or sale I guess for that matter, what's the opportunity for corporate level expense reductions and how did you weigh those against any potential lost synergy by splitting the two organizations.

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

Charles, as we said we are in the exploration early stages. Clearly those questions you're asking are questions that need to be considered. And I hope -- I'm not trying to be difficult, but we're just not really in a spot where we can talk about that until we get our work done and until we get to a decision.

Charles Boorady - *Citigroup - Analyst*

Is it conceivable that through that process you will find that the synergies were greater than any corporate level expense reductions that you could have gotten and you decide it's better to keep the organizations together.

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

Well, I don't want to speculate. I do want to keep coming back, though, again I'm sorry, I'm not trying to dance around your question. I realize that it's, I apologize that it sounds that way. But really, we're going to make the right decision for the long-term value of our shareholders. And that's the best I can give you right now. We're going to be thinking not just immediately, but over the long-term what's the right place and as I said, I think if it's the right place for both our segments going forward that we're under consideration here so that all Cardinal shareholders are getting the right long-term, the best long-term deal for them. So we should take this at face value, like you said, you're exploring the spinoff but it sounds like you haven't reached a point where you're leaning towards a spinoff. We are in the exploration as you said.

Charles Boorady - *Citigroup - Analyst*

Okay. And then just last question on just the sharp rise in commodity prices, which -- and specifically how it would relate to the CMP business, how do you think about that increase and do you have an opportunity to factor them into your pricing and benefit from a rising value of any inventories that you have. Or is it the other way around where you take a hit on margins as your costs go up before you're able to raise prices to your customers.

Dave Schlotterbeck - *Clinical & Medical Products - Vice Chairman & CEO*

First of all in our guidance we have taken this into account for the full year. When we have an opportunity to partner with our customers to share in some of this responsibility we do take the opportunity to do that. For quite some time now we have had relentless cost reduction programs going on because we do so much manufacturing that is commodity related outside of the United States and so we deal with things like the price of latex, the price of oil, currency fluctuations and we have done that for quite sometime.

Charles Boorady - *Citigroup - Analyst*

And can you put any quantification around it just in terms of how much -- it sounds like it hurts you before it could, then you have to raise price to catch up with it then. Am I interpreting that right, is that a reflection of the commodity nature of your products or do you feel like there was a missed opportunity to sort of raise price ahead of your input costs going up.

Dave Schlotterbeck - *Clinical & Medical Products - Vice Chairman & CEO*

Well, we anticipate what we believe will happen in the market so that we are prepared for it. I view that as an obligation to our shareholders, so that we can maintain the appropriate margins that we have committed to.

Charles Boorady - *Citigroup - Analyst*

Any way to quantify the exact impact your margins from the rising input costs and what you factored into guidance for it.

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

Hi, Charles, it is Jeff. Let me comment on that. For FY '08, for the total company the increase in oil prices affected both fuel and our purchase of oil related commodities with incremental cost was just north of $30 million. And that affects both of our segments. We have budgeted for a significantly higher number than that in FY '09, which we think is fairly consistent with where we have seem trading levels over the past couple of months. Let me go back to your prior question on book value and the reason I hesitated, it not an easy question when you start looking at potentially splitting apart a company. I am not going to give you a specific number other than to say that 45% of our property, plant, equipment currently resides in CMP and the other 55% in HSCS. There are a lot of asset that are held at the corporate level, et cetera, that if we ever went this direction we would have to split up, so it is hard to give a number and a little bit premature.

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

Thanks very much. Next question.

Operator

Our next question comes from the line of Barbara Ryan with Deutsche Bank, please proceed.

Barbara Ryan - *Deutsche Bank - Analyst*

Thank you so much, my were all taken, appreciate it.

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

Oh, hi, Barbara,.

Barbara Ryan - *Deutsche Bank - Analyst*

Hi, how are you.

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

Fine. So there is nothing you want to ask us, is that.

Barbara Ryan - *Deutsche Bank - Analyst*

Well, mine were all about the IT and pharma distribution and I think that was broadly covered in pretty good detail in your answers, so I appreciate that.

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

Thank you, Barbara

Operator

Our next question comes from the line of John Kreger with William Blair, please proceed.

John Kreger - *William Blair - Analyst*

Hi, thanks very much. A follow up question for George on the pricing environment. As you see contracts come up for renewal in both the drug distribution and med surge distribution side, what sort of pricing pressure are you seeing out there, if any? And is your strategy to price to hold share at this point or are you actually trying to increase share in those two units?

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

Well, because you know in most of our businesses, both in the pharmaceutical and the medical side, these are generally very competitive kinds of markets and so part of the key is to have a good feel for market price, but the reality is this price tends not to be much of a differentiator in most of those markets. And what dictates our ability to move business is really the perceived value of the customer, or go to provide the right set of offerings, services, products value, price is a component of that but it has almost become sort of a market phenomenon. So I tend to not see price as a high differentiator in most of our markets. And our goal, as I mentioned today, is rooted to drive as much value as we can first from existing customers where I feel like we are perhaps a bit under penetrated and to recapture some lost business. And I do believe that there is a certain amount of churn in every business and we'd like our greater position of that share of that churn. But our general approach is create value and we have a chance of getting business.

John Kreger - *William Blair - Analyst*

Great. And then just a quick follow up, are you satisfied with your current customer mix or would you like to consciously tilt it back towards smaller independents and hospitals?

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

Well, look, I am satisfied with that many of our big, big bulk customers are important partners for us, but I would, in fact, like to expand the DSD business. So yes, in a sense, I would like also to mix a bit, but it is not necessarily a trade, it is I'd like to expand a part of our business that I think has been little bit under developed and I think that will help out.

Operator

Our next question comes from the line of John Ransom with Raymond James

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John Ransom - *Raymond James - Analyst*

Hi, good morning. Would you mind repeating what you said about the split of depreciation. Did you say you couldn't really offer that at this time between the two businesses.

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

Sorry, John, you were breaking up a little bit, could you repeat your question, please?

John Ransom - *Raymond James - Analyst*

Yes. Would you mind repeating what you said about the split of depreciation between CMP and Supply Chain.

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

Actually, I didn't give a split of depreciation, what I gave was a split of property, plant and equipment and then I said about 45% of our current property, plant and equipment is in the existing CMP segment.

John Ransom - *Raymond James - Analyst*

So, if we were to split the depreciation that way would it just be wildly off. I know you are not ready to do to the penny, but just ballpark.

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

I really don't have any good guidance to give you on that. Honestly, John, it is probably not an unreasonable approach to take, if I were you.

John Ransom - *Raymond James - Analyst*

Not unreasonable you said.

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

Not unreasonable.

John Ransom - *Raymond James - Analyst*

Okay, perfect. My other question is I know the company has a legacy of acquisition history, has some 15 or something different IT systems. What does that look like three years from now, is that going to be five or three or one, I know it has been a -- it is easier to talk about then to do, but I was just kind of curious about customer pricing software and IT and kind of where you are versus where you need to be.

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

First of all, I am not sure a company of our complexity and size can ever get down to just one system, but we did make a decision several years ago to begin migrating towards one general platform and that is using SAP. We are on a multi-year path toward achieving that. A great deal of that work has already happened within CMP and manufacturing. We are also just at the finishing stages of amending our financial modal of SAP across the company and we have also begun some of those steps within HSCS as well. So our goal is to put it as much as we can onto SAP, assuming it -- the value proposition and the benefits of that system makes sense, Now, obviously there will always be certain systems that need to be bolted on, but our goal is to get as consistently on SAP as we can within the next three years or so.

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

John, Kerry, here. The -- we do have a well above average number of legacy systems in our company. A very large number, which also impacts our or how our current IT dollars are being spent, because a lot of them being spent on run maintenance of legacy systems and so we may -- not only are we spending below, but we also not really feeling comfortable with where those dollars are going because of the high number of legacy systems. So getting to much fewer legacy systems just at to one is not really likely, but to get a significant reduction in our legacy systems is a benchmark number we have set internally.

Operator

Our next question comes from the line of Eric Coldwell with Robert W. Baird

Eric Coldwell - *Robert W. Baird - Analyst*

Thank you. Actually John just asked one of my main questions on the D&A split, but would it also be safe to allocate debt in a roughly commiserate manner or how would we allocate debt to the CMP division.

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

Hi, Eric, it is Jeff. I understand why you are asking these questions, but honestly I think it is much too premature. We really need to get through this exploration before we can start talking about things like capitalization. But, thank you for the question.

Eric Coldwell - *Robert W. Baird - Analyst*

Okay, that's fair. Follow up question, is it too early to give us some sense of proceeds from the Tecomet sale?

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

We expect the gross price to be just under $100 million.

Eric Coldwell - *Robert W. Baird - Analyst*

Okay. And same kind of discussion on Borschow, can you give us a sense of the acquisition cost and then also the revenue of that business and what percent is split between medical and pharmaceutical?

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

Yes. In terms of the acquisition price it was $125 million or so, Eric. And I'm sorry, I've forgotten the secondary question.

Eric Coldwell - *Robert W. Baird - Analyst*

The revenue and the split between medical products and pharmaceutical products.

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

I can't give you, again, Eric, this is George, an exact breakdown, but it is more heavily balanced towards the retail part of the world than the hospital part of the world.

Eric Coldwell - *Robert W. Baird - Analyst*

In revenue?

George Barrett - *Healthcare Supply Chain Services - Vice Chairman & CEO*

Yes.

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

Thanks, Eric, next question.

Operator

We have no further questions. I will now like to turn the presentation back over to Mr Kerry Clark for closing remarks.

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

Thank you very much for joining us for this extended call and we appreciate your attention and interest and please don't hesitate to give Sally or her gang a call if you would like to have some further follow ups. Thanks for being with us today.

Operator

Thank you for your participation in today's conference. This concludes the presentation. Everyone have a great day.