

CARDINAL HEALTH INC  
Form 10-Q  
February 05, 2010  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**Form 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF**  
**THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarter ended December 31, 2009**

**Commission File Number 1-11373**

**Cardinal Health, Inc.**

(Exact name of registrant as specified in its charter)

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Ohio  
(State or other jurisdiction of

31-0958666  
(I.R.S. Employer

incorporation or organization)

Identification No.)

7000 CARDINAL PLACE, DUBLIN, OHIO 43017

(Address of principal executive offices and zip code)

(614) 757-5000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The number of Registrant's Common Shares outstanding at the close of business on February 2, 2010 was as follows:

Common Shares, without par value: 361,459,464

**Table of Contents**

**CARDINAL HEALTH, INC. AND SUBSIDIARIES**

**Index \***

|                                                                                                                                | <b>Page No.</b> |
|--------------------------------------------------------------------------------------------------------------------------------|-----------------|
| Part I. <u>Financial Information:</u>                                                                                          | 3               |
| Item 1. <u>Financial Statements:</u>                                                                                           | 3               |
| <u>Condensed Consolidated Statements of Earnings for the Three and Six Months Ended December 31, 2009 and 2008 (unaudited)</u> | 3               |
| <u>Condensed Consolidated Balance Sheets at December 31, 2009 (unaudited) and June 30, 2009</u>                                | 4               |
| <u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended December 31, 2009 and 2008 (unaudited)</u>         | 5               |
| <u>Notes to Condensed Consolidated Financial Statements</u>                                                                    | 6               |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                           | 23              |
| Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>                                                      | 34              |
| Item 4. <u>Controls and Procedures</u>                                                                                         | 34              |
| Part II. <u>Other Information:</u>                                                                                             | 35              |
| Item 1. <u>Legal Proceedings</u>                                                                                               | 35              |
| Item 1A. <u>Risk Factors</u>                                                                                                   | 35              |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>                                                     | 35              |
| Item 4. <u>Submission of Matters to a Vote of Security Holders</u>                                                             | 36              |
| Item 6. <u>Exhibits</u>                                                                                                        | 37              |

\* Items not listed are inapplicable.

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1: Financial Statements****CARDINAL HEALTH, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS****(Unaudited)****(in millions, except per Common Share amounts)**

|                                                                                                                                                                                                                                              | Three Months Ended<br>December 31, |             | Six Months Ended<br>December 31, |             |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------|-------------|----------------------------------|-------------|
|                                                                                                                                                                                                                                              | 2009                               | 2008        | 2009                             | 2008        |
| Revenue                                                                                                                                                                                                                                      | \$ 24,919.7                        | \$ 24,117.8 | \$ 49,700.4                      | \$ 47,554.9 |
| Cost of products sold                                                                                                                                                                                                                        | 23,962.0                           | 23,202.7    | 47,833.9                         | 45,738.6    |
| Gross margin                                                                                                                                                                                                                                 | 957.7                              | 915.1       | 1,866.5                          | 1,816.3     |
| Operating expenses                                                                                                                                                                                                                           |                                    |             |                                  |             |
| Distribution, selling, general and administrative expenses                                                                                                                                                                                   | 605.2                              | 578.5       | 1,191.3                          | 1,168.8     |
| Restructuring and employee severance                                                                                                                                                                                                         | 10.7                               | 16.9        | 70.4                             | 37.6        |
| Impairments and loss on sale of assets                                                                                                                                                                                                       | 0.4                                | 6.9         | 24.0                             | 10.5        |
| Litigation (credits)/charges, net                                                                                                                                                                                                            | (25.4)                             | (0.3)       | (25.9)                           | (0.3)       |
| Operating earnings                                                                                                                                                                                                                           | 366.8                              | 313.1       | 606.7                            | 599.7       |
| Other (income)/expense, net                                                                                                                                                                                                                  | (25.6)                             | 19.7        | (34.5)                           | 22.2        |
| Interest expense, net                                                                                                                                                                                                                        | 27.4                               | 22.2        | 61.3                             | 51.4        |
| Loss on extinguishment of debt                                                                                                                                                                                                               |                                    |             | 39.9                             |             |
| Earnings before income taxes and discontinued operations                                                                                                                                                                                     | 365.0                              | 271.2       | 540.0                            | 526.1       |
| Provision for income taxes                                                                                                                                                                                                                   | 134.8                              | 102.2       | 371.6                            | 184.9       |
| Earnings from continuing operations                                                                                                                                                                                                          | 230.2                              | 169.0       | 168.4                            | 341.2       |
| Earnings from discontinued operations (net of tax expense of \$2.4 and \$56.7, respectively, for the three months ended December 31, 2009 and 2008 and \$28.4 and \$88.7, respectively, for the six months ended December 31, 2009 and 2008) | 4.3                                | 147.5       | 27.9                             | 224.4       |
| Net earnings                                                                                                                                                                                                                                 | \$ 234.5                           | \$ 316.5    | \$ 196.3                         | \$ 565.6    |
| Basic earnings per Common Share:                                                                                                                                                                                                             |                                    |             |                                  |             |
| Continuing operations                                                                                                                                                                                                                        | \$ 0.64                            | \$ 0.48     | \$ 0.47                          | \$ 0.96     |
| Discontinued operations                                                                                                                                                                                                                      | 0.01                               | 0.41        | 0.08                             | 0.62        |
| Net basic earnings per Common Share                                                                                                                                                                                                          | \$ 0.65                            | \$ 0.89     | \$ 0.55                          | \$ 1.58     |
| Diluted earnings per Common Share:                                                                                                                                                                                                           |                                    |             |                                  |             |
| Continuing operations                                                                                                                                                                                                                        | \$ 0.64                            | \$ 0.47     | \$ 0.47                          | \$ 0.95     |
| Discontinued operations                                                                                                                                                                                                                      | 0.01                               | 0.41        | 0.07                             | 0.62        |
| Net diluted earnings per Common Share                                                                                                                                                                                                        | \$ 0.65                            | \$ 0.88     | \$ 0.54                          | \$ 1.57     |

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Weighted average number of Common Shares outstanding:

|                                          |          |          |          |          |
|------------------------------------------|----------|----------|----------|----------|
| Basic                                    | 359.0    | 357.3    | 359.1    | 357.0    |
| Diluted                                  | 361.0    | 360.3    | 361.1    | 361.2    |
| Cash dividends declared per Common Share | \$ 0.175 | \$ 0.140 | \$ 0.350 | \$ 0.280 |

See notes to condensed consolidated financial statements.

**Table of Contents**

**CARDINAL HEALTH, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(in millions)

|                                                                                                                                                                              | December 31,<br>2009<br>(Unaudited) | June 30,<br>2009   |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|--------------------|
| <b>ASSETS</b>                                                                                                                                                                |                                     |                    |
| Current assets:                                                                                                                                                              |                                     |                    |
| Cash and equivalents                                                                                                                                                         | \$ 1,746.8                          | \$ 1,221.6         |
| Trade receivables, net                                                                                                                                                       | 4,927.5                             | 5,214.9            |
| Inventories                                                                                                                                                                  | 7,961.0                             | 6,832.8            |
| Prepaid expenses and other                                                                                                                                                   | 674.1                               | 523.0              |
| Assets from businesses held for sale and discontinued operations                                                                                                             | 148.9                               | 7,189.4            |
| <b>Total current assets</b>                                                                                                                                                  | <b>15,458.3</b>                     | <b>20,981.7</b>    |
| Property and equipment, at cost                                                                                                                                              | 3,105.9                             | 3,139.6            |
| Accumulated depreciation and amortization                                                                                                                                    | (1,682.7)                           | (1,675.1)          |
| <b>Property and equipment, net</b>                                                                                                                                           | <b>1,423.2</b>                      | <b>1,464.5</b>     |
| Other assets:                                                                                                                                                                |                                     |                    |
| Investment in CareFusion                                                                                                                                                     | 897.4                               |                    |
| Goodwill and other intangibles, net                                                                                                                                          | 2,294.7                             | 2,266.9            |
| Other                                                                                                                                                                        | 747.9                               | 405.7              |
| <b>Total assets</b>                                                                                                                                                          | <b>\$ 20,821.5</b>                  | <b>\$ 25,118.8</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                                                                                                                  |                                     |                    |
| Current liabilities:                                                                                                                                                         |                                     |                    |
| Current portion of long-term obligations and other short-term borrowings                                                                                                     | \$ 12.7                             | \$ 366.2           |
| Accounts payable                                                                                                                                                             | 10,543.1                            | 9,041.9            |
| Other accrued liabilities                                                                                                                                                    | 1,609.9                             | 1,496.2            |
| Liabilities from businesses held for sale and discontinued operations                                                                                                        | 37.3                                | 1,370.9            |
| <b>Total current liabilities</b>                                                                                                                                             | <b>12,203.0</b>                     | <b>12,275.2</b>    |
| Long-term obligations, less current portion and other short-term borrowings                                                                                                  | 2,099.2                             | 3,271.6            |
| Deferred income taxes and other liabilities                                                                                                                                  | 1,293.2                             | 847.3              |
| Shareholders' equity:                                                                                                                                                        |                                     |                    |
| Preferred Shares, without par value: Authorized 0.5 million shares, Issued none                                                                                              |                                     |                    |
| Common Shares, without par value: Authorized 755.0 million shares, Issued 363.6 million shares and 363.7 million shares at December 31, 2009 and June 30, 2009, respectively | 2,893.0                             | 3,031.6            |
| Retained earnings                                                                                                                                                            | 2,306.5                             | 5,953.9            |
| Common Shares in treasury, at cost, 2.3 million shares and 3.7 million shares at December 31, 2009 and June 30, 2009, respectively                                           | (173.8)                             | (343.0)            |
| Accumulated other comprehensive income                                                                                                                                       | 200.4                               | 82.2               |
| <b>Total shareholders' equity</b>                                                                                                                                            | <b>5,226.1</b>                      | <b>8,724.7</b>     |

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|                                            |             |             |
|--------------------------------------------|-------------|-------------|
| Total liabilities and shareholders' equity | \$ 20,821.5 | \$ 25,118.8 |
|--------------------------------------------|-------------|-------------|

See notes to condensed consolidated financial statements.

**Table of Contents****CARDINAL HEALTH, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****(in millions)**

|                                                                                                            | <b>Six Months Ended<br/>December 31,</b> |             |
|------------------------------------------------------------------------------------------------------------|------------------------------------------|-------------|
|                                                                                                            | <b>2009</b>                              | <b>2008</b> |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                                               |                                          |             |
| Net earnings                                                                                               | \$ 196.3                                 | \$ 565.6    |
| Earnings from discontinued operations                                                                      | (27.9)                                   | (224.4)     |
| Earnings from continuing operations                                                                        | 168.4                                    | 341.2       |
| Adjustments to reconcile earnings from continuing operations to net cash provided by operating activities: |                                          |             |
| Depreciation and amortization                                                                              | 125.8                                    | 116.1       |
| Loss on extinguishment of debt                                                                             | 39.9                                     |             |
| Gain on sale of CareFusion common stock                                                                    | (20.0)                                   |             |
| Impairments and loss on sale of assets                                                                     | 24.0                                     | 10.5        |
| Share based payment compensation                                                                           | 42.1                                     | 50.2        |
| Provision for bad debts                                                                                    | 21.4                                     | 21.8        |
| Change in operating assets and liabilities, net of effects from acquisitions:                              |                                          |             |
| Decrease/(increase) in trade receivables                                                                   | 269.2                                    | (238.6)     |
| Increase in inventories                                                                                    | (1,127.2)                                | (1,820.3)   |
| Increase in accounts payable                                                                               | 1,499.2                                  | 1,299.1     |
| Other accrued liabilities and operating items, net                                                         | (259.0)                                  | (286.4)     |
| Net cash provided by/(used in) operating activities continuing operations                                  | 783.8                                    | (506.4)     |
| Net cash provided by operating activities discontinued operations                                          | 146.8                                    | 717.6       |
| Net cash provided by operating activities                                                                  | 930.6                                    | 211.2       |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                                               |                                          |             |
| Acquisition of subsidiaries, net of divestitures and cash acquired                                         | (32.0)                                   | (6.2)       |
| Proceeds from sale of property and equipment                                                               | 4.3                                      | 12.3        |
| Additions to property and equipment                                                                        | (79.9)                                   | (130.5)     |
| Proceeds from sale of CareFusion common stock                                                              | 135.0                                    |             |
| Net cash provided by/(used in) investing activities continuing operations                                  | 27.4                                     | (124.4)     |
| Net cash used in investing activities discontinued operations                                              | (9.9)                                    | (51.7)      |
| Net cash provided by/(used in) investing activities                                                        | 17.5                                     | (176.1)     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                                               |                                          |             |
| Net change in commercial paper and short-term borrowings                                                   |                                          | 101.1       |
| Reduction of long-term obligations                                                                         | (1,484.9)                                | (304.5)     |
| Proceeds from long-term obligations, net of issuance costs                                                 |                                          | 21.4        |
| Proceeds from issuance of Common Shares                                                                    | 27.9                                     | 20.7        |
| Tax (expense)/benefit from stock options                                                                   | (6.1)                                    | 2.3         |
| Payment of premiums for debt extinguishment                                                                | (66.4)                                   |             |
| Dividends on Common Shares                                                                                 | (127.2)                                  | (100.0)     |



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|                                                                               |  |            |          |
|-------------------------------------------------------------------------------|--|------------|----------|
| Purchase of treasury shares                                                   |  | (50.0)     |          |
| Net cash used in financing activities – continuing operations                 |  | (1,706.7)  | (259.0)  |
| Net cash provided by/(used in) financing activities – discontinued operations |  | 1,283.8    | (2.3)    |
| Net cash used in financing activities                                         |  | (422.9)    | (261.3)  |
| <b>NET INCREASE/(DECREASE) IN CASH AND EQUIVALENTS</b>                        |  | 525.2      | (226.2)  |
| <b>CASH AND EQUIVALENTS AT BEGINNING OF PERIOD</b>                            |  | 1,221.6    | 808.8    |
| <b>CASH AND EQUIVALENTS AT END OF PERIOD</b>                                  |  | \$ 1,746.8 | \$ 582.6 |
| <b>SUPPLEMENTAL INFORMATION</b>                                               |  |            |          |
| Non-cash investing and financing transactions for:                            |  |            |          |
| Investment in CareFusion                                                      |  | 863.1      |          |
| Non-cash dividend in connection with Spin-Off                                 |  | 3,728.4    |          |

See notes to condensed consolidated financial statements.

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**Table of Contents**

**CARDINAL HEALTH, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Spin-Off of CareFusion Corporation***

Effective August 31, 2009, Cardinal Health, Inc. (the Company) completed the distribution to its shareholders of approximately 81% of the then outstanding common stock of CareFusion Corporation (CareFusion), with the Company retaining 41.4 million shares of CareFusion common stock (the Spin-Off). Under the requirements of the Private Letter Ruling obtained from the Internal Revenue Service, the Company is required to dispose of the retained shares of CareFusion common stock within five years of the Spin-Off. During the second quarter of fiscal 2010, the Company disposed of approximately 5.5 million shares of CareFusion common stock. Refer to Note 6 for additional information. While Cardinal Health is a party to a separation agreement and various other agreements relating to the separation, including a transition services agreement, a tax matters agreement, an employee matters agreement, intellectual property agreements and certain other commercial agreements, the Company has determined that it has no significant continuing involvement in the operations of CareFusion. Accordingly, the net assets of CareFusion are presented separately in these condensed consolidated financial statements as assets from businesses held for sale and discontinued operations and the operating results of CareFusion are presented within discontinued operations for all periods presented through the date of the Spin-Off. The Company retained certain surgical and exam gloves, surgical drapes and apparel and fluid management businesses previously within the Clinical and Medical Products segment following the Spin-Off.

For fiscal 2009, the Company had three reportable segments: Healthcare Supply Chain Services, Clinical and Medical Products and All Other. Effective July 1, 2009, the Company changed its reportable segments to: Pharmaceutical, Medical and CareFusion. The Pharmaceutical segment encompasses the businesses previously within the Healthcare Supply Chain Services segment that distributed pharmaceutical, radiopharmaceutical and over-the-counter healthcare products as well as the businesses previously within the All Other segment. The Medical segment encompasses the remaining businesses within the Healthcare Supply Chain Services segment as well as certain surgical and exam gloves, surgical drapes and apparel and fluid management businesses previously within the Clinical and Medical Products segment. The CareFusion segment encompasses the businesses previously within the Clinical and Medical Products segment excluding the above-referenced surgical and exam gloves, surgical drapes and apparel and fluid management businesses and includes all businesses included in the Spin-Off.

In connection with the Spin-Off, the Company reorganized its reportable segments into two segments: Pharmaceutical and Medical. See Note 14 for information about these segments.

***Relationship between the Company and CareFusion***

On July 22, 2009, the Company and CareFusion entered into a separation agreement to effect the Spin-Off and provide a framework for the relationship between the Company and CareFusion after the Spin-Off. In addition, on August 31, 2009, the Company and CareFusion entered into a transition services agreement, a tax matters agreement, an employee matters agreement, intellectual property agreements and certain other commercial agreements. These agreements, including the separation agreement, provide for allocation between the Company and CareFusion of the Company's assets, employees, liabilities and obligations (including its investments, property and employee benefits and tax-related assets and liabilities) attributable to periods prior to, at and after the Spin-Off and govern certain relationships between the Company and CareFusion after the Spin-Off. The Company and CareFusion also entered into a stockholders and registration rights agreement pursuant to which, among other things, CareFusion agrees that, upon the request of the Company, CareFusion will use its commercially reasonable efforts to effect the registration under applicable federal and state securities laws of any shares of CareFusion common stock retained by Cardinal Health.

Pursuant to the transition services agreement, for the three months ended December 31, 2009, the Company recognized approximately \$42.5 million in transition service fee income which approximately offsets the costs associated with providing the transition services. The Company has recognized \$55.2 million in transition service fee income year-to-date since the Spin-Off. Additionally, the Company purchased \$167.2 million of CareFusion trade receivables pursuant to an accounts receivable factoring arrangement between the Company and CareFusion during the three months ended December 31, 2009. The Company has purchased \$273.5 million of CareFusion trade receivables year-to-date since the Spin-Off.

***Basis of Presentation***

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The condensed consolidated financial statements of the Company include the accounts of all majority-owned subsidiaries and all significant intercompany amounts have been eliminated. References to the Company or Cardinal Health in these condensed consolidated financial statements shall be deemed to be references to Cardinal Health, Inc. and its majority-owned subsidiaries unless the context otherwise requires.

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## Table of Contents

The condensed consolidated financial statements have been prepared in accordance with the U.S. Securities and Exchange Commission ( SEC ) instructions to Quarterly Reports on Form 10-Q and include all of the information and disclosures required by accounting principles generally accepted in the United States ( GAAP ) for interim financial reporting. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the condensed consolidated financial statements and accompanying notes. Actual amounts may differ from these estimated amounts. In addition, operating results presented for this fiscal 2010 interim period are not necessarily indicative of the results that may be expected for the full fiscal year ending June 30, 2010. Beginning in the first quarter of fiscal 2010, the Company changed the presentation of certain items on the condensed consolidated statements of earnings. Prior periods have been adjusted to conform with this new presentation. The Company has disclosed all material subsequent events through February 5, 2010, the date the financial statements were issued.

These condensed consolidated financial statements are unaudited and are presented pursuant to the rules and regulations of the SEC. Accordingly, the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q (this Form 10-Q ) should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2009, as updated by the Company s Form 8-K filed on November 16, 2009 ( FY2009 Financial Statements ). Note 1 of the Notes to Consolidated Financial Statements from the FY2009 Financial Statements is specifically incorporated in this Form 10-Q by reference. In the opinion of management, all adjustments necessary for a fair presentation of the condensed consolidated financial statements have been included. Except as disclosed elsewhere in this Form 10-Q, all such adjustments are of a normal and recurring nature.

*Revenue Recognition.* The Company recognizes revenue when persuasive evidence of an arrangement exists, product delivery has occurred or the services have been rendered, the price is fixed or determinable and collectability is reasonably assured. Revenue is recognized net of sales returns and allowances.

Pharmaceutical. This segment recognizes distribution revenue when title transfers to its customers and the business has no further obligation to provide services related to such merchandise.

Revenue within this segment includes revenue from bulk customers. Most deliveries to bulk customers consist of product shipped in the same form as the product is received from the manufacturer. Bulk customers have the ability to process large quantities of products in central locations and self distribute these products to their individual retail stores or customers. Revenue from bulk customers is recorded when title transfers to the customer and the Company has no further obligation to provide services related to such merchandise.

Revenue for deliveries that are directly shipped to customer warehouses from the manufacturer whereby the Company acts as an intermediary in the ordering and delivery of products is recorded gross in accordance with accounting standards addressing reporting revenue on a gross basis as a principal versus on a net basis as an agent. This revenue is recorded on a gross basis since the Company incurs credit risk from the customer, bears the risk of loss for incomplete shipments and does not receive a separate fee or commission for the transaction and, as such, is the primary obligor.

Radiopharmaceutical revenue is recognized upon delivery of the product to the customer. Service-related revenue, including fees received for analytical services or sales and marketing services, is recognized upon the completion of such services.

Pharmacy management and other service revenue is recognized as the services are rendered according to the contracts established. A fee is charged under such contracts through a capitation fee, a dispensing fee, a monthly management fee or an actual costs-incurred arrangement. Under certain contracts, fees for services are guaranteed by the Company not to exceed stipulated amounts or have other risk-sharing provisions. Revenue is adjusted to reflect the estimated effects of such contractual guarantees and risk-sharing provisions.

Through its Medicine Shoppe International, Inc. and Medicap Pharmacies Incorporated franchise operations (collectively, Medicine Shoppe ), the Company has apothecary-style pharmacy franchisees from which it earns franchise and origination fees. Franchise fees represent monthly fees that are either fixed or based upon franchisees sales and are recognized as revenue when they are earned. Origination fees from signing new franchise agreements are recognized as revenue when the new franchise store is opened.

Medical. This segment recognizes distribution revenue when title transfers to its customers and the business has no further obligation to provide services related to such merchandise. Revenue from the sale of medical products and supplies is recognized when title and risk of loss transfers to its customers, which is typically upon delivery.

Multiple Segments or Business Units. Arrangements involving multiple segments or business units containing no software or software which is incidental to the functionality of the product or service are accounted for as revenue arrangements with multiple deliverables. If the deliverable meets the criterion of a separate unit of accounting, the arrangement revenue is allocated to each element based upon its relative fair value and

recognized in accordance with the applicable revenue recognition criteria for each element.

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## **Table of Contents**

### ***Recent Financial Accounting Standards***

In December 2007, the FASB issued new accounting guidance on the accounting and reporting for business combinations and minority interests in consolidated financial statements. This guidance is effective for fiscal years beginning after December 15, 2008. The adoption of this new accounting guidance in the first quarter of fiscal 2010 did not have a material impact on the Company's financial position or results of operations; however, it may have an impact on the Company's accounting and disclosure practices for future business combinations.

In June 2008, the FASB issued new accounting guidance addressing whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the computation of earnings per share. This guidance is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The adoption of this new accounting guidance in the first quarter of fiscal 2010 did not have a material impact on the Company's financial position or results of operations.

In June 2009, the FASB issued new accounting guidance on the accounting for transfers of financial assets. This guidance improves the relevance, representational faithfulness and comparability of information provided about a transfer of financial assets, the effects of a transfer of financial assets on an entity's financial statements, and a transferor's continuing involvement, if any, in financial assets transferred. This guidance is effective for fiscal years beginning after November 15, 2009. The Company is in the process of determining the impact of adopting this new accounting guidance.

In June 2009, the FASB issued new accounting guidance regarding the consolidation of variable interest entities. This guidance improves the financial reporting by enterprises involved with variable interest entities. This guidance is effective for fiscal years beginning after November 15, 2009. The Company is in the process of determining the impact of adopting this new accounting guidance.

In June 2009, the FASB issued the Accounting Standards Codification (the Codification), which became the source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities effective July 1, 2009. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. Effective July 1, 2009, the Codification superseded all then-existing non-SEC accounting and reporting standards. The adoption of this new accounting guidance in the first quarter of fiscal 2010 did not have an impact on the Company's financial position or results of operations. The Company has updated its disclosures in the notes to the financial statements to reflect the updated accounting guidance.

## **2. RESTRUCTURING AND EMPLOYEE SEVERANCE**

### ***Restructuring Policy***

The Company classifies a restructuring activity as a program whereby the Company fundamentally changes its operations such as closing facilities, moving manufacturing of a product to another location or outsourcing the production of a product. Restructuring activities may also involve substantial re-alignment of the management structure of a business unit in response to changing market conditions. A liability for a cost associated with an exit or disposal activity is recognized and measured initially at its fair value in the period in which it is incurred except for a liability for a one-time termination benefit which is recognized over its future service period.

### ***Restructuring and Employee Severance***

Effective July 1, 2008, the Company consolidated its businesses into two primary operating and reportable segments to reduce costs and align resources with the needs of each segment. The costs incurred related to this consolidation during the three months ended December 31, 2008 were \$(0.9) million and for the six months ended December 31, 2009 and 2008 were \$1.0 million and \$17.2 million, respectively. In connection with the Spin-Off, these reportable segments have since been reorganized. Refer to Notes 1 and 14 for additional information regarding the Company's current reportable segments.

Also, during fiscal 2009 and the first half of fiscal 2010, the Company incurred restructuring expenses related to the Spin-Off consisting of employee-related costs, costs to evaluate and execute the transaction, costs to separate certain functions and information technology systems and other one-time transaction related costs. The costs incurred related to this restructuring during the three months ended December 31, 2009 and 2008 were \$6.6 million and \$12.7 million, respectively, and for the six months ended December 31, 2009 and 2008 were \$56.1 million and \$13.0 million, respectively.

In addition to the restructuring programs discussed above, from time to time the Company incurs costs to implement smaller restructuring efforts for specific operations within its segments. These restructuring plans focus on various aspects of operations, including closing and consolidating certain manufacturing and distribution operations, rationalizing headcount, and aligning operations in the most strategic and cost-efficient

structure.

**Table of Contents**

The following table summarizes activity related to the Company's restructuring and employee severance costs during the three and six months ended December 31, 2009 and 2008:

| (in millions)                                     | Three Months Ended<br>December 31, |                | Six Months Ended<br>December 31, |                |
|---------------------------------------------------|------------------------------------|----------------|----------------------------------|----------------|
|                                                   | 2009                               | 2008           | 2009                             | 2008           |
| Employee related costs (1)                        | \$ 2.1                             | \$ 0.1         | \$ 29.2                          | \$ 21.1        |
| Facility exit and other costs (2)                 | 8.6                                | 16.8           | 41.2                             | 16.5           |
| <b>Total restructuring and employee severance</b> | <b>\$ 10.7</b>                     | <b>\$ 16.9</b> | <b>\$ 70.4</b>                   | <b>\$ 37.6</b> |

- (1) **Employee-Related Costs.** These costs primarily consist of one-time termination benefits provided to employees who have been involuntarily terminated and duplicate payroll costs during transition periods. In addition, during the six months ended December 31, 2009, the Company incurred \$18.6 million of costs related to the retirement of its former Chairman and Chief Executive Officer upon completion of the Spin-Off.
- (2) **Facility Exit and Other Costs.** Facility exit and other costs consist of accelerated depreciation, equipment relocation costs, project consulting fees and costs associated with restructuring the Company's delivery of information technology infrastructure services. In addition, facility exit and other costs include certain costs related to the Spin-Off such as costs to evaluate and execute the transaction, costs to separate certain functions and information technology systems and other one-time transaction related costs.

**Restructuring and Employee Severance Accrual Rollforward**

The following table summarizes activity related to liabilities associated with the Company's restructuring and employee severance activities during the six months ended December 31, 2009:

| (in millions)                    | Employee Related<br>Costs | Facility Exit and<br>Other Costs | Total   |
|----------------------------------|---------------------------|----------------------------------|---------|
| Balance at June 30, 2009 (1)     | \$ 14.0                   | \$ 17.2                          | \$ 31.2 |
| Additions                        | 29.2                      | 41.2                             | 70.4    |
| Payments and other adjustments   | (25.8)                    | (44.7)                           | (70.5)  |
| Balance at December 31, 2009 (1) | \$ 17.4                   | \$ 13.7                          | \$ 31.1 |

- (1) Included within employee related costs are accruals of \$6.3 million and \$10.6 million at June 30, 2009 and December 31, 2009, respectively, related to the Spin-Off. Included within facility exit and other costs are accruals of \$11.7 million and \$5.9 million at June 30, 2009 and December 31, 2009, respectively, related to the Spin-Off.

**3. IMPAIRMENTS AND LOSS ON SALE OF ASSETS**

During the six months ended December 31, 2009, the Company recognized a \$20.0 million impairment loss related to the write-down of SpecialtyScripts, LLC (SpecialtyScripts), a business within the Pharmaceutical segment, to expected fair value less costs to sell. See Note 4 for further information regarding the anticipated sale of SpecialtyScripts.

**4. DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE****CareFusion**

Effective August 31, 2009, the Company completed the distribution to its shareholders of approximately 81% of the then outstanding common stock of CareFusion, with the Company retaining 41.4 million shares of CareFusion common stock, and met the criteria for classification as



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discontinued operations in the Company's financial statements. During the second quarter of fiscal 2010, the Company disposed of approximately 5.5 million shares of CareFusion common stock. The Company's investment in CareFusion common stock does not provide the Company the ability to influence the operating or financial policies of CareFusion and accordingly does not constitute significant continuing involvement. Furthermore, while the Company is a party to a separation agreement and various other agreements relating to the separation, including a transition services agreement, a tax matters agreement, an employee matters agreement, intellectual property agreements and certain other commercial agreements, the Company has determined that the continuing cash flows generated by these agreements, which are expected to be eliminated within 5 years, and its investment in CareFusion common stock, do not constitute significant continuing involvement in the operations of CareFusion. Accordingly, the net assets of CareFusion are presented separately as discontinued operations and the operating results are presented within discontinued operations for all periods presented through the date of the Spin-Off.

**Table of Contents**

The results of CareFusion included in discontinued operations for the three and six months ended December 31, 2009 and 2008 are summarized as follows:

| (in millions)                                            | Three Months Ended<br>December 31, |          | Six Months Ended<br>December 31, |            |
|----------------------------------------------------------|------------------------------------|----------|----------------------------------|------------|
|                                                          | 2009                               | 2008     | 2009<br>(1)                      | 2008       |
| Revenue                                                  | \$                                 | \$ 957.0 | \$ 592.1                         | \$ 1,840.9 |
| Earnings before income taxes and discontinued operations |                                    | 200.2    | 43.7                             | 304.1      |
| Income tax expense                                       |                                    | (53.2)   | (23.6)                           | (83.1)     |
| Earnings from discontinued operations                    |                                    | 147.0    | 20.1                             | 221.0      |

(1) Reflects the results of CareFusion through August 31, 2009, the effective date of the Spin-Off. Interest expense allocated to discontinued operations for CareFusion was \$16.5 million for the three months ended December 31, 2008 and \$12.8 million and \$38.1 million for the six months ended December 31, 2009 and 2008, respectively. Interest expense was allocated considering the debt issued by CareFusion in connection with the Spin-Off and the overall debt balance of the Company. In addition, a portion of the corporate costs previously allocated to CareFusion have been reclassified to the remaining two segments.

There were no assets and liabilities from businesses held for sale for CareFusion at December 31, 2009. At June 30, 2009, the major components of assets and liabilities from businesses held for sale for CareFusion were as follows:

| (in millions)            | June 30,<br>2009 |
|--------------------------|------------------|
| Current assets           | \$ 1,832.0       |
| Property and equipment   | 408.5            |
| Other assets             | 4,774.2          |
| Total assets             | \$ 7,014.7       |
| Current liabilities      | 469.2            |
| Long-term debt and other | 875.4            |
| Total liabilities        | \$ 1,344.6       |

Cash flows from discontinued operations are presented separately on the Company's condensed consolidated statements of cash flows.

**PTS Business**

See Note 7 of the Notes to Consolidated Financial Statements from the FY2009 Financial Statements, for information regarding the sale of the former Pharmaceutical Technologies and Services segment, other than certain generic-focused businesses (the PTS Business), during the fourth quarter of fiscal 2007.

The Company incurred minor amounts of activity related to the PTS Business during the three and six months ended December 31, 2008 as a result of changes in certain estimates made at the time of the sale, activity under a transition services agreement and other adjustments. The loss related to the PTS Business included in discontinued operations was \$0.2 million and \$0.8 million for the three and six months ended December 31, 2009, respectively. The loss related to the PTS Business included in discontinued operations was \$2.4 million and \$3.1 million for the three and six months ended December 31, 2008, respectively.

The liabilities of the PTS Business included in liabilities held for sale were \$1.4 million as of December 31, 2009 and June 30, 2009.

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Cash flows from discontinued operations are presented separately on the Company's condensed consolidated statements of cash flows.

### **Other**

During the fourth quarter of fiscal 2009, the Company committed to plans to sell its United Kingdom-based Martindale injectable manufacturing business ( Martindale ) within its Pharmaceutical segment, and met the criteria for classification as assets held for sale in the Company's financial statements. Accordingly, the net assets of Martindale are presented separately as held for sale and discontinued operations and the operating results are presented within discontinued operations for all periods presented. During the fourth quarter of fiscal 2009, the Company also committed to plans to sell SpecialtyScripts within its Pharmaceutical segment, and met the criteria for classification as held for sale in the Company's financial statements. Accordingly, the net assets of this business are presented separately as assets held for sale on the Company's condensed consolidated balance sheet at December 31, 2009 and June 30, 2009. The results of SpecialtyScripts are reported within earnings from continuing operations on the Company's condensed consolidated statements of earnings because it did not satisfy the criteria for classification as discontinued operations. Additionally, the net assets held for sale of SpecialtyScripts were recorded at the net expected fair value less costs to sell, as this amount was lower than its net carrying value (see Note 3 for further information).

**Table of Contents**

The results of Martindale included in discontinued operations for the three and six months ended December 31, 2009 and 2008 are summarized as follows:

| (in millions)                                            | Three Months Ended<br>December 31, |         | Six Months Ended<br>December 31, |         |
|----------------------------------------------------------|------------------------------------|---------|----------------------------------|---------|
|                                                          | 2009                               | 2008    | 2009                             | 2008    |
| Revenue                                                  | \$ 30.6                            | \$ 24.6 | \$ 59.6                          | \$ 50.9 |
| Earnings before income taxes and discontinued operations | 6.4                                | 4.0     | 12.3                             | 9.1     |
| Income tax expense                                       | (1.9)                              | (1.1)   | (3.7)                            | (2.6)   |
| Earnings from discontinued operations                    | 4.5                                | 2.9     | 8.6                              | 6.5     |

Cash flows from discontinued operations are presented separately on the Company's condensed consolidated statements of cash flows.

At December 31, 2009 and June 30, 2009, the major components of assets and liabilities from businesses held for sale related to Martindale and SpecialtyScripts were as follows:

| (in millions)            | December 31,<br>2009 | June 30,<br>2009 |
|--------------------------|----------------------|------------------|
| Current assets           | \$ 59.1              | \$ 74.2          |
| Property and equipment   | 22.8                 | 19.3             |
| Other assets             | 67.0                 | 81.2             |
| Total assets             | \$ 148.9             | \$ 174.7         |
| Current liabilities      | 28.2                 | 16.5             |
| Long-term debt and other | 7.7                  | 8.4              |
| Total liabilities        | \$ 35.9              | \$ 24.9          |

**5. GOODWILL AND OTHER INTANGIBLE ASSETS****Goodwill**

The following table summarizes the changes in the carrying amount of goodwill by segment for the six months ended December 31, 2009:

| (in millions)                                                                                           | Pharmaceutical | Medical  | Total      |
|---------------------------------------------------------------------------------------------------------|----------------|----------|------------|
| Balance at June 30, 2009                                                                                | \$ 1,232.8     | \$ 963.7 | \$ 2,196.5 |
| Goodwill acquired net of purchase price adjustments, foreign currency translation adjustments and other | 32.5           | 10.4     | 42.9       |
| Balance at December 31, 2009                                                                            | \$ 1,265.3     | \$ 974.1 | \$ 2,239.4 |

Due to the Spin-Off and reorganization of the reporting units, goodwill was tested for impairment in the first quarter of fiscal 2010. Based on this analysis, there was no impairment. The Company's determination of estimated fair value of the reporting units is based on a combination of a discounted cash flow analysis, a multiple of earnings before interest, taxes, depreciation and amortization (EBITDA) and, if available, a review of the price/earnings ratio for publicly traded companies similar in nature, scope and size of the respective reporting units. The discount rates used for impairment testing are based on the risk-free rate plus an adjustment for risk factors. The EBITDA multiples used for impairment testing are judgmentally selected based on factors such as the nature, scope and size of the applicable reporting unit. The use of alternative estimates, peer groups or changes in the industry, or adjusting the discount rate, EBITDA multiples or price earnings ratios used could affect the estimated fair value of the reporting units and potentially result in goodwill impairment.

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The allocations of the purchase price related to certain small acquisitions are not yet finalized and are subject to adjustment as the Company completes the valuation analyses for these acquisitions.

**Table of Contents****Intangible Assets**

Intangible assets with definite lives are amortized over their useful lives which range from three to twenty years. The detail of other intangible assets by class as of June 30, 2009 and December 31, 2009 is as follows:

| (in millions)                 | Gross<br>Intangible | Accumulated<br>Amortization | Net<br>Intangible |
|-------------------------------|---------------------|-----------------------------|-------------------|
| June 30, 2009                 |                     |                             |                   |
| Unamortized intangibles:      |                     |                             |                   |
| Trademarks and patents        | \$ 11.4             | \$                          | \$ 11.4           |
| Total unamortized intangibles | 11.4                |                             | 11.4              |
| Amortized intangibles:        |                     |                             |                   |
| Trademarks and patents        | 30.2                | 12.9                        | 17.3              |
| Non-compete agreements        | 3.9                 | 2.5                         | 1.4               |
| Customer relationships        | 46.6                | 35.1                        | 11.5              |
| Other                         | 66.2                | 37.4                        | 28.8              |
| Total amortized intangibles   | 146.9               | 87.9                        | 59.0              |
| Total intangibles             | \$ 158.3            | \$ 87.9                     | \$ 70.4           |
| December 31, 2009             |                     |                             |                   |
| Unamortized intangibles:      |                     |                             |                   |
| Trademarks and patents        | \$ 9.2              | \$                          | \$ 9.2            |
| Total unamortized intangibles | 9.2                 |                             | 9.2               |
| Amortized intangibles:        |                     |                             |                   |
| Trademarks and patents        | 22.1                | 13.1                        | 9.0               |
| Non-compete agreements        | 4.1                 | 2.7                         | 1.4               |
| Customer relationships        | 49.7                | 38.4                        | 11.3              |
| Other                         | 63.0                | 38.6                        | 24.4              |
| Total amortized intangibles   | 138.9               | 92.8                        | 46.1              |
| Total intangibles             | \$ 148.1            | \$ 92.8                     | \$ 55.3           |

There were no significant acquisitions of other intangible assets during the periods presented. Amortization expense for the three and six months ended December 31, 2009 was \$2.6 million and \$6.0 million, respectively, and \$3.3 million and \$7.1 million, respectively, during the comparable prior year periods.

Amortization expense for each of the next five fiscal years is estimated to be:

| (in millions)        | 2010    | 2011   | 2012   | 2013   | 2014   |
|----------------------|---------|--------|--------|--------|--------|
| Amortization expense | \$ 11.0 | \$ 9.1 | \$ 4.6 | \$ 3.2 | \$ 1.7 |

**6. INVESTMENT IN CAREFUSION**

The following table provides a summary of the Company's available-for-sale securities as of December 31, 2009:

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| (in millions)         | Cost<br>(2) | Available-for-Sale Securities |                               | Estimated<br>Fair<br>Value |
|-----------------------|-------------|-------------------------------|-------------------------------|----------------------------|
|                       |             | Gross<br>Unrealized<br>Gains  | Gross<br>Unrealized<br>Losses |                            |
| Equity securities (1) | \$ 748.2    | \$ 149.2                      | \$                            | \$ 897.4                   |
| Total                 | \$ 748.2    | \$ 149.2                      | \$                            | \$ 897.4                   |

- (1) Equity securities consist of the Company's ownership of approximately 35.9 million shares of CareFusion common stock retained in connection with the Spin-Off. These securities are stated at fair value, with unrealized gains and losses reported in other comprehensive income. Realized gains and losses, and declines in fair value deemed to be other-than-temporary are recognized in net earnings immediately. During the three months ended December 31, 2009, the Company disposed of approximately 5.5 million shares of CareFusion common stock resulting in proceeds of approximately \$135.0 million and a pre-tax realized gain of approximately \$20.0 million. The net adjustment to unrealized holding gains on CareFusion common stock included in other comprehensive income totaled \$115.2 million during the same period.
- (2) Represents the Company's cost investment in the net book value of CareFusion's assets immediately following the Spin-Off adjusted for the sale of securities during the three months ended December 31, 2009.

**Table of Contents****7. LONG-TERM OBLIGATIONS AND OTHER SHORT-TERM BORROWINGS**

On September 24, 2009, the Company completed a debt tender announced on August 27, 2009 for an aggregate purchase price, including an early tender premium but excluding accrued interest, fees and expenses, of up to \$1.2 billion of the following series of debt securities (listed in order of acceptance priority): (i) 7.80% Debentures due October 15, 2016 of Allegiance Corporation; (ii) 6.75% Notes due February 15, 2011 of the Company; (iii) 6.00% Notes due June 15, 2017 of the Company; (iv) 7.00% Debentures due October 15, 2026 of Allegiance Corporation; (v) 5.85% Notes due December 15, 2017 of the Company; (vi) 5.80% Notes due October 15, 2016 of the Company; (vii) 5.65% Notes due June 15, 2012 of the Company; (viii) 5.50% Notes due June 15, 2013 of the Company; and (ix) 4.00% Notes due June 15, 2015 of the Company. The Company purchased more than \$1.1 billion pursuant to the offer using the order of priority set forth above. In connection with the debt tender, the Company incurred a pre-tax loss for the early extinguishment of debt of approximately \$39.9 million, which included an early tender premium of \$66.4 million, the write-off of \$5.3 million of unamortized debt issuance costs, and an offsetting \$31.8 million fair value adjustment to the respective debt related to previously terminated interest rate swaps.

Long-term obligations and other short-term borrowings consist of the following as of December 31, 2009 and June 30, 2009:

| (in millions)                                                               | December 31,<br>2009 | June 30,<br>2009 |
|-----------------------------------------------------------------------------|----------------------|------------------|
| 4.00% Notes due 2015                                                        | \$ 520.7             | \$ 523.8         |
| 5.50% Notes due 2013                                                        | 299.2                | 300.0            |
| 5.65% Notes due 2012                                                        | 216.2                | 317.1            |
| 5.80% Notes due 2016                                                        | 309.8                | 526.4            |
| 5.85% Notes due 2017                                                        | 158.0                | 500.0            |
| 6.00% Notes due 2017                                                        | 214.9                | 350.4            |
| 6.75% Notes due 2011                                                        | 217.9                | 494.6            |
| 7.80% Debentures due 2016                                                   | 44.1                 | 75.7             |
| 7.00% Debentures due 2026                                                   | 124.5                | 192.0            |
| Floating Rate Notes due 2009                                                |                      | 350.0            |
| Other obligations                                                           | 6.6                  | 7.8              |
| Total                                                                       | 2,111.9              | 3,637.8          |
| Less: current portion and other short-term borrowings                       | 12.7                 | 366.2            |
| Long-term obligations, less current portion and other short-term borrowings | \$ 2,099.2           | \$ 3,271.6       |

**8. INCOME TAXES**

Effective July 1, 2007, the Company adopted new accounting guidance regarding the accounting for uncertainty in income taxes recognized in the financial statements, resulting in a \$139.3 million reduction of retained earnings. This accounting guidance provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. The amount recognized is measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon settlement. This interpretation also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The balance of unrecognized tax benefits and the amount of interest and penalties were as follows as of December 31, 2009 and June 30, 2009:

| (in millions)                                                                    | December 31,<br>2009 | June 30,<br>2009 |
|----------------------------------------------------------------------------------|----------------------|------------------|
| Unrecognized tax benefits (1) (2) (3)                                            | \$ 698.5             | \$ 848.8         |
| Portion that, if recognized, would reduce tax expense and effective tax rate (2) | 333.8                | 610.9            |
| Accrued penalties and interest (2) (3) (4)                                       | 222.3                | 247.0            |



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- (1) The Company includes the full amount of unrecognized tax benefits in deferred income taxes and other liabilities in the condensed consolidated balance sheets.
- (2) Due to the anticipated repatriation of certain foreign earnings, taxes associated with a special purpose entity transaction no longer represent uncertain tax benefits and have been classified at December 31, 2009 as deferred tax liabilities.
- (3) The December 31, 2009 balance includes unrecognized tax benefits related to CareFusion. In accordance with indemnification provisions of the tax matters agreement entered into between the Company and CareFusion, the Company is entitled to reimbursement from CareFusion. The Company has recorded a long term receivable of approximately \$214.5 million from CareFusion for these amounts (net of any tax refund claims).
- (4) Balances are gross amounts before any tax benefits and are included in deferred income taxes and other liabilities in the condensed consolidated balance sheets.

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## **Table of Contents**

Upon completion of the Spin-Off, the Company recorded a tax charge of approximately \$171.9 million related to the anticipated repatriation of a portion of cash currently loaned to the Company's entities within the United States from its international subsidiaries. This charge is included within earnings from continuing operations for the six months ended December 31, 2009.

The Company files income tax returns in the U.S. federal jurisdiction, various U.S. state jurisdictions and various foreign jurisdictions. With few exceptions, the Company is subject to audit by taxing authorities for fiscal years ended June 30, 2001 through the current fiscal year.

The Internal Revenue Service ( IRS ) currently has ongoing audits of fiscal years 2001 through 2007. During the three months ended December 31, 2007, the Company was notified that the IRS transferred jurisdiction over fiscal years 2001 and 2002 from the Office of Appeals back to the Examinations level to reconsider previously-unadjusted specific issues. During the three months ended March 31, 2008, the Company received Notices of Proposed Adjustment ( NPA s ) from the IRS related to fiscal years 2001 through 2005 challenging deductions arising from the sale of trade receivables to a special purpose accounts receivable and financing entity. The amount of additional tax, excluding penalties and interest, proposed by the IRS in these notices was \$178.9 million. The Company anticipates that this transaction could be the subject of proposed adjustments by the IRS in tax audits of fiscal years 2006 to 2009. As discussed above, the Company recorded a charge of \$171.9 million during the first quarter of fiscal 2010 to reflect the anticipated repatriation of earnings from the special purpose entity. Due to the anticipated repatriation of the earnings, the tax associated with the transaction, including the tax assessed by the IRS, no longer represents an uncertain tax benefit. Taxes associated with this transaction, including both the charge taken in the first quarter of fiscal 2010 and the amount previously accrued as an unrecognized tax benefit, are classified as deferred tax liabilities or current taxes payable.

During fiscal 2009, the Company received a Revenue Agent's Report for tax years 2003 through 2005, which included the NPA s discussed above and new NPA s related to the Company's transfer pricing arrangements between foreign and domestic subsidiaries and the transfer of intellectual property among subsidiaries of an acquired entity prior to its acquisition by the Company. The amount of additional tax proposed by the IRS in the new notices total \$598.1 million, excluding penalties and interest, but including \$462.1 million related to issues for which CareFusion is liable under the tax matters agreement in the event the amount must be paid to the taxing authority. The Company disagrees with these proposed adjustments and intends to vigorously contest them. The Company believes that it is adequately reserved for the uncertain tax position relating to these matters.

It is reasonably possible that there could be a change in the amount of unrecognized tax benefits within the next 12 months due to activities of the IRS or other taxing authorities, including proposed assessments of additional tax, possible settlement of audit issues, or the expiration of applicable statutes of limitations. The Company estimates that the range of the possible change in unrecognized tax benefits within the next 12 months is a decrease of approximately zero to \$25 million excluding penalties and interest.

The Company's provision for income taxes as a percentage of pretax earnings from continuing operations ( effective tax rate ) was 36.9% and 68.8%, respectively, for the three and six months ended December 31, 2009 compared to 37.7% and 35.1%, respectively, for the three and six months ended December 31, 2008. Generally, fluctuations in the effective tax rate are due to changes within international and U.S. state effective tax rates resulting from the Company's business mix and the impact of restructuring and employee severance, impairments and other discrete items. During the six months ended December 31, 2009 the effective tax rate was impacted by an unfavorable adjustment of \$172 million, or 31.8%, attributable to earnings no longer indefinitely invested offshore.

## **9. CONTINGENT LIABILITIES**

### ***Legal Proceedings***

In addition to commitments and obligations in the ordinary course of business, the Company is subject to various claims, other pending and potential legal actions for damages, investigations relating to governmental laws and regulations and other matters arising out of the normal conduct of its business. When accruing for contingencies related to litigation, the Company considers the degree of probability and range of possible loss. An estimated loss contingency is accrued in the Company's consolidated financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Because litigation is inherently unpredictable and unfavorable resolutions could occur, assessing contingencies is highly subjective and requires judgments about future events. The Company regularly reviews contingencies to determine the adequacy of the accruals and related disclosures. The amount of ultimate loss may differ from these estimates. It is possible that cash flows or results of operations could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies.

The Company recognizes income from the favorable outcome of legal settlements, judgments or other resolution of legal and regulatory matters when the associated cash or assets are received.



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## **Table of Contents**

Estimated loss contingencies related to litigation and regulatory matters and income from favorable resolution of legal and regulatory matters are recognized in litigation (credits)/charges, net in the Company's condensed consolidated statements of earnings.

### ***Insurance Proceeds***

In the three months ending December 31, 2009, the Company recognized \$27.2 million of income related to insurance proceeds released from escrow following the resolution of securities and derivative litigation against certain of the Company's directors and officers. This amount is comprised of \$25.7 million received from directors and officers' insurance policies recognized in litigation (credits)/charges, net and \$1.5 million of accrued interest income recognized in interest expense, net. For further information regarding this matter, see the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2007.

### ***Income Taxes***

See Note 8 for discussion of contingencies related to the Company's income taxes.

### ***Other Matters***

The Company also becomes involved from time-to-time in litigation and regulatory matters incidental to its business, including, but not limited to, personal injury claims, employment matters, commercial disputes, intellectual property matters, inclusion as a potentially responsible party for environmental clean-up costs, and litigation in connection with acquisitions and divestitures. The Company intends to vigorously defend itself against such litigation and does not currently believe that the outcome of any such litigation will have a material adverse effect on the Company's consolidated financial statements.

From time to time, the Company receives subpoenas or requests for information from various government agencies relating to the business, accounting or disclosure practices of customers or suppliers. The responses to these subpoenas and requests for information sometimes require considerable time and effort, and can result in considerable costs being incurred by the Company. The Company expects to incur additional costs in the future in connection with existing and future requests. Such subpoenas and requests also can lead to the assertion of claims or the commencement of legal proceedings against the Company.

Also from time to time, the Company may determine that products marketed, manufactured, or distributed by the Company may not meet Company specifications, published standards or regulatory requirements. In such circumstances, the Company will investigate and take appropriate corrective action. Such actions can lead to costs to repair or replace affected products, temporary interruptions in product sales and action by regulators, and can adversely impact results of operations.

## **10. GUARANTEES**

In the ordinary course of business, the Company, from time to time, agrees to indemnify certain other parties under agreements with the Company, including under acquisition and disposition agreements, customer agreements and intellectual property licensing agreements. Such indemnification obligations vary in scope and, when defined, in duration. In many cases, a maximum obligation is not explicitly stated and therefore the overall maximum amount of the liability under such indemnification obligations cannot be reasonably estimated. Where appropriate, such indemnification obligations are recorded as a liability. Historically, the Company has not, individually or in the aggregate, made payments under these indemnification obligations in any material amounts. In certain circumstances, the Company believes that its existing insurance arrangements, subject to the general deduction and exclusion provisions, would cover portions of the liability that could arise from any of these indemnification obligations. In addition, the Company believes that the likelihood of a material liability being triggered under these indemnification obligations is not significant.

In the ordinary course of business, the Company, from time to time, enters into agreements that obligate the Company to make fixed payments upon the occurrence of certain events. Such obligations primarily relate to obligations arising under acquisition transactions, where the Company has agreed to make payments based upon the achievement of certain financial performance measures by the acquired business. Generally, the obligation is capped at an explicit amount. The Company's aggregate exposure for these obligations, assuming the achievement of all financial performance measures, is not material.

In the ordinary course of business, the Company, from time to time, extends loans to its customers which are subsequently sold to a bank. The bank services and administers these loans as well as any new loans the Company may direct. In order for the bank to purchase such loans, it requires the absolute and unconditional obligation of the Company to repurchase such loans upon the occurrence of certain events described in the agreement including, but not limited to, borrower payment default that exceeds 90 days, insolvency and bankruptcy. At December 31, 2009

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and June 30, 2009, notes in the program subject to the guaranty of the Company totaled \$39.6 million and \$39.9 million, respectively. These loans are reported in the Company's condensed consolidated balance sheet.

**Table of Contents****11. FAIR VALUE MEASUREMENTS**

In September 2006, the FASB issued new accounting guidance on fair value measurements. The guidance defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. Additionally, this guidance established a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair values are as follows:

Level 1 Observable prices in active markets for identical assets and liabilities.

Level 2 Observable inputs other than quoted prices in active markets for identical assets and liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities.

In February 2008, the FASB issued additional guidance permitting a one-year deferral with regard to nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company adopted this new accounting guidance on July 1, 2008 with respect to all financial assets and liabilities and on July 1, 2009 with respect to all non-financial assets and liabilities. The adoption of this guidance did not have a material impact on the Company's financial position or results of operations in either period.

***Recurring Fair Value Measurements***

The following table presents the fair values for those assets and (liabilities) measured on a recurring basis as of December 31, 2009:

| (in millions)         | Fair Value Measurements |                |           |                   |
|-----------------------|-------------------------|----------------|-----------|-------------------|
|                       | Level 1                 | Level 2        | Level 3   | Total             |
| Cash Equivalents (1)  | \$ 987.5                | \$             | \$        | \$ 987.5          |
| Equity Securities (2) | 897.4                   |                |           | 897.4             |
| Forward Contracts (3) |                         | 82.0           |           | 82.0              |
| Other Investments (4) | 73.2                    |                |           | 73.2              |
| <b>Total</b>          | <b>\$ 1,958.1</b>       | <b>\$ 82.0</b> | <b>\$</b> | <b>\$ 2,040.1</b> |

- (1) Cash equivalents are comprised of highly liquid investments purchased with a maturity of three months or less. The carrying value of these cash equivalents approximates fair value due to their short-term maturities.
- (2) Equity securities consist of the Company's investment in CareFusion common stock. The fair value of these securities is determined using the quoted market price of the security.
- (3) The fair value of the Company's foreign currency forward contracts and commodity contracts is determined based on the present value of expected future cash flows considering the risks involved, including nonperformance risk, and using discount rates appropriate for the respective maturities.
- (4) The other investments balance includes investments in mutual funds, which are used to offset fluctuations in the Company's deferred compensation liabilities. The fair value of these investments is determined using quoted market prices.

***Non-Recurring Fair Value Measurements***

The following table presents the fair values for those assets and (liabilities) measured on a nonrecurring basis as of December 31, 2009:

| (in millions)                           | Fair Value Measurements |         |         |        |
|-----------------------------------------|-------------------------|---------|---------|--------|
|                                         | Level 1                 | Level 2 | Level 3 | Total  |
| Long-lived assets held for sale (1) (2) | \$                      | \$      | \$ 7.0  | \$ 7.0 |

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|       |    |    |        |        |
|-------|----|----|--------|--------|
| Total | \$ | \$ | \$ 7.0 | \$ 7.0 |
|-------|----|----|--------|--------|

- (1) During the six months ended December 31, 2009, certain long-lived assets held for sale were written down to their estimated fair value, less cost to sell, resulting in an impairment charge of \$20.0 million, which is included in impairments and loss on sale of assets in the condensed consolidated statements of earnings (see Note 3 for further information).
- (2) The fair value of long-lived assets held for sale is determined based on the best available information, including quoted market prices when available (level 1), market prices for similar assets (level 2) and internal cash flow estimates discounted at the appropriate interest rate (level 3), as appropriate.

**Table of Contents****12. EARNINGS PER SHARE AND SHAREHOLDERS EQUITY****Earnings per Share**

Basic earnings per Common Share ( Basic EPS ) is computed by dividing net earnings (the numerator) by the weighted average number of Common Shares outstanding during each period (the denominator). Diluted earnings per Common Share ( Diluted EPS ) is similar to the computation for Basic EPS, except that the denominator is increased by the dilutive effect of vested and unvested stock options, restricted shares and restricted share units computed using the treasury stock method.

The following table reconciles the number of Common Shares used to compute Basic EPS and Diluted EPS for the three and six months ended December 31, 2009 and 2008:

| (in millions)                                                        | Three Months Ended |       | Six Months Ended |       |
|----------------------------------------------------------------------|--------------------|-------|------------------|-------|
|                                                                      | December 31,       |       | December 31,     |       |
|                                                                      | 2009               | 2008  | 2009             | 2008  |
| Weighted-average Common Shares basic                                 | 359.0              | 357.3 | 359.1            | 357.0 |
| Effect of dilutive securities:                                       |                    |       |                  |       |
| Employee stock options, restricted shares and restricted share units | 2.0                | 3.0   | 2.0              | 4.2   |
| Weighted-average Common Shares diluted                               | 361.0              | 360.3 | 361.1            | 361.2 |

The potentially dilutive securities that were antidilutive for the three months ended December 31, 2009 and 2008 were 24.7 million shares and 32.6 million shares, respectively, and for the six months ended December 31, 2009 and 2008 were 23.0 million shares and 24.7 million shares, respectively.

The total number of Common Shares issued less the Common Shares held in treasury is used to determine the Common Shares outstanding.

**Shareholders Equity**

During the three months ended December 31, 2009, the Company repurchased approximately \$50 million of its Common Shares under its existing \$500 million share repurchase program announced on August 5, 2009. This repurchase authorization expires on August 31, 2012. At December 31, 2009, approximately \$450 million remained from the \$500 million repurchase authorization. The Company expects to use this repurchase program to at least offset equity plan issuances.

In connection with the Spin-Off on August 31, 2009, the Company issued a non-cash dividend of approximately \$3.7 billion to its shareholders through the pro-rata distribution of approximately 81% of the CareFusion Corporation common shares.

**13. COMPREHENSIVE INCOME**

The following is a summary of the Company's comprehensive income for the three and six months ended December 31, 2009 and 2008:

| (in millions)                                               | Three Months Ended |          | Six Months Ended |          |
|-------------------------------------------------------------|--------------------|----------|------------------|----------|
|                                                             | December 31,       |          | December 31,     |          |
|                                                             | 2009               | 2008     | 2009             | 2008     |
| Net earnings                                                | \$ 234.5           | \$ 316.5 | \$ 196.3         | \$ 565.6 |
| Foreign currency translation adjustments                    | 3.6                | (85.3)   | (37.8)           | (168.6)  |
| Net unrealized gain/(loss) on derivative instruments        | 2.4                | (9.8)    | 15.0             | (0.9)    |
| Net unrealized gain on investment in CareFusion, net of tax | 117.5              |          | 141.0            |          |
| Total comprehensive income                                  | \$ 358.0           | \$ 221.4 | \$ 314.5         | \$ 396.1 |



**14. SEGMENT INFORMATION**

The Company's operations are principally managed on a products and services basis. In connection with the Spin-Off, the Company reorganized its businesses into two reportable segments - Pharmaceutical and Medical. The factors for determining the reportable segments include the manner in which management evaluates the performance of the Company combined with the nature of the individual business activities.

**Table of Contents**

The Pharmaceutical segment distributes pharmaceutical products, over-the-counter healthcare products and consumer health products and provides support services to retail customers, hospitals and alternate care providers in the United States and Puerto Rico. It also provides services to branded pharmaceutical manufacturers and operates a pharmaceutical repackaging and distribution program. In addition, this segment operates centralized nuclear (radiopharmaceutical) pharmacies, provides third-party logistics support services and distributes therapeutic plasma to hospitals, clinics and other providers located in the United States. It also franchises apothecary-style retail pharmacies through its Medicine Shoppe International, Inc. and Medicap Pharmacies Incorporated franchise systems. Finally, it provides pharmacy management services to hospitals and other healthcare facilities.

The Medical segment develops, manufactures and distributes medical and surgical products including sterile and non-sterile procedure kits to hospitals, surgery centers, laboratories, physician offices and other healthcare providers in the United States, Canada and Puerto Rico. The medical and surgical products manufactured by the business, including single-use surgical drapes, gowns and apparel, exam and surgical gloves and fluid suction and collection systems, are also sold in various regions of the world outside of the United States, including countries in North America, Europe, and Asia.

The following table includes revenue for each reportable segment and reconciling items necessary to agree to amounts reported in the condensed consolidated financial statements:

| (in millions)              | Three Months Ended<br>December 31, |             | Six Months Ended<br>December 31, |             |
|----------------------------|------------------------------------|-------------|----------------------------------|-------------|
|                            | 2009                               | 2008        | 2009                             | 2008        |
| Segment revenue:           |                                    |             |                                  |             |
| Pharmaceutical (1)         | \$ 22,694.7                        | \$ 22,078.7 | \$ 45,257.0                      | \$ 43,482.8 |
| Medical (2)                | 2,232.4                            | 2,057.3     | 4,469.4                          | 4,094.0     |
| Total segment revenue      | 24,927.1                           | 24,136.0    | 49,726.4                         | 47,576.8    |
| Corporate (3)              | (7.4)                              | (18.2)      | (26.0)                           | (21.9)      |
| Total consolidated revenue | \$ 24,919.7                        | \$ 24,117.8 | \$ 49,700.4                      | \$ 47,554.9 |

- (1) The Pharmaceutical segment's revenue is derived from the distribution of pharmaceutical, radiopharmaceutical and over-the-counter healthcare products.
- (2) The Medical segment's revenue is derived from the manufacturing and distribution of medical, surgical and laboratory products and medical procedure kits.
- (3) Corporate revenue consists of the elimination of inter-segment revenue.

The Company evaluates the performance of the segments based upon, among other things, segment profit. Segment profit is segment revenue less segment cost of products sold, less segment distribution, selling, general and administrative expense (SG&A). Segment SG&A expense includes equity compensation expense as well as allocated corporate expenses for shared functions, including corporate management, corporate finance, financial shared services, human resources, information technology, legal and an integrated hospital sales organization. Corporate expenses are allocated to the segments based upon headcount, level of benefit provided and ratable allocation. Information about interest income and expense and income taxes is not provided at the segment level. In addition, restructuring and employee severance, impairments and loss on sale of assets, litigation (credits)/charges, net and certain investment spending are not allocated to the segments. Investment spending generally includes the first year spend for certain projects which require incremental strategic investments in the form of additional operating expenses. The Company urges its segments to identify investment projects which will encourage innovation and provide future returns. As approval decisions for such projects are dependent upon executive management, the expenses for such projects are retained at Corporate. See Notes 2 and 3, respectively, for further discussion of the Company's restructuring and employee severance and impairments and loss on sale of assets. The accounting policies of the segments are the same as those described in Note 1.

The following table includes segment profit by reportable segment and reconciling items necessary to agree to amounts reported in the condensed consolidated financial statements:

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| (in millions)        | Three Months Ended |          | Six Months Ended |          |
|----------------------|--------------------|----------|------------------|----------|
|                      | December 31,       |          | December 31,     |          |
| Segment profit:      | 2009               | 2008     | 2009             | 2008     |
| Pharmaceutical       | \$ 259.6           | \$ 262.6 | \$ 468.0         | \$ 475.9 |
| Medical              | 102.5              | 74.5     | 217.4            | 172.4    |
| Total segment profit | 362.1              | 337.1    | 685.4            | 648.3    |

**Table of Contents**

| (in millions)                         | Three Months Ended |          | Six Months Ended |          |
|---------------------------------------|--------------------|----------|------------------|----------|
|                                       | December 31,       |          | December 31,     |          |
|                                       | 2009               | 2008     | 2009             | 2008     |
| Corporate (1)                         | 4.7                | (24.0)   | (78.7)           | (48.6)   |
| Total consolidated operating earnings | \$ 366.8           | \$ 313.1 | \$ 606.7         | \$ 599.7 |

- (1) For the three and six months ended December 31, 2009 and 2008, Corporate includes, among other things, restructuring and employee severance, impairments and loss on sale of assets, litigation (credits)/charges, net and certain investment spending which are not allocated to the segments.

The following table includes total assets at December 31, 2009 and June 30, 2009 for each segment as well as reconciling items necessary to agree to the amounts reported in the condensed consolidated financial statements:

| (in millions)       | December 31, | June 30,    |
|---------------------|--------------|-------------|
|                     | 2009         | 2009        |
| Segment assets:     |              |             |
| Pharmaceutical      | \$ 13,536.0  | \$ 12,625.3 |
| Medical             | 3,897.6      | 3,747.9     |
| Corporate (1)       | 3,387.9      | 8,745.6     |
| Consolidated assets | \$ 20,821.5  | \$ 25,118.8 |

- (1) The Corporate assets primarily consist of cash and equivalents, the Company's investment in CareFusion, net property and equipment, and the Company's contractual tax indemnification receivable from CareFusion (see Note 8 for further information regarding this receivable). Additionally, the Corporate assets as of June 30, 2009 include CareFusion assets and other assets held for sale and discontinued operations.

**15. EMPLOYEE EQUITY PLANS****Employee Equity Plans**

The Company maintains several stock incentive plans (collectively, the Plans) for the benefit of certain of its officers, directors and employees. Employee options granted under the Plans during fiscal 2008 through fiscal 2010 generally vest in equal annual installments over three years and are exercisable for periods up to seven years from the date of grant at a price equal to the fair market value of the Common Shares underlying the option at the date of grant. Employee options granted under the Plans during fiscal 2007 generally vest in equal annual installments over four years and are exercisable for periods up to seven years from the date of grant at a price equal to the fair market value of the Common Shares underlying the option at the date of grant. Employee restricted shares and restricted share units granted under the Plans during fiscal 2007 through fiscal 2010 generally vest in equal installments over three years and entitle holders to dividends or cash dividend equivalents. Restricted shares and restricted share units that were awarded after August 1, 2006 accrue dividends or cash dividend equivalents that are payable upon vesting of the awards.

The compensation expense recognized for all share-based payment awards is net of estimated forfeitures and is recognized using the straight-line method over the applicable service period. The Company classifies share-based payment compensation within SG&A expenses to correspond with the same line item as the majority of the cash compensation paid to employees.

The following table illustrates the impact of share-based payment compensation on reported amounts for the three and six months ended December 31, 2009 and 2008:

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| (in millions, except per share amounts) | Three Months Ended<br>December 31, |           | Six Months Ended<br>December 31, |           |
|-----------------------------------------|------------------------------------|-----------|----------------------------------|-----------|
|                                         | 2009                               | 2008      | 2009                             | 2008      |
| Operating earnings (1) (2)              | \$ (20.1)                          | \$ (29.2) | \$ (42.1)                        | \$ (50.2) |
| Earnings from continuing operations     | \$ (12.8)                          | \$ (19.6) | \$ (27.0)                        | \$ (33.8) |
| Net earnings (3) (4)                    | \$ (12.8)                          | \$ (23.1) | \$ (29.3)                        | \$ (39.4) |
| Net basic earnings per Common Share     | \$ (0.04)                          | \$ (0.06) | \$ (0.08)                        | \$ (0.11) |
| Net diluted earnings per Common Share   | \$ (0.04)                          | \$ (0.06) | \$ (0.08)                        | \$ (0.11) |

- (1) The total share-based payment compensation expense for the three months ended December 31, 2009 and 2008 includes gross restricted share and restricted share unit expense of approximately \$11.5 million and \$17.6 million, respectively, gross employee stock option expense of approximately \$8.2 million and \$10.6 million, respectively, gross employee stock purchase plan expense of approximately \$0.0 million and \$2.7 million, respectively and gross stock appreciation right (income)/expense of \$0.4 million and \$(1.7) million, respectively.
- (2) The total share-based payment compensation expense for the six months ended December 31, 2009 and 2008 includes gross restricted share and restricted share unit expense of approximately \$22.8 million and \$29.1 million, respectively, gross employee stock option expense of approximately \$17.6 million and \$16.8 million, respectively, gross employee stock purchase plan expense of approximately \$1.1 million and \$6.1 million, respectively and gross stock appreciation right (income)/expense of \$0.6 million and \$(1.8) million, respectively.
- (3) Share-based payment compensation expense charged to discontinued operations was approximately \$3.5 million, net of tax benefits of \$2.1 million, during the three months ended December 31, 2008.
- (4) Share-based payment compensation expense charged to discontinued operations was approximately \$2.3 million and \$5.6 million, net of tax benefits of \$1.5 million and \$3.4 million, during the six months ended December 31, 2009 and 2008, respectively.

**Table of Contents**

**Stock Options**

The fair value of the Company's stock options is determined using a lattice valuation model. The Company believes the lattice model provides for better estimates because it has the ability to take into account employee exercise patterns based on changes in the Company's stock price and other variables and it provides for a range of input assumptions.

The following summarizes all stock option transactions for the Company under the Plans from July 1, 2009 through December 31, 2009:

| (in millions, except per share amounts) | Options Outstanding (1) | Weighted Average Exercise Price per Common Share (2) | Weighted Average Remaining Contractual Life in Years | Aggregate Intrinsic Value |
|-----------------------------------------|-------------------------|------------------------------------------------------|------------------------------------------------------|---------------------------|
| Balance at June 30, 2009                | 29.4                    | \$ 59.25                                             | 3.9                                                  | \$ 1.8                    |
| Granted                                 | 7.2                     | \$ 28.08                                             |                                                      |                           |
| Exercised                               | (0.8)                   | \$ 24.31                                             |                                                      |                           |
| Forfeited and cancelled                 | (10.7)                  | \$ 63.37                                             |                                                      |                           |
| <b>Balance at December 31, 2009</b>     | <b>25.1</b>             | <b>\$ 37.71</b>                                      | <b>4.3</b>                                           | <b>\$ 43.2</b>            |
| Exercisable at December 31, 2009        | 16.3                    | \$ 41.98                                             | 3.5                                                  | \$ 2.5                    |

- (1) Included within the options granted and forfeited and cancelled activity for the six months ended December 31, 2009 is the impact of the Company's stock option exchange program and the adjustments to stock incentive plans as discussed below.
- (2) Exercise prices related to stock options granted prior to the date of the Spin-Off have not been adjusted to reflect the impact of the Spin-Off.

**Restricted Shares and Restricted Share Units**

The fair value of restricted shares and restricted share units is determined by the number of shares granted and the grant date market price of the Company's Common Shares.

The following table summarizes all activity related to restricted shares and restricted share units from July 1, 2009 through December 31, 2009:

| (in millions, except per share amounts) | Shares (1) | Weighted Average Grant Date Fair Value Per Share (2) |
|-----------------------------------------|------------|------------------------------------------------------|
| Nonvested at June 30, 2009              | 3.1        | \$ 57.10                                             |
| Granted                                 | 2.1        | \$ 27.35                                             |
| Vested                                  | (1.1)      | \$ 59.70                                             |
| Forfeited and cancelled                 | (0.2)      | \$ 47.82                                             |
| <b>Nonvested at December 31, 2009</b>   | <b>3.9</b> | <b>\$ 33.63</b>                                      |

- (1) Included within the restricted shares and restricted share units forfeited and cancelled activity for the six months ended December 31, 2009 is the impact of the adjustments to stock incentive plans as discussed below.
- (2)

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Grant date fair values per share of awards granted prior to the date of the Spin-Off have not been adjusted to reflect the impact of the Spin-Off.

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**Table of Contents**

***Stock Option Exchange Program***

On May 6, 2009, the Company's Board of Directors authorized, and on June 23, 2009, the Company's shareholders approved, a program that permitted certain current employees to exchange certain outstanding stock options with exercise prices substantially above the current market price of Cardinal Health Common Shares for a lesser number of stock options that have a fair value that is lower than the fair value of the out of the money options. The program began on June 19, 2009 and was completed on July 17, 2009. The Company believes that this program was necessary to more closely align employee and shareholder interests through equity compensation programs. The program was designed to motivate and retain key employees and to reinforce the alignment of the Company's employees' interests with those of its shareholders. As a result of this program, 9.8 million outstanding eligible stock options were exchanged for 1.4 million new options at an exercise price of \$31.27. These new options have a new minimum vesting condition of an additional 12 months, and the term of each new option is the longer of three years from the grant date and the remaining term of the eligible stock option for which it was exchanged. The new options were treated as a probable-to-probable modification under the accounting guidance for share-based payment compensation. The Company did not incur incremental expense associated with the modification.

***Adjustments to Stock Incentive Plans***

In connection with the Spin-Off, on August 31, 2009, the Company adjusted its existing stock incentive plans to provide for the conversion and adjustment of share-based payment compensation awards granted under its Plans into awards based on the Company's common shares and/or CareFusion common stock, as applicable. For purposes of the vesting of these equity awards, continued employment or service with the Company or with CareFusion is treated as continued employment for purposes of both the Company's and CareFusion's equity awards.

Each Cardinal Health stock option granted on or prior to September 26, 2007 was converted into an adjusted Company stock option and a CareFusion stock option. The exercise prices of the CareFusion stock option and the adjusted Company stock option and the number of shares subject to each such stock option reflects a mechanism that is intended to preserve the intrinsic value of the original Company stock option. A Company stock option granted after September 26, 2007 to current or former employees of the Company or to directors of the Company continues to be exercisable only for the Company's common shares and was adjusted in a manner intended to preserve the intrinsic value of such stock option. A Company stock option granted after September 26, 2007 to CareFusion employees or directors was replaced with a CareFusion stock option, subject to an adjustment mechanism intended to preserve the intrinsic value of such stock option. The resulting Company stock options and CareFusion stock options are subject to substantially the same terms, vesting conditions and other restrictions, if any, that were applicable to the Company stock option immediately prior to the distribution.

A holder of the Company's restricted shares granted on or prior to September 26, 2007 received 0.5 restricted shares of CareFusion common stock in respect of each of such holder's restricted shares of the Company. The underlying Company restricted shares will remain outstanding and unadjusted. Unvested Company restricted shares granted after September 26, 2007 to current or former employees of the Company were cancelled and replaced with newly issued restricted shares of the Company. Such newly issued Company restricted shares were determined in a manner that is intended to preserve the fair market value of the cancelled awards and the holders of such Company restricted shares received no CareFusion common stock with respect to such restricted shares. Unvested Company restricted shares granted after September 26, 2007 to CareFusion employees were cancelled and replaced with restricted shares of CareFusion common stock in a manner that is intended to preserve the fair market value of the cancelled awards. The Company restricted shares and the CareFusion restricted shares are subject to substantially the same terms (including entitlement to any cash dividends, accrued but unpaid at the distribution date), vesting conditions and other restrictions, if any, that were applicable to the cancelled Company restricted shares.

Following the Spin-Off, if any of the Company's restricted shares that are held by one of CareFusion's employees fail to become vested, such Company restricted shares will be forfeited to the Company and if any CareFusion restricted shares that are held by an employee of the Company fail to become vested, such CareFusion restricted shares will be forfeited to CareFusion.



**Table of Contents**

A holder of the Company's restricted share units granted prior to September 26, 2007 or granted in connection with the Spin-Off, or issued in exchange for an option initially granted prior to September 26, 2007, received, in connection with the Spin-Off, CareFusion restricted stock units representing the right to receive 0.5 shares of CareFusion common stock for each Company common share subject to the award. The underlying Company restricted share units will remain in effect unadjusted. An employee or director of the Company who holds unvested Company restricted share units, other than those described in the first sentence of this paragraph, did not receive any CareFusion restricted stock units in connection with the Spin-Off, but such Company restricted share units were adjusted in a manner intended to preserve the fair market value of such awards. The unvested Company's restricted share units, other than those described in the first sentence of this paragraph, granted to CareFusion employees or directors were replaced with a number of CareFusion restricted stock units intended to preserve the fair market value of the awards. The adjusted Company restricted share units or the replacement CareFusion restricted stock units that a holder received in connection with the Spin-Off will be subject to substantially the same terms (including entitlement to any cash dividend equivalents, accrued but unpaid at the distribution date), vesting conditions and other restrictions, if any, that were applicable to the Company's restricted share units prior to the distribution.

The adjustments to the Company's stock incentive plans were treated as a modification in accordance with stock based compensation accounting guidance and resulted in a total incremental compensation cost of \$0.6 million.

The following table summarizes the share-based payment awards outstanding as of December 31, 2009:

| (in millions)                                          | Cardinal Health Awards |                                   | CareFusion Awards |                                   |
|--------------------------------------------------------|------------------------|-----------------------------------|-------------------|-----------------------------------|
|                                                        | Stock Options          | Restricted Shares and Share Units | Stock Options     | Restricted Shares and Share Units |
| Held by Cardinal Health employees and former employees | 22.5                   | 3.7                               | 7.4               | 0.3                               |
| Held by CareFusion employees                           | 2.6                    | 0.2                               |                   |                                   |
| <b>Total</b>                                           | <b>25.1</b>            | <b>3.9</b>                        |                   |                                   |

**Table of Contents****Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations**

The discussion and analysis presented below is concerned with material changes in financial condition and results of operations for the Company's condensed consolidated balance sheets as of December 31, 2009 and June 30, 2009, and for the condensed consolidated statements of earnings for the three and six month periods ended December 31, 2009 and 2008. This discussion and analysis should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included in the FY2009 Financial Statements.

Portions of this Form 10-Q (including information incorporated by reference) include forward-looking statements. The words believe, expect, anticipate, project, and similar expressions, among others, generally identify forward-looking statements, which speak only as of the date the statements were made. The matters discussed in these forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from those made, projected or implied in the forward-looking statements. The most significant of these risks, uncertainties and other factors are described in Exhibit 99.1 to this Form 10-Q and in Part II, Item 1A of this Form 10-Q. Except to the extent required by applicable law, the Company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

**Overview**

Cardinal Health, Inc. (the Company) is a leading provider of products and services that help improve the cost-effectiveness of healthcare. The Company helps pharmacies, hospitals and ambulatory care sites focus on patient care while helping reduce costs, improve efficiency and quality, and increase profitability. As one of the largest healthcare companies in the world, Cardinal Health is an essential link in the healthcare supply chain, providing pharmaceuticals and medical products to more than 40,000 locations each day.

Demand for the Company's products and services during the three and six months ended December 31, 2009 led to revenue of \$24.9 billion and \$49.7 billion, up 3% and 5%, respectively, from the same periods in the prior year. Operating earnings were approximately \$367 million and \$607 million, up 17% and 1%, respectively, from the same periods in the prior year. Operating earnings were positively impacted by increased gross margin (\$43 million and \$50 million, respectively) and negatively impacted by increased distribution, selling, general and administrative expenses (SG&A) (\$27 million and \$23 million, respectively). Net earnings for the three and six months ended December 31, 2009 were \$235 million and \$196 million, respectively, and net diluted earnings per Common Share were \$0.65 and \$0.54, respectively. See Note 12 of Notes to the Condensed Consolidated Financial Statements for a reconciliation of Basic EPS to Diluted EPS.

The CareFusion spin-off described below impacted the results for the three and six months ended December 31, 2009. Operating earnings for the six months ended December 31, 2009 were adversely impacted by severance and restructuring costs in connection with the spin-off (\$56 million). Net earnings for the three months ended December 31, 2009 were positively impacted by \$20 million related to gains from the sale of shares of CareFusion common stock. Also in connection with the spin-off, net earnings for the six months ended December 31, 2009 were adversely impacted by a tax charge of approximately \$172 million related to the anticipated repatriation of certain foreign earnings and a \$40 million net loss on the extinguishment of debt. Finally, net earnings for both periods were adversely affected by a significant reduction in earnings from discontinued operations as a result of the spin-off. In addition, operating earnings for the three and six months ended December 31, 2009 were positively impacted by \$(26) million in litigation (credits) for insurance proceeds released from escrow and operating earnings for the six months ended December 31, 2009 were negatively impacted by a \$20 million impairment charge related to SpecialtyScripts, LLC (SpecialtyScripts), a business within the Pharmaceutical segment.

Cash provided by operating activities totaled \$931 million during the six months ended December 31, 2009, primarily due to operating earnings and changes in working capital. Cash provided by investing activities was \$18 million primarily due to proceeds from the sale of CareFusion common stock (\$135 million) partially offset by capital spending (\$80 million). Cash used in financing activities was \$423 million primarily due to the Company's repayment of long-term obligations (\$1.6 billion which includes \$66 million early tender premium) offset by permanent financing obtained by CareFusion prior to the Spin-Off (\$1.4 billion). Also during the six months ended December 31, 2009, the Company paid \$127 million in dividends and repurchased \$50 million of outstanding common shares.

***Spin-Off of CareFusion Corporation***

Effective August 31, 2009, the Company completed the spin-off of CareFusion through a pro rata distribution to its shareholders of approximately 81% of the then outstanding shares of CareFusion common stock (the Spin-Off). The Company first announced on September 29, 2008 that it intended to separate its clinical and medical products business from its other businesses. The Company has retained certain surgical and exam gloves, surgical drapes and apparel and fluid management businesses that were previously part of its Clinical and Medical Products segment. As explained elsewhere in this Form 10-Q, the Spin-Off had a significant impact on the results of operations and financial condition of the Company.



**Table of Contents**

During the three months ended December 31, 2009, the Company sold approximately 5.5 million shares of the 41.4 million shares of CareFusion common stock that it held immediately after the Spin-Off, which resulted in a gross realized gain of approximately \$20 million. As of December 31, 2009, the Company's ownership of approximately 35.9 million shares of CareFusion common stock had an estimated fair value of \$897 million. See Note 6 of Notes to the Condensed Consolidated Financial Statements for additional details regarding the Company's investment in CareFusion. The Company expects to sell its remaining CareFusion stock within the next 18 months and is assessing the method and timing based on market conditions and other factors.

CareFusion net assets are presented separately as assets from businesses held for sale and discontinued operations and the operating results of this business are presented within discontinued operations for all reporting periods through the date of the Spin-Off.

**Relationship between the Company and CareFusion**

On July 22, 2009, the Company and CareFusion entered into a separation agreement to effect the Spin-Off and provide a framework for the relationship between the Company and CareFusion after the Spin-Off. In addition, on August 31, 2009, the Company and CareFusion entered into a transition services agreement, a tax matters agreement, an employee matters agreement, intellectual property agreements and certain other commercial agreements. These agreements, including the separation agreement, provide for allocation between the Company and CareFusion of the Company's assets, employees, liabilities and obligations (including its investments, property and employee benefits and tax-related assets and liabilities) attributable to periods prior to, at and after the Spin-Off and govern certain relationships between the Company and CareFusion after the Spin-Off. The Company and CareFusion also entered into a stockholder's and registration rights agreement pursuant to which, among other things, CareFusion agrees that, upon the request of the Company, CareFusion will use its commercially reasonable efforts to effect the registration under applicable federal and state securities laws of any shares of CareFusion common stock retained by Cardinal Health.

Pursuant to the transition services agreement, for the three months ended December 31, 2009, the Company recognized approximately \$43 million in transition service fee income which approximately offsets the costs associated with providing the transition services. The Company has recognized \$55 million in transition service fee income year-to-date since the Spin-Off. Additionally, the Company purchased \$167 million of CareFusion trade receivables pursuant to an accounts receivable factoring arrangement between the Company and CareFusion during the three months ended December 31, 2009. The Company has purchased \$274 million of CareFusion trade receivables year-to-date since the Spin-Off.

**Consolidated Results of Operations**

The following summarizes the Company's consolidated results of operations for the three and six months ended December 31, 2009 and 2008:

| (in millions, except per common share amounts)             | Three Months Ended<br>December 31, |             |             | Six Months Ended<br>December 31, |             |             |
|------------------------------------------------------------|------------------------------------|-------------|-------------|----------------------------------|-------------|-------------|
|                                                            | Change (1)                         | 2009        | 2008        | Change (1)                       | 2009        | 2008        |
| Revenue                                                    | 3%                                 | \$ 24,919.7 | \$ 24,117.8 | 5%                               | \$ 49,700.4 | \$ 47,554.9 |
| Cost of products sold                                      | 3%                                 | 23,962.0    | 23,202.7    | 5%                               | 47,833.9    | 45,738.6    |
| Gross margin                                               | 5%                                 | 957.7       | 915.1       | 3%                               | 1,866.5     | 1,816.3     |
| Distribution, selling, general and administrative expenses | 5%                                 | 605.2       | 578.5       | 2%                               | 1,191.3     | 1,168.8     |
| Restructuring and employee severance                       | N.M.                               | 10.7        | 16.9        | N.M.                             | 70.4        | 37.6        |
| Impairments and loss on sale of assets                     | N.M.                               | 0.4         | 6.9         | N.M.                             | 24.0        | 10.5        |
| Litigation (credits)/charges, net                          | N.M.                               | (25.4)      | (0.3)       | N.M.                             | (25.9)      | (0.3)       |
| Operating earnings                                         | 17%                                | 366.8       | 313.1       | 1%                               | 606.7       | 599.7       |
| Other (income)/expense, net                                | N.M.                               | (25.6)      | 19.7        | N.M.                             | (34.5)      | 22.2        |
| Interest expense, net                                      | 24%                                | 27.4        | 22.2        | 19%                              | 61.3        | 51.4        |

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|                                                          |       |          |          |       |          |          |
|----------------------------------------------------------|-------|----------|----------|-------|----------|----------|
| Loss on extinguishment of debt                           | N.M.  |          |          | N.M.  | 39.9     |          |
| Earnings before income taxes and discontinued operations | 35%   | 365.0    | 271.2    | 3%    | 540.0    | 526.1    |
| Provision for income taxes                               | 32%   | 134.8    | 102.2    | N.M.  | 371.6    | 184.9    |
| Earnings from continuing operations                      | 36%   | 230.2    | 169.0    | (51)% | 168.4    | 341.2    |
| Earnings from discontinued operations, net of tax        | N.M.  | 4.3      | 147.5    | N.M.  | 27.9     | 224.4    |
| Net earnings                                             | (26)% | \$ 234.5 | \$ 316.5 | (65)% | \$ 196.3 | \$ 565.6 |

**Table of Contents**

| (in millions, except per common share amounts) | Three Months Ended<br>December 31, |         |         | Six Months Ended<br>December 31, |         |         |
|------------------------------------------------|------------------------------------|---------|---------|----------------------------------|---------|---------|
|                                                | Change (1)                         | 2009    | 2008    | Change (1)                       | 2009    | 2008    |
| Diluted earnings per Common Share:             |                                    |         |         |                                  |         |         |
| Continuing operations                          | 36%                                | \$ 0.64 | \$ 0.47 | (51)%                            | \$ 0.47 | \$ 0.95 |
| Discontinued operations                        | N.M.                               | 0.01    | 0.41    | N.M.                             | 0.07    | 0.62    |
| Net diluted earnings per Common Share          | (26)%                              | \$ 0.65 | \$ 0.88 | (66)%                            | \$ 0.54 | \$ 1.57 |

N.M. Not meaningful

(1) Change is calculated as the percentage increase or (decrease) for the three and six months ended December 31, 2009 compared to the same periods in the prior year.

**Revenue**

Revenue for the three and six months ended December 31, 2009 increased \$802 million or 3% and \$2.1 billion or 5%, respectively, compared to the same periods in the prior year. The increase was due to pharmaceutical price appreciation and increased volume from existing customers (with a combined impact of \$1.2 billion and \$2.5 billion, respectively) and the addition of new customers (\$75 million and \$229 million, respectively). The Company uses the internal metric pharmaceutical price appreciation index to evaluate the impact of pharmaceutical and consumer product price appreciation on revenue from the pharmaceutical distribution business. This metric is calculated using the change in the manufacturer's published price at the beginning of the period as compared to the end of the period weighted by the units sold by the pharmaceutical distribution business during the period. The pharmaceutical price appreciation index was 8.2% for the trailing twelve months ended December 31, 2009. Revenue was negatively impacted during the three and six months ended December 31, 2009 by the loss of customers (\$552 million and \$835 million, respectively). Refer to Segment Results of Operations below for further discussion of the specific factors affecting revenue in each of the Company's reportable segments.

**Cost of Products Sold**

Cost of products sold for the three and six months ended December 31, 2009 increased \$759 million or 3% and \$2.1 billion or 5%, respectively, compared to the same periods in the prior year. The increase in cost of products sold was mainly due to the 3% and 5% increase in revenue for the three and six months ended December 31, 2009, respectively, compared to the same periods in the prior year. See the Gross Margin discussion below for further discussion of additional factors impacting cost of products sold.

**Gross Margin**

Gross margin for the three and six months ended December 31, 2009 increased \$43 million or 5% and \$50 million or 3%, respectively, compared to the same periods in the prior year. Gross margin was favorably impacted by increased distribution service agreement fees and pharmaceutical price appreciation under branded manufacturer agreements (combined impact of \$24 million and \$46 million, respectively), increased manufacturer cash discounts (\$17 million and \$46 million, respectively), a generic transition within the nuclear pharmacy business within the Pharmaceutical segment (\$12 million and \$42 million, respectively) and a decrease in raw materials costs within the Medical segment (\$19 million and \$32 million, respectively). During the six months ended December 31, 2009, gross margin was also favorably impacted by the previously deferred intercompany revenue for sales to CareFusion (\$14 million). Prior to the Spin-Off, the Company deferred revenue for products sold to CareFusion businesses until the products were sold to the end customers. In connection with the Spin-Off, the previously deferred revenue was recognized. Gross margin was negatively impacted for the three and six months ended December 31, 2009 by an increase in customer discounts (\$24 million and \$69 million, respectively) as a result of customer repricings and increased sales volume. Also negatively impacting gross margin were the timing and reduction in new generic launches (\$27 million and \$45 million, respectively). Refer to the Segment Results of Operations below for further discussion of the specific factors affecting gross margin in each of the Company's reportable segments.

Due to the competitive markets in which the Company's businesses operate, the Company expects competitive pricing pressures to continue. In addition, the Company expects certain factors to negatively impact fiscal 2010 including the timing of generic launches and price deflation, the effects of repricing of certain customer contracts and strategic positioning moves (such as repositioning Medicine Shoppe and transitioning a significant vendor relationship in the pharmaceutical distribution business to a distribution service agreement).

**Distribution, Selling, General and Administrative Expenses**

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SG&A expenses for the three and six months ended December 31, 2009 increased \$27 million or 5% and \$23 million or 2%, respectively, compared to the same periods in the prior year. SG&A expenses were negatively impacted during the three and six months ended December 31, 2009 by an increase in incentive compensation expenses (\$32 million and \$35 million, respectively). Incentive compensation expense includes the Company's annual performance-based management incentive plan and performance-based funding of its 401(k) Savings Plan. Beginning in fiscal 2010, the Company replaced the 401(k) Saving Plan employer fixed rate contribution with a new variable rate contribution which is dependent upon the Company's financial performance; this is applicable to all U.S. employees. Also negatively impacting SG&A expenses during the three and six months ended December 31, 2009 were increases in incremental strategic project investments (\$17 million and \$31 million, respectively) and expenses related to the performance of the Company's deferred compensation plan (\$8 million and \$21 million, respectively). The expense related to the performance of the Company's deferred compensation plan is offset by income presented within other (income)/expense, net.

**Table of Contents**

During the second half of fiscal 2009, the Company implemented several cost control measures, which have favorably impacted SG&A expense for the three and six months ended December 31, 2009 as compared to the prior year period. Refer to Segment Results of Operations below for further discussion of the specific factors affecting SG&A expenses in each of the Company's reportable segments.

**Impairments and Loss on Sale of Assets**

The Company recognized impairments and loss on sale of assets of less than \$1 million and \$24 million, respectively, for the three and six months ended December 31, 2009 compared to \$7 million and \$11 million for the three and six months ended December 31, 2008. During the six months ended December 31, 2009, the Company recognized an impairment charge of \$20 million related to the write-down of SpecialtyScripts, a business within the pharmaceutical segment, to net expected fair value less costs to sell. See Note 4 of Notes to Condensed Consolidated Financial Statements for further information regarding the anticipated sale of SpecialtyScripts.

**Restructuring and Employee Severance**

The following is a summary of the Company's restructuring and employee severance for the three and six months ended December 31, 2009 and 2008:

| (in millions)                                     | Three Months Ended<br>December 31, |                | Six Months Ended<br>December 31, |                |
|---------------------------------------------------|------------------------------------|----------------|----------------------------------|----------------|
|                                                   | 2009                               | 2008           | 2009                             | 2008           |
| Employee related costs                            | \$ 2.1                             | \$ 0.1         | \$ 29.2                          | \$ 21.1        |
| Facility exit and other costs                     | 8.6                                | 16.8           | 41.2                             | 16.5           |
| <b>Total restructuring and employee severance</b> | <b>\$ 10.7</b>                     | <b>\$ 16.9</b> | <b>\$ 70.4</b>                   | <b>\$ 37.6</b> |

During the three and six months ended December 31, 2009, the Company recognized restructuring and employee severance of \$11 million and \$70 million, respectively, primarily related to the Spin-Off (\$6 million and \$56 million, respectively). Included within the six months amount is approximately \$19 million of costs related to the retirement of the Company's former Chairman and Chief Executive Officer upon completion of the Spin-Off. During the six months ended December 31, 2008, the Company recognized restructuring and employee severance of \$38 million primarily related to the restructuring of its segment operating structure. See Note 2 of Notes to Condensed Consolidated Financial Statements for additional detail of the Company's restructuring and employee severance during the three and six months ended December 31, 2009 and 2008.

The Company estimates it will incur additional costs in future periods associated with various existing restructuring activities totaling approximately \$43 million. These estimated costs are primarily comprised of costs associated with the Spin-Off.

**Litigation (Credits)/Charges, Net**

Litigation (credits)/charges, net were \$(25) million and \$(26) million, respectively, during the three and six months ended December 31, 2009. During the three months ended December 31, 2009, the Company recognized \$(26) million in litigation (credits)/charges, net for insurance proceeds released from escrow following the resolution of securities and derivative litigation against certain of the Company's directors and officers. For further information, see the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2007.

**Operating Earnings**

Operating earnings increased \$54 million or 17% and \$7 million or 1%, respectively, during the three and six months ended December 31, 2009 compared to the same periods in the prior year. The increase during the three and six months ended December 31, 2009 was primarily due to increased gross margin (\$43 million and \$50 million, respectively) partially offset by increases in SG&A expenses (\$27 million and \$23 million, respectively). Operating earnings were also positively impacted by litigation (credits)/charges, net (\$(25) million and \$(26) million, respectively). Increased impairments and loss on sale of assets (\$14 million) and an increase in restructuring and employee severance (\$33 million) negatively impacted operating earnings for the six months ended December 31, 2009.

**Other (Income)/Expense, Net**



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Other (income)/expense, net decreased \$45 million and \$57 million, respectively, during the three and six months ended December 31, 2009 compared to the same periods in the prior year. The decrease was primarily due to the recognition of income related to realized gains from the sale of shares of CareFusion common stock (\$20 million), income related to the performance of the Company's deferred compensation plan assets (\$8 million and \$21 million, respectively) and the impact of foreign exchange (\$7 million and \$9 million, respectively). The income related to the performance of the Company's deferred compensation plan assets is offset by expense presented within SG&A.

**Table of Contents*****Interest Expense, Net***

Interest expense, net increased \$5 million and \$10 million, respectively, during the three and six months ended December 31, 2009 compared to the same periods in the prior year primarily due to increased fees relating to the Company's amended revolving credit facility and accounts receivable securitization agreement. The increase was also due to less income received from interest rate swaps compared to the same periods in the prior year.

***Loss on Extinguishment of Debt***

On September 24, 2009, the Company completed a debt tender. In connection with the debt tender, the Company incurred a pre-tax loss for the early retirement of debt of approximately \$40 million, which included an early tender premium of \$67 million, the write-off of \$5 million of unamortized debt issuance costs, and an offsetting \$32 million fair value adjustment to the respective debt related to previously terminated interest rate swaps. See Note 7 of Notes to Condensed Consolidated Financial Statements for additional information on the debt tender.

***Provision for Income Taxes***

The Company files income tax returns in the U.S. federal jurisdiction, various U.S. state jurisdictions and various foreign jurisdictions. With few exceptions, the Company is subject to audit by taxing authorities for fiscal years ended June 30, 2001 through the current fiscal year.

The Internal Revenue Service (IRS) currently has ongoing audits of fiscal years 2001 through 2007. During the three months ended December 31, 2007, the Company was notified that the IRS transferred jurisdiction over fiscal years 2001 and 2002 from the Office of Appeals back to the Examinations level to reconsider previously-unadjusted specific issues. During the three months ended March 31, 2008, the Company received Notices of Proposed Adjustment (NPAs) from the IRS related to fiscal years 2001 through 2005 challenging deductions arising from the sale of trade receivables to a special purpose accounts receivable and financing entity. The amount of additional tax, excluding penalties and interest, proposed by the IRS in these notices was \$179 million. The Company anticipates that this transaction could be the subject of proposed adjustments by the IRS in tax audits of fiscal years 2006 to 2009. As discussed in Note 8 of Notes to Condensed Consolidated Financial Statements, the Company recorded a charge of \$172 million during the first quarter of fiscal 2010 to reflect the anticipated repatriation of earnings from the special purpose entity. Due to the anticipated repatriation of the earnings, the tax associated with the transaction, including the tax assessed by the IRS, no longer represents an uncertain tax benefit. Taxes associated with this transaction, including both the charge taken in the prior quarter and the amount previously accrued as an unrecognized tax benefit, are classified as deferred tax liabilities or current taxes payable.

During fiscal 2009, the Company received a Revenue Agent's Report for tax years 2003 through 2005, which included the NPAs discussed above and new NPAs related to the Company's transfer pricing arrangements between foreign and domestic subsidiaries and the transfer of intellectual property among subsidiaries of an acquired entity prior to its acquisition by the Company. The amount of additional tax proposed by the IRS in the new notices total \$598 million, excluding penalties and interest, but including \$462 million related to issues for which CareFusion is liable under the tax matters agreement in the event the amount must be paid to the taxing authority. The Company disagrees with these proposed adjustments and intends to vigorously contest them. The Company believes that it is adequately reserved for the uncertain tax position relating to these matters.

It is reasonably possible that there could be a change in the amount of unrecognized tax benefits within the next 12 months due to activities of the IRS or other taxing authorities, including proposed assessments of additional tax, possible settlement of audit issues, or the expiration of applicable statutes of limitations. The Company estimates that the range of the possible change in unrecognized tax benefits within the next 12 months is a decrease of approximately zero to \$25 million excluding penalties and interest.

The Company's provision for income taxes as a percentage of pretax earnings from continuing operations (effective tax rate) was 36.9% and 68.8%, respectively, for the three and six months ended December 31, 2009 compared to 37.7% and 35.1%, respectively, for the three and six months ended December 31, 2008. Generally, fluctuations in the effective tax rate are due to changes within international and U.S. state effective tax rates resulting from the Company's business mix and the impact of restructuring and employee severance, impairments and other discrete items. During the six months ended December 31, 2009 the effective tax rate was impacted by an unfavorable adjustment of \$172 million, or 31.8%, attributable to earnings no longer indefinitely invested offshore.

**Table of Contents**

The effective tax rates for the three and six months ended December 31, 2008 were unfavorably impacted by \$2 million and favorably impacted by \$10 million, respectively, as the result of discrete tax adjustments. During the three and six months ended December 31, 2008 there were favorable tax adjustments of \$3 million and \$23 million, respectively, as the result of the release of a valuation allowance that had previously been established for capital losses for which the Company's ability to utilize were uncertain. The remaining unfavorable tax adjustments relate primarily to adjustments to the Company's state deferred tax rates.

See Note 8 of Notes to Condensed Consolidated Financial Statements for additional information on the Company's provision for income taxes and unrecognized tax benefits.

**Earnings from Discontinued Operations**

Earnings from discontinued operations were \$4 million and \$28 million, respectively, for the three and six months ended December 31, 2009 compared to \$148 million and \$224 million for the same periods in the prior year. CareFusion operating results are included within earnings from discontinued operations for all periods through the date of the Spin-Off. See Note 4 of Notes to Condensed Consolidated Financial Statements for information on the Company's discontinued operations.

**Segment Results of Operations**

**Reportable Segments**

In connection with the Spin-Off, during the first quarter of fiscal 2010, the Company reorganized its businesses into two reportable segments Pharmaceutical and Medical. The Company evaluates the performance of the individual segments based upon, among other things, segment profit. Segment profit is segment revenue less segment cost of products sold, less segment SG&A expenses. Segment SG&A expense includes equity compensation expense as well as allocated corporate expenses for shared functions, including corporate management, corporate finance, financial shared services, human resources, information technology, legal and an integrated hospital sales organization. Information about interest income and expense and income taxes is not provided at the segment level. In addition, restructuring and employee severance, impairments and loss on sale of assets, litigation (credits)/charges, net and certain investment spending are not allocated to the segments. Investment spending generally includes the first year spend for certain projects which require incremental strategic investments in the form of additional operating expenses. The Company urges its segments to identify investment projects which will encourage innovation and provide future returns. As approval decisions for such projects are dependent upon executive management, the expenses for such projects are retained at Corporate. See Note 14 of Notes to Condensed Consolidated Financial Statements for additional information on the Company's reportable segments.

The following table summarizes segment revenue for the three and six months ended December 31, 2009 and 2008:

| (in millions, except growth rates) | Three Months Ended<br>December 31, |             |             | Six Months Ended<br>December 31, |             |             |
|------------------------------------|------------------------------------|-------------|-------------|----------------------------------|-------------|-------------|
|                                    | Change (1)                         | 2009        | 2008        | Change (1)                       | 2009        | 2008        |
| Pharmaceutical                     | 3%                                 | \$ 22,694.7 | \$ 22,078.7 | 4%                               | \$ 45,257.0 | \$ 43,482.8 |
| Medical                            | 9%                                 | 2,232.4     | 2,057.3     | 9%                               | 4,469.4     | 4,094.0     |
| Total segment revenue              | 3%                                 | 24,927.1    | 24,136.0    | 5%                               | 49,726.4    | 47,576.8    |
| Corporate (2)                      | N.M.                               | (7.4)       | (18.2)      | N.M.                             | (26.0)      | (21.9)      |
| Total consolidated revenue         | 3%                                 | \$ 24,919.7 | \$ 24,117.8 | 5%                               | \$ 49,700.4 | \$ 47,554.9 |

(1) Change is calculated as the percentage increase or (decrease) for the three and six months ended December 31, 2009 as compared to the same periods in the prior year.

(2) Corporate revenue primarily consists of the elimination of inter-segment revenue.

The following table summarizes segment profit for the three and six months ended December 31, 2009 and 2008:

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| (in millions, except growth rates)    | Three Months Ended<br>December 31, |          |          | Six Months Ended<br>December 31, |          |          |
|---------------------------------------|------------------------------------|----------|----------|----------------------------------|----------|----------|
|                                       | Change (1)                         | 2009     | 2008     | Change (1)                       | 2009     | 2008     |
| Pharmaceutical                        | (1)%                               | \$ 259.6 | \$ 262.6 | (2)%                             | \$ 468.0 | \$ 475.9 |
| Medical                               | 38%                                | 102.5    | 74.5     | 26%                              | 217.4    | 172.4    |
| Total segment profit                  | 7%                                 | 362.1    | 337.1    | 6%                               | 685.4    | 648.3    |
| Corporate (2)                         | N.M.                               | 4.7      | (24.0)   | N.M.                             | (78.7)   | (48.6)   |
| Total consolidated operating earnings | 17%                                | \$ 366.8 | \$ 313.1 | 1%                               | \$ 606.7 | \$ 599.7 |

- (1) Change is calculated as the percentage increase or (decrease) for the three and six months ended December 31, 2009 as compared to the same periods in the prior year.
- (2) Corporate includes, among other things, restructuring and employee severance, impairments and loss on sale of assets, litigation (credits)/charges, net and certain investment spending which are not allocated to the segments.

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**Table of Contents*****Pharmaceutical Segment Performance***

The Pharmaceutical segment revenue growth of \$616 million or 3% and \$1.8 billion or 4%, respectively, during the three and six months ended December 31, 2009 as compared to the prior year periods was primarily due to pharmaceutical price appreciation and additional volume from existing customers (the combined impact was \$1.0 billion and \$2.2 billion, respectively). The pharmaceutical price appreciation index was 8.2% for the trailing twelve months ended December 31, 2009. Revenue was also positively impacted by the addition of new customers (\$36 million and \$144 million, respectively) and negatively impacted by the loss of customers (\$468 million and \$663 million, respectively).

Pharmaceutical segment profit decreased \$3 million or 1% and \$8 million or 2%, respectively, during the three and six months ended December 31, 2009 as compared to the prior year periods. Segment profit was negatively impacted by a decrease in gross margin of \$16 million and \$30 million for the three and six months ended December 31, 2009, respectively, partially offset by a decrease in SG&A of \$13 million and \$22 million for the three and six months ended December 31, 2009, respectively. The decline in gross margin was primarily due to increased customer discounts (\$24 million and \$69 million, respectively) as a result of customer repricings and increased sales volume and the timing and reduction in new generic launches (\$27 million and \$45 million, respectively). The decline in gross margin was also due to the repositioning of Medicine Shoppe (\$26 million and \$41 million, respectively) which was partially offset by efficiencies gained within SG&A. The decline in gross margin was partially offset by increased distribution service agreement fees and pharmaceutical price appreciation under branded manufacturer agreements (combined impact of \$24 million and \$46 million, respectively). Also offsetting the decline in gross margin were increased manufacturer cash discounts (\$17 million and \$46 million, respectively), the favorable impact of a generic transition within the nuclear pharmacy business (\$12 million and \$42 million, respectively) and various initiatives focused on generic products. The increased distribution service agreement fees and manufacturer cash discounts were primarily the result of increased sales volume. The Company expects a certain level of continued pricing pressure due to the competitive market in which it operates. The decline in SG&A expenses was primarily due to company-wide cost control initiatives.

The Company's results could be adversely affected if sales of pharmaceutical products decline, competitive pricing pressure intensifies, the frequency of new generic pharmaceutical launches decreases, generic price deflation increases, or pharmaceutical price appreciation on branded products decreases. Alternatively, the Company's results could benefit if sales of pharmaceutical products increase, the frequency of new generic pharmaceutical launches increases, generic price deflation decreases, or pharmaceutical price appreciation on branded products increases.

The Pharmaceutical segment's nuclear pharmacy services business dispenses several products prepared using a particular radioisotope. The supply of that radioisotope is currently adversely affected by a continued and prolonged shortage of the raw material used to derive that radioisotope. The Company is working closely with manufacturers to build long-term solutions to this supply challenge.

***Bulk and Non-Bulk Customers.*** The Pharmaceutical segment differentiates between bulk and non-bulk customers because bulk customers generate significantly lower segment profit as a percentage of revenue than that generated by non-bulk customers. Bulk customers consist of retail chain customers' centralized warehouse operations and customers' mail order businesses. All other customers are classified as non-bulk customers (for example, retail stores, pharmacies, hospitals and alternate care sites). Bulk customers include the warehouse operations of retail chains whose retail stores are classified as non-bulk customers. A single retail chain pharmacy customer may be both a bulk customer with respect to its warehouse operations and a non-bulk customer with respect to its retail stores. Bulk customers have the ability to process large quantities of products in central locations and self-distribute these products to their individual retail stores or customers. Substantially all deliveries to bulk customers consist of product shipped in the same form as the product is received from the manufacturer, but a small portion of deliveries to bulk customers are broken down into smaller units prior to shipping. Non-bulk customers, on the other hand, require more complex servicing by the Company. These services, all of which are performed by the Company, include receiving inventory in large or full case quantities and breaking it down into smaller quantities, warehousing the product for a longer period of time, picking individual products specific to a customer's order and delivering that smaller order to a customer location.

**Table of Contents**

The Company tracks revenue by bulk and non-bulk customers in its financial systems. An internal analysis has been prepared to estimate segment profit from bulk and non-bulk customers by allocating segment expenses (total of segment cost of products sold and segment SG&A expenses) separately for bulk and non-bulk customers. The following table shows the allocation of segment expenses, segment profit and segment profit as a percentage of revenue for bulk and non-bulk customers for the three and six months ended December 31, 2009 and 2008 (prior period amounts differ from those previously disclosed as they have been updated to remove Martindale which has been reclassified to discontinued operations):

| (in millions, except percentage of revenue)                                                   | Three Months Ended<br>December 31, |             | Six Months Ended<br>December 31, |             |
|-----------------------------------------------------------------------------------------------|------------------------------------|-------------|----------------------------------|-------------|
|                                                                                               | 2009                               | 2008        | 2009                             | 2008        |
| <b>Non-bulk customers:</b>                                                                    |                                    |             |                                  |             |
| Revenue from non-bulk customers                                                               | \$ 11,670.1                        | \$ 10,954.3 | \$ 22,906.0                      | \$ 21,629.5 |
| Segment expenses allocated to non-bulk customers (1)                                          | \$ 11,434.3                        | \$ 10,725.9 | \$ 22,467.0                      | \$ 21,215.9 |
| Segment profit from non-bulk customers (1)                                                    | \$ 235.8                           | \$ 228.4    | \$ 439.0                         | \$ 413.6    |
| Segment profit from non-bulk customers as a percentage of revenue from non-bulk customers (1) | 2.02%                              | 2.08%       | 1.92%                            | 1.91%       |
| <b>Bulk customers:</b>                                                                        |                                    |             |                                  |             |
| Revenue from bulk customers                                                                   | \$ 11,024.6                        | \$ 11,124.4 | \$ 22,351.0                      | \$ 21,853.3 |
| Segment expenses allocated to bulk customers (1)                                              | \$ 11,000.8                        | \$ 11,090.2 | \$ 22,322.0                      | \$ 21,791.0 |
| Segment profit from bulk customers (1)                                                        | \$ 23.8                            | \$ 34.2     | \$ 29.0                          | \$ 62.3     |
| Segment profit from bulk customers as a percentage of revenue from bulk customers (1)         | 0.22%                              | 0.31%       | 0.13%                            | 0.29%       |

- (1) Amounts shown are estimates based upon the internal analysis described above. The preparation of this internal analysis required the use of complex and subjective estimates and allocations based upon assumptions, past experience and judgment that the Company believes are reasonable. The core pharmaceutical distribution operation ( Distribution ) services both bulk and non-bulk customers. Therefore, expenses associated with this operation were allocated between bulk and non-bulk customers as described below. The brokerage operation ( Brokerage ) only services bulk customers, therefore, expenses associated with Brokerage are allocated to bulk customers. The remaining operations (i.e., excluding Distribution) service non-bulk customers, therefore, expenses associated with these operations were allocated to non-bulk customers.

The following describes the allocation of the major components of cost of products sold for Distribution between bulk and non-bulk customers:

Cost of products sold for pharmaceutical products is determined by specifically tracking the manufacturer's designated price of products, at the time the products are sold, by bulk and non-bulk customers. The manufacturer's designated price is then reduced by other components impacting cost of products sold, including distribution service agreement fees, pharmaceutical price appreciation, manufacturer cash discounts and manufacturer rebates and incentives. In addition, other inventory charges and credits are added or subtracted, as appropriate, to arrive at cost of products sold. The Company used the following methods that it believes provide a reasonable correlation to allocate the remaining components of cost of products sold between bulk and non-bulk customers:

Distribution service agreement fees and pharmaceutical price appreciation are tracked by manufacturer. Therefore, the Company allocated the distribution service agreement fees and pharmaceutical price appreciation associated with each manufacturer among their products in proportion to sales of each product between bulk and non-bulk customers.

Manufacturer cash discounts are recognized as a reduction to cost of products sold when the related inventory is sold and were allocated in proportion to the manufacturer's published price of the product sold to bulk and non-bulk customers.

Manufacturers' rebates and incentives are based on the individual agreements entered into with manufacturers related to specific products. Rebates and incentives were grouped by contract terms and then allocated in proportion to sales to bulk and

non-bulk customers.

Other inventory charges and credits include charges for outdated and returned inventory items and fluctuation in inventory reserves. The Company estimated the portion of these inventory charges and credits attributable to each product and then allocated them to bulk and non-bulk customers in proportion to the sales of these products.

The Company used methods that it believes provide a reasonable correlation to allocate the SG&A expenses for Distribution between bulk and non-bulk customers as follows:

Warehouse expense includes labor-related expenses associated with receiving, shipping and handling the inventory as well as warehouse storage costs including insurance, taxes, supplies and other facility costs. Warehouse expense was allocated in proportion to the number of invoice line items filled for each bulk or non-bulk customer because the Company believes that there is a correlation between the number of different products ordered as reflected in invoice lines and the level of effort associated with receiving, shipping and handling that order (bulk customers typically order substantially larger quantities of products and therefore generate substantially fewer invoice lines which results in substantially less warehouse expense being allocated to bulk customers);

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**Table of Contents**

Delivery expense includes transportation costs associated with physically moving the product from the warehouse to the customer's designated location. Delivery expense was allocated in proportion to the number of invoices generated for each bulk or non-bulk customer on the assumption that each invoice generates a delivery;

Sales expense includes personnel-related costs associated with sales and customer service activities (such activities are the same for both bulk and non-bulk customers). Sales expense was allocated in proportion to the number of invoices generated for each bulk or non-bulk customer because customer invoices are a reasonable estimate of the amount of customer service calls and sales effort; and

General and administrative expenses were allocated in proportion to the units of products sold to bulk or non-bulk customers. These expenses were allocated on the assumption that general and administrative expenses increase or decrease in direct relation to the volume of sales.

The internal analysis indicated segment expenses as a percentage of revenue were higher for bulk customers than for non-bulk customers because of lower pricing on sales for bulk customers and higher segment cost of products sold partially offset by lower segment SG&A expenses. Bulk customers receive lower pricing on sales of the same products than non-bulk customers due to volume pricing in a competitive market and the lower costs related to the services provided by the Company. In addition, sales to bulk customers in aggregate generate higher segment cost of products sold as a percentage of revenue than sales to non-bulk customers because bulk customers' orders consist almost entirely of higher cost branded products. The higher segment cost of products sold as a percentage of revenue for bulk customers is also driven by lower manufacturer distribution service agreement fees and branded pharmaceutical price appreciation and lower manufacturer cash discounts. Manufacturer distribution service agreement fees and manufacturer cash discounts are recognized as a reduction to segment cost of products sold and are lower as a percentage of revenue due to the mix of products sold. Pharmaceutical price appreciation increases customer pricing which, in turn, results in higher segment gross margin for sales of inventory that was on-hand at the time of the manufacturer's price increase. Since products sold to bulk customers are generally held in inventory for a shorter time than products sold to non-bulk customers, there is less opportunity to realize the benefit of pharmaceutical price appreciation. Consequently, segment cost of products sold as a percentage of revenue for bulk customers is higher than for non-bulk customers and segment gross margin as a percentage of revenue is substantially lower for bulk customers than for non-bulk customers. Deliveries to bulk customers require substantially less services by the Company than deliveries to non-bulk customers. As such, segment SG&A expenses as a percentage of revenue from bulk customers are substantially lower than from non-bulk customers. However, the lower SG&A expenses do not offset the higher cost of products sold and as a result, segment profit as a percentage of revenue is significantly lower for bulk customers than for non-bulk customers.

The Company defines bulk and non-bulk customers based on the way in which the Company operates its business and the services it performs for its customers. The Company is not aware of an industry standard regarding the definition of bulk customers and based solely on a review of the Annual Reports on Form 10-K of other national pharmaceutical wholesalers, the Company notes that other companies in comparable businesses may, or may not, use a different definition of bulk customers.

During the three and six months ended December 31, 2009, revenue from non-bulk customers increased \$716 million and \$1.3 billion, respectively, compared to the same periods in the prior year due to increased revenue from existing customers. Segment profit from non-bulk customers increased \$7 million and \$25 million, respectively, during the three and six months ended December 31, 2009 compared to the same periods in the prior year due to increased distribution service agreement fees and pharmaceutical price appreciation and a decrease in SG&A expenses, partially offset by customer discounts, reduction in generic launches and the repositioning of Medicine Shoppe.

During the three months ended December 31, 2009, revenue from bulk customers decreased \$100 million compared to the same period in the prior year due to the timing of purchases by certain customers and the loss of a customer. During the six months ended December 31, 2009, revenue from bulk customers increased \$498 million compared to the same period in the prior year due to increased volume from existing customers. Segment profit from bulk customers decreased \$10 million and \$33 million, respectively, for the three and six months ended December 31, 2009 compared to the same period in the prior year primarily due to increased customer discounts as a result of customer repricings.

***Medical Segment Performance***

The Medical segment revenue growth of \$175 million or 9% and \$375 million or 9%, respectively, during the three and six months ended December 31, 2009 as compared to the prior year periods was primarily due to additional volume from existing customers (\$155 million and \$310 million, respectively). The additional volume was partially driven by strong demand for flu-related products. Revenue was also positively impacted by the addition of new customers (\$39 million and \$85 million, respectively) and new products (\$16 million and \$38 million,



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respectively). Revenue growth was negatively impacted by the loss of customers (\$84 million and \$172 million, respectively). Revenue for the six months ended December 31, 2009 was also positively impacted by the recognition of previously deferred intercompany revenue for sales to CareFusion (\$51 million). Prior to the Spin-Off, the Company deferred revenue for products sold to CareFusion businesses until the products were sold to the end customers. In connection with the Spin-Off, the previously deferred revenue was recognized.

**Table of Contents**

The Medical segment profit increased \$28 million or 38% and \$45 million or 26%, respectively, during the three and six months ended December 31, 2009 as compared to the same periods in the prior year. Segment profit was positively impacted by an increase in gross margin of \$54 million and \$76 million, respectively. The increase in gross margin was primarily due to a decrease in raw materials costs (\$19 million and \$32 million, respectively) and increased revenue. Gross margin for the six months ended December 31, 2009 was also positively impacted by the recognition of the deferred revenue for sales to CareFusion discussed above (\$14 million). SG&A expenses for the three and six months ended December 31, 2009 increased \$26 million and \$31 million, respectively, compared to the same periods in the prior year primarily due to incremental strategic project investments (\$13 million and \$24 million, respectively) and in support of the 9% revenue growth. The increase in SG&A was partially offset by company-wide cost control initiatives.

**Liquidity and Capital Resources****Sources and Uses of Cash**

The following table summarizes the Company's Condensed Consolidated Statements of Cash Flows for the six months ended December 31, 2009 and 2008:

| (in millions)                                             | Six Months Ended |            |
|-----------------------------------------------------------|------------------|------------|
|                                                           | December 31,     |            |
|                                                           | 2009             | 2008       |
| Net cash provided by/(used in) - continuing operations:   |                  |            |
| Operating activities                                      | \$ 783.8         | \$ (506.4) |
| Investing activities                                      | 27.4             | (124.4)    |
| Financing activities                                      | (1,706.7)        | (259.0)    |
| Net cash provided by/(used in) - discontinued operations: |                  |            |
| Operating activities                                      | \$ 146.8         | \$ 717.6   |
| Investing activities                                      | (9.9)            | (51.7)     |
| Financing activities                                      | 1,283.8          | (2.3)      |

**Operating activities.** Net cash provided by operating activities from continuing operations during the six months ended December 31, 2009 totaled \$784 million, which was driven by earnings and changes in working capital. The most significant changes in working capital were increased accounts payable (\$1.5 billion) offset by increased inventories (\$1.1 billion) during the regular course of business. Cash flows from operations can be significantly impacted by factors such as the timing of inventory purchases, customer payments of accounts receivable and payments to vendors during the regular course of business.

Net cash provided by operating activities from discontinued operations for the six months ended December 31, 2009 totaled \$147 million primarily related to the earnings and changes in working capital for CareFusion.

Net cash used in operating activities from continuing operations during the six months ended December 31, 2008 totaled \$506 million primarily related to increased inventories (\$1.8 billion) offset by increased accounts payable (\$1.3 billion). These increases were due primarily to timing of inventory purchases, receipts and payments to vendors.

Net cash provided by operating activities from discontinued operations for the six months ended December 31, 2008 totaled \$718 million primarily related to the earnings and changes in working capital for CareFusion.

**Investing activities.** Net cash provided by investing activities from continuing operations of \$27 million during the six months ended December 31, 2009 primarily reflected proceeds from the sale of CareFusion common stock (\$135 million) partially offset by capital spending (\$80 million). The Company expects to sell its remaining CareFusion stock within the next 18 months and is assessing the method and timing based on market conditions and other factors.

Net cash used in investing activities from continuing operations for the six months ended December 31, 2008 of \$124 million primarily reflected capital spending (\$131 million).

**Financing activities.** Net cash used in financing activities from continuing operations for the six months ended December 31, 2009 of \$1.7 billion primarily reflected the Company's repayment of long-term obligations (\$1.6 billion which includes a \$66 million early tender premium) and payment of dividends (\$127 million).

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Net cash provided by financing activities from discontinued operations for the six months ended December 31, 2009 of \$1.3 billion primarily reflected permanent financing obtained by CareFusion prior to the Spin-Off offset by \$90 million cash funding provided by the Company to CareFusion pursuant to the Spin-Off separation agreement.

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## **Table of Contents**

Net cash used in financing activities from continuing operations for the six months ended December 31, 2008 of \$259 million reflected Company's repayment of long term obligations (\$305 million).

### ***Share Repurchase Program***

During the three and six months ended December 31, 2009, the Company repurchased \$50 million of its Common Shares pursuant to the \$500 million share repurchase program announced on August 5, 2009. This repurchase authorization expires on August 31, 2012. As of December 31, 2009, \$450 million remained from the \$500 million repurchase authorization. The Company expects to use this repurchase program to at least offset equity plan issuances.

See the table under Part II, Item 2 of this Form 10-Q for more information regarding Company repurchases of Common Shares during the three months ended December 31, 2009.

### ***Capital Resources***

The Company's cash and equivalents balance was \$1.7 billion at December 31, 2009 compared to \$1.2 billion at June 30, 2009. The cash balance at December 31, 2009 was affected by net cash provided by operating activities of \$931 million, which was driven by earnings and changes in working capital as described above.

The Company's cash and equivalents balance as of December 31, 2009 included \$406 million of cash held by its subsidiaries outside of the United States. Although the vast majority of cash held outside the United States is available for repatriation, doing so could subject it to U.S. federal, state and local income tax. The Company, as a U.S. parent of foreign subsidiaries, may temporarily access cash held by its foreign subsidiaries without subjecting the Company to U.S. federal income tax through intercompany loans. Not included in the previously disclosed cash held by subsidiaries outside of the United States, is an intercompany loan of \$873 million from the Company's international Accounts Receivable and Financing Entity (see below for discussion of this entity), which is due by fiscal 2012.

In addition to cash, the Company's sources of liquidity include a \$1.5 billion commercial paper program backed by a \$1.5 billion revolving credit facility and a committed receivables sales facility program with the capacity to sell \$950 million in receivables. The Company had no outstanding borrowings from the commercial paper program at December 31, 2009 and had no outstanding balance under the committed receivables sales facility program at December 31, 2009.

During fiscal 2001, the Company entered into an agreement to periodically sell trade receivables to a special purpose accounts receivable and financing entity (the Accounts Receivable and Financing Entity), which was exclusively engaged in purchasing trade receivables from, and making loans to, the Company. The Accounts Receivable and Financing Entity, which was consolidated by the Company as it was the primary beneficiary of the variable interest entity, issued preferred variable debt securities to parties not affiliated with the Company. On October 3, 2008, the Company repaid the remaining balance of \$149 million for the preferred debt securities and the agreement was terminated. On November 10, 2009, the Company amended its existing committed receivables sales facility program to extend the program for an additional 364 days.

On July 14, 2009 CareFusion obtained permanent financing of \$1.4 billion in the form of fixed rate senior notes, and in connection with the Spin-Off, CareFusion distributed \$1.4 billion of cash to the Company immediately prior to the Spin-Off.

On September 24, 2009, the Company completed a debt tender announced on August 27, 2009 for an aggregate purchase price, including an early tender premium but excluding accrued interest, fees and expenses, of up to \$1.2 billion of the following series of debt securities (listed in order of acceptance priority): (i) 7.80% Debentures due October 15, 2016 of Allegiance Corporation; (ii) 6.75% Notes due February 15, 2011 of the Company; (iii) 6.00% Notes due June 15, 2017 of the Company; (iv) 7.00% Debentures due October 15, 2026 of Allegiance Corporation; (v) 5.85% Notes due December 15, 2017 of the Company; (vi) 5.80% Notes due October 15, 2016 of the Company; (vii) 5.65% Notes due June 15, 2012 of the Company; (viii) 5.50% Notes due June 15, 2013 of the Company; and (ix) 4.00% Notes due June 15, 2015 of the Company. The Company purchased more than \$1.1 billion pursuant to the offer using the order of priority set forth above. In connection with the debt tender, the Company incurred a pre-tax loss for the early extinguishment of debt of approximately \$40 million, which included an early tender premium of \$66 million, the write-off of \$5 million of unamortized debt issuance costs, and an offsetting \$32 million fair value adjustment to the respective debt related to previously terminated interest rate swaps. See Note 7 of Notes to Condensed Consolidated Financial Statements for additional information on the debt tender and the Company's remaining long-term obligations at December 31, 2009.

On October 2, 2009, the Company repaid its \$350 million floating rate notes that had reached their maturity.

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The Company's capital resources are more fully described in "Liquidity and Capital Resources" within "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Notes 4, 9 and 19 of the "Notes to Consolidated Financial Statements" from the FY2009 Financial Statements.

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## **Table of Contents**

The Company currently believes that, based upon existing cash, operating cash flow, available capital resources (as discussed above) and other available market transactions, it has adequate capital resources at its disposal to fund currently anticipated capital expenditures, business growth and expansion, working capital needs, contractual obligations and current and projected debt service requirements, including those related to business combinations.

From time to time, the Company considers and engages in acquisition transactions in order to expand its role as a leading provider of products and services that improve the cost-effectiveness of healthcare. If additional transactions are entered into or consummated, the Company may need to enter into funding arrangements for such acquisitions.

### ***Debt Ratings/Covenants***

The Company's senior debt credit ratings from Standard & Poor's Rating Services (S&P), Moody's Investors Service (Moody's) and Fitch Ratings (Fitch) are BBB+, Baa3 and BBB, respectively, and the commercial paper ratings are A-2, P-3 and F2, respectively. The S&P and Fitch ratings outlooks are stable. The Moody's outlook is negative. The senior debt credit ratings and short-term ratings limit the Company's ability to gain access to the commercial paper market, but the Company believes that it will be able to utilize alternative sources of credit that are available to the Company.

On April 16, 2009, in connection with the Spin-Off, the Company amended its \$1.5 billion revolving credit facility to, among other things, replace a minimum net worth covenant with covenants that require the Company to maintain a consolidated interest coverage ratio as of the end of any fiscal quarter of at least 4-to-1 and to maintain a consolidated leverage ratio of no more than 3.25-to-1. The new covenants became effective on September 1, 2009 following consummation of the Spin-Off and completion of the cash distribution from CareFusion to the Company.

On May 1, 2009, the Company amended its committed receivables sales facility program to replace a minimum net worth covenant in the Performance Guaranty with covenants that require the Company to maintain a consolidated interest coverage ratio as of the end of any fiscal quarter of at least 4-to-1 and to maintain a consolidated leverage ratio of no more than 3.25-to-1. The new covenants became effective on September 1, 2009.

As of December 31, 2009, the Company was in compliance with these financial covenants.

### **Contractual Obligations**

Except as disclosed in the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009, there have been no material changes, outside of the ordinary course of business, in the Company's outstanding contractual obligations since the end of the 2009 fiscal year.

### **Off-Balance Sheet Arrangements**

See Liquidity and Capital Resources Capital Resources and Note 19 of Notes to Consolidated Financial Statements in the FY2009 Financial Statements, which is incorporated herein by reference, for a discussion of off-balance sheet arrangements.

### **Recent Financial Accounting Standards**

See Note 1 of Notes to Condensed Consolidated Financial Statements for a discussion of recent financial accounting standards.

### **Item 3: Quantitative and Qualitative Disclosures about Market Risk**

The Company believes that there has been no material change in the quantitative and qualitative market risks since the end of the Company's 2009 fiscal year end.

### **Item 4: Controls and Procedures**

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*Evaluation of Disclosure Controls and Procedures.* The Company carried out an evaluation, as required by Rule 13a-15(e) under the Exchange Act, with the participation of the Company's principal executive officer and principal financial officer, of the effectiveness of the Company's disclosure controls and procedures as of December 31, 2009. Based on this evaluation, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures were effective as of December 31, 2009 to provide reasonable assurance that information required to be disclosed in the Company's reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms and to provide that such information is accumulated and communicated to management to allow timely decisions regarding required disclosure.

**Table of Contents**

***Changes in Internal Control Over Financial Reporting.*** There were no changes in the Company's internal control over financial reporting during the quarter ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

***Inherent Limitations on Effectiveness of Controls.*** The Company's management, including its principal executive officer and the principal financial officer, does not expect that the Company's disclosure controls or its internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

**PART II. OTHER INFORMATION****Item 1: Legal Proceedings**

The legal proceedings described in Note 9 of Notes to Condensed Consolidated Financial Statements are incorporated by reference into this Part II, Item 1.

**Item 1A: Risk Factors**

The risk factors in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2009 (the 2009 Form 10-K) included risks that were specific to CareFusion. The Company completed the Spin-Off of CareFusion on August 31, 2009 and as such the risk factors in the 2009 Form 10-K were superseded by the risk factors set forth in Part II, Item 1A Risk Factors of the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009 (the September 30, 2009 Form 10-Q). In addition to the other information set forth in this Form 10-Q, you should carefully consider the risks discussed in Part II, Item 1A Risk Factors in the September 30, 2009 Form 10-Q, which could materially and adversely affect the Company's results of operations, financial condition, liquidity, cash flows and/or future business prospects.

The risks described in the September 30, 2009 Form 10-Q and in this Form 10-Q are not the only risks that the Company faces. The information in this Form 10-Q and the risks described in the September 30, 2009 Form 10-Q should be read in conjunction with the 2009 Form 10-K and the Company's filings with the SEC since June 30, 2009. The Company's results of operations, financial condition, liquidity, cash flows and/or future business prospects could also be affected by additional risks and uncertainties not known to the Company at the time of the filing of this Form 10-Q or that the Company currently considers to be immaterial.

**Item 2: Unregistered Sales of Equity Securities and Use of Proceeds**

The following table provides information about purchases the Company made of its Common Shares during the quarter ended December 31, 2009:

**Issuer Purchases of Equity Securities**

| Period | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly | Approximate Dollar Value of Shares that May Yet Be Purchased Under the |
|--------|--------------------------------------|------------------------------|------------------------------------------------------|------------------------------------------------------------------------|
|--------|--------------------------------------|------------------------------|------------------------------------------------------|------------------------------------------------------------------------|



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|                     |           |          | <b>Announced<br/>Program (2)</b> | <b>Program (2)</b> |
|---------------------|-----------|----------|----------------------------------|--------------------|
| October 1-31, 2009  | 668       | \$ 27.60 |                                  | \$ 500,000,000     |
| November 1-30, 2009 | 1,625,626 | 30.76    | 1,625,415                        | 450,000,023        |
| December 1-31, 2009 | 925       | 32.67    |                                  | 450,000,023        |
| Total               | 1,627,219 | \$ 30.76 | 1,625,415                        | \$ 450,000,023     |

- (1) Includes 134, 113 and 170 Common Shares purchased in October, November and December 2009, respectively, through a rabbi trust as investments of participants in the Company's Deferred Compensation Plan. Also includes 534, 98 and 755 restricted shares surrendered in October, November and December 2009, respectively, by employees upon vesting to meet tax withholding.
- (2) During the three months ended December 31, 2009, the Company repurchased approximately \$50 million of its Common Shares under its existing \$500 million share repurchase program announced on August 5, 2009. This repurchase authorization expires on August 31, 2012. At December 31, 2009, approximately \$450 million remained from the \$500 million repurchase authorization. The Company expects to use this repurchase program to at least offset equity plan issuances.

**Table of Contents****Item 4: Submission of Matters to a Vote of Security Holders**

The Company's 2009 Annual Meeting of Shareholders was held on November 4, 2009. Matters voted upon at the meeting and the votes tabulated with respect to such matters are as follows:

**Election of Directors**

| Director             | Votes For   | Votes Against | Abstentions |
|----------------------|-------------|---------------|-------------|
| Colleen F. Arnold    | 319,507,610 | 8,226,597     | 924,484     |
| George S. Barrett    | 318,071,760 | 9,796,633     | 790,298     |
| Glenn A. Britt       | 319,170,660 | 8,547,602     | 940,429     |
| Calvin Darden        | 307,569,601 | 20,116,004    | 973,086     |
| Bruce L. Downey      | 322,384,101 | 5,315,484     | 959,106     |
| John F. Finn         | 317,182,334 | 10,611,817    | 864,540     |
| Gregory B. Kenny     | 304,480,904 | 23,217,188    | 960,599     |
| Richard C. Notebaert | 307,736,902 | 19,993,486    | 928,303     |
| David W. Raisbeck    | 318,861,618 | 8,873,658     | 923,415     |
| Jean G. Spaulding    | 307,656,716 | 20,148,811    | 853,164     |

**Management and Shareholder Proposals**

|                                                                                                                                                                | Votes Cast  |             |           | Broker<br>Non-Votes |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-------------|-----------|---------------------|
|                                                                                                                                                                | For         | Against     | Abstain   |                     |
| Ratification of the selection of the Company's independent registered accounting firm for fiscal 2010                                                          | 324,017,904 | 4,358,800   | 281,987   |                     |
| Re-approval of the material terms of the performance criteria under Cardinal Health's Amended and Restated Management Incentive Plan                           | 317,281,419 | 9,695,421   | 1,681,851 |                     |
| Shareholder proposal regarding performance-based stock options                                                                                                 | 124,305,405 | 171,238,610 | 3,127,285 | 29,987,391          |
| Shareholder proposal regarding an amendment to the Company's Restated Code of Regulations to require that the Chairman of the Board be an independent director | 47,623,612  | 250,190,818 | 856,870   | 29,987,391          |

**Table of Contents**

**Item 6: Exhibits**

| Exhibit Number | Exhibit Description                                                                                                                                                                                                                                                                    |
|----------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1            | Amended and Restated Articles of Incorporation of Cardinal Health, Inc., as amended (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, File No. 1-11373)                                               |
| 3.2            | Cardinal Health, Inc. Restated Code of Regulations, as amended (incorporated by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, File No. 1-11373)                                                                    |
| 10.1           | Second Amendment to Cardinal Health, Inc. 2005 Long-Term Incentive Plan (as amended and restated as of November 5, 2008) (incorporated by reference to exhibit 10.1.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009, File No. 1-11373)       |
| 10.2           | First Amendment to Cardinal Health, Inc. 2007 Nonemployee Directors Equity Incentive Plan (incorporated by reference to exhibit 10.2.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009, File No. 1-11373)                                      |
| 10.3           | Form of amended and restated Aircraft Time Sharing Agreement between Cardinal Health, Inc. and George S. Barrett (incorporated by reference to exhibit 10.4.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009, File No. 1-11373)               |
| 10.4           | Third Amendment, dated as of November 10, 2009, to the Third Amendment and Restated Receivables Purchase Agreement, dated as of November 19, 2007 (incorporated by reference to exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 16, 2009, File No. 1-11373) |
| 10.5           | Third Amendment to the Cardinal Health, Inc. Broadly-based Equity Incentive Plan, as amended                                                                                                                                                                                           |
| 10.6           | Fourth Amendment to Cardinal Health, Inc. Amended and Restated Equity Incentive Plan, as amended                                                                                                                                                                                       |
| 12.1           | Computation of Ratio of Earnings to Fixed Charges                                                                                                                                                                                                                                      |
| 31.1           | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                     |
| 31.2           | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                     |
| 32.1           | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                                      |
| 32.2           | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                                      |
| 99.1           | Statement regarding Forward-Looking Information                                                                                                                                                                                                                                        |
| 101.INS*       | XBRL Instance Document                                                                                                                                                                                                                                                                 |
| 101.SCH*       | XBRL Taxonomy Extension Schema Document                                                                                                                                                                                                                                                |
| 101.CAL*       | XBRL Taxonomy Extension Calculation Linkbase Document                                                                                                                                                                                                                                  |
| 101.DEF*       | XBRL Taxonomy Definition Linkbase Document                                                                                                                                                                                                                                             |
| 101.LAB*       | XBRL Taxonomy Extension Label Linkbase Document                                                                                                                                                                                                                                        |
| 101.PRE*       | XBRL Taxonomy Extension Presentation Linkbase Document                                                                                                                                                                                                                                 |

\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

**Cardinal Health Website**

The Company uses its website as a channel of distribution for material company information. Important information, including news releases, analyst presentations and financial information regarding the Company, is routinely posted and accessible on the Investors page at [www.cardinalhealth.com](http://www.cardinalhealth.com). In addition, the Company's website allows investors and other interested persons to sign up to automatically receive

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email alerts when the Company posts news releases, SEC filings and certain other information on its website.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CARDINAL HEALTH, INC.

Date: February 5, 2010

/s/ GEORGE S. BARRETT  
**George S. Barrett**  
**Chairman and Chief Executive Officer**

/s/ JEFFREY W. HENDERSON  
**Jeffrey W. Henderson**  
**Chief Financial Officer**