MAY 2021

Cardinal Update

Steady as She Goes in Healthcare

Healthcare companies outperformed the broader index early on in the pandemic as there was a flight to safety. Since then, we have seen the technology sector and cyclical sectors such as financials and industrials significantly outperform, while healthcare has lagged. Healthcare is one of the few sectors not trading at an elevated valuation today, despite solid earnings growth and strong upcoming catalysts. The pandemic has caused the deferral of physician visits which in turn has led to fewer procedures and reduced screening for diseases. As we return to a more normal state, revenue and earnings growth should accelerate and companies such as **Merck, Gilead Sciences**, and **Becton Dickinson** will all be better off. Still, all of these names trade at attractive valuations relative to their historical ranges, peers, and the overall market.

Almost 70% of Merck's products are administered by physicians in a hospital or clinic setting and thus COVID has been a headwind on results. In addition to the patient access issues created by COVID, there have also been delayed cancer diagnoses that as a result have postponed the start of treatments on Keytruda, which is Merck's largest drug and a significant growth driver for the company. Despite these headwinds, Merck still grew earnings 14% in 2020 and should grow at a double-digit rate again in 2021. Merck has a rock-solid balance sheet, pays a growing 3.5% dividend yield, and still only trades at 12.0 times earnings, which offers good value and downside protection, in our opinion.

Gilead Sciences is often viewed as a pandemic beneficiary as Veklury, its treatment for hospitalized COVID patients, has generated over $1 billion in sales in each of the last two quarters. While Veklury has been a recent tailwind for the company, it has also been an offset for the HIV, hepatitis C and oncology franchises which have all faced headwinds from delayed physician visits and a reluctance by physicians to switch patients' medications during the pandemic. Gilead pays a growing 4.2% dividend yield, has numerous upcoming pipeline catalysts from recent acquisitions, and still only trades at 9.5 times earnings, which we believe offers good value and downside protection.

Becton Dickinson (BD) is a relatively recent addition to portfolios but is not new to Cardinal as it has been a successful holding in the past. BD's diagnostics business has been a beneficiary from COVID as it has developed multiple COVID tests across its various diagnostics platforms. What often gets overlooked is that other areas of its business, like routine diagnostic testing and hernia repair, are still operating below pre-pandemic levels due to delayed doctor and hospital visits. BD's balance sheet has significantly improved since it undertook a large acquisition and we should see increased cash returned to shareholders going forward via larger dividend increases and share repurchases as the capital allocation priorities shift away from debt repayment. BD trades at 18.0 times earnings, which is an attractive valuation compared to its medical device peers, and the company should be able to grow earnings consistently at a double-digit rate.

COMPANY FOCUS: ENEL SPA

Enel Spa (Enel) is the largest European utility with a market capitalization of 83B EUR and pays a dividend yielding 4.4%. The Rome-based company owns and operates a diverse set of integrated utility operations spanning power generation, distribution, retail, and other solutions across a number of countries including Italy, Spain/Portugal, Brazil, Columbia, Chile, and North America. Enel is the largest publicly-traded renewable power generator, distribution network operator (73M end users), and retail utility (71M customers) in the world. We believe the company is well positioned for dividend growth from investments related to the global e nergy transition.

The investments required in renewable generation and electrical distribution grids to transition the world's energy consumption towards a net zero carbon goal is immense. To meet the Paris goals, annual investment in renewables, nuclear, and networks must increase from $640B/year to over $1T/year. The Enel of today is set up to provide growth in both earnings and dividends as it helps to drive a global energy transition towards decarbonization. While operating 48GW of renewables today, the company plans on adding an additional 100GW from 2020-2030. Alongside investments in upgrading the electricity grid, this should drive steady 7-8% annual growth in earnings and dividends.

DIVIDEND INCREASES

Johnson & Johnson	5.0%

(During the period April 1-30, 2021)

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