

Scott P. Anderson
President & Chief Executive Officer

- Good morning and thanks for taking time to participate in our fourth quarter earnings conference call.
- Joining me today is Steve Armstrong, our executive vice president and chief financial officer, who will review some highlights of our fourth quarter performance following my opening remarks.
- Since Regulation FD prohibits us from providing investors with any earnings guidance unless we release that information simultaneously, we provided financial guidance for fiscal 2013 in our press release earlier this morning.
- This guidance is subject to a number of risks and uncertainties that could cause Patterson's actual results to vary from our forecasts.
- These risks and uncertainties are discussed in detail in our Annual Report on Form 10-K and our other SEC filings, and we urge you to review this material.
- Turning now to our fourth quarter results, sales totaled \$936.3 million, an increase of 6% from \$883.8 million in the fourth quarter of fiscal 2011.
- Net income of \$62.1 million or \$0.58 per diluted share included incremental expense of \$0.03 related to Patterson's Employee Stock Ownership Plan, or ESOP.
- Excluding this ESOP-related expense, fourth quarter earnings were \$0.61 per diluted share.
- We included an ESOP expense reconciliation table in this morning's release that provides full detail on this item.
- Patterson reported earnings of \$62.7 million or \$0.53 per diluted share in the fourth quarter of fiscal 2011.
- For fiscal 2012, consolidated sales rose 4% to \$3.5 billion.
- The additional sales week in the first quarter of fiscal 2011, which made that year a 53-week period, negatively affected fiscal 2012 sales growth by approximately two percentage points.
- Net income in fiscal 2012 of \$212.8 million, or \$1.92 per diluted share, included \$0.13 per share of ESOP-related expense.
- Excluding this expense, earnings were \$2.05 per diluted share for the year.
- Earnings in fiscal 2011 were \$225.4 million or \$1.89 per diluted share.
- While on the topic of our recent operating results, I also want to mention that Patterson repurchased approximately 1.2 million shares during the fourth quarter under our 25 million share buyback authorization that expires in 2016.
- For the year, we acquired 12 million shares, with approximately 11 million shares remaining available for repurchase under this authorization.
- In addition, Patterson's quarterly cash dividend was increased 17% to \$0.14 per share in March 2012, bringing our annual dividend rate to \$0.56 per share.
- Including share repurchases and quarterly dividends, Patterson returned \$400 million to shareholders in fiscal 2012, reflecting our commitment to generating value for our stakeholders.
- Now, for the next few minutes, I will briefly review our fourth quarter operating results for each of our divisions.
- Each of our three businesses performed at planned levels during this period despite persistently soft and unsettled economic conditions, both at home and abroad.
- We believe our ability to perform effectively in the current environment bodes well for Patterson's performance in a stronger economy.
- Within Patterson Dental, sales of consumable supplies increased 3.5% before the impact of foreign currency exchange rate changes.
- This marked the fourth consecutive quarter of solid consumables sales growth, an indication of the continued strengthening of the overall North American dental market.
- We were also encouraged by the 6% improvement in fourth quarter sales of dental equipment given the fact that equipment sales were particularly robust in the year-earlier period.
- In addition to mid-single digit sales growth of basic equipment, we benefited from strong double-digit sales growth of CEREC systems, which was generated primarily by new users.

- We believe this reflects the growing acceptance of CAD/CAM and other new digital technologies, which are enabling dentists to strengthen productivity, generate additional income and improve clinical outcomes.
- We estimate that CEREC systems have now penetrated only about 12% of the North American dental market, which means this product line has significant sales potential going forward.
- To help spur continued demand for CEREC and our other next-generation products, we will continue to focus our marketing initiatives on Patterson Dental's industry-leading line-up of technology offerings.
- Fourth quarter sales of Webster Veterinary increased 13% to \$207.5 million, a record level for this unit.
- The August 2011 acquisition of American Veterinary Supply Corporation, a full-service veterinary distributor located on Long Island, accounted for 2 percentage points of the unit's sales growth for this period.
- Webster's fourth quarter sales growth was driven by robust demand for consumable supplies, including flea-tick and heartworm medications as the relatively mild winter led to an early onset of these summer pests.
- Despite the challenging economy, pet owners are increasing expenditures on veterinary care.
- Through its full-service platform, which includes equipment and a new technical service capability, our companion-pet veterinary unit is positioned to capitalize upon positive pet ownership and spending trends.
- We intend to continue investing in our efforts to diversify our revenue offerings in this growing business.
- Sales of Patterson Medical, our rehabilitation supply and equipment unit, increased 3%, excluding the impact of currency, to \$130 million in the fourth quarter.
- Patterson Medical's fourth quarter performance was paced by above-plan sales of consumables in the North American market.
- This unit's equipment business continued to be affected by the uncertainty around proposed changes in the U.S. health care system.
- We believe this situation, which dampened equipment demand throughout the past year, will likely persist in fiscal 2013.
- Patterson Medical is positioned to take maximum advantage of worldwide long-term demographic trends fueling the growth of the rehabilitation market.
- Consistent with its global business strategy, Patterson Medical acquired Australian-based Surgical Synergies this past April, a \$10.0 million distributor of physiotherapy, rehabilitation and mobility products that strengthens our previously established position in the Australian and New Zealand rehabilitation markets.
- Finally, as we stated in this morning's release, we issued financial guidance of \$2.10 to \$2.16 per diluted share for fiscal 2013.
- As we look ahead to fiscal 2013, we believe the market for dental consumables will grow in the 2% to 3% range, while the equipment market will grow in a 5% to 7% range.
- The companion-pet veterinary market is forecasted to grow in the range of 3% to 4%, while the global rehabilitation market is not expected to increase in fiscal 2013.
- We believe each of our sales units will continue to grow at faster rates than their respective markets.
- As we look back on fiscal 2012, I would like to highlight a few of the important investments that we made to enhance our opportunities for success in the future.
- First, we completed the multi-year expansion of our domestic distribution capacity with the completion of the South Bend, Indiana facility.
- This should allow us to double our business without significant additional investment in our distribution capacity.
- Second, we completed and opened a new facility for the Patterson Technology Center.
- This state-of-the-industry facility will provide our customers with a full complement of resources to support their on-going investments in technologies for their practices.
- Third, we developed and deployed updated customer service and order management systems throughout the domestic dental operation to better support the growth of the business and address the changing needs of our dental customers.
- Fourth, we made investments in educational programs for our sales organization that will continue into fiscal 2013, and we accelerated the build-out of our technical service capabilities in the veterinary unit.

- While these investments added incremental expense in the short-term, we believe that the return to the shareholder over the long-term will be substantial.
- In all, we believe our markets are gradually recovering from the impact of the recession, although they have not returned to historic growth norms.
- In closing, I want to emphasize that Patterson's businesses are well-positioned to capitalize upon their market opportunities, and we are looking forward to an exciting and successful fiscal 2013.
- We are equally optimistic about Patterson's long-term future.
- Thank you. Now, Steve Armstrong will review some additional financial highlights from our fourth quarter results.

R. Steven Armstrong
Chief Financial Officer

- Thank you, Scott.
- My comments will focus primarily on some of the more significant aspects of our financial results in the fourth quarter and matters affecting our guidance for fiscal 2013.
- Let me begin with a few brief comments on consolidated operations.
- Currency had only a 30 basis point negative impact on our consolidated revenue growth, although our Medical unit was negatively affected by 90 basis points.
- Our consolidated gross margin declined by 90 basis points in the quarter compared to the prior year but improved sequentially, as anticipated, by 120 basis points.
- The year-over-year decline was due primarily to sales mix and some increase in promotional costs.
- Our operating expense ratio improved 10 basis points despite the incremental \$5.6 million of ESOP expense as we were able to gain leverage from revenue growth and expense management.
- The ESOP expense increase accounted for the majority of the decline in the operating margin, with the impact of product mix and promotional costs accounting for the remainder.
- Specifically, the Dental operating margin was 11.7% for the quarter.
- As a reminder, this segment absorbs the largest portion of the ESOP expense.
- The Veterinary and Medical segments reported operating margins of 5.8% and 16.2%, respectively.
- Interest expense has increased by approximately \$3.1 million from the prior year period due to the issuance of debt in the third quarter.
- While we have to absorb this increased expense in the near-term, we believe this new debt provides very competitively priced long-term capital to support the growth of business.
- Our fiscal 2012 tax expense continued to benefit from the dividends paid on the shares held by our Employee Stock Ownership Plan.
- This portion of the dividend is deductible on our income tax return and provides an increasing benefit to our overall tax rate as the dividend rate grows.
- In addition, during the fourth quarter, we settled an Internal Revenue Service audit, and as a result, we were able to release approximately \$1.4 million of previously provided tax reserves.
- This release of reserves positively impacted our fourth quarter tax rate by 150 basis points.
- As we look to fiscal 2013, we expect a tax rate of approximately 36%.
- Looking now at our cash flow, we generated approximately \$92 million from operations in the fourth quarter, compared to \$71 million in the prior year.
- This increase was a result of better working capital management and a larger amount of finance contract sales during the period compared to the fourth quarter of last year.
- A couple notes on the balance sheet, our DSO stood at 45 compared to the year-ago 48 days.
- Our inventory turns declined slightly to 6.7, from 6.9 last year.
- You may also have noted that \$125 million of our debt has moved from a long-term classification to short-term.
- This portion of the debt matures in March of 2013, and we intend to retire it at that time using proceeds from our debt issuance this past December.
- Looking ahead to fiscal 2013, revenues at our Webster Veterinary unit will be adversely affected by a change in a distribution agreement with a nutritional vendor.
- We formerly distributed product for this vendor under a buy-sell arrangement in one region of the US market.

- Beginning in fiscal 2013 we will represent the vendor under a national agency arrangement.
- This change is expected to reduce revenues by approximately \$45 million, although the effect on operating profit is expected to be minimal.
- In addition, our expense structure during the coming fiscal year will reflect a comparable amount of ESOP expense as in fiscal 2012, since the change in accounting for this item has been grandfathered into our expenses.
- Finally, our guidance for fiscal 2013 reflects the outstanding share count with which we ended fiscal 2012.
- As Scott noted earlier, we have approximately 11 million shares remaining under our current repurchase authorization, and we expect to continue to purchase shares as the opportunity presents itself.
- A final note on our view of fiscal 2013, we expect our CAPEX to approximate \$25 to \$30 million, while depreciation and amortization should be \$45 million.
- With that, I'll turn the call back to the conference operator, who will poll you for your questions.