PATTERSON COMPANIES

EDITED TRANSCRIPT

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PRESENTATION

Operator

Good day, everyone, and welcome to the Patterson Companies' First Quarter Fiscal 2015 Earnings Announcement. Today's conference is being recorded.

At this time, I would like to turn the conference over to Ann Gugino. Please go ahead.

Ann Gugino *Vice President, Strategy and Planning*

Thank you, April. Good morning, everyone, and thank you for participating in Patterson Companies' Fiscal 2015 First Quarter Earnings conference call. With me today are Scott Anderson, our Chairman and Chief Executive Officer, and Steve Armstrong, our Executive Vice President and CFO. After a brief review of the quarter by management, we will open the call up to your questions.

Before we begin, let me remind you that certain comments made during the course of this conference call are forward-looking in nature and subject to certain risks and uncertainties. These factors are discussed in detail in our Form 10-K and our other filings with the Securities and Exchange Commission. We urge you to review this material.

Also, since Regulation FD prohibits us from providing investors with earnings guidance unless we release that information simultaneously, we've provided financial guidance for fiscal 2015 in our press release and financial slide presentation that can be found in the Investor Relations section of our website.

Be advised that this call is being recorded and will be available for replay starting today at 12:00 p.m. Central Time for a period of one week.

With that, I'd like to hand the call over to Scott Anderson. Scott?

Scott Anderson *Chairman, President and Chief Executive Officer*

Thank you, Ann, and welcome, everyone, to this morning's conference call. As you saw in today's earnings release, Patterson Companies' consolidated revenues rose more than 20% in the fiscal 2015 first quarter. We are pleased with the trends we saw in the period and the business performed within our expectations. We are confident that we will continue to execute well and sustain solid gains through the remainder of the fiscal year. With the actions we took in fiscal 2014 to increase our efficiency, coupled with the long-term investments we are making to build on our capabilities, we have positioned Patterson Companies for future success.

So with that as a backdrop, let's take a look at our operational performance in the first quarter, starting with Dental. This business, which accounts for a little more than half of our total sales, experienced sales growth in both consumables and basic equipment. Sales for Patterson Dental improved slightly from a year ago on a constant currency basis to $556 million, while the negative impact of currency exchange reduced reported sales to $552.7 million. We were pleased to see positive trends in sales of dental consumables, which increased by 2.5% from the prior year on a constant currency basis. Basic equipment growth, which includes chairs, units and cabinetry, was also strong, posting double-digit gains in the fiscal first quarter. This marked our third consecutive quarter of solid basic equipment growth.

New unit sales of the CEREC Omnicam also grew nicely and posted double-digit year-over-year gains. Patterson continues to win in competitive CAD/CAM sales situations, with Omnicam leading the way. However, this growth in new CEREC units and basic equipment did not offset the sales associated with the Omnicam trade-up program in the first quarter of the prior year that resulted from orders taken at the time of the introduction of the Omnicam in the fall of calendar 2012. As a reminder, we began delivering on this trade-up program in the fourth quarter of fiscal 2013, and since that time, we have upgraded more than 2,000 customers from Bluecam to Omnicam. This first program was a tremendous success.

One of the great things about the CEREC family of products is the ability for the dentist to grow into new CEREC technologies over time. We will see this continue to play out with our large CEREC user base, but today our focus is primarily on new users. Sirona recently announced the release of its version 4.3 software for CEREC. This is another exciting leap forward for our CEREC users and takes the Omnicam to an even higher level of functionality and ease of use. In conjunction with Sirona, we held a technology summit in July for our CEREC sales force and equipment specialists. The feedback on the new software has been tremendous, both internally and with our CEREC trainers, who are power users of the product in their own dental practices.

Our sales force is very committed to delivering the benefits of digital dentistry to the practitioner. Our CEREC customers have a very high level of satisfaction across both the Omnicam and Bluecam user base. This gives us even more confidence as to the exciting future ahead for this aspect of digital dentistry. We are the proven leader in dental equipment in the dental equipment market, offering best-in-class technology and basic equipment that we enhance with Patterson's industry-leading after-sales support platform. The growth prospects from our technology offerings, combined with the fact that there is considerable opportunity for dentists to invest in their practices, position us well going forward.

Moving next to Patterson Veterinary, which comprises more than one third of total sales, first quarter sales for this unit increased nearly 94% from the prior year period to $386.3 million. Performance was solid in the US, where sales rose nearly 7% to $212.7 million. The US experienced an increase in consumable veterinary sales of medications and supplies of more than 7%, partially driven by the later arrival of the warmer spring weather. Sales of equipment were in line with the prior year levels, as we continue to execute against our strategy to be a national provider of veterinary equipment and services.

We had another quarter of strong contributions from NVS, our UK-based veterinary business, as the unit contributed $173.6 million to consolidated sales and $0.02 to earnings per diluted share. In addition to the contributions from new customers acquired since we made this acquisition just one year ago, this quarter's performance was boosted by the more intense flea and tick season that resulted from the warmer and dryer weather in the United Kingdom. NVS continues to perform well. We are pleased with the integration process and execution from the talented group of personnel that we have in place there.

On a final note for Patterson Veterinary, I would like to review recent developments regarding IDEXX Laboratories. Late in July, IDEXX informed Patterson that as of January 1st, 2015, it will move to a direct distribution model for all its veterinary products in the United States rather than selling through distributors. We estimate that this change, unmitigated, could impact earnings by $0.04 to $0.05 per share annually, with the greatest impact occurring in Patterson's fiscal fourth and first quarters, due to the seasonal usage of many of these products. However, we believe we are well positioned for this transition due to the diversification of our business and the infrastructure investments that we have made. As a result, we do not believe these actions will have a material impact on fiscal 2015 earnings. We are exploring various alternatives for replacing these important needs for our customers and expect to mitigate the impact of this change. While we are disappointed by IDEXX's distribution decision, we are very focused on devoting the necessary resources to manage this transition, and we are excited by the opportunities we see to form new partnerships and help our customers. We look forward to updating you later in the fall on our efforts and providing you more visibility into our transition plan.

So before I move to Medical, let me reiterate our go-forward strategy for Veterinary. We continue to execute against our strategy to enhance both our equipment and technical service offerings in order to take advantage of favorable marketplace dynamics as pet ownership and the dollar amount people invest in veterinary care for their pets continues to grow. Veterinarians will require sophisticated equipment and capabilities in their clinics and hospitals to meet this market need and Patterson will be there to support them.

Turning now to Patterson Medical, our rehabilitation supply and equipment unit, which now represents approximately 11% of total Company revenues, the business performed in line with our expectations for the period. Sales in the fiscal first quarter were flat with prior year levels, after accounting for the planned divestitures of non-core product lines that we began in the fiscal first quarter of 2014. With the divestitures now behind us, we have aligned our business around those areas that have the highest strategic value and where we can demonstrate a core competency. We are also excited about the new leadership in this division and the approach they are taking to reposition the business in our selected markets. Notably, during the quarter, we are pleased to welcome Ian Thomas, a seasoned professional who has held international senior leadership positions with premier healthcare organizations, to head up our international group. Given our substantial industry leadership, as well as our extensive branded and proprietary product and service offerings, Patterson Medical is poised to capture additional share as market conditions stabilize.

Next, I'd like to cover our corporate-wide information technology initiative. As I have previously stated, we've undertaken this effort in order to support the Company's future growth, further enhance the customer experience and secure productivity gains going forward. We see this as a five-year effort to overhaul our primary systems and strengthen our internal business processes. The project thus far is on schedule and in scope. We are taking a phased approach and have completed the blueprinting stage of our IT investments. Now we are in the design and build-in phase of the project. We will update you in the coming quarters as we begin piloting and implementation. Our information technology investment is critical to improve scale in our business platform and provide Patterson with the flexibility to adjust as opportunities warrant, in order to accommodate growth. Our customers will continue to benefit from these improvements as we further execute on this strategy.

We are reaffirming our earnings per share guidance range of $2.20 to $2.30 per diluted share for fiscal 2015. The base assumptions we use to build that range remain: stable North American and international markets, with conditions similar to fiscal 2014; no impact from additional share repurchases that may occur during the year; the long-term extension of the $250 million of debt that is due in March; and no material acquisitions during the year. We believe the recent distribution change announced by IDEXX Laboratories will not materially impact our fiscal 2015 outlook. We fully expect to mitigate the potential reduction from this move.

Before I turn the call over to Steve, I would like to take a moment to talk about an announcement we made in June. As we announced, Steve Armstrong will step down as CFO of Patterson at the end of October, after more than 15 years with the Company. At that time, Ann Gugino will become Patterson's CFO. Let me take a few moments to comment on this transition and thank Steve for his time at Patterson.

Over the past 15 years, Steve has been instrumental in helping to manage the Company during a period of substantial growth and transformation. He has provided Patterson with exceptional counsel during his tenure and is highly respected by his colleagues at Patterson, our Board of Directors, the financial community and our shareholders. Steve has helped build our strong financial platform, as well as strategically position the Company for the future, and I am personally grateful for his support throughout my career, particularly since I became CEO. While we're sad to see an old friend leave, we are equally excited to have Ann assume the CFO role. She has been a key leader in both financial management and strategic planning for Patterson for more than a decade and we are excited to have Ann move into this position. Steve recognized her considerable talents and brought her into Patterson nearly 15 years ago. With her deep understanding of Patterson's operations, her business and financial acumen, and her ability to interact with our shareholders and the financial community, we know that this will be a smooth transition and look forward to her immediate contributions.

With that, I'll ask Steve to review the financials. Steve?

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

Thank you, Scott. Before I begin the financial review and since this is my final earnings call as CFO, I guess I get to take a minute to extend my appreciation to you, Scott, and the Patterson organization for making the past decade and a half an extremely satisfying and professional personal experience. Patterson's focus on exceptional customer service, a spirit of innovation and a commitment to long-term value creation, all within a culture grounded in integrity and fairness, provided a terrific opportunity for me. Obviously, you and the investment community have been a big part of my last 15 years as well, and believe it or not, I'll actually miss working with you. I have enjoyed it immensely. Let me also say I have the utmost confidence in Ann. Many of you already know her and will have a chance to work with her in the coming months. I look forward to continuing to work with Scott and Ann to complete the transition.

With that, let me review the financial results, and please note this represents the last full quarter that National Veterinary Services, or NVS acquisition, will impact the year-over-year comparison, since the acquisition was completed just a year ago. For comparative purposes, my comments that follow will generally exclude the results of NVS, unless otherwise noted. In this morning's earnings press release, we have provided our consolidated operating metrics based on our reported results, as well as adjusted to exclude the impact of the NVS acquisition. In the press release, we also have provided operating profit by segment, so you don't have to wait several weeks for our SEC filings to obtain the data. And one final note, beginning this fiscal year, we have begun reclassifying, or classifying dental handpieces as a consumable sale, consistent with the remainder of the market. We reclassified last year's amounts for comparability, but I would note that there is negligible impact on the growth percentages for the respective categories for the current period.

During the quarter, the impact of foreign currency exchange on revenue growth was unfavorable in the Dental segment by 60 basis points, but favorable by 140 basis points in the Medical segment. Our consolidated sales growth was negatively impacted by 20 basis points from currency.

Fiscal first quarter consolidated gross margins improved 30 basis points from the prior year. Improvements in the Dental and Medical division gross margins were partially offset by a decline in the Veterinary margins. The changes in gross margins within the divisions were generally the result of mix changes, while we also experienced some reduction in rebates within the Veterinary segment.

Looking at our consolidated operating expense ratio, we saw 40 basis points of increase resulting primarily from the timing of the recognition of performance-based compensation expense between periods. We believe our operating expense ratio will improve throughout the year, with an overall improvement for the fiscal year after excluding the prior year restructuring charges in the Medical division. By segment, our first quarter adjusted operating margins were 9.6% for Dental, 4.6% for Veterinary, and 14.6% for Medical. Note that the operating margin for the Dental segment absorbed the majority of the compensation expense I mentioned earlier.

Our adjusted effective tax rate in fiscal first quarter was 35.6%, an 80-basis-point decrease from the prior year. As our tax rate for the full fiscal year is expected to decline, we are anticipating an annual tax rate between 34.5% and 35% for fiscal 2015. This lower rate, when compared to fiscal 2014, is due to the unfavorable impact of the restructuring costs on our prior year rate, as well as a change in the mix of the international versus domestic taxable income, which will have a favorable impact on the tax rate. Again, not including NVS, our DSOs were at 44, a slight increase from the prior year's 42 days for the first quarter, while inventory turns were at 6.5 compared to 6.8 one year ago.

Two items of note on our balance sheet. Beginning with accounts receivable, sales volume in our fourth quarter is generally higher than that of the subsequent first quarter. Our accounts receivable balance will generally decrease during the first quarter as the higher level of sales from the fourth quarter term through the balance sheet. This is a historical trend that continues. Second, our inventories have increased compared to our year-end balances. This increase is due to a combination of factors, beginning with our historic practice of building our consumable inventories during our operating year to improve service levels. We've reduced our inventory levels at year end to minimize the impact of our LIFO computations. Also, the Veterinary segment is carrying additional product under buy/sell arrangements this year that were previously sold under agency agreements which do not require the distributor to carry inventory. Finally, our Dental equipment inventories have increased as we manage the more complicated supply channel for several of the technology products that we sell. We would expect our inventory levels to moderate as we approach our fiscal year end.

In fiscal 2015 first quarter, our cash flow from operations totaled $69 million, compared to $21 million in the year ago period. The prior year quarter was negatively impacted by the timing of payments of taxes and accounts payable.

We also continued to execute on our capital allocation strategy. During the quarter, we paid cash dividends of $20 million to our shareholders. Also, we repurchased approximately 1.1 million shares of our common stock with a value of $43.9 million, leaving approximately 21 million shares available under our current authorization.

Our capex in the first quarter totaled $16.7 million and included payments for the normal replacements, as well as the ERP project. For fiscal 2015 full year, we are currently estimating cap ex of approximately $45 million. Over half of this amount is directly related to the ERP system.

With that, I'll turn it back to Scott. Scott?

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Steve. As we progress through fiscal 2015, we believe we can continue to capture market share as we exceed our customers' expectations. Our very strong strategic partnerships continue to grow and strengthen across all of our businesses, and enhanced by Patterson's unparalleled service and support platform, we continue to receive very positive feedback from our customers.

We entered the year with a conservative view of our markets due to the relatively soft performances in the global economies. We expect conditions in our markets to remain the same as they were in fiscal 2014. While we are starting to see stability in certain areas, we continue to take a guarded approach to the economic environment. That said, we are confident in our ability to execute in any economic environment. With a streamlined and more efficient organization, we believe we have positioned Patterson for the future, and we continue to be bullish on the long-term prospects for our Company.

Now we'd like to take your questions. I'll turn the call over to April.

Operator

Thank you. If you'd like to ask a question, simply press the star key, followed by the digit one on your telephone keypad. Also, if you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, star, one at this time. We'll pause for just a moment.

We'll first hear from John Kreger of William Blair.

John Kreger *William Blair – Analyst*

Hi, thanks very much. Scott, a follow-up maybe on your market environment question. If you think about your basic dental equipment trends in the past, dental office build-outs have been a big part of that. How does your pipeline look? Any signs of improving demand on that front?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, John, great question. As I said, we're very encouraged to see three straight quarters of growth from basic equipment, but I'd also, you know, sort of send out a reminder that the basic equipment category industry-wide in North America has not yet recovered to pre-2008 levels. But we are encouraged because we're starting to see an increase in our dental furniture and cabinetry lines, which typically are associated with office remodels and new office build-outs. So I would say we're cautiously optimistic about our pipeline and our prospects going into the heavy selling season, which, as you know, is during the later fall/winter times.

John Kreger *William Blair – Analyst*

Great, thank you. Then the strong growth you're seeing in your UK Vet business, do you think that's sustainable, and if you could just elaborate a little bit more on what drove such a nice sequential uptick.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, I think it was two things. One, the group really hit the ground running post-acquisition almost a year ago. They've had some nice customer wins. We also absolutely benefited in the quarter from a milder summertime in the UK. So I would not say that the current growth rate is sustainable, but, you know, what I'm excited about is we have a strong competitive position and we think we have some strategic opportunities to expand the portfolio in terms of things we bring to our UK customers. So, really, one year in, we couldn't be more pleased with the performance that's coming from our UK group.

John Kreger *William Blair – Analyst*

Great, and one last quick one. When do you expect Medical to start growing again?

Scott Anderson *Chairman, President and Chief Executive Officer*

I would say fairly soon. The thing I would say about our Medical business in the quarter – and give our management team over there a pat on the back, they really have stabilized the business, they're implementing growth strategies, they've sort of retooled their United States management team, have got a great leader now over in our international group, so Mike Orscheln, our President, and his team are absolutely focused on growth.

I would say from a market perspective – and as I've said many times before, that's been the toughest underlying market of the three businesses we have – it seems like the fog is starting to clear and the underlying markets are beginning to firm up, and we really like our competitive position and the competitive advantage we have in the physical therapy rehab business. So that is absolutely the expectation for that team, is to start showing revenue growth going forward. They did a great job managing the business and streamlining the business, so from a bottom line perspective, it was a very nice quarter for our Medical group.

John Kreger *William Blair – Analyst*

Great. Thanks much.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, John.

Operator

Next we'll hear from Robert Willoughby of Bank of America.

Robert Willoughby *Bank of America – Analyst*

Hi, Scott and—who's that CFO again? Steve. In a prior dialogue, Scott, you'd mentioned that there was some urgency around the whole kind of addressing the valuation discrepancy aspect (audio interference) Dental constituents. Where do you stand on that front? This looks like a, you know, strong quarter or just a shot straight down the fairway here, but what's different about the approach to the balance sheet or the business mix with these results?

Scott Anderson *Chairman, President and Chief Executive Officer*

Well, since this is his last call, I'll let the CFO start and I'll give color after that. His name's Steve, by the way.

Robert Willoughby *Bank of America – Analyst*

Steve. Steve, yes.

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

Yes. Thank you, Bob. Not much change to the balance sheet, other than the inventory build, which we had anticipated some of it because of changes in the underlying markets themselves or the businesses. But other than that, not any changes here, from my perspective.

Robert Willoughby *Bank of America – Analyst*

But you've referenced—you'd referenced, Steve, that you were looking to term out the debt, the $250 million debt that's coming due. Prospects for raising more than that and buying some stock back given the valuation here or, you know, looking at the strategic fit of all the businesses, thoughts to potentially monetize some assets?

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

You know, Bob, we've historically run this balance sheet fairly lean, or conservative, I guess is how I would term it. We do intend to term out the $250 million that comes due in March of '15. Adding more debt will sort of depend on what happens in the acquisition market as we get deeper into the year, what we see going into '16, and, obviously, that's an opportunity, that's a card we can play. We just don't intend to play it in the short term to leverage up the balance sheet just to buy back shares.

Scott Anderson *Chairman, President and Chief Executive Officer*

And I would add to that, Bob, you know, the maximization of the portfolio is our key driving strategic intent. You know, that's one of the reasons why we felt the IT investments were so critical, is to drive even more efficiency in the organization, and we've got three great franchises and it's our job to get full value out of all three. So we continually evaluate the businesses and the fit and the strategic opportunities going forward for our shareholders.

Robert Willoughby *Bank of America – Analyst*

Scott, you may have referenced it, the Medical business itself, can we expect that to continue to rebound sequentially from a revenue perspective, and can we expect profitability for that business to move higher as well this year?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, I think we'll see revenue growth. I wouldn't predict a big snap back, but, you know, that's a business that I feel right now is very well run, has a good strategic plan and has a strong theme in terms of execution. So, absolutely, we would look for the Medical business to be more of a tailwind than a headwind, like it has been the last 24 months.

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

This is Steve, the CFO. Just to remind everyone that there is a—we've got a bit of a headwind in that division. Growth may be disguised a little bit. We're anticipating growth from the underlying business, but we've got some divestitures that we'll have to overcome throughout the year. So I think we alerted everybody it would be about a 4- to 5-point drag going into the year. So, to Scott's comments, I'm just trying to qualify it so that everybody understands that there is that drag.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, but the underlying business, absolutely growing.

Robert Willoughby *Bank of America – Analyst*

Okay. Thank you.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Bob.

Operator

Next we'll hear from Kevin Ellich, Piper Jaffray.

Kevin Ellich *Piper Jaffray – Analyst*

Good morning. Thanks for taking the questions. Steve, it's been great working with you. Everyone's going to miss you. Hope you have a fun time in retirement, living on a lake and hunting, hopefully. Moving on to the Dental segment, you guys reclassified some products from equipment into consumables. Just wondering why you did that now? Then, you know, you called out dental handpieces; wondering what type of margins you guys see on those types of products, and what other products were reclassified besides dental handpieces?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, it was predominantly dental handpieces, and that's pretty consistent to how the whole industry classifies handpieces. We felt it was a more efficient way to go to market through our territory sales representatives. We also brought on the cable (ph) line of handpieces from Danaher last year in the quarter, so we feel like we're a little under-represented on the handpiece side and we'll put a big focus on that. It really had no material impact in the quarter and the sundries number has been restated, so our 2.5% sundries growth, which we feel is, you know, definitely growing faster than the market, is a real solid number, and it was very consistent across geography and products. So we're excited about our handpiece opportunities going forward.

Kevin Ellich *Piper Jaffray – Analyst*

Got it. So just to be clear, Scott, you know, on an apples-to-apples, if you didn't make this reclassification, consumables would have been up 2.5% still?

Scott Anderson *Chairman, President and Chief Executive Officer*

Absolutely, yes.

Kevin Ellich *Piper Jaffray – Analyst*

Okay, gotcha.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes.

Kevin Ellich *Piper Jaffray – Analyst*

Then you called out Sirona's new software that they rolled out, the 4.3 version. I'm just wondering, you know, what does it do that the previous version didn't do, and I guess why do the dentists like it so much?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, you know, I don't want to get into the weeds on this, but there are some features in terms of margination and digital capture that actually were a little more efficient with the Bluecam than the Omnicam, and that—you know, so the former Bluecam users missed that feature when they went to Omnicam, yet the new Omnicam users had never experienced that so they were fine with that. So that really makes the leap from Blue to Omni even more intriguing for our Bluecam user base. It also is a much improved digital capture in terms of digital impressioning. So, you know, it really was a home run from the engineers at Sirona and, like I said, the sales rep feedback from our technology summit was great, but what I was very excited to see was really strong endorsement from the key opinion leaders in the CEREC community, so could not be more excited about the CEREC opportunities for our customers as we head into the busier selling season here in the fall.

Kevin Ellich *Piper Jaffray – Analyst*

Got it, okay. Then just lastly, on the Vet business, one, how are the conversations with the other diagnostic manufacturers going; and then, two, Steve, I think you made a comment about Vet margin was affected by some rebate changes, I'm just wondering if you can provide a little bit more color on that front? Thanks.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, at this time, I wouldn't want to give any specific details on any discussions we have, other than we feel Patterson brings really unique capabilities to the market, both in terms of our technical service and support, and what we feel is just the premier sales force in the veterinary space, so we couldn't be more excited about building new partnerships in that space, and I'll let Steve give a little color on rebates.

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

Yes, Kevin, as you know from following this industry and market, there's been a lot of manufacturer shuffling going on on some of the seasonal products, and because of that we were not able to pick up a rebate that we had last year at this time. So it was more due to the shuffling and new players coming into the marketplace than it was from any of our performance, per se.

Kevin Ellich *Piper Jaffray – Analyst*

Got it. Okay, sounds good. Thanks, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Kevin.

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

Thanks.

Operator

Next we'll hear from Jeff Johnson of Robert Baird.

Jeff Johnson *Robert W. Baird – Analyst*

Thank you. Good morning, guys. Can you hear me okay?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes. Hi, Jeff.

Jeff Johnson *Robert W. Baird – Analyst*

Hey. So, Steve, I'll throw my congrats out there and good luck in retirement as well. It's been a great 10, 11, I guess 11, 12 years working together so good luck to you. A question on the margins, if I could. Rehab margin, the EBIT margin, up to levels we haven't seen really I guess since 2009, 2010 or so. Is that being driven by some of the divestitures? How sustainable should we think that is going forward?

Then on the Dental side, I know on the operating margins, Steve, I think it was you who called out some of the comp costs in there. That makes sense. I would think with the mix on the lower upgrades, which I think the upgrades would carry lower margins, I would assume, you know, was that not enough to offset the higher stock comp or the higher comp costs? I'm just trying to figure out what drove that margin down, maybe the 40 basis points or so it did at the EBIT line this quarter.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, Jeff, I'll start with Medical. I think you're seeing some of the benefits from the actions we took in the fourth quarter to streamline parts of the business, and we have a team that's very focused not only on growth, but, more importantly, profitable growth. So I don't think you'll see quite as much margin accretion but you absolutely will see it throughout the year in the Medical business, and that's what their plan entails, and I'll pop it over to Steve for a little color on the Dental business.

Jeff Johnson *Robert W. Baird – Analyst*

Thank you.

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

The Dental margins, Jeff, you're correct, they did see some improvement from a lesser amount of trade-up activity, but that came through on the gross margin line. The operating expense was primarily due to some of the changes – there's a number of factors going into it, but the big change year-over-year was just the timing of that expense recognition that we had, and that's why you didn't see the margin improvement there. Strictly a first quarter phenomenon, you won't see that for the rest of the year.

Jeff Johnson *Robert W. Baird – Analyst*

All right, that's helpful. Then, you know, on the CEREC, you gave kind of the two parts, what was up, what was down. I think they were directionally almost exactly opposite last year in this quarter. So can you help us on a net basis or in the quarter what CEREC did, or I guess even more importantly, just kind of how are you thinking about the CEREC business as you run through the next four to six quarters or so? Is it a mid-single-digit growing business, an upper-single-digit growing business, or any kind of color you can put on that, as we bring the upgrades and the new system component sales together?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes. Yes, good question, Jeff. You know, I would say, from a comparability standpoint, I just want to remind everyone on two things, and that's a reminder that during the first quarter of fiscal 2013, which was the spring of 2012, we finished a very large trade-up program where we converted Red customers, Redcam to the Bluecam, and just as a reminder, that was critical to accomplish before the launch of Omnicam, which happened in the fall of 2012, because the new 4.0 software works only on Blue and Omnicam machines. So, back to first quarter and that's the spring of 2012, you know, just a sort of a blowout CEREC quarter on trade-ups. Then last year, we followed that up with obviously another very strong trade-up performance, where we delivered Omnicams to the Bluecam users, but from a volume perspective, it wasn't as large as the prior year. So I think bottom line, just to level set everyone, we feel like we're in a great position with our install base at this point in terms of satisfaction and opportunities going forward, and I think, Jeff, you're—yes, the good question in terms of there has to be some caution that we don't get wrapped around the axle on percentages when you talk about the timing of upgrades.

So our direction for our team is to really drive the new user base, and we'll be doing that this year up against some trade-up comparables, particularly in the second quarter, but at the same time we still feel like, and we know that there is a large opportunity out there to continue to move people from Bluecam to Omnicam. So it's a little tough to pinpoint the timing of sales growth, but we'll be very focused on new unit growth and winning competitive situations in the market, and based off our first quarter results which, you know, I would say were good but we really could have done better, we really will look to grow that new user base over the year. I hope that helps.

Jeff Johnson *Robert W. Baird – Analyst*

Yes, that does, thank you, and then the last two just very quick ones. ESOP expense, Steve, could you give us that in the quarter? Then just, Scott, any, you know, monthly trends? It seems like July, we're hearing, was a pretty decent month. Did that continue into August, but, you know, are we coming out of the quarter kind of on a little bit stronger footing than we might have gone into the quarter on?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, I'll start and then I'll turn it over to Steve on ESOP. Yes, we saw sort of a gradual acceleration throughout the quarter, which was good to see, and, you know, particularly from a consumable standpoint, we've seen that continue into August. It's a little harder to predict, obviously, the equipment business, but like I said in my answer earlier on, basically, we feel like the pipeline is strengthening. So once again, cautiously optimistic as we, you know, get August behind us here.

I'll let Steve give you some information on ESOP.

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

Jeff, we've never—I mean, we adjusted it last year. I think it was running about 24 million last year, 23, 24 million. Third quarter last year, we told you we were bringing it down as a contribution percentage. So right now, we're targeting about $11 million to $12 million of annual expense for the ESOP, so you'd spread that over the four quarters.

Jeff Johnson *Robert W. Baird – Analyst*

All right, great. Thanks, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Jeff.

Operator

Next we'll hear from Michael Cherny of ISI Group.

Elizabeth Anderson *ISI Group – Analyst*

Hi. This is Elizabeth Anderson in for Michael. I was just wondering if you could elaborate a little bit …

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

Can you speak up a little bit?

Scott Anderson *Chairman, President and Chief Executive Officer*

Hey, Elizabeth, can you speak up a little bit?

Elizabeth Anderson *ISI Group – Analyst*

(Cross talking).

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

(Cross talking) having a real tough time hearing you.

Elizabeth Anderson *ISI Group – Analyst*

Yes, sorry about that. Is that better?

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

Perfect.

Scott Anderson *Chairman, President and Chief Executive Officer*

Very good, thank you.

Elizabeth Anderson *ISI Group – Analyst*

Perfect. Great. Sorry about that. I was wondering if you could comment a little bit further on the competitive landscape of the CAD/CAM market, any changes you guys have seen sequentially or year-over-year.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, you know, as I said, we continue to be very pleased with our success rate in head-to-head competitive situations, and I've said this many times, you know, that we are very excited about the number of competitive products in the market and feel it's a really good thing long term for the CAD/CAM space, because customers have a lot of different options to look at, and also, I think this is a very important point, you probably have triple the number of industry sales people talking about the future of dentistry and how chair-side CAD/CAM is great for the patient and the dentist. So the advent of multiple products in the marketplace, I think, has done a great job of really validating the technology. We've been selling chair-side CAD/CAM for over a decade now, and I've said it many times, I still think we're probably in the early innings of what will be a major transformation for how dentists deliver great dental care and patients benefit from great efficiency and productivity. So an exciting time in the dental space.

Elizabeth Anderson *ISI Group – Analyst*

Great, and just as a quick follow-up, I was just wondering if you are seeing any pricing impact at all from that competition.

Scott Anderson *Chairman, President and Chief Executive Officer*

I would say minimal pricing impact. These are relatively smaller markets and, you know, one of the key things with any product is not only to sell it, but do you have the wherewithal to support the customer after the fact? So the economics of being able to drive technology, drive innovation, but also be able to support the customers, leads to a fairly balanced pricing environment out there, so I think it would be very difficult for anyone to have a very aggressive pricing strategy in this space and actually stay in business for very long.

Elizabeth Anderson *ISI Group – Analyst*

Okay, great. Thank you.

Operator

We'll go next to Robert Jones of Goldman Sachs.

Robert Jones *Goldman Sachs – Analyst*

Thanks for the questions, and, Steve, just also wanted to extend my gratitude for, you know, working with us over the years. Looking at the performance in dental equipment in the quarter, you know, quite a bit lower than what we were looking for. I know you guys called out about $8 million due to the re-class of the handpieces, and I know you mentioned also cycling out the CEREC trade-ups from last year. If I missed this, I apologize, but can you quantify what the impact was on the lower trade-ups on sales year-over-year? Then I guess more broadly, I know you're reiterating guidance overall today, but any comments you can share on how the equipment business has been tracking against the original expectations would be helpful.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, Bob, you know, we hate to break out by specific product category, but because the trade-up comp was so large, I think we'll be a little more transparent this quarter, just to make sure there isn't any confusion or there isn't anyone who thinks that somehow, you know, we're losing market share. It's hard to lose market share against yourself when the only thing that was down was the trade-up business. So the new unit business was up double-digit strong, basic equipment was up double-digit strong, our digital portfolio was flat, up against a tough comp, so really, the entire shortfall – and, you know, we won't give you the exact specifics – but the entire shortfall and negative sales growth was tied to trade-ups versus a program that was wildly successful. So I would say all in all, we feel very good about the underlying trends of our equipment business, and if anything didn't track to our internal plan, I think we could have done even more on the new CEREC units, but coming off a very large fourth quarter, sometimes you have the sales force take a bit of a breath before they move on.

Robert Jones *Goldman Sachs – Analyst*

No, that's helpful. Then, Scott, you mentioned the IDEXX move to direct distribution and how, you know, there's not expected to be a material impact to '15. Is there any sense you can give us, you know, as far as next year goes? I know it's a little bit down the road and there's some time to plan, but anything you could share with us as far as how you'll offset those losses? I know you've been investing in the sales force there. Is part of the plan for them to maybe go out and try to start switching vets to competitor products? I'm just trying to get a better sense of the strategy.

Scott Anderson *Chairman, President, and Chief Executive Officer*

Yes, Bob, I think it's too early to talk about those plans. I would say we'll probably have more clarity at our Investor Day in October and on our November call, but it's a little too early to reach out into next fiscal year.

Robert Jones *Goldman Sachs – Analyst*

Totally fair. Thanks so much, and Steve, enjoy your retirement.

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

Bob, thank you very much. Appreciate it.

Operator

Next we'll hear from Steven Valiquette of UBS.

Steven Valiquette *UBS – Analyst*

All right, thanks. Good morning, Scott, and for Steve, let me also say congrats on a great career. Now, I don't want to beat this dental equipment topic to death here but, you know, it does seem like there's always some volatility in dental equipment sales growth due to timing of CEREC promotions, et cetera, and I guess as a sidebar comment, I'm trying to figure out which dentists are buying this high-end equipment during the non-promotion periods. But I guess despite the quarterly volatility in your equipment sales, it's been pretty rare for Patterson to have two quarters in a row where dental equipment sales are down year-over-year, which is what just happened, and this may be sort of a tough question to answer on the fly, but I guess my question is, does it really make sense to continue to have these on/off cycles for promotions on such a high-end expensive product, where they buyer is probably savvy enough to wait for a promotional deal before buying or upgrading? So I guess what I'm just trying to better understand is the promotional strategy here. Thanks.

Scott Anderson *Chairman, President and Chief Executive Officer*

Well, yes, part of the Omnicam demand really wasn't promotional, it was innovation, and you go back to our quarter two years ago, you know, our first quarter two years ago, we were up 20%. So, you know, as a reminder, we sell over half the dental equipment in the North American market, and when customer demand is there like it was for Omnicam, we're going to meet that demand. In a perfect world, you know, I'm sure we'd love to just have smooth 7 to 8, 9, 10% growth every quarter, but this was really the launch of a new innovative product that, you know, we had thousands of orders for in the fall of 2012, and just from a supply chain perspective, couldn't get those orders in until we had enough supply of product. So you're right, our goal is to sell the product and help Sirona smooth out their supply chain as well, but when you have a product that was as hot as Omnicam was – and just as a reminder, you know, that 20% quarter we had two years ago, that was moving people from Redcam to Bluecam, which was critical to the success of Omnicam – that volatility just comes with the territory of being the distributor of the best CAD/CAM product in the world.

Steven Valiquette *UBS – Analyst*

Okay. How much of the promotional strategy is driven by Patterson versus Sirona? Then also, are you maybe feeling more pressure to do promotions this year if the competitive landscape has become a bit more intense for chair-side CAD/CAM crown restoration systems?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, we—you know, for over a decade, we plan our marketing and sales strategy in conjunction with Sirona, so we work as one team on that. Obviously, with more competitors, you know, you'll see different types of incentives and opportunities. At the end of the day, though, the technology wins out, and I think that's why CEREC continues to have a dominant market share, not only in North America but globally, it is the product of choice.

Steven Valiquette *UBS – Analyst*

Okay, got it. Okay. All right, thanks

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Steve.

Operator

Next we'll hear from Jon Block of Stifel.

Jon Block *Stifel Nicolaus – Analyst*

Great, thanks and good morning.

Scott Anderson *Chairman, President and Chief Executive Officer*

Jon.

Jon Block *Stifel Nicolaus – Analyst*

The vast majority of my questions have been answered. I'll try to drill down on two or three within the Vet space. The first one, Steve, you called out 7% growth in the US ex-NVS on the consumables side, but you also called out some products moving from agency to buy/sell, so did that aid the reported revenue growth of 7%, and if so, does that exist for the next sort of three quarters until we lap it?

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

The impact of the buy/sell really had no impact on our overall growth rate. It was a movement between primarily buy/sell vendors for us. So we had new buy/sell product coming in, but it was basically cannibalizing buy/sell that was already there, so it really had no effect on our growth. You know, our 7% is based on dosages and we look at dosages and that's really where the growth comes from. The 7 (cross talking).

Jon Block *Stifel Nicolaus – Analyst*

Understood, so …

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

It's revenue-based, but we confirm that with the dosages going out the door as well.

Jon Block *Stifel Nicolaus – Analyst*

Understood. So it wasn't agency to buy/sell within a manufacturer, per se; it was buy/sell to buy/sell amongst different manufacturers?

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

That's correct.

Jon Block *Stifel Nicolaus – Analyst*

Okay. Then, you know, I think Bob touched on this question earlier, maybe I'll try to ask it a different way, but you talked several times about mitigating the impact from losing the IDEXX line. Is mitigating specific to fiscal '15, because you're really only exposed for, you know, a stub, call it several months since IDEXX is terminating the deal Jan 1 of 2015, or is it mitigating in the context of you guys feel very confident that you'll be able to fill the void with the loss of the relationship?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, good question. You know, for clarification, we feel like we can mitigate the stub in terms of our fiscal year, and then we are fully committed to being a great partner to different manufacturers going forward, and that will play out over time. So I think it's too early to say right now. We will mitigate the entire impact in the next fiscal year, but that would be our intent and that would be our strategy. Our estimate for the entire year – Scott mentioned it earlier – is $0.04 to $0.05. There's a lot of ways to make up $0.04 to $0.05 when you put your mind to it and when you've got your organization focused on it.

Jon Block *Stifel Nicolaus – Analyst*

Understood. Understood, and my last one, Scott, you talked about strategy in different ways to fill it. I guess what's unique in the vet space and in clinic diagnostics is there are really only two, possibly three, manufacturers that have some mind share within the vet practices, and one obviously is going direct and two already has – number two already has a pre-existing relationship with MWI. So, you know, if we take a step back and, for some reason, the number two player stuck exclusively with MWI, could you talk to maybe what plan B is for Patterson? In other words, would you go ahead and possibly source this product yourself, or what is that other alternative? Thanks, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Well, I don't want to get into details right now, other than the fact that we feel like we have multiple options, but at the same time we feel like, from a manufacturer perspective, Patterson is a very unique partner in terms of our sales force and our infrastructure and our commitment to not only selling technology, which is a core competency, but, more importantly, supporting it after the fact. So I would say, you know, there will be a lot of potential manufacturers, if we did not have product, that would definitely be at our front doorstep looking at how we could grow together in the North American market.

Jon Block *Stifel Nicolaus – Analyst*

Understood. Thanks for your time, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thank you.

Steve Armstrong *Executive Vice President, Chief Financial Officer and Treasurer*

Thanks, Jon.

Operator

Our final question for today will come from Ross Taylor of CL King.

Ross Taylor *CL King – Analyst*

Hi. I have a couple of questions related to the Vet business as well, but, first, do you think the change in IDEXX's distribution strategy will create any M&A opportunities with the smaller regional distributors in the Vet sector?

Scott Anderson *Chairman, President and Chief Executive Officer*

Potentially. You know, we feel like we're a great strategic fit for many business owners, and we have a history of culturally really, you know, moving companies forward when they join the Patterson family, and if you look at our history, both in dental and vet, when the time is right for some of these companies, we would love to be the place where owners would entrust their business long term. But I would say our absolute laser focus right now is not on that, it's on taking care of our customers and building new relationships going forward.

Ross Taylor *CL King – Analyst*

Okay. Just a second and final question related to Vet, you know, you all have probably had a little bit more experience with the new Merck product, BRAVECTO, maybe close to two months of experience with that, but how is that performing out in the marketplace now, and is there any difference in how you go to market or sell that product compared to the other oral flea and tick product, NexGard?

Scott Anderson *Chairman, President and Chief Executive Officer*

You know, I think it's been an exciting year for innovation, and one of the things you always want to see from a distribution standpoint is that, you know, manufacturers are investing in R&D and they're moving the profession forward with unique products that help both pet owner and pet and improve efficiency. So I would say, ever since the NAVC, where a lot of these were launched, it's been a great year of innovation, and I think you'll continue to see that in the vet space as you have more, you know, I think industry focus by some of these pharmaceutical companies on animal health in general, so it's been all positive to date.

Ross Taylor *CL King – Analyst*

Okay, good. Thanks very much.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Ross.

Operator

There are no further questions at this time. I'll turn the conference back over to our presenters for any additional or closing comments.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, April. During the fiscal first quarter, we made progress on our strategic initiatives to improve on our offerings of best-in-class product innovation and services in order to fuel growth. We're focused on capitalizing on growth opportunities that lie ahead and look forward to updating you as we move forward into fiscal 2014 [sic].

As a reminder, we are hosting our annual Investor Day in New York on October 1st. We will send out formal invitations soon but, hopefully, you've received the save-the-date notification we sent at the beginning of the summer. We invite you to join us for a discussion of Patterson's growth strategies from our executive leadership team, including more in-depth information regarding NVS and our enterprise-wide IT initiative. This will also be an opportunity to hear from Ann as our incoming CFO, in addition to the leaders from our three business units.

Once again, thanks for taking time to join us today and we'll see you in October or on the call in November. Thank you.

Operator

That does conclude today's conference. Thank you all for your participation.