PATTERSON COMPANIES

EDITED TRANSCRIPT

PATTERSON COMPANIES 2nd QUARTER
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PRESENTATION

Operator

Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Patterson Companies' Second Quarter Fiscal 2014 Earnings Announcement. At this time, all participants are in a listen-only mode. Following the presentation, we will conduct a question and answer session and instructions will be given at that time. If anyone has any difficulties hearing the conference, please press star, followed by zero for Operator assistance at any time. I would like to remind everyone that this conference call is being recorded today, Thursday, November 21st, 2013, at 9:00 a.m. Central Time.

I will now turn the conference over to Ms. Ann Gugino, Vice President, Strategy and Planning. Please go ahead.

Ann Gugino *Vice President, Strategy and Planning*

Thank you, Ron, and good morning, everyone, and thank you for participating in Patterson Companies' Fiscal Second Quarter Earnings conference call. With me in the room today are Scott Anderson, our Chief—our Chairman and Chief Executive Officer, and Steve Armstrong, our Chief Financial Officer. After a brief review of the quarter by Management, we will open up the call 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.

The reported results for the second quarter of 2014 are significantly impacted by the acquisition of National Veterinary Services, or NVS, in the UK, and by the previously-announced decision to restructure the Patterson Medical unit. Please note that in this morning's conference call, we will be referencing adjusted results for the quarter, which excludes only the costs associated with the restructuring activity within Patterson Medical. Also, because the NVS acquisition had a fairly dramatic impact on our various operating ratio—ratios due to its margin and cost structure, in our press release, we provided a reconciliation for the ratios that adjusts for the NVS acquisition and the restructuring cost of Patterson Medical. We believe that this provides a better comparison against the historical results of the business and a forward perspective on the go-forward results of the Company. Since Regulation FD prohibits us from providing investors with earnings guidance unless we release that information simultaneously, we've provided financial guidance for fiscal 2014 in our press release earlier this morning, as well as in the financial slide presentation that can be found in the Investor Relations section of our website at pattersoncompanies.com.

Be advised that this call is being recorded and will be available for replay starting at 11:00 a.m. Central Time for a period of one week. And 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 reported a solid second quarter, with double digit sales growth and increased adjusted earnings compared to the prior year quarter. Consolidated sales reached nearly $1 billion in the quarter, at $998.8 million, and earnings were $48.7 million or $0.48 per share.

We are pleased with the progress we have made in many aspects of our business. For example, our NVS acquisition performed quite well and is positioning us to grow in the international veterinary market. Sales of veterinary equipment were robust during the quarter, with double digit year-over-year growth in that category. Sales in our Dental segment increased year-over-year but not as much as we had anticipated. We are focused on building stronger momentum in that unit.

Let's take a deeper look at our operational performance in the second quarter, starting with Dental. The business, which accounts for a little more than half of our total sales, reported fiscal 2014 second quarter sales of $563.1 million, which was nearly 3%—which was a nearly 3% increase versus the year prior period on a constant currency basis. We saw second quarter dental equipment and software sales rise nearly 5% from the earlier—year earlier level. Patterson Dental excels at providing customers with industry-leading technology, wrapped by a suite of value-added services. Our approach helped generate higher 2014 second quarter results in our Dental business. Overall, demand for the CEREC technology remained strong.

Also contributing to revenues in the Dental segment was a 2.3% rise against—again, on a constant currency basis in sales of consumable dental supplies versus a year ago. While Dental consumable sales were up year-over-year, consumable growth remained sluggish, as we have not seen any substantial improvement in the underlying macroeconomic factors that drive those sales, such as the unemployment rate. On a macro level, since the economic downturn, dentists have remained cautious about expanding or upgrading their basic practice infrastructure, which includes chairs, units and cabinetry. We continue to believe that there is considerable pent-up demand for these investments in their businesses. This factor, plus the growth opportunities from our technology offerings position us well as dentistry migrates to a digital platform, and as the dental market, post recession, returns to historical growth levels, we expect to benefit and gain market share.

Let's turn to Patterson Veterinary, which is responsible for nearly one third of our total sales. Second quarter fiscal 2014 sales for this unit rose 67% to $308.1 million. As the press release notes, the NVS acquisition contributed nearly $118 million to this segment. We are excited about NVS because of its market position and it offers us exceptional platform to expand Patterson's strategies into new geographic markets. We are very pleased, not only with the performance of NVS to date but also with the talented team of managers and employees there. Notably, the contribution from NVS was only for a partial quarter following the acquisition close in mid-August. We fully expect the investment in NVS to enhance shareholder value in the long term, validated by being immediately accretive to our fiscal 2014 full year earnings by $0.03 to $0.04 per diluted share.

Looking at our US Veterinary business, our second quarter sales gain stemmed from a nearly 2% increase in consumable sales, such as medications and supplies. The year-over-year growth in this category continues to be constrained due to last year's unusually severe tick and heartworm season. We had a 31% increased growth in the equipment and software category. We believe that the solid performance across all of our veterinary equipment lines indicates that our strategy to enhance our infrastructure and become a national and international technical service provider is working. Our priority remains to increase both our equipment and technical service offerings so we can take advantage of the favorable marketplace dynamics as consumers seek better clinical outcomes for their pets.

In order to demonstrate our commitment to delivering value-added services to our customers and enhancing their experience with the Patterson Veterinary team, we have added our—we at last expanded our team of sales representatives and service technicians. The number of reps has grown from 234 at the end of fiscal 2013 to 255 in the first quarter to 270 at the end of the second quarter. While many of these new sales people are focused on building the equipment and technology platform, we did add approximately 10 new territory managers late in the quarter and would expect sales contributions from these professionals as they continue to ramp up through the year. We see significant opportunities to grow Patterson Veterinary, and particularly, we believe fiscal 2014 is a growth year on the equipment side of this unit.

Turning to our Medical business, which represents approximately 13% of total Company sales; sales for Patterson Medical, our rehabilitation supply and equipment unit, declined nearly 5% to $127.7 million. Sales were essentially in line with our expectation for the period after adjusting for the reduced revenue associated with the divestiture of certain non-core Medical business assets in the quarter. By divesting non-core product lines, we can lower the operating expense levels of our European medical distribution operations and concentrate on more strategic business for Patterson. We believe that these actions will benefit our growth in those markets over the long term.

Beyond the divestitures, this market continues to be affected by the continual uncertainties surrounding this nation’s health care system and in international markets, from the ongoing austerity measures that have dampened demand for the past few quarters—few years. Although these factors are likely to persist in the short term, we are encouraged by our new Medical leadership team’s renewed focus and vision. Moreover, this business has very favorable demographic—demographics and we expect to capture future growth opportunities in the rehabilitation market. Patterson Medical has attractive operating margins, as well as industry-leading products and service offerings.

Next, I’d like to update you on our information technology initiative. As previously stated, we’ve undertaken this effort in order to support the Company’s future growth, further enhance the customer experience and secure future productivity gains. Patterson’s incremental information technology investment over the next five years is estimated at $55 million to $65 million. While approximately half of this amount will be capitalized or amortized, we continue to anticipate expensing an incremental $10 million on this key effort in fiscal 2014. The financial impact in this year’s second quarter from information technology investments was approximately $0.02 per diluted share. This project has reached another major milestone, as we are in the final stages of selecting our technology providers. We intend to begin moving aggressively into the design phase over the next few quarters.

We believe our informational—information technology investment is critical to providing Patterson with the flexibility to adjust our platform, as opportunities warrant, to create long-term shareholder value. In the meantime, our customers will continue to benefit from various improvements we will implement to our existing infrastructure. Our progress to date includes making substantial enhancements to our Dental and Veterinary websites, to provide a best-in-class experience for our customers as they seek to fulfill their practice needs. Also, Company-wide, we continue to roll out new sales tools that quickly and concisely put more market and customer information in the hands of our sales reps to build on our already strong customer service offering. We began the rollout to our Dental business in the first fiscal quarter and expanded the rollout to our Medical business in the second quarter, with Vet soon to follow. In our proprietary product lines, updated versions of our EagleSoft and IntraVet practice management software for the dental and veterinary markets are in the process of being released.

Going forward, Patterson Companies continues to have strong cash generation capabilities and a flexible balance sheet so we can take advantage of opportunistic acquisitions to augment our organic growth initiatives. Acquisitions remain part of our comprehensive capital allocation strategy, which also includes strategic investments, dividend growth and share repurchases. So, before I turn the call over to Steve, let me point out that while Dental revenue growth was lower than we had anticipated in the second quarter, we are pleased that our focus on Company-wide cost management initiatives helped to generate strong earnings in the period. We remain confident that as we work our way through markets that are sluggish and difficult to predict, we can provide earnings growth to our shareholders and while we continue to emphasize strong cost controls going forward, we remain fully committed to our planned technology investments and growth initiatives for long-term success.

Now, I’ll ask Steve to review the financials. Steve?

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

Thank you, Scott. As Ann mentioned earlier in this call, the impact of the NVS acquisition and the restructuring costs for Patterson Medical are fairly significant to our second quarter results. My comments will focus on our operating performance generally, excluding the impact of both (ph), which will provide a better comparability to the historical results. During this year’s second quarter, foreign currency exchange rate changes had a negative effect of 40 basis points on our consolidated sales growth, which is a larger impact than we have experienced in the past several quarters.

Turning to gross margins, we saw a slight decline year-over-year of 20 basis points that is primarily attributable to our finance business. We are generally seeing lower interest rates in the market and volatility at the longer end of the rate curve from quarter-to-quarter, which is reducing the gains recognized when we sell finance contracts.

Fiscal second quarter of 2014 operating expenses included an approximate incremental $3 million or $0.02 per diluted share for our planned information technology investments. Our adjusted operating margin in the second quarter was 9%, up from the prior year when you exclude the impact of the planned information technology investment. By segment, our second quarter adjusted operating margins were 9.4% for Dental, 4.7% for Veterinary and 13.1% for Medical. Note that operating margins for the Dental business include the information technology investments. Excluding IT and the NVS acquisition, we still expect to gain approximately 20 basis points of operating margin for the fiscal year. Incrementally, the Veterinary segment expense structure includes the cost from the increases in sales and technical service personnel, as Scott mentioned earlier.

Our adjusted effective tax rate in the fiscal second quarter was 35.6%. While our overall effective rate for the second quarter is relatively high at 37.9%, this is the result of the tax treatment for certain of the cost from the Patterson Medical restructuring. We are anticipating tax rates in the mid-35s for the final two quarters of the fiscal year.

Not including NVS, our DSOs were consistent with the prior year at 43 days for the quarter, while inventory turns were 6.5 compared to 7.0 one year ago. The majority of our balance sheet changes result from the NVS acquisition. Inventory also rose in the second quarter due to the continued rebuilding of our CEREC inventory after last year's successful trade-up program.

In the fiscal 2014 second quarter, our cash flow from operations totaled $72 million compared to $73 million in the year ago period. Our cap ex in the second quarter mainly consisted of regular ongoing expenditures, in addition to the planned investment in information technology.

Before I turn the call back to Scott for some closing comments, I will review our guidance for fiscal 2014. Based on our expectations for the second half and the stability in the underlying markets for our businesses, we are maintaining our EPS outlook of $2.13 to $2.24 for 2014. This excludes the $0.12 per share diluted impact from the restructuring charge in the medical unit we announced last quarter, of which $0.07 was recorded in the second quarter. This is primarily non-cash charges and we expect these actions will generate annual savings worth approximately $2 million, or $0.01 per diluted share, beginning in fiscal 2015. Again, our fiscal 2014 guidance is predicated on several assumptions that include stable economic conditions in our markets; modest operating margin expansion, excluding our planned information technology investment; and no impact from share repurchases that may occur during the remainder of the year.

With that, I'll turn it back to Scott for some closing comments. Scott?

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Steve. Entering the fiscal 2014 third quarter, we are poised to capture market share as we continue to exceed our customers' expectations. Our very strong strategic partnerships have resulted in a best-in-class product offering, and this is wrapped by Patterson's unparalleled service and support platform. As we've previously stated, the economic headwinds of the past five years have constrained consumer spending, as well as capital investments by our key (ph) customers. We continue to be encouraged as all of our markets are experiencing some tailwinds from favorable demographics.

Patterson is focused on efficiency and is well positioned for growth, and we are maintaining our EPS guidance for fiscal 2014. We are committed to generating long-term shareholder value through targeted investments, dividend growth and strategic share repurchases.

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

Operator

Thank you. Ladies and gentlemen, we will now conduct a question and answer session. If you have a question, please press the star, followed by the one on your touchtone phone. You will hear a tone acknowledging your request. Your questions will be polled in the order they are received. Please ensure you lift the handset if you're using a speakerphone before pressing any keys. One moment, please, for your first question.

And your first question comes from the line of Robert Jones with Goldman Sachs. Please go ahead.

Nathan Rich *Goldman Sachs – Analyst*

This is Nathan Rich filling in for Bob. Thanks for taking my question. If I could just first ask on the equipment side, I'd be interested to get your thoughts on the competitive dynamics in the marketplace right now. You know, one of your bigger competitors recently announced a deal to distribute its CAD/CAM to Aspen Dental. Could you just talk about what you're seeing around pricing and competition right now?

Scott Anderson *Chairman, President and Chief Executive Officer*

Well, I think, it's—Nathan, thanks for the question. I think it's a very exciting time in terms of the competitive landscape. The fact that we now have the number of competitors we do, I think, leads to the validity that digital dentistry and CAD/CAM dentistry is a part of the future, and we're excited for that competitive environment going forward. So to me, I look at the competitive landscape as a net positive because I think competition will accelerate decisioning—decision process over time with our customers, and I think it's always important to remember that there is a lot of opportunities out there over the next decade as dentists migrate to a digital platform.

Nathan Rich *Goldman Sachs – Analyst*

Thanks. And then sort of, the second question, if I could just ask on the consumables side, you know, growth was a little bit softer than in the first quarter. Could you just go into more detail about what you're seeing in the environment, you know, and your expectations for kind of continued stability going forward?

Scott Anderson *Chairman, President and Chief Executive Officer*

Sure. You know, when you—what we see as a stable market, you know, patient flow at the dental office continues to be stable but there has been no catalyst that has been an inflection point moving it upward. You know, we're still growing above market rates so we continue to take market share against the broader market, but obviously, it was frustrating to see that market slow a bit from what it had in the first quarter.

Nathan Rich *Goldman Sachs – Analyst*

Thanks for the questions.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Nathan.

Operator

And your next question comes from the line of Kevin Ellich with Piper Jaffray. Please go ahead.

Kevin Ellich *Piper Jaffray – Analyst*

Good morning, guys. Nice quarter. Scott, just wanted to start off on the Dental side. It looked like growth was a little lower than you expected, based on your comments. You know, equipment faced a pretty easy comp. How does, you know, the 4.8% growth compare to your internal expectations, and you know, what do you need to see in the back half of the year to hit your guidance?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, sure, Kevin. You know, obviously, we were expecting stronger growth in the second quarter. One of the issues we ran into – and I talked about it in the first quarter – the strong backlog we have for Omnicam upgrades for our Bluecam customers, and one of the issues we did run into in the quarter was the process of installing Bluecams to our—or Omnicams to our Bluecam customers. That process took longer than we had anticipated. Most of these customers are sort of our power users and our salespeople ended up taking more time in terms of the change management process. The good news is once we got through the training process, very high level of satisfaction; and then on the flip side, the new Omnicam users, that training process has gone incredibly well and as well, a really high level of satisfaction. When you look at the tail half of the year, when we look at how we get to guidance, it's not just dependent on equipment growth. We have the ability, and we do every year, to adjust our business plan midstream in terms of how we attack different parts of the business, and we feel comfortable that we can execute on the expense side, as well as continue to drive the revenue side, to meet our full year guidance.

Kevin Ellich *Piper Jaffray – Analyst*

Got it. I guess just two follow-ups there, Scott. One, how did basic equipment grow this quarter? And then, you know, last quarter, I think you made a comment on the call saying you expected double digit growth from equipment for the year – sorry to harp on equipment – but just wondering if you're still confident that you can still drive double digit growth there?

Scott Anderson *Chairman, President and Chief Executive Officer*

Well, I think it's going to be tough to drive net double digit growth for the full fiscal year from where we're at today. Our basic equipment business was down slightly the prior year. That is a business—a shared (ph) unit-light business that continues to sort of bounce off of a bottom of about a 20% decrease from 2009 levels, so the replacement business continues to be a tough business and we still are working with all of our partners on initiatives to drive new programs and new ways where dentists can look at refurbing their offices and building new offices. You know, the actual CEREC growth was very strong in the quarter. We just thought, with the backlog we had on the Omnicam, we would be able to put in more than we were able to execute on in the quarter and between those two things, explain the shortfall.

Kevin Ellich *Piper Jaffray – Analyst*

Got it, got it. And then just one last one; on the Vet side, you know, you saw some good contributions from NVS and strong growth in the equipment business. Just wondering, you know, what drove that strong vet equipment. Was that mainly diagnostics, or was there other components and do you expect that to continue?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, good question, Kevin. It was really across the board, so it was strong growth across the whole portfolio of products. Yes, while the percentages are big, I still will caution everyone that the base is small, but it—to me, very encouraging to see strong growth across the whole portfolio of products we sell in the Vet business.

Kevin Ellich *Piper Jaffray – Analyst*

Got it. Thanks, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Kevin.

Operator

Your next question comes from the line of Brandon Couillard with Jefferies. Please go ahead.

Sachin Kulkarni *Jefferies – Analyst*

Hi, Scott. This is Sachin in for Brandon. Thanks for taking my questions. Could you elaborate what you saw on a monthly basis in the Dental business throughout the quarter? Was consumables and equipment demand weaker in October around the government shutdown?

Scott Anderson *Chairman, President and Chief Executive Officer*

Well, there's no doubt that, you know, the government shutdown didn't do anyone any favors in terms of consumer confidence or uncertainty in the economy. I wouldn't call that out as a specific but, obviously, it didn't do anyone any favors, as I said before.

Sachin Kulkarni *Jefferies – Analyst*

Got it, thanks. Moving towards the Medical segment, what were the impacts of the product line divestitures to the overall growth rate?

Scott Anderson *Chairman, President and Chief Executive Officer*

(Inaudible), Steve.

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

It was about half of the decline for the period, so about 2.5 percentage points of impact.

Sachin Kulkarni *Jefferies – Analyst*

All right, that's it. Thank you very much.

Operator

And your next question comes from the line of Lisa Gill with JP Morgan. Please go ahead.

Gavin Weiss *JP Morgan – Analyst*

Hi, this is actually Gavin Weiss in for Lisa. You know, you mentioned that utilization continues to be light but that you're growing above the market. Without the underlying market trend turning around, can you talk about how much opportunity you think there remains to take a share from the smaller players?

Scott Anderson *Chairman, President and Chief Executive Officer*

Well, I still think, you know, particularly because of the breadth of our value-added portfolio we bring to bear with the customer, that we still have quite a bit of opportunity to grow our business, not only in the customers we have today but also to find new customers through the introduction of new technologies through EagleSoft, through CEREC, through introduction to digital x-ray with Schick, so we absolutely are very focused on continuing to grow business and not wait on the underlying markets to recover.

Gavin Weiss *JP Morgan – Analyst*

Okay. And then in terms of the share repurchase program, it looks like there was no activity in the quarter. What is your expectation for the remainder of the year, and what, if anything is included in guidance?

Scott Anderson *Chairman, President and Chief Executive Officer*

As I stated earlier, Gavin, there's no anticipated repurchases in our guidance numbers.

Gavin Weiss *JP Morgan – Analyst*

Okay.

Scott Anderson *Chairman, President and Chief Executive Officer*

Our outlook for the remainder of the year is that we'll continue to be opportunistic. With the acquisition of NVS during the second quarter, we still haven't placed anything permanent with regard to net financing and so until we've got that decision crystallized, we'll probably be fairly judicious on entering the market and buying back shares. But there will be some share activity; I'm fairly confident of that; it's just whether it would be in the third or the fourth quarter.

Gavin Weiss *JP Morgan – Analyst*

Okay. Thank you very much. That's helpful.

Operator

And your next question comes from the line of Steven Valiquette with UBS. Please go ahead.

Steven Valiquette *UBS – Analyst*

Okay, thanks. Good morning, guys. Just to clarify, the—as far as—a couple of financial questions here. Just to move from the $0.41 reported EPS of $0.48 suggests that you're only excluding the Medical restructuring cost, is that correct?

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

That's correct, Steve.

Steven Valiquette *UBS – Analyst*

Okay. So then in the slides and everything else where you're showing all these margin adjustments for NVS and for IT investment, that's sort of just for demonstration purposes, not to obviously try to get to a $0.48 EPS number.

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

No, you're correct. It's trying to—it's to make the historical results as compared to the (audio interference) current results. It's not (audio interference) where it's relevant.

Steven Valiquette *UBS – Analyst*

Okay, just wanted to clarify. Yes, I'm over in Europe right now, so I don't have the luxury of being able to plug in all the numbers real time but the other question, just you guys provided the size of the restructuring number on an after-tax basis, that 6.6 million, but what was it on pre-tax? Just so we can sort of try to adjust the tax rate (inaudible) the pre-tax medical restructuring cost number?

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

Without getting into a lot of details, Steven, the number was just about the same at the operating line and the net earnings line. The tax implications of those transactions that were involved in the second quarter basically netted out to zero, so there's really no offsetting tax benefit, if you will, from the expenses and the charges that we took.

Steven Valiquette *UBS – Analyst*

Okay. I think that's helpful, the words (ph) and the numbers, so okay. All right, thanks.

Operator

And your next question comes from the line of Jon Block with Stifel. Please go ahead.

Jon Block *Stifel Nicolaus – Analyst*

Great, thanks and good morning. Maybe just the first one to start on Vet; I think you talked about consumables up about 2% in the quarter year-over-year in the US. Do you have an adjusted number once you look at buy/sell versus agency?

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

No, that would be the number. We didn't change anything with regard to our arrangements during the quarter, Jon, so we've had no impact from switching from buy/sell to agency. Some of the competitors, I think—some of the other players in the market did change the way they went to market with certain of their products, but we had no impact from that.

Jon Block *Stifel Nicolaus – Analyst*

Okay. So unlike the other guys, you fully lapped that impact, if you would, Steve?

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

Correct.

Jon Block *Stifel Nicolaus – Analyst*

Okay, okay. And, Scott, maybe this one's for you. I mean, just on the basic equipment, you know, you talk about the accounts still being hesitant, the environment not being great, but you've alluded to that for, you know, several quarters or maybe even a couple of years now. I mean, is there anything that you can point to out in the field where you're starting to see that move forward or maybe thaw (ph) out, you know, some reps that believe some accounts are taking a closer look at finally upgrading their offices on the basic equipment side? Thanks.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, I mean, that's a great point, Jon, and I think that's part of our frustration. You know, as we've said before, we—we're the clear market leader in terms of the capital equipment business and are great believers in the return on investment customers have when they invest in our practices. We have a very stable market. Our customers have strong cash flows. Interest rates are low, and we think there's a very compelling story to be had about making investments now for the future, because when you look out over the next 10 years, dentistry is going to experience some nice demographic tailwinds in terms of an aging population needing more dentistry. So I think, you know, this part of our story we continue to work on with our customers is make sure you are prepared to the future of dentistry in terms of your infrastructure and your facility. You couple that with the technology side in terms of how do you leverage efficiencies and bring higher clinical outcomes through products like GALILEOS and CEREC and our Schick product, we feel it's a compelling story. That being said, we still are fighting a very cautious, conservative customer base right now.

Jon Block *Stifel Nicolaus – Analyst*

Okay. Okay, great. That's very helpful, and maybe just one last one. The commentary around the Omnicam upgrades, just taking a little bit longer to move some of the guys or train them on the move from Bluecams to Omnicams, that would suggest just that the tail will be longer when we think about the back half of your fiscal '14, so is that a safe assumption, that you know, you didn't let it all go in fiscal 2Q and we'll see some of those upgrades spill over to fiscal 3Q or 4Q?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, you're correct, Jon, on that.

Jon Block *Stifel Nicolaus – Analyst*

All right. Thanks, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks.

Operator

Your next question comes from the line of Jeff Johnson with Robert Baird. Please go ahead.

Jeff Johnson *Robert Baird – Analyst*

Thank you. Good morning, guys. Hey, Steve, I guess starting with you, on the core margin side, you know, obviously the business faced some margin pressures over the years, you've got the NVS in there, you've got the IT investments in there. But if I back that stuff out, and I know it's a lot of noise around that and you guys helped with the reconciliations at the end of the press release, but if I back that out, it looks like two quarters in a row core margins have stabilized, have actually gone up a little bit. I mean, does it feel like to you guys we're at the end of kind of a multi-year run here of some pressures and those margins now are at a defensible base, and once we drop out, some of these IT incremental investments and what have you, that we can get back to an expanding trend?

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

I couldn't have said it better myself, Jeff. We would agree with you.

Scott Anderson *Chairman, President and Chief Executive Officer*

And I would echo those comments, Jeff, and that's what we're committed to.

Jeff Johnson *Robert Baird – Analyst*

All right, that's helpful. And how much of that—Scott, I guess you mentioned in your prepared remarks or in maybe in the Q&A about, you know, you can adjust the cost basis if you need and what have you. How much of what we're seeing on the 10, 20 basis points of core improvement the last couple of quarters, I'm sorry, are you guys turning those screws down on the cost side versus truly seeing just some, you know, longer-term margin expansion opportunities?

Scott Anderson *Chairman, President and Chief Executive Officer*

I think it's more on the longer term, Jeff.

Jeff Johnson *Robert Baird – Analyst*

Okay, that's helpful. And then two last follow-ups. They've kind of been asked in the Q&A already, but let me—I want to come back to both points. One, just on the October questions, you know, your competitors, either on the distribution side or even some of the manufacturers, their numbers look sequentially pretty stable. On the consumables side, you guys showed some slowing, and you guys go into October, so it would suggest that October was kind of the cause there of maybe the sequential slowing for you guys versus others. And then if I go back to your Analyst Day, which was right at the end of September, it sounded like then you were still pretty confident about double digit equipment growth, and it doesn't sound like you're as confident today; you didn't deliver that in the second quarter. So, it sounds again, October you can blame there, so how much of it was October kind of government issues, as you said, maybe didn't help versus market softened, how—or maybe if you could dovetail in there what you're seeing the first few weeks of November here? Or any of that would be helpful.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, I think it's tough just—and I would never want to use the government shutdown as an excuse, but as the market, I think for everyone in the industry, has been tough to read over the last 12, 24 months, you know, November's off to a nice start. You know, part of that is our November had a little bit of the Hurricane Sandy comparable, but in terms of across the Dental portfolio, you know, November to date has been solid, without giving too much information. So, you know, I think what you may see in terms of comparability, us versus the rest of the market, could be a timing issue with months. I would tell you, as I talk to all of our top manufacturers, you know, I am absolutely confident in the statement that we continue to maintain and take share across our portfolios.

Jeff Johnson *Robert Baird – Analyst*

Okay. And the last question then would just be on the equipment side, the basic equipment being flat, or down a little bit this quarter, you know, it seems like your largest competitor has delivered some basic equipment growth, has now been leading you guys maybe for a few quarters. Is there something other than comps or anything else in the numbers, a different focus that maybe you guys are placing on tech that they might not be product line issues? Anything different between you and your largest competitor on the basic equipment side, why they'd be seeing growth and you guys aren't at this point?

Scott Anderson *Chairman, President and Chief Executive Officer*

No. The only thing I could maybe point to is they have a large exposure in the national accounts space, and that space has been fairly active in terms of de novo projects, so they could be seeing some growth from that segment which really, until recently, we haven't really competed in that spot.

Jeff Johnson *Robert Baird – Analyst*

Any early traction in that business for you, Scott? And then I'll drop.

Scott Anderson *Chairman, President and Chief Executive Officer*

You know, we're making good progress in terms of building out the infrastructure, making relationships, but you know, this is a long-term play.

Jeff Johnson *Robert Baird – Analyst*

Thanks, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Jeff.

Operator

Your next question comes from the line of John Kreger with William Blair & Company. Please go ahead.

Robbie Fatta *William Blair & Company – Analyst*

Hi, good morning. It's actually Robbie Fatta in for John today. Thanks for taking the question. Just a couple of quick ones on equipment still. Did you see anything interesting in the CAD/CAM for everything—everyone strategy? Do you have enough experience at this point to know which side of the market people are going to?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, thanks, Robbie. I think it's too early. The strategy's just begun, but I would say we're very excited to be able to go to the marketplace and offer customers different entry points in terms of pricing functionality and we think that will be a winning long-term strategy, and—but I would say right now, it's fairly early in that process, and right now, the majority of the interest across the board is still around the Omnicam.

Robbie Fatta *William Blair & Company – Analyst*

Got it, that's helpful. Second, in terms of promotional activity, is there anything interesting that you guys are putting into effect for the end of the year?

Scott Anderson *Chairman, President and Chief Executive Officer*

I would say nothing out of normal, but we always—you know, our third and fourth quarter are our large equipment quarters so we always put together programs with our vendor partners, but I would say nothing incrementally that is different from what we've done in the past.

Robbie Fatta *William Blair & Company – Analyst*

Got it. And then finally, in terms of NVS, it looks like it's annualizing at a little bit higher of a rate than we had initially expected. Is that a level that can continue or will we see a little bit of a drop off?

Scott Anderson *Chairman, President and Chief Executive Officer*

Revenue side or (cross talking).

Robbie Fatta *William Blair & Company – Analyst*

On the revenue side.

Scott Anderson *Chairman, President and Chief Executive Officer*

I think the revenue side; there's been some activity over there that's been positive for us, Robbie. I'd be a little bit judicious because this is only a partial quarter that shows up in these results and I wouldn't run too fast with that, but there have been some positive result—changes in that marketplace that will benefit us in—on the revenue side longer term.

Robbie Fatta *William Blair & Company – Analyst*

Okay, and is there anything that has surprised you so far with that acquisition?

Scott Anderson *Chairman, President and Chief Executive Officer*

Just how good they are.

Robbie Fatta *William Blair & Company – Analyst*

That's great to hear. Thanks very much.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Robbie.

Operator

Once again, ladies and gentlemen, if there are any additional questions at this time, please press the star, followed by the one. As a reminder, if you're using a speakerphone, please lift the handset before pressing the keys.

Next, we have a follow-up question from the line of Kevin Ellich with Piper Jaffray. Please go ahead.

Kevin Ellich *Piper Jaffray – Analyst*

Just a couple of follow-up questions here. Scott, on the CEREC upgrades, is this just a matter of timing? Is there enough inventory, or are you—is there any backlog billing that, you know, you guys don't have enough supply to meet the demand still?

Scott Anderson *Chairman, President and Chief Executive Officer*

No, we're in good position with inventory. As I mentioned in the first quarter, we really used the first quarter to rebuild inventory, rebuild our training centers in terms of having the right technology in that spot, so there are no supply chain constraints.

Kevin Ellich *Piper Jaffray – Analyst*

Got it, okay. And then, you know, in your prepared remarks, you made comments about adding a number of salespeople in the Patterson Vet business, and I think you even said another 10 territory managers. I'm just wondering if there's any specific geography or region in the country that you're focused on in that business.

Scott Anderson *Chairman, President and Chief Executive Officer*

It's determined by market need through our branch and region manager network, so I wouldn't point them in map or as any specific geography.

Kevin Ellich *Piper Jaffray – Analyst*

Okay. And then if I could squeeze one in for—a couple of questions for Steve. Inventories was up pretty meaningfully this quarter. I think you said that NVS contributed quite a bit of that. Was that entirely the reason, or was there anything else there, Steve?

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

No, I commented that there was—it was due to NVS, and in addition, we had some additional build in the CEREC inventories, as Scott said, to get them back up towards comfortable operating levels. And then there were some opportunities that we took advantage of on the consumables side from a couple of vendors that boosted that inventory a little bit.

Kevin Ellich *Piper Jaffray – Analyst*

And the opportunities that you took advantage of, was that Dental or Vet or both?

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

Mostly Dental.

Kevin Ellich *Piper Jaffray – Analyst*

Mostly Dental, okay. I was just wondering, you know, in the Vet business, we hear—we've heard that Trifexis is launching in Europe and just wondering if there was any inventory build based on that launch?

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

No.

Kevin Ellich *Piper Jaffray – Analyst*

Okay. And then lastly, Steve, could you break out the difference between volume and price on the Dental consumable business?

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

Not very specifically. I'm not prepared to do that on the call (inaudible) we could probably spend some time and work on it. But it's difficult to get the price versus volume on consumables because your mix is changing. If you're looking for how much is—inflation is in there, you know, we could give you our standard answer – it's usually between 1 and 2% – and there really hasn't been a lot that change in that.

Kevin Ellich *Piper Jaffray – Analyst*

Got it. Well, maybe I can win the stump-the-chump question then.

Scott Anderson *Chairman, President and Chief Executive Officer*

Well, you've got the chump part right.

Kevin Ellich *Piper Jaffray – Analyst*

Anyway, just kidding. Thanks, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Kevin.

Operator

Your next question comes from Ross Taylor with CL King. Please go ahead.

Ross Taylor *CL King – Analyst*

Hi. Two relatively basic questions, but you know, first, I wondered what it is about, you know, the upgrade from Bluecam to Omnicam that's just sparking the need for more training than you had initially expected and then my second question relates to NVS. Obviously, it's still very early days, but I just wondered if you've learned anything so far that—you know, on the positive or a negative side that may suggest this is either easier or more difficult to integrate into your existing operations.

Scott Anderson *Chairman, President and Chief Executive Officer*

Sure. On the upgrade to Omnicam, it's interesting. I mentioned earlier that, you know, the Omnicams are going to our really power-user CEREC base, and many of these customers use the product and features and are incredibly efficient in how they've used the Bluecam for, some of them, up to four years. So, the change management process was larger than we probably had anticipated going forward, or anticipated from the beginning. So, it's really just a matter of the CEREC specialist spending some additional time and getting the customer used to the fact that the way you take an impression with the Omnicam is different than Bluecam. You know, it's analogous for any of us when we change from one thing to the other, you know, I'll give you that anyhow (ph). I just got an iPhone yesterday after years of a BlackBerry and, you know, would love to go back to the BlackBerry today, but I know eventually I'll never want to go back to the BlackBerry. So, the great part about it is, after we get through the training process, customers love the Omnicam, they love the fact that there's no powder, but I think, in an interesting way, it just speaks to what a great product the Bluecam is.

Second piece on NVS, you know, what we've learned, with any acquisition, you know, one of the key things is people, and I think what I'm excited about is the quality of people we have in that organization, management on down. I think they're very excited to be part of the Patterson family. They're excited to be part of a long-term strategic player in the veterinary space, and, you know, it's been fun to watch our team in the US and the UK interact and start to brainstorm on areas where they can help each other. So, you know, obviously, there will be some things we find that will surprise us to the negative as well, but I would say, you know, out of the gate, the real huge positive is the people.

Ross Taylor *CL King – Analyst*

Very good. Thanks for taking my question.

Scott Anderson *Chairman, President and Chief Executive Officer*

You bet.

Operator

There are no further questions at this time. Please continue.

Scott Anderson *Chairman, President and Chief Executive Officer*

Well with that, we want to thank everyone for taking their time today with us. We look forward to updating you in February at the conclusion of our third quarter and we want to wish everyone a happy Thanksgiving and a great holiday season. We look forward to talking to you in a few months. Thank you.

Operator

Ladies and gentlemen, this concludes the conference call for today. Thank you for participating. You may now disconnect your lines.