# PATTERSON COMPANIES (PADILLACRT)

**Moderator: David Heinsch**
**May 26, 2016**
**9:00 am CT**

Operator: Please stand by. Good day, and welcome to the Patterson Companies Fourth Quarter Fiscal 2016 Earnings Announcement conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to John Wright. Please go ahead.

John Wright: Thank you, (Leann). Good morning, everyone, and thank you for participating in Patterson Companies fiscal 2016 fourth quarter earnings conference call. Joining me today are Scott Anderson, our Chairman, President & Chief Executive Officer; and Ann Gugino, our Executive Vice President & Chief Financial Officer. After a brief review of the quarter and the year 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, which could cause actual results to materially differ from those indicated in such forward-looking statements, are discussed in detail in our Form 10-K, and our other filings with the Securities and Exchange Commission. We encourage you to review this material. In addition, comments about the markets we serve, including growth rates and market shares are based on the Company's internal analysis and estimates.

The context of this conference call contains time sensitive information that is accurate only as of the date of the live broadcast May 26, 2016. Patterson undertakes no obligations to revised or update any forward-looking statements to reflect events or circumstances after the date of this call. Also, a financial slide presentation can be found in the Investor Relations section of our Web site at pattersoncompanies.com.

Please note that in this morning's conference call, we will reference our adjusted results for both the fiscal 2015 and 2016 fourth quarters, which exclude the impact of one-time transaction-related costs, deal amortization and foreign currency. Additionally, our discussion of results is adjusted to reflect the reclassification of Patterson Medical as a discontinued operation. A reconciliation of our reported and adjusted results can be found in this morning's press release.

Today's earning announcement and our discussion also reflect the realignment of our reportable segments. In addition to reporting our Dental segment, our Companion Animal business and our new production animal distribution business are now reported as our Patterson Animal Health segment. Our other and more centralized shared functions that were previously embedded within the Dental segment are now being reported in a separate corporate segment. This call is being recorded and will be available for replay starting today at noon Central Time for a period of one week.

Now, I'd like to hand the call over to Scott Anderson.

Scott Anderson: Thank you, John, and welcome everyone to today's conference call. I'd like to begin my remarks by discussing where Patterson Companies is today from a strategic standpoint, highlight the journey we are on and put our fourth quarter and fiscal 2016 into some important perspective. As we concluded fiscal 2015 a year ago and worked on fiscal 2016, we set on our path to transform Patterson Companies for a future of more sustainable, profitable growth. Our path to where we are today and where we are going is thoughtful, well planned and multi-dimensional. We know that to fully realize our ambitions it will require strategies designed to transform Patterson in multiple ways.

It involves ensuring that we are technologically advanced to not only serve the customers of today and tomorrow, but to take Patterson to increasing levels of efficiency, fundamentally repositioning our portfolio of businesses around stronger long-term growth markets and go-to-market approaches that are highly compatible.

Closely scrutinizing our existing operations as part of our portfolio evaluations to make sure we are fully optimized and positioned for the future, even in areas where we believe we are traditionally very strong, and lastly ensuring that as we drive this change we preserve and enhance the high performance culture that is made Patterson a leader and employer of choice.

In our 140 years as a Company Patterson has seen its fair share of market changes and has always stepped up to lead our chosen markets. Fiscal 2017 was arguably one of the most ambitious years of large skill change we have undertaken in a nearly century and a half. We took our initial transformational steps during the fiscal year beginning with the refocusing of our portfolio on two highly compatible growth focused businesses, and consummating the largest transaction in our history.

We moved forward with a pilot of our new ERP system, which we believe we will lead to whole new levels of operational effectiveness. We made significant strides in integrating our new animal health platform which is roughly 50% of our business, and capturing the synergies we committed this fiscal year, all while preserving our cultural strengths.

And we strengthened our leadership, attracting seasoned high level executives to our bench, and balancing our management team with both inside and outside perspective. Given the scope and sophistication of the initiatives we’re pursuing and pressured top-line performance in some areas, I am pleased to report that we were able to finish the year strong on the bottom-line.

Consolidated sales from continuing operations rose nearly 42% on a constant currency basis to $1.5 billion, reflecting the Animal Health International acquisition. And we ended the year with adjusted earnings per share from continuing operations of $2.47.

Looking at our markets, conditions were roughly unchanged compared to the last quarter, but there were some subtle changes in the complexion in our end markets during the fourth quarter that are worth noting. In Dental, we continued to see relative stable to steadily improving conditions.

Looking at market segment conditions affecting our Animal Health segment, the Companion Animal market like Dental continued to show stable to steadily improving characteristics. Certainly, the milder winter conditions provided some tailwind in our third quarter. However, the cooler damper spring conditions we experienced in our Q4, especially in the Northeastern United States weighed on sales of certain products. We remain confident in the prevailing market conditions that reflect solid employment levels, and consumer resilience.

Performance in Production Animal continues to reflect the softness in the livestock industry, especially in dairy and beef cattle markets. We’re beginning to see some signs of end-market improvement, especially in the swine market. This is part of the cyclicality of the livestock markets and we anticipate gradual improvement as we head into fiscal 2017. Against this backdrop, I’ll now provide some insights into segment performance starting with Dental.

While we’re generally pleased with the bottom-line results within Dental for the quarter, our sales performance was mixed even in spite of the tough comparable, and fell short of our internal expectations. Sales of consumables were generally in line with market, and with the exception of our fiscal 2016 third quarter consistent with sales performance trends over the past several quarters.

Sales performance and equipment, digital equipment more specifically is where we were more challenged and also were faced with the toughest comparable. Overall equipment sales fell 6.9% in constant currency, driven by lower digital x-ray equipment sales. In some ways, we believe these results are a function of our own success.

These intra-oral digital technologies have penetrated approximately 70% to 80% of the market and Patterson Dental has garnered the largest market share. Going forward, we see many opportunities across our digital platforms, particularly for Cone Beam technologies.

As I stated last quarter, the importance of properly supporting these technology investments is critical today, and will only deepen as we move forward and dental offices become even more digitized, providing support which help makes technology investments worry-free for the practitioner so they can focus on patient care, which will be an increasingly important differentiator for Patterson in the future. Dental offices that are embracing digital dentistry are looking for partners they can make, integrating these technologies into their practice environment, and supporting them seamless.

This means investing in and delivering best-in-class training programs, and highly effective technical backend support. The Patterson Technology Center provides our customers with the length to that seamless experience. The PTC is currently supporting over 100,000 end product users both in the Dental and Veterinary businesses. It took more than 1 million customer interactions annually or about 5,000 daily from practitioners who have placed the premium on the digital backbone of their practices. We fully expect the volume and value of these services to grow.

Turning now to core equipment, sales were largely flat and in line with our internal expectations. Throughout fiscal 2016 we proved our ability to enrich our basic equipment portfolio in a way that gives us a more sustainable long-term platform for future growth. ADEC has been and remains a very important partner to us, and we had a strong year with them. Our broader manufacturer relationships which included new editions of Pelton & Crane, Belmont and Sirona line of treatment centers helps us to be more flexible and support the needs of a wider range of customers.

Looking now at CEREC sale, our momentum in this category was very strong in the fourth quarter even in spite of the difficult year-over-year comparable CEREC sales had record levels. Clearly, there is tremendous enthusiasm for Sirona's new Zirconia workflow for CEREC and we capitalized on this recent product introduction. The Zirconia workflow combines CAD/CAM technology support with full-contour zirconia material. The prospects of adding high strength zirconia material to single-visit restorations has created fresh interest in and demand for chair-side restorations and we do not see this abating.

If there is any source of disappointment within CEREC sales for the full year, it would be a slower pace of trade ups. However, as we have said in the past, this is a testament of the strength of the Sirona platforms and the high level of customer satisfaction with their products and our support infrastructure. As we move forward our focus will be on expanding into new customer segments, seeking fresh opportunities to gain more reach, and intensifying our focus on sales execution.

Turning now to Animal Health segment, during the quarter we posted solid top and bottom-line results in both Companion Animal and Production Animal that were in line with expectations and reflect current end-market dynamics.

We need to keep in mind that while Production Animal market cyclicality has prompt producers to adjust herd size, producers must continue to manage the health of their animals regardless of market conditions, and we are the market leaders in helping them achieve this important objective. As we head into fiscal 2017, we anticipate improvements in producer level economics as animal pricing strengthens and producers look to increase breeding activity, especially in beef cattle.

This quarter in addition to favorable performance in our US Companion Animal business, we saw encouraging growth once again out of our UK division NVS. Sales in our Companion Animal business grew 8.2% in constant currency during the quarter. Sales growth at NVS our UK division added 5% on the same basis. We remain very impressed with the management and team at NVS. Their commitment to execution proves optimistic with the momentum in their business.

Sales from the acquisition contributed an additional $404 million to our Animal Health segment in the fourth quarter. Naturally, our ongoing integration efforts in our Animal Health segment are intense focused and we continue to concentrate on both operational refinement and sales execution across our entire platform.

In terms of synergy captured, today our sales, marketing and operation support functions are fully integrated and we are presenting one voice to the industry. We have fully rationalized all the core function within Animal Health and now can move towards optimizing our distribution footprint. I am very pleased with the assertive and positive approach the entire team has taken on this.

We recently completed strategic planning sessions for Animal Health segment and it’s encouraging to see such an intense focus on the customer and open sharing their ideas to better propel the business. This dynamic coupled with our success thus far in capturing synergies, gives us optimism that we can further build on the strong leadership position we already have.

With that, I’ll ask Ann to review the financials.

Ann Gugino: Thank you, Scott. As Scott mentioned, our effort to improve our operational discipline paid off during our fourth quarter and will continue to play an important role as we move forward towards sustained profitable growth. During the quarter, these efforts were clearly reflected across the number of metrics, such as operating margin expansion, improvements in working capital levels, and of course our bottom-line.

We are pleased to have met our annual guidance range for adjusted EPS from continuing operations for a second consecutive year. As I've done in the past, I will again discuss sales and adjusted results from continuing operations to focus on our current portfolio of businesses.

This past quarter was the third full quarter of contribution from Animal Health International, so, where appropriate, I will highlight organic sales which strip out the contribution from the acquisition currency effects and a change in selling arrangement from agency to buy/sell to provide a more normalized view of results.

Let's start with the top-line. Consolidated sales for the quarter totaled 1.5 billion up nearly 42% on a constant currency basis. Organic revenue growth rose 1.6%. Again for this quarter, the impact of currency translation moderated slightly. On a consolidated basis, currency translations reduced sales by approximately 1.1% which is down sequentially from 1.7% last quarter. We continue to anticipate that between 15% to 20% of our total revenue will come from international sources.

Turning now to margins, when examining margins it's helpful to keep in mind that the core rationale for our portfolio move over the last past year was to begin to build platforms for long-term growth and return on invested capital, in exchange for some margin dilution. Consolidated operating margin during the fourth quarter reflected that impact declining 80 basis points.

However, with the additional earnings contribution from Animal Health International, our operating income topped 119 million, up 28% over the prior year. The fourth quarter was solid in terms of operating margin expansion in both our Dental and legacy Companion Animal businesses, reflecting a range of factors from changes in product mix, synergy capture and improved operational discipline. Finally, on the bottom-line we posted quarterly adjusted earnings from continuing operations of 77 cents per diluted share.

Now, let’s move to our segments. In Dental, sales were essentially flat on a constant currency basis in the quarter. On that same basis, consumable sales were up 3.3% growing slightly faster than the end-markets in the categories we serve. As Scott mentioned, equipment sales were mixed and we had a large year-over-year sales comparable to overcome, 23.3% growth in last year’s Q4. Overall equipment sales declined 6.9% in constant currency on that tough comparable.

The decline mainly reflects lower digital x-ray sales, both in terms of volume and lower price point offerings. As we discussed during our call last quarter, we expected new product innovation and focused promotional offerings to enhance our Q4 CEREC sales and we are very pleased with our performance this quarter. CEREC sales were up low to mid single-digit reaching an all-time quarterly high.

Dental operating margins rose more than 50 basis points over the prior year. Again, this improvement was largely due to a blended factor including mix and operational effectiveness. Last quarter, we had forecasted that we are on-track to deliver operating margin expansion between 20 and 30 basis points in Dental for the full fiscal year. We ended the year with 26 basis points of improvements right in the middle of our range.

Now turning to our Animal Health segment. For the sake of clarity in this discussion, organic sales metrics exclude the contributions from the acquisition and currency, but includes the benefit of the change in selling arrangements for certain products from agencies to buy/sell. Please note that this change will continue to impact sales results going forward.

Organic sales in the segment rose 8.2% for the quarter, driven by solid sales performance in both the US and UK. Specifically, sales from the legacy US Companion Animal business were up 10.5% and UK sales grew by 5% in constant currency. US sales reflected that change in selling arrangements which added 2 to 3 percentage points of growth and consolidated Animal Health results. The sales contribution from the acquisition during the period totaled roughly $404 million.

With that contribution, sales for the consolidated Animal Health segment more than doubled from the prior year. The Production Animal market continues to be impacted by softness in some markets, particularly beef and dairy cattle.

We anticipate some end-market strengthening as we move into fiscal 2017 especially in the back half of the fiscal year. Operating margin excluding the acquisition in our legacy Companion Animal business improved nearly 50 basis points primarily reflecting higher sales levels and synergies.

After factoring in the acquisition, consolidated operating margin within the Animal Health segment increased nearly 10 basis points. We expect operating margins to continue to expand going forward. For the full year we had forecasted operating margins on an adjusted basis of 4% to 5% in this segment.

Adjusted operating margins rose 24 basis points to 4.6% which is right in the range. Regarding synergies, we made good progress and we estimate that our synergy capture came in on-target for the year. Our synergy focus in fiscal 2016 was on the integration of our Companion Animal salesforces, reducing our facility expenses, and lowering logistics cost. Moving into fiscal 2017, our focus will turn to more effectively leveraging our supply chain across both of our businesses and further consolidation of our back office functions. We remain on-track to achieve our stated goal of capturing between 20 million and 30 million in annualized synergies over a three year period.

Now a look at a few balance sheet and cash flow items. Last quarter, we said that working capital level should come down over the next few quarters and we finish the year strong. During the quarter, we more effectively managed working capital and generated solid cash flow.

Net cash provided by operating activities from continuing operations was over $242 million in Q4, an improvement over the first nine months of the year. For the full fiscal year, we generated cash flow from operations and was up $195 million compared to $205 million during the last fiscal year.

We remain confident in our ability to generate growing cash returns on our business and expect to return to converting between 85% and 100% of net income into free cash flow in fiscal 2017. CAPEX totaled $23 million in Q4 and included investments from normal replacements, as well as our corporate-wide information technology initiative. For the 2016 fiscal year total CAPEX came in at $79 million.

And let’s look at tax rates. Our adjusted effective tax rate for the quarter was 33.3%, while we did see some benefit during the quarter from a true book contingency reserve. For the full year our adjusted tax rate was unchanged compared to fiscal 2015.

Looking ahead we anticipate an uptick in the rate next year to around 35%. In terms of shareholder return year-to-date we have returned a total of 291 million to our shareholders through a combination of 91 million in dividends and 200 million of share buyback.

I’ll wrap up with the discussion of our fiscal 2017 guidance. First I’d like to echo Scott -- Patterson is a midstream in a process of repositioning itself for larger growth goals ahead. In fiscal 2017, we will continue to move through a period of intense execution on the range of initiatives that we believe are critical to top and bottom-line expansion. It is also helpful to consider the market dynamics we expect to face.

As we head into fiscal 2017, we currently expect the Dental market to continue growing at a pace of 2% to 3%. In Companion Animal we have anticipate 4% to 5% market growth, and in Production Animal we are expecting underlying market growth of roughly 2%.

The guidance range we are providing today does include as we began to discuss last quarter, a pretax $25 million step up in operating expense associated with the ERP implementation. As we explained, this investment will start depreciating as we move further into broader implementation during the fall. During this period, we will essentially be running redundant systems to help ensure a seamless transition to our new platform. This step up in expense which will began in the late fall, includes cost for depreciation, roll out and infrastructure support.

We believe our new ERP platform will lead to new efficiencies. However, some of them cannot be realized until the platform is fully implemented. That said we believe we have a sound process in place from migrating to our new system in a way that ensures business continuity and high levels of customer support, and leads to significant future efficiencies once the transition is complete.

I would also like to provide some framework on operating margin expectation. For fiscal year 2017, we expect consolidated operating margins to be flat to down slightly after absorbing the $25 million step-up in ERP expenses, the majority of which will be allocated back to our business segments.

In Dental, we are targeting operating margins between 13% and 13.5% and for Animal Health we expect operating margins to be flat with fiscal 2016. With all of this in mind, we are establishing our fiscal 2017 guidance range for adjusted earnings per diluted share from continuing operations at $2.60 to $2.70 per share.

Our guidance range assumes stable North American and international markets and excludes the following, the impact of additional share repurchases, new acquisitions and transaction related cost, integration and business restructuring expense and deal amortization. Lastly, we anticipate that the additional earnings per share that we expect to generate in fiscal 2017 will be relatively evenly distributed across the fourth quarter.

With that I will turn it back to Scott for some further comments.

Scott Anderson: Thanks, Ann. As I mentioned at the beginning of our call, Patterson will celebrate 140 years as a company in fiscal 2017. We have achieved countless milestones in that time and intend to reach many more as we move ahead. In fiscal 2016, we topped $5 billion in annual sales for the first time. We confidently met our full year synergy goals for the integration in our Animal Health segment.

Last quarter, we began the first pilot implementations for our next-generation system initiative, this involved six branches, two fulfillment centers and several corporate functions directly involving more than 1,000 employees. The volumes in these branches are testing well and we continue to refine this system weekly. I believe, we are well on our way to establishing a stable, modern, scalable ERP platform that will better allow us to succeed in any growth environment.

In Dental, we are bullish on the opportunities that lie ahead. We have built the product and technical competency in Dental that I believe will provide substantial differentiation and value for customers, especially those who strive to transform their patient experiences. However, we need to find ways to be more effectively shape our approach to today’s market and better address the needs of our customers. And in Animal Health, we are headed towards completing our first full year after adding Animal Health International to the Patterson family.

We can clearly see when you compare the customer profiles and their needs across both of our business segments that our customer profiles are evolving towards small, mid-sized and large customer categories, each has unique needs and different definitions for value and our business model is well suited to address all of them.

Finally, we remain committed to our three-pronged capital allocation strategy, we believe there are more acquisition opportunities out there that can allow us to build on the platform we have created in a capital efficient way. We will continue to explore these opportunities along with supporting our dividend and share repurchases.

Now we'd like to take your questions. I'll turn the call back over to (Leann).

Operator: Thank you. If you would like to ask a question please signal by pressing star 1 on your telephone keypad. If you are using a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment. Again press star 1 to ask a question. And we'll take our first question from Robert Jones of Goldman Sachs.

Nathan Rich: Hi. This is Nathan Rich on for Bob this morning. First, if I could start on dental equipment, just kind of looking at the year as a whole, sales were about flat on a constant currency basis. You know, Scott, you know, I think this is probably so much disappointing just, you know, given the end-market seemed to be pretty healthy and, you know, Dental seemed well into investment equipment and, you know, I feel like you do have the right channel partners.

So just wanted to get your perspective on performance for the year and any changes you think that need to be made on just, you know, how you go-to-market. You know, I know you touched on looking to new customer segments and sales execution. Could you just give us a little bit more detail there?

Scott Anderson: Sure. Thanks, Nathan. You know, I think when we look at the full year and I will put it in some context were as I said in my prepared remarks, I think we're very pleased in how we transitioned to a more expanded portfolio of traditional equipment partners.

We have a fantastic partner, legacy partner in ADEC and when we looked at the transition, and put our internal projections together we actually exceeded those internal projections. And sort of looking forward instead of looking backwards, we're really excited about the upcoming year.

ADEC has some significant new product launches in fact our entire equipment salesforce is in the process of being trained on each products at ADEC factories in Oregon.

And I say, bottom-line with the portfolios we have more access to more customers that is the constant feedback I have. I would say we were disappointed as we looked at our third quarter, which is the calendar fourth quarter that the section 179 issue did not get resolved, but are very excited that that has resolved and is part of the discussion today with our customers.

So as we look forward, we think the fundamentals are building and the foundation is building for dentists to actively invest in our products and Patterson has always taken a leadership area in terms of the technology and equipment sales.

Nathan Rich: Appreciate the color there. And then maybe just moving over to the Animal Health business, you know, on the production side, you know, end-market seemed it'll still be challenging. I was just wondering if would you kind of be willing to share what organic growth for the Animal Health International business, k looks like for the quarter and how that maybe compares for the 2% guidance you gave for fiscal '17. And then if you could just comment on synergies, you know, where we are as you exit the year and kind of what is baked into guidance for next year?

Scott Anderson: Sure. I'll start and I'll turn it over to Ann. So I want to be very clear that we talked about underlying growth rates of 2% not our internal plan. I would say when we look at the full year of their performance, we're pleased in their ability to deliver under tougher economic conditions and that's one of the legacy parts to that business. So I'll turn it over to Ann for, maybe Nathan repeat the question for Ann and exactly what you want to get out of the numbers.

Nathan Rich: Yes, yes sure, you know, just how the AHI business grew organically and then just an update on synergies kind of where you are, you know, exiting fiscal '16 and what you're assuming for fiscal '17?

Ann Gugino: Okay great. Thanks for repeating that. So organic growth for the current quarter was about 2 percentage points of growth on a pro forma basis and I would say that's pretty consistent with their year-to-date performance. We mentioned and in line with market growth, we have been looking at market share very closely and we believe we are maintaining our market share.

As we look forward, as we mentioned in our prepared remarks, we're looking at underlying market growth at 2% and we would expect to view a point or two better than that next year in the Production Animal business. So we'd expect to take some share there.

As it relates to synergies, you'll have the annualization of the current year synergies. So we build up to, you know, about a $9 million to $10 million run rate at the end of the current fiscal year. So that will continue to annualize into next year's numbers as well as you'll add-on building throughout the year, another $10 million, so that as you get to the end of next year, you'll be at an annual rate of $20 million.

Nathan Rich: Okay great. Thanks for the questions.

Scott Anderson: Thanks, Nathan.

Operator: And we'll take our next question from Ross Muken with Evercore ISI.

Elizabeth Anderson: This is Elizabeth Anderson in for Ross. I had a question on the Dental consumable trend. I wondering if you could sort of dig into a little bit more detail on sort of see you talk a little bit more about whether you sort of seeing that come through from any, you know, particular market segment or just sort of generalized growth? Any additional comments on that would be really helpful.

Scott Anderson: Sure. Thanks, thanks, Elizabeth, for the question. I would say we saw very consistent growth geographically and across customer segments. You know, there was a bit of a step down in the growth curve from the last quarter and I would attribute that more to the fact that the winter months in the industry were up against a pretty easy comparable and how tough the winter months a year ago.

So I would say there is really no underlying change in terms of utilization that we see, but continued, you know, really stable consistent growth throughout our customer base, both in our largest customers as well as mid-sized and smaller customers.

Elizabeth Anderson: Okay great, that's really helpful. And then as a follow-up, one of your competitors was pointing to sort of the potential growth that they are seeing in the scanner-only market. And I just wanted to get your thoughts and how you see sort of selling scanners versus like a full chair side solution? And that would be, yes would be helpful. Thank you.

Scott Anderson: Sure. You know, as many of you, you know, know if you know the Patterson story we've been a real pioneer and leader with our relationship with Sirona and others in sort of building digital platforms. And as we look to the future, we absolutely believe that the chair side CAD/CAM component will be a very important part of dentistry in the future.

But there will also be a component that will be attached to digital scanning and our current partners will absolutely be a part of that. If you look at your just pure volume and penetration right now, you know, there is no doubt that the CEREC system is the true market leader, but this will be a market that evolves in companies with great research and development and commitment to the future, will be the winners long-term.

And I think what we really like about our position in Patterson is and I talked about it in my comments is we have built an infrastructure to partner with the technology, you know, the fact that we're taking on and have over 1 million customer interactions a year on the digital side that we have a chemical infrastructure technicians that can visit practices that number is over a 1,000. We will be a partner of choice for many years to come to help dentists to integrate these technologies. So it's exciting to see how this space is evolving.

Elizabeth Anderson: Yes, definitely. Thank you.

Operator: And we'll take our next question from John Kreger of William Blair.

John Kreger: Hi, thanks very much. Scott in your press release you talked about Dental having same changing needs of the market and customers, can you just expand a bit on what you are seeing and what was behind that comment?

Scott Anderson: Sure. Thanks, John. You know, we absolutely see and experience and do business with customers that are moving into different market models, you know, from very-very large dental service organizations to practices that are evolving into one, two three, four, five practices within a geographic location.

So when we look at how do we use the power of Patterson and the relationships we have with our manufacturers to serve those customers, we know that it is not a one-size-fits-all strategy so we are building and continuing to build ways that we can serve dentistry and the Animal Health segment so there are a lot of synergies in terms of business models, how we can serve those different business models incredibly, effectively and really ensure customers' success regardless of practice size.

John Kreger: That's helpful. Thank you. And I think this was the first quarter where you were dealing with the newly combined Dentsply-Sirona any comments there, is there any sort of change in underlying strategy, given the new entity?

Scott Anderson: No as I would say we, you know, performed very well across the whole portfolio outside of some softness on the digital products. But, you know, we have been a great partner of the entire team over there Dentsply-Sirona as they are going through their integration, so we see nothing but very interesting opportunities going forward.

John Kreger: Great, thanks. And then one last quick one, Scott you mentioned digital x-ray is getting up to I think you said 70% to 80% penetration, should we start to think about that category more as a stable kind of replacement cycle type of business if you think that can continue to be a strong grower over time?

Scott Anderson: I think there is a lot of growth opportunities but you have to accept the reality that the market is maturing. And we have a history of building markets and sort of greenfielding markets and then watching then mature and then they become, you know, fantastic replacements and innovation markets.

So, you know, there is no doubt that the digital x-ray sensor and that is the -- I want to be very clear that's the one product that is getting to a higher level of penetration. You know, I would say they are still as a segment of our customer base that uses film and probably use film until they retire. But I don't want to have anyone think that there is not growth opportunity here because guilty manufacturers' innovate you'll see processes get better and the digital workflow will be a huge part of the modern practice.

John Kreger: Great, thank you.

Scott Anderson: Thanks, John.

Operator: And we will take our next question from Steven Valiquette with Bank of America.

Steven Valiquette: Thanks. Good morning, Scott and Ann, thanks for taking the questions. Yes I guess for me I need to start off with one on the Animal Health side, there have been a few other Production Animal Health companies that talked about some smaller sales of MSAs in the US, you know, maybe ahead of some kind of regulatory changes for reduction, and elimination of antibacterials and protein production. Can you just remind us whether or not Patterson has any material exposure to that situation?

Scott Anderson: You know, I'd say that's an issue that we spend a lot of time as we learn the market and through due diligence and we feel comfortable that as treatments evolve new products will be established that will replace older legacy products. We look at some markets in Europe that have gone through this transition.

And I get back to when you look at our business and if you really have to focus on where is a partner that helps the producer keep animals healthy. And there will be innovation that creates product that do that for the producers, so we don't feel there is a material exposure, but there could be a transition from one product to a new type of product.

Steven Valiquette: Okay got it. Okay. And then one other quick one here, I am not sure if this is still easy for you guys to quantify or not but within the new FY’17 EPS guidance and the 260 to 270, do you have a sense for the approximate amount of increment EPS accretion year-over-year from AHI that is baked into that assumption?

Ann Gugino: Sure so it’s obviously an estimate because as you alluded to we are integrating rapidly right, but if -- my estimate would be about 8 cents to 10 cents for next year.

Steven Valiquette: Okay that’s helpful. Actually one other quick clarification one too, you did highlight it in the press release, you know, the lower digital equipment sales were a culprit in the decline year-over-year for dental equipment, and there has been a few questions on dental equipment but just to clarify is that primarily, you know, digital x-ray equipment that you are alluding to, when you make that statement or is it a much wider portfolio of products that you are referencing when you talk about the lower digital equipment sales?

Scott Anderson: It is really digital but I also think it’s very important to clarify we were up against a very significant comparable from a year ago in fact our cone beam business a year ago was up nearly 50% so in no way do we want the signal that there is a slowdown in the Digital business.

One of that the interesting components and it will be a net positive is on the extraoral we introduced new products this year with our partner Sirona that are ortho SL. And I think what we are seeing bottom-line is that products are getting better, but price points are coming down but this brings tremendous value to the practitioner.

So, you know, we could not be more excited about the ongoing opportunity, but we did run into a bit of a headwind here in the quarter. Otherwise I would say the fundamentals of the Dental business were very sound but we also leave and enter the new fiscal year with a lot of urgency internally because we feel there is so much opportunity out there.

Steven Valiquette: Okay got it. Okay thanks.

Scott Anderson: Thanks, Steve.

Operator: And we'll take our next question from Jon Block with Stifel.

Jonathan Block: Great thanks and good morning, guys.

Scott Anderson: Hey Jon.

Jonathan Block: Hey, Scott. Maybe just two questions, first one for you Scott you mentioned that the early traction, you know, with Zirconia for CEREC and now that maybe you're a couple of months into the launch how would you characterize Zirconia's ability to sort of meaningfully accelerate new system sales, specifically you're seeing some doors open that were previously closed?

And then Ann just one for you down the same road, I think last quarter you called out some high levels of inventory specific to CEREC where you had the quarter, so where do you guys go with the inventory level specific to CEREC at year-end?

Scott Anderson: Great, thanks Jon. I'll talk to sort of the early feedback on Zirconia I think this is a story that's going to play out over the long-term and we take a long-term perspective on this relationship having been doing it for well over a decade. The initial feedback is the Zirconia really opened up doors once again for a large segment to the dental population so as to look at CEREC again. And we always get excited when the innovation curve allows us to do that because many times the impression of CEREC maybe a dentist who looked at the product 2,3,4,5 years ago.

So we have a lot of activity, you know, very pleased and I would say if there was risk going into the fourth quarter and when you have a new product launch and you have to train everyone up and you have to get the supply chain right and get the products in the right spot to serve the demand there is a lot of risk in that side, I could not be more pleased with our dental team and how they particularly our folks in the field and the branches are how they have met that demand for the customers.

So we are generally historically summer can be quieter a period of time. I think we'll have a lot of interaction with customers over the summer about Zirconia and I'll turn it over to Ann to talk about inventories.

Ann Gugino: Okay. Sure, so you might recall we were carrying higher levels of inventories but also higher levels in our long-term receivables for a number of reasons, you mentioned CEREC being one which was certainly the case because of the delay in section 179, but we also had -- we are carrying inventory levels higher than normal because of the consolidation and integration activities within the Animal Health business and SAP implementation.

So certainly we saw good reductions in our investments in working capital both in inventory and long-term receivables, certainly CEREC was a portion of that and you'll see inventory in total came down nicely about $90 million. I think there is still room to improve in terms of working capital in total and as we move into FY17 I think there is still room to improve upon that and as I mentioned in my remarks we expect to get back to that 85% to 100% of net income to free cash flow conversion next year.

Jonathan Block: Okay great, great, very helpful. And just one more sort of long one from me, Scott you know about a year and a half after ADEC's announcement to go direct and then obviously you've got a real solid partner with Abaxis but you seem to come out of the gate real strong and maybe a little bit more modest as a leader how do you view how that relationship has progressed over the quarters?

And then Ann just going forward will we just get -- would you sort of normalize and take it in other words going forward would that be all in Animal Health numbers now that diagnostics has been with you for a year plus? Thanks guys.

Scott Anderson: Yes, thanks, Jon. You know, as I said we were, you know, for years a great partner of ADEC and I have a ton of respect for the company, but at the same time I think we've established a great partnership with Abaxis and continue to incrementally grow that business internally and it remains a really high focus item.

With that being said, you know, I think one of the really exciting things that is coming out of the transformation of our Animal Health business is a real sense of excitement inside our Companion business about what we can do to help our customers.

So, you know, we think it's a great market with really strong underlying dynamics and we think the Patterson position is going to be position that is going to drive market share over the coming years. So continue to be very excited about that and within the construct of our go-to-market Abaxis continues to be a very important partner to us.

Ann Gugino: Sure. And then Jon, just in terms of the sales results, your right. The diagnostics change actually annualized into our results last quarter, but I think as you know within the Animal Health segment the terms and selling arrangements with the manufacturers do change from time-to-time it is what you saw this quarter with one manufacturer their sales moved from an agency relationship with us to a more traditional distributor role, which we refer to as buy/sell and so that change that happened this quarter did add about 2 to 3 percentage points of revenue growth to that total Animal Health segment and that change will continue to affect us for the next three quarters.

Jonathan Block: Got it. Thank you, guys.

Scott Anderson: Thanks, Jon.

Operator: And our next question comes from Jeff Johnson with Robert Baird.

Jeff Johnson: I'm sorry. Scott, can you hear me okay now?

Scott Anderson: We can. Hi, Jeff.

Jeff Johnson: Okay great. Good morning. So just a few questions here if I could, so first on Zirconia obviously the CEREC numbers was a good number especially against that tough comp, wondering if you could just update us on maybe capacity constraints there. I know Sirona has had some issues getting some of that out the door initially. So where are you with inventory or ability to get your hands on that product?

And how do we think about the opportunity potentially to do a Dry Mill upgrade over the next few quarters or is this going to be about in the first year, is it going to be about the supplying new users the Mill to begin with?

Scott Anderson: Yes, I would say we feel good about the supply chain. You know, there were some short-term issues on the Speed Fire Oven, but most of those have been rectified. And I would say just as we look at the Omnicam strategy two-three years ago, the strategy will be around new users here in the short to medium-term, but absolutely believe there is a growing opportunity longer term as people still have the opportunity to not only move into Omnicam, but also move into the Dry Mill and the Speed Fire with Zirconia. So exciting time in the CEREC community.

Jeff Johnson: All right, great. And then Ann a question for you just on the ERP expenses the $25 million. You know, I think there have been some discussion over the last few months about some of that could potentially be non-GAAP or looked at as kind of non-recurring expenses, and, you know, you chose not to do that look I actually applaud you for it and then just absorbing it into model, but I guess my question is as we think about fiscal ‘18 of those $25 million, are those new infrastructure expenses that stay in place or some of those kind of one timers in nature that could start coming out as we go to ‘18 just how to think about kind of what’s part of that $25 million this year?

Ann Gugino: Sure I think I might start by giving you a breakdown of the $25 million and some rough ranges, so what I would tell is about 20% to 25% of the step up is deprecation, keep in mind that is a partial year depreciation because we’re implementing it for about half a year, but about 20% to 25% of the $25 million step up is deprecation, about 25% is rollout and implementation cost so that’s the piece that you can think about that would go away right in the back half of ‘18 as we complete the rollout.

And then the balance is what is required to support the system. I think when you think about 2018 and how much comes out, you know, we expect to see some benefits in the back half of ‘18 because the training and implementation is done, you’re fully up and running and so now you can turn off the legacy systems and you can also now truly harness the benefits of the new system. But I am not ready to really publically quantify dollar amounts at this time as we’re still working on those estimates refining them.

Jeff Johnson: Okay, no, the breakout is helpful there. And then just my last question just on the production market, you know, I think you guys are talking about 2% market growth than slightly higher for the AHI business itself this year.

Scott I think you made the comment I was in and out of the call so forgive me if it was Ann -- if it was you instead, but I think you made the comment about, you know, expecting maybe a rebound in protein prices to support that 2% market growth this year, you know, as I look at futures it looks like beef and dairy futures have both taken a bit of a step down even in the last month, month and a half, so how much of that 2% market growth is subject to we need to see a rebound in protein prices or that can tied more back to just if we bounce along at these levels just wondering conceptually how you're thinking about that 2% market number?

Scott Anderson: Yes, as we spend a lot of time with the management team at AHI and this is a team that, you know, has really deep 10, 20, 30 year experience in the industry and we put our plan together really what they're beginning to see is a move and an expansion of the herd size as profitability gets better for the producer. You've got some people holding back calves this year, so we feel that that is what they have talked about, you know, the tailwind beginning to build throughout the fiscal year. So we feel really good about the market and our opportunity to really execute in that type of market.

Ann Gugino: The other place I would point you Jeff is the swine area, which is a significant piece of our portfolio and that's one where we're already starting to see some tailwinds in that area and would expect that to continue to improve.

Jeff Johnson: All right great. Thanks, guys.

Scott Anderson: All right thanks, Jeff.

Operator: And we'll take our next question from Kevin Kedra with Gabelli & Company.

Kevin Kedra: Hi, guys. Thanks for taking the question. First I just want to ask about CEREC you said you had a good quarter, just wondering if you guys have reached the necessary requirements for that first year of expansion of your exclusive agreement with Sirona I guess dent supply, can you just give a little bit more detail about kind of what the agreement looks like and where you're on some of those extenders?

Scott Anderson: Yes, I would say Kevin we have never spoken publically about the details of the contract. You know, we continue to perform and have performed well over a decade at the partnership but we don't discuss the contract specifics publicly.

Kevin Kedra: Okay. And thinking about the equipment business and I know in the past you guys have been talking about opportunities there for, you know, double-digit at least high single-digit growth just haven't quite seen that in the last year or two. Just how should we really be thinking about that business over the next two to three years especially as you talked about x-ray being, digital x-ray being a bit of a kind of maturing business?

Scott Anderson: Yes, I would say we would anticipate in the coming fiscal year mid single-digits growth. I would say the outlier to that potential upside would be if the section 179 tailwind really kicks in and we would get back to sort of 2008-2009 levels in terms of the core equipment business and you would see sort of historical levels of new office construction. So those would all be upsides to our model that are not included. So we would see stable growth in the coming fiscal year but would probably I would say lean towards optimism that this could be a year where we could begin to see growth trajectory move back up to a more traditional level.

Kevin Kedra: Great, thanks.

Scott Anderson: Thanks, Kevin.

Operator: And our next question comes from Robert Willoughby with Credit Suisse.

Robert Willoughby: Thanks. Scott, are you expecting any promotional activity on the equipment side this fiscal year or do you think that's weeded effectively out of the industry? And then was there any real disparities in the strength of the equipment over the quarter were winter months of February much stronger on easy comp or was it kind of a similar trend across all three months?

Scott Anderson: Yes, you know, our March, April time period is always a bit stronger. So I would say it was pretty traditional. I would say very good and also I think it's important to note there was nothing we did incrementally in terms of promotions in the quarter particularly around CEREC. So I think it was really good end-user demand and the strong sales execution. And I would say going forward, we will do nothing that would be out of our past practices in terms of promotional activity.

You know, without doubt the biggest promotion that is out there for small business owners is the benefits from section 179. So the fact that extension was made permanent and it's something we are talking about everyday today with customers, I would say it's probably the greatest potential tailwind for the industry as a whole.

Robert Willoughby: And the comment on acquisitions you have interest in doing them, you know, what's the likelihood though of you identifying and closing something this year, is it, you know, first half, second half it is geared towards or is it just, you know, hey we're always interested but nothing in the pipeline?

Scott Anderson: Well I'd say we're always looking, we have a lot of activity going on, you know, as we talked about one of our strategic intents that we laid out was an expanded view of the market. But at the same time we will be very disciplined with the capital and we'll look for good partnerships at the right price.

I wish I was smart enough to perfectly time when an acquisition would happen, but I would just say we're out there looking, we think we're a great partner and we would say -- talk a lot about, you know, this is the 140th year anniversary for Patterson and this is a company started by two brothers in a drug store. So over those times, we have combined with many other great businesses and family owned businesses and we'll continue to build those relationships. I would say from a internal capacity and from a financial capacity, we're in a good position to be able to integrate additional acquisitions at this time.

Robert Willoughby: And can you weigh in I know it is hard to say but Animal Health versus Dental, is Animal Health still kind of the better area right now or more geared...

(Crosstalk)

Scott Anderson: No I would say they are equally attractive.

Robert Willoughby: Okay. Thank you.

Scott Anderson: Thanks, Bob.

Operator: And our next question comes from Lisa Gill with JPMorgan.

Mike Minchak: It is actually Mike Minchak in for Lisa. So first on the dental consumable side, despite the sequential deceleration in constant currency growth rate you saw this quarter versus the strong third quarter, you mentioned in the press release that your growth was ahead of the growth in the end-market that you serve.

What do you estimate the end-market is growing at, you know, how is that accelerating versus historical levels and if so is that something that you view as more transitory and that you would expect to see improvements going forward or are we kind of in a normal here?

Scott Anderson: Yes, I would see the underlying markets are probably growing about 200 basis points when we look at our sales, market share with our major suppliers, the 3M, Dentsply, Cablecure, Danaher's we feel confident that we're taking share and growing faster than the underlying market.

You know, I think it's definitely an era of stability of right now in the Dental market and I would say if there is any bias over the next five years, it would be a bias towards an increase in market growth driven by particularly how strong the underlying demographics are in the North American market but currently you've got a underlying consumable market that we think is growing about 200 basis points.

Mike Minchak: Got it. And then maybe just a quick follow-up for Ann, can you talk about the exposure to Fx and what's incorporated into your 2017 guidance?

Ann Gugino: Sure so our main exposures just to remind are in the UK and Canada and we have got about 1% to 2% headwind baked into the guidance on the top-line.

Mike Minchak: Got it. Thanks for the comments.

Scott Anderson: Thanks, Mike.

Operator: And that does conclude our question-and-answer session for today. I'd now like to turn it back to CEO, Scott Anderson, for any additional or closing remarks.

Scott Anderson: Thank you, (Leann) and thanks everyone for joining us today. Again we're optimistic as we begin fiscal 2017 and we look forward to updating you on our results in the next quarter.

Operator: And that does conclude today's conference. Thank you for your participation. You may now disconnect.

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