PATTERSON COMPANIES

EDITED TRANSCRIPT

PATTERSON COMPANIES 3rd QUARTER
FISCAL 2015 EARNINGS CONFERENCE CALL

EVENT/DATE/TIME: February 19, 2015/9:00 AM CT

CORPORATE PARTICIPANTS

Leslie Nagel *Investor Relations*

Scott Anderson *Chairman, President and Chief Executive Officer*

Ann Gugino *Vice President, Chief Financial Officer and Treasurer*

CONFERENCE CALL PARTICIPANTS

Nathan Rich *Goldman Sachs – Analyst*

Kevin Ellich *Piper Jaffray – Analyst*

Glen Santangelo *Credit Suisse – Analyst*

Michael Cherny *ISI Group – Analyst*

Brandon Couillard *Jefferies – Analyst*

Robert Willoughby *Bank of America Merrill Lynch – Analyst*

Jeffrey D. Johnson *Robert W. Baird – Analyst*

John Kreger *William Blair – Analyst*

Steven Valiquette *UBS Securities – Analyst*

Ethan Roth *Stifel Nicolaus – Analyst*

PRESENTATION

Operator

Please standby. We're about to begin. Good day and welcome to the Patterson Companies' Third Quarter Fiscal 2015 Earnings Announcement Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Leslie (ph) Nagel (ph). Please go ahead.

Leslie Nagel *Investor Relations*

Thank you, Doug. Good morning, everyone, and thank you for participating in Patterson Companies' Fiscal 2015 Third Quarter Earnings Conference Call. With me today are Scott Anderson, our Chairman and Chief Executive Officer, and Ann Gugino, our Chief Financial Officer. After a brief review of the quarter by Management, we will open up the call up to your questions.

Before we begin, let me remind you that certain comments made during the course of this conference call are forward-looking in nature and subject to certain risks and uncertainties. These factors are discussed in detail in our Form 10-K and our other filings with the Securities and Exchange Commission. We encourage you to review this material. Also, a financial slide presentation can be found in the Investor Relations section of our website at pattersoncompanies.com.

Please note that in this morning's conference call, we will reference our adjusted results for fiscal 2014, which exclude the impact of the restructuring charge for the medical divestiture, as well as constant currency results for fiscal 2015. A reconciliation of our reported and adjusted results and foreign currency impact can be found in this morning's press release.

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

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

Scott Anderson *Chairman, President and Chief Executive Officer*

Thank you, Leslie. Welcome, everyone, to this morning's conference call. During the third quarter, we continued to execute on our strategic growth plan by enriching our product and service offerings, pursuing efficiencies, investing in our people and systems, and making the most of our expanded geographic reach. I am pleased to say that we made significant progress on all of these fronts.

The first half of fiscal 2015 was strong for Patterson, and despite flat revenues in the third quarter on a constant currency basis, we are on track to meet our financial objectives as we move toward the end of our fiscal year. Most importantly, we are confident in the strength of our business and encouraged by the stable and strengthening market conditions we are witnessing.

As detailed in today's earnings release, Patterson Companies consolidated revenues totaled $1.1 billion, which is roughly flat compared to the same period last year. On a year-to-date basis, our consolidated sales are up 8.9% to $3.2 billion. Earnings per diluted share were 55 cents during the quarter compared to 57 cents in the prior-year period, excluding medical unit restructuring costs. Through three quarters, earnings per diluted share have risen to $1.59 from $1.50 a year ago. As Ann will note later in the call, EPS in last year's third quarter benefited from a one-time non-cash stock compensation adjustment.

During the quarter, we saw several positive macro trends and made strides in all three of our business units. Let's take a closer look at our operational performance starting with Patterson Dental. Dental, which is our largest business, represents about 58% of our total sales. On the consumable side of Dental, we once again posted solid growth with sales rising 4% on a constant currency basis from the prior year. We believe this group reflects (ph) a combination of higher office visits and overall demand for dental services and the ability of our industry-leading sales force to meet the needs of our dental customers. Consumable growth continues to be supported by a steadily improving job market and consumer confidence.

On the Equipment and Software side of the business, we experienced a headwind driven by the uncertainty around the reinstatement of Section 179 tax benefits. This was a risk we foreshadowed in our second quarter conference call. Virtually the entire shortfall to our internal plan occurred from early November to the December 19 time period when Congress finally reinstated the tax benefits. From December 19 to the end of the quarter, our Equipment business performed at plan levels, but it could not make up for the shortfall created by the delay. We feel this was an industry-wide issue and do not see any change to our growth outlook to our Equipment and Technology in our fourth quarter or in our new fiscal year beginning in May.

Clearly, our partnerships with equipment manufacturers are a key factor in our success at Patterson. During the quarter, we announced our intent to broaden the range of products we sell in the basic dental equipment space. With the support of our long-time strategic partner, A-dec, we have built a reputation as the leader in selling dental equipment in North America. We look forward to continuing our strong partnership with A-dec and seeing many years of growth opportunities ahead for both companies.

In the coming months, we will announce new relationships that will expand the offering we bring to our guests. We have already noted the broadening of our relationship with Sirona, to over time introduce their market leading treatment centers to the United States market. We are excited to work with our partners to bring innovative products that enhance the productivity gains that technology affords our customers.

Patterson Dental is on the leading edge of the technology trends and digitization of the dental office. We believe that fundamentals are in place for continued growth. Our exceptional sales, training, and technical support infrastructure all position us well to capitalize on the digitization trend as it builds further momentum. Technology investments continue to be at the top of dentists' wish lists. Tax implications aside, demand for CEREC CAD/CAM units remains healthy and we are helping dental offices adopt and deploy this technology.

As I have stated many times before, we believe that the CEREC Chairside CAD/CAM platform truly has the potential to become the standard of care in dentistry. In early January, we held a meeting in Minneapolis with roughly 400 Patterson branch managers, CEREC specialists, equipment specialists, and territory representatives. The objective was to lay out our Company goal of achieving 30,000 CEREC users by 2020. This would double the CEREC user base in North America in the next five years. We will continue to work closely with Sirona to develop strategies to accomplish this goal. We will do everything in our power in terms of sales, marketing, and support infrastructure to help accelerate this tremendous opportunity.

As we have highlighted on the past several calls, we are committed to further expanding our product and service offerings for our Dental customers. In December, we acquired Holt Dental Supply located near Milwaukee, Wisconsin. This acquisition will help accelerate Patterson Dental's reach and deepen our Midwest influence. We are delighted to welcome Holt Dental to Patterson Companies, as they bring a long-standing and stellar reputation in their markets and maintain a culture much like ours, focused on accountability, integrity and customer service.

Moving on to Patterson Veterinary which comprises just under a third of our total sales, we believe the underlying market in Veterinary continues to perform well. We are well-positioned in both the United States and the United Kingdom. Pet ownership and the dollar amount people invest in vet care for their pets continues to grow. You'll recall that our go-forward strategy for Patterson Veterinary is to further diversify our equipment and technical service offerings to capitalize on the favorable marketplace dynamics. Patterson brings market-leading technical service and support capabilities, as well as deep premier (ph) sales force.

Pet consumables increased by 3-1/2% in the quarter and were impacted by a sales mix shift in pharmaceutical products sold under buy-sell arrangements to those sold under agency arrangements. We are confident in our manufacturing partner's commitment to investing in innovation and are optimistic that this, along with the promising pet ownership trends, will continue to benefit Patterson Veterinary.

On the Equipment side of Vet, sales increased 3-1/2%. Equipment and Technology will continue to be a growth opportunity and differentiator as we further drive our strategy to provide unique services that support the success of our Vet customers. We are still early in our transition from IDEXX to our new strategic partnership with Abaxis, but we are off to a good start and are pleased with Abaxis' placements today.

Abaxis is a leading manufacturer of point-of-care blood instrumentation and consumables to the veterinary market, as well as to medical and research customers. We are selling Abaxis' full line of veterinary diagnostic products, including external reference lab services and in-clinic testing. We are excited about Abaxis' products and people and are committed to securing the success of this new partnership.

Turning now to Patterson Medical, this is our rehabilitation supply and equipment unit and we have made significant progress here. This business represents approximately 10% of our total Company revenues. Our Management Team has worked hard to sharpen the focus of this business on select rehab markets and those efforts are paying off. We are pleased that Medical delivered its third consecutive quarter of growth, excluding currency and divestiture impacts. We are confident that our restructuring has created a strong platform and momentum in the business. We are the global market leader in physical therapy, occupational therapy, and sports medicine markets. Our Team is executing well against its strategic plan. We remain confident in our ability to capture additional market share as the underlying market conditions continue to stabilize.

We are optimistic at Patterson that we will finish the year strong with momentum heading into fiscal year 2016. With that, I'll ask Ann to review the financials. Ann?

Ann Gugino *Vice President, Chief Financial Officer and Treasurer*

Thank you, Scott. I'll start with some context on the top line. Nationally, foreign currency had a meaningful impact on our non-U.S. sales. About 20% of our total revenue comes from international sources. On a consolidated basis, sales were reduced by 1.2 percentage points for currency.

Turning to each of our segments, beginning with Dental, sales were down 2.6% on a constant currency basis year-over-year. In Dental, as Scott mentioned, we were pleased with our continued seasonable (ph) growth. After a strong second quarter in Equipment, sales were affected in the fiscal third quarter by the late reinstatement of cash incentives for equipment purchases.

Looking at Veterinary, as a reminder, our NVS acquisition closed more than a year ago, so those results are now considered organic. Vet sales were $337.8 million, up 3.5% on a constant currency basis. Breaking it down further, U.S. sales declined

1.9% and the U.K. sales rose 10.4% in local currencies. Total Vet revenues include several items. First, as you are aware, IDEXX took the products direct to the customer on January 1. We are replacing those products with Abaxis' line, but this does cause some disruption in the channel. That said, we are confident in the strength of our Abaxis partnership, as Scott said. Additionally, Vet sales in the quarter reflect the impact of changes in selling arrangements on certain products from buy-sell to agency on the pharmaceutical end of the business.

Regarding Medical, this unit performed well, as Scott noted. Sales in the quarter were up 2.6% excluding currency and divestiture impacts.

Looking at margins, consolidated gross margin was 28.5%, down 40 basis points from the adjusted fiscal 2014 third quarter. This reflects the impact of revenue mix with lower margin Veterinary revenues outpacing the U.S. Dental revenues. We are pleased with our cost control efforts during the quarter. Operating expenses on an absolute basis declined by $2.5 million. On a consolidated basis, excluding the impact of the medical divestiture, the operating expense ratio in the fiscal third quarter was 19.9%, which is in line with last year's level.

To help understand margin performance, it is useful to adjust for last year's impact of the medical divestitures, as well as the one-time non-cash stock-based compensation adjustment, most of which was in the Dental business. On this basis, consolidated operating margins expanded 20 basis points. By segment, they were improved in both Dental and Medical, and were flat in Veterinary. Specifically, operating margins for the quarter were 10.7% in Dental, 3.5% in Veterinary, and 11.6% for Medical.

As expected, our adjusted effective tax rate in the third quarter was 33.8% versus 35.2% in the prior year. We continue to anticipate an annual tax rate of approximately 35% for fiscal 2015. This will be in line with our annual tax rate for fiscal 2014.

Our DSO stands at 50 days, up 4 days from a year ago, reflecting the lower mix of equipment sales which are typically not financed through our trade receivables. Our inventory turns were at 6.7 compared to 6.5 a year ago.

Also, please keep in mind a few additional items on the balance sheet. A year ago we bought both a one-year time deposit and a two-year Guaranteed Investment Contract, or GIC, totaling approximately $100 million. Both are similar to certificates of deposits. When the one-year time deposit matured, the balance transferred to cash, and at the same time the two-year GIC moved from long-term to current assets.

Cash flow for the fiscal 2015 third quarter was basically flat at $59.7 million. On a year-to-date basis, cash flow from operations totaled approximately $158 million, up from roughly $150 million in the first nine months of fiscal 2014.

We also continued to execute on our capital allocation strategy by returning cash to our shareholders. During the quarter, we returned approximately $20.2 million to our shareholders in dividends. As you know, Patterson has $250 million of debt that is due in March. We are moving forward with a long-term extension of this debt facility. We remain confident in our ability to generate growing cash returns on our business investments and growth opportunities. Our cap ex in the third quarter totaled $14.3 million and included payments for normal replacements, as well as our Corporate-wide information technology initiative. For the fiscal 2015 full year, we are currently estimating cap ex of approximately $50 million to $55 million.

Finally, as you saw in our release, we are reaffirming our fiscal 2015 earnings guidance range of $2.20 to $2.30 per diluted share. While we did not provide quarterly guidance, I'd like to remind you of a couple of items that affect our fiscal fourth quarter year-over-year comparisons. Our performance in last year's fourth quarter was hurt by unusually adverse winter weather conditions and our resulting impact on utilization rates for our customers. Also, please keep in mind that we took a non-cash - I'm sorry - we took a nonrecurring severance charge in last year's fourth quarter. We're confident in our ability to close the year strong.

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

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Ann. As we move toward the end of our fiscal year, we remain confident in our ability to generate value for our shareholders and financially achieve what we set out to do this fiscal year through an array of strategies we have underway: enriching our product and service offerings, striving to make Patterson more efficient, investing in our people and systems, and making the most of our expanded geographic reach. We have made significant strides with our Corporate-wide information technology initiative, which is moving into the pilot phase. Our information technology investments are critical to improving scale in our business platform.

We have momentum at Patterson Medical, putting this business like our others on solid footing for future growth and market share gains. Last week, we took the leadership position on an issue we care deeply about. To help protect against potentially unsafe dental products entering the marketplace, in January we announced that we are formalizing our efforts to promote supply chain integrity for our Dental customers. We will share more details at next week's Chicago Dental Society Midwinter Meeting. This initiative demonstrates our commitment to ensuring the integrity of our supply chain for our Dental customers.

Now with that, we'd like to take questions. I'll turn the call back over to Doug.

Operator

Thank you. If you would like to ask a question, please signal by pressing star, 1 on your telephone keypad. 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 with Goldman Sachs.

Nathan Rich *Goldman Sachs – Analyst*

Hi. This is Nathan Rich on for Bob today. Scott, you talked about the goal of doubling the North America CEREC user base by 2020. Could you share your high-level thoughts, at least initially, just on what's needed to achieve this? I mean, does this require you guys to invest in the sales force at all, and are there maybe opportunities to expand the market? You know, I know that Sirona has talked about going more after orthos. Just any thoughts here would be helpful.

Scott Anderson *Chairman, President and Chief Executive Officer*

Sure. Thanks, Nathan. You know, we're very excited about the opportunity ahead with CEREC and believe we're at a very interesting time with the technology and with the marketplace and I really look at the opportunity around three areas and it will touch on your question. Number one is the customer. We're really dealing with the next generation of dentists that are embracing digital dentistry. Each year those millennials become a bigger part of the decision-making part of the customer base, so we look at that as a big factor in driving future utilization.

The second one - and it's a big one - is the product. Sirona just continues to innovate. You talked about the ortho expansion and I think you'll see more things come out of Sirona that help expand all of the things that a CEREC machine can do for the customer and for the specialists going forward. Each improvement with CEREC, it becomes easier, faster and it just produces better and better dentistry. And I would also add you have the materials innovations as well.

The last part - and that's our part at Patterson - and that's sales execution. So in terms of our commitment, our sales force is absolutely motivated, engaged in their role, and in helping change dentistry, and we also are willing to invest to make sure that we have the infrastructure that can support the after sales support for our customers.

I would say that this goal is very important to everyone in this Organization because, you know, at Patterson we're committed to being one of the many catalysts that helps CEREC reach a tipping point in the market and become the long-term standard in care and dentistry.

Nathan Rich *Goldman Sachs – Analyst*

Great. Thanks. And then, Ann, if I could follow up with a quick question for you; I think back at the Analyst Day you talked about being able to deliver kind of 30 to 50 basis points of operating margin expansion over time. You know, margins were down this quarter and I - it's probably fair to say that sales were below your plan. So, I kind of get the dynamics there, but you know, when we look going forward now that we've kind of fully integrated the NVS acquisition, what should we think about in terms of the margin trajectory from here, and, you know, as we look into fiscal '16, I mean, do you think that we will see operating margins expand?

Ann Gugino *Vice President, Chief Financial Officer and Treasurer*

Sure, Nathan. So, really, you hit on it. In the current quarter, in addition to a sales issue, I would also highlight it's really a comp issue with the prior-year quarter where we had some one-time adjustments. And then I would also just point out that year-to-date, excluding the incremental impact from NVS, our operating margins are flat. So we're pleased with the progress we're making this year. We believe we're on target to achieve probably around 20 basis points of margin expansion this year, because while we had a tough comp in operating margins year-over-year, this quarter we actually have an easier comp coming up in fourth quarter because of a) the weather headwinds, and then b), we took that one-time severance charge last quarter. So current year, we should end up with some modest margin expansion.

Looking forward, to FY '16, we continue to see opportunities to improve even further moving forward as we continue to drive operating efficiencies within the Organization, and I would - you know, depending on the revenue levels and where the market is, you know, we would target 20 to 30 (ph) basis points, higher than that if the revenues can accelerate.

Nathan Rich *Goldman Sachs – Analyst*

Great. Thanks for the questions.

Operator

And we'll now take our next question from Kevin Ellich with Piper Jaffray.

Kevin Ellich *Piper Jaffray – Analyst*

Good morning. Just a couple of questions, I guess. Scott, starting off in Dental, you talked about expanding, you know, some other relationships. Could you maybe expand upon that and kind of what areas you're looking at without giving away you know, who the relationships are going to be with?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes. We won't talk about specifics, but we will broaden the offering that we have in the traditional equipment space, and we'll be announcing some new partnerships probably at the beginning of the fiscal year. We also, as we've talked about over time, probably in the fall of 2015, we'll be bringing some of the Sirona products to the U.S. So we're excited about having really more options for our customers.

That being said, as I said in my prepared remarks, we will continue to be a great partner of IDEXX and think that long-term this is going to drive competition and drive, really I think, manufacturers towards tighter integration of technology, and that will benefit the dentists and put Patterson, I think, in the sweet spot of selling equipment.

Kevin Ellich *Piper Jaffray – Analyst*

Great. Great. And then I guess switching over to the Vet business, Ann, you talked about the mix shift from buy-sell to agency. If you excluded that impact, I guess, what would consumable sales have been?

Ann Gugino *Vice President, Chief Financial Officer and Treasurer*

Thanks, Kevin. So what I can tell you - and I would just remind you that in addition to the buy-sell mix that you're asking about, we did have one month of impact of the IDEXX to Abaxis change. But if we look specifically at the buy-sell versus agency, I would quantify that to say that it depressed our growth rates by about 3 to 4 percentage points, and then I would also just comment that our absolute dosages (ph) are up year-over-year even though the top line is down.

Kevin Ellich *Piper Jaffray – Analyst*

Okay. That's helpful. And then, Scott, maybe could you talk about the strategic direction and, I guess, where you want to drive the Vet business? You know, I think you've talked a little bit about expanding in that space and thoughts on further expansion in livestock or the production of animal business in the U.S. Is this something you can do organically over time or is this something you'd have to go out and look for a big acquisition?

Scott Anderson *Chairman, President and Chief Executive Officer*

Well, you know, number one is we love the animal health space and feel like we have got a great team at Patterson Vet, and there's many different opportunities that we could act on. Obviously, last year we were very pleased to act on the NVS acquisition and expand our geographic reach to become the number one distributor in the United Kingdom. And I would just say that one of our strategic intents at Patterson is to take a broadened view of markets, so as we look at the space we would be the type of company that I think could act on many different opportunities that are in front of us here over the coming year and beyond. But the long term, this is a great space to be in and it'll be one that we would want to invest capital to grow and grow at good returns for our shareholders.

Kevin Ellich *Piper Jaffray – Analyst*

Great. Okay. Sounds good. Thanks, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Kevin.

Operator

And our next question is from Glen Santangelo with Credit Suisse.

Glen Santangelo *Credit Suisse – Analyst*

Oh. Yeah. Thanks and good morning. Scott, just a couple of questions for you. First I want to talk about the Equipment business maybe in a little bit more detail. You know, on past calls you talked about, you know, the recent strength in Basic Equipment and it seems like sort of given the continued improvement in the consumable number, you probably feel pretty good about that. So maybe could you give us, you know, a more detailed assessment of what happened in this quarter between Basic Equipment and high-tech and, you know, as you think about sort of bringing, you know, Sirona's treatment centers to the U.S., could that be a meaningful opportunity for you?

Scott Anderson *Chairman, President and Chief Executive Officer*

Sure. Glen, just looking at the quarter, most of the shortfall was around technology. It was really around the digital products and CEREC, which are really the classic products that do well in that tax buying season. So our core equipment business was fairly stable throughout the quarter. You know, so I really - you know, when you look at what happened in industry-wide in November and December, I would say what we experienced was fairly consistent with the marketplace, and as I said in my prepared comments, really doesn't change our outlook going forward.

To the Sirona opportunity, we think there's a real nice opportunity at the higher end of the market when you look at many of our customers who currently own CEREC machines or GALILEOS machines that are looking for tight integration of technology. Those are products that we feel the United States and Canadian markets are absolutely ready for and are excited about the opportunity ahead. I think it's a little too early to quantify the impact, but absolutely upside growth opportunity for Patterson.

Glen Santangelo *Credit Suisse – Analyst*

Okay. Maybe if I just follow up with one other question on the Medical.

Scott Anderson *Chairman, President and Chief Executive Officer*

Sure.

Glen Santangelo *Credit Suisse – Analyst*

The Rehab business - I mean, it seems, you know, pretty clear that the restructuring efforts are starting to bear a little bit of fruit given it's, you know, the third consecutive quarter of growth. But on past calls you sort of talked about maybe taking a longer-term strategic look at this business, and I know you're in the process of spending, you know, some incremental cap ex on a new ERP system, and as you think about making investments, you know, throughout calendar 2015, it feels like you'll ultimately come to a strategical crossroads as far as that business is concerned. So I'm just kind of curious, has there been any update in your thinking or is it still to be determined or how should we think about, you know, how you think about things from a longer-term strategic perspective? Thanks.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes. Glen, great question, and we've been, I think, very clear about the strategic options for the Medical business and the fact that there potentially is a decision point around the implementation of our ERP. That being said, I could not be more pleased or proud of all of the employees at Patterson Medical and the Management Team and really the focus of that business. And I'm encouraged on sort of two fronts: one is just the pure execution against the strategic plan, but also the momentum in that business as we're starting to see signs of underlying market growth. And as we've talked before, there are really three big growth drivers for that business: in aging active populations, increased utilization, and access to physical therapy, and physical therapy's role in managing healthcare costs to create a strong backdrop to the opportunity ahead in the space.

So that being said, we continue to evaluate the strategic fit of Patterson Medical inside our portfolio, but feel really good about where that business sits today in terms of the execution of the Team - folks in Chicago and overseas.

Glen Santangelo *Credit Suisse – Analyst*

Okay. Thanks for the details.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Glen.

Operator

And our next question is from Michael Cherny with Evercore ISI.

Michael Cherny *ISI Group - Analyst*

Morning, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Hi, Michael.

Michael Cherny *ISI Group - Analyst*

I wanted to expand on Glen's question a little bit regarding Dental Equipment. You know, as you think about your Organization and think about the business and think about planning, I know that this is a business where you have a whole bunch of cyclical factors, particularly relative to consumables, but as you think about, you know, planning out for coming years, especially given that we're moving into fiscal '16, what do you think or how do you plan about what should be the run rate, you know, typical growth for the Dental Equipment business, you know, when you cut through all the moving pieces and one-timers on a multiyear basis?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, Michael, that's a great question. You know, when we looked at this year, we saw the strengthening of the traditional Equipment business. We had four consecutive quarters of growth up until this quarter, which was flattish in Equipment, and then over time we see a CAGR of 10%-plus on the technology side and we also - you know, as we looked at the year in terms of planning guidance, I think we did a very good job of creating a plan that - to handle short-term revenue shortfalls and that's why we're absolutely on target to meet our plans.

In fact, I think your colleague Elizabeth asked me the question last quarter about guidance and I sort of talked about strength in Consumables and if we had a strong third quarter in Equipment that would push us to the upper end and we would be able to mitigate any softness. So that absolutely goes back to how we plan out the year. The reality is - and we've been a market leader in selling equipment for well over 20 years - is there is a bit of lumpiness and a roller coaster to Dental Equipment unlike Consumables which are very pretty easy to predict and plan against.

Michael Cherny *ISI Group - Analyst*

No. I understand. And then, Ann, a question for you - and it may be a tough one to answer, but, you know, looking back at the model - and this is the first time I can recall in a long while where you haven't bought back shares or really bought back any shares for two straight quarters. Is there any change that we should think about relative to your thought process behind specifically where (ph) purchases, given the large outstanding authorization you have?

Ann Gugino *Vice President, Chief Financial Officer and Treasurer*

No. I would say there's no underlying change in the philosophy of capital allocation strategy. And I would just say that we can't really comment on why we're out of the market at this point, but we are - we were not in the market this quarter.

Operator

And we'll now go to our next question from Brandon Couillard with Jefferies.

Brandon Couillard *Jefferies – Analyst*

Thanks. Good morning.

Scott Anderson *Chairman, President and Chief Executive Officer*

Hey, Brandon.

Brandon Couillard *Jefferies – Analyst*

Scott, you mentioned that, you know, after the tax incentives were re-inplaced (ph) in late December, trends seemed to normalize in the Dental Equipment business. How did they fare in January particularly? And, overall, did Basic Equipment grow in the third quarter?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes. First, the Basic Equipment was flattish, maybe down a hundred basis points. The January business performed to our plan, but it - we couldn't make up for that gap that was created between early November and mid-December, which is sort of the classic time when dentists will sit down with their tax advisors and decide whether or not they're going to make equipment purchases. So it's not like those sales just moved into January. I would say January was a good month and we're off to a nice start in February year-over-year.

If there could be a potential really nice tailwind if the Section 179 is reinstated at a time like it usually is, which is usually early fall, we could see a very active equipment market next year in the calendar fourth quarter, the November/December time period, particularly against the backdrop where Consumables are growing nicely. Our dentists are getting busier, which means their practices are performing well. So everything would line up towards, I think, a very solid 2015/ 2016 trend for Equipment overall.

Brandon Couillard *Jefferies – Analyst*

Thanks. And then Ann, one for you, just in terms of the guidance, it implies an unusually wide range of outcomes for the fourth quarter. Can you just give us some color on just the rationale for sort of maintaining the range instead of narrowing it a bit with one quarter left?

Ann Gugino *Vice President, Chief Financial Officer and Treasurer*

Sure. Certainly we've adjusted our guidance range in the past, but at this time we think it makes most sense to keep our original guidance range for 2015. We had a really strong first half of the year, and then primarily due to uncontrollable factors like 179, we came in lower than last year in the third quarter, so we believe it's prudent to just maintain the range we set. You know, we've tried to share with you the various items that can affect our EPS one way or another, but I would just say our expectation is to turn in a strong performance for the fiscal year and we're confident we can deliver on the fourth quarter.

Brandon Couillard *Jefferies – Analyst*

Thank you.

Operator

And our next question is from Robert Willoughby with Bank of America Merrill Lynch.

Robert Willoughby *Bank of America Merrill Lynch*

Scott, on the acquisition front, is there any change to your view from a veterinary standpoint whether we'll capitalize player entering the sector also looking to do deals through the MWI merger, and how would you characterize some of the seller expectations overseas for some of the dental assets that you mentioned given divergent economies and currency issues?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes. I think we will absolutely be a player on the acquisition front in the animal health space and see multiple opportunities, both in the North American market and abroad. I would say seller expectations for Dental when you look at an international global perspective are very rational. As I've said on past calls and at Analyst Days, we have very good relationships with many of the large international distributors and would see Patterson as a strong strategic partner, and an exit partner for some of those businesses when it becomes the appropriate time for the family owners.

So when I look at the M&A pipeline - and you never can predict exact timing - I think there's plenty of opportunity in front for Patterson and we're absolutely well-capitalized to act on multiple opportunities that are going to be in front of us.

Robert Willoughby *Bank of America Merrill Lynch*

And on the Vet side, you know, would they be seeing the fray? All of our companies have cited, you know, opportunities to consolidate in the vet sector. I mean, how are the seller expectations there?

Scott Anderson *Chairman, President and Chief Executive Officer*

I would say it's too early to say, Bob. Obviously, that was an interesting evaluation and probably something we won't comment on here in the short-term, but the vet space is a great space and there's a scarcity of assets, so I think it's a great space to be in and we'll just continue to build relationships. Our President of our Vet business, George, is very well respected, George Henriques, and we think we'll be at the table for multiple deals in the years ahead.

Robert Willoughby *Bank of America Merrill Lynch*

And maybe just lastly on the dividend payout, I see it's kind of down year-over-year on absolute dollar terms. As your fiscal year-end, a time to revisit that, a logical timeframe to revisit the dividend?

Ann Gugino *Vice President, Chief Financial Officer and Treasurer*

Yes. You're right. We typically revisit it at year-end here and we would typically announce an increase in the next quarter. Our plan is to generally grow that with earning over time, so I think you can expect an increase. As it relates to the current quarter, it's really a timing issue and you'll see a little bit bigger payment in the next quarter. But it's just a timing issue in the current quarter.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes. As a reminder we raised the dividend 25% last year, so just a timing issue.

Robert Willoughby *Bank of America Merrill Lynch*

Okay. Thank you.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Bob.

Operator

And our next question is from Jeff Johnson with Robert Baird.

Jeffrey D. Johnson *Robert W. Baird – Analyst*

Thank you. Good morning. Ann, I wanted to start with you; a question on margins. Just, as I adjust for the stock option expense, and I think the ESOP issues in that from last year that created the tough comp this quarter, you know, once I adjust for those, it still looks like to me the Dental margins were kind of flat in a quarter where Consumables were up nicely and Equipment down. I'm just having trouble kind of reconciling that, and even into that having a little trouble understanding if the shift to agency should help margins. But those margins, even adjusting for the stock option issues, looked flat to down in the quarter. Just, can you help me out why the margin is down in periods where both those segments should've been helped?

Ann Gugino *Vice President, Chief Financial Officer and Treasurer*

Yes. I think there's a lot of moving pieces in the margins, so let me just take your questions one by one. As it relates to the Vet segment, I think what you're seeing there is just a mix between NVS and U.S. Vet on the consolidated rates, so we're up about ten basis points over prior year consolidated, but if you look at the individual segments, which you can't see, both are up. So it's really a mix issue because NVS growth outpaced the U.S. growth this quarter.

As it relates to the U.S., we might need to take that off-line and just take a look at your math because I show that we're actually up on an operating margin in the Dental business when I take out the ESOPs, so up just slightly.

I think in terms of the Consumable mix, you're right. You'd expect that to drop through because of the Equipment. What I would tell you is that as a result of the Equipment being lower, our financing income was also lower which is pretty profitable, so it's kind of a double whammy when we have a reduction in Equipment. So my guess is that's where the doubt (ph) is.

Jeffrey D. Johnson *Robert W. Baird – Analyst*

Yes. No, those both make sense and that's helpful. Thank you. Then, Scott, I guess just one bigger picture question on the CEREC doubling that penetration here over the next five years, you know, which I think we'd all like to see happen. But every survey we've done, every survey we've ever seen kind of points to pricing as the biggest hurdle on CEREC so (ph) I want a $100,000 box. And, you know, to double that penetration, at least by our math it looks like you'd have to literally increase your annual penetration by three to four folds. That's a huge move. For that to happen, do you think you can do it selling the high-end CEREC system north of $100,000 or does that have to come down? Just, you know, it's a big move and I guess I'm struggling to see how you make that move with these pricing dynamics, things like that.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, Jeff. It's a big move and it's also an aspirational goal for the Company and for our sales people and for our customers. But at the same time this is going to be an evolving market over the next five years. You're going to see a lot of innovation come out of Sirona. It is interesting because we do have products at multiple price points currently and still well over 95% of our sales are at the high-end because of the feature and benefits of the Omnicam and the full Chairside complement, as well as the return on investment. You know, we now have almost 16,000 CEREC users in the U.S. and Canada and have an incredibly low return rate, and consistently what you see is, while it is a high ASP, there probably is no piece of equipment a dentist can invest in that brings a higher return to the practice and more patient satisfaction in terms of a single visit.

So, you know, there's absolutely challenges in us not only accelerating to that type of rate of getting to 2,000 to 3,000 to 4,000 CEREC sales a year, but at the same time if you look at tipping points and adoptions of technologies, CEREC is right at that point where we believe that this technology is absolutely the future and can take off, and we're going to do everything on our end to make that happen.

Jeffrey D. Johnson *Robert W. Baird – Analyst*

Got it. Thank you.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Jeff.

Operator

And our next question is from John Kreger with William Blair.

John Kreger *William Blair – Analyst*

Hi, thanks. I had a question about the diagnostic component of your Vet business. Obviously, you only had a one-month impact here, but can you talk a little bit more about how long you think it'll take to really rev up your placements in Abaxis machines and ultimately how long you think it'll take before that becomes a bottom line growth driver for you again in the Vet business?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, John, I'll take that - and just to baseline everyone, as a reminder, we launched our relationship with Abaxis on October 1. We've gone through full training of our sales force. We also entered in a relationship with Antech during the third quarter, representing the external reference lab at Antech. And I would say we're very pleased at our early success in December/

January and I will also note, if you were at the NAVC meeting in January in Orlando, by far in my six years of attending that convention, it was the busiest I've ever seen our booth and we had a lot of interest in the Abaxis product.

That being said, this is going to take time. It's not going to be a case of clear winners and losers in one quarter. I'd say we're very pleased with our placements in the third quarter, and for competitive reasons we won't give that number. But I think you'll start seeing an impact in our fiscal '16 and beyond and we are excited about the relationship, and I think our sales force is absolutely excited and up to the challenge of helping make Abaxis a real big time player in the veterinary space.

John Kreger *William Blair – Analyst*

Great. Thanks. And then one follow-up on the Medical business; it sounds like that business is performing a lot better. Now that you've sort of restructured the portfolio and you're seeing some underlying growth, where do you think you can get the margin in that business back to? It's been a lot higher longer-term. Is this something you can get to 15% or better at the EBIT line?

Ann Gugino *Vice President, Chief Financial Officer and Treasurer*

Yes. I think that's about right. So if you look at the current quarter, the margins are down sequentially but that's really a seasonality issue. So if you look year-over-year - or quarter-over-quarter I should say - the margins are actually up slightly. So Q3 is our lowest sales volume quarter, but if you look at it on an annual basis, you know, we'll be in the low- to mid-teens this year; and I think you're right targeting about 15% for FY '16 is reasonable.

Scott Anderson *Chairman, President and Chief Executive Officer*

I think there's other opportunities and Mike and his Team are doing that in terms of how we structure the business. We made some investments in that business three, four years ago to build out infrastructure to really serve a decentralized model that's similar to Dental and Vet, and as that market evolved over the last three to four years driven by changes in the Affordable Healthcare Act, we've also begun to adjust the business model.

So there's multiple levers that the Team can act on to drive improved operating margin over time, and then with that business you get the tailwind and the volume increases. They'll absolutely see benefits from scale, as well.

John Kreger *William Blair – Analyst*

And, Scott, do you think those businesses are actually growing now - not your business but those underlying markets at this point? I know you said they're improving some.

Scott Anderson *Chairman, President and Chief Executive Officer*

I think we're starting to see some growth. You know, we're now the third consecutive quarter of growth at the Medical business and, you know, there is some segmentation inside that business. Our Acute Care Hospital business is growing very nicely and I think they're seeing definitely some underlying market growth and increased utilization.

John Kreger *William Blair – Analyst*

Great. Thank you.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, John.

Operator

And as a reminder, if you'd like to ask a question, please signal by pressing star, 1. And we'll now take our next question from Steven Valiquette with UBS.

Steven Valiquette *UBS Securities – Analyst*

All right. Thanks. Good morning Scott and Ann. So a couple of questions here; I guess first when thinking about the tax incentive issue for Dental, I just want to confirm that it seems less likely that there'd be an overachievement of Equipment sales in the upcoming fiscal 4Q '15 because obviously the incentive went away on December 31. So you probably have to wait until your next fiscal 3Q '16 to get some tax incentive related to upside again. Of course, that's assuming that the incentives are put in place again and hopefully in a more timely basis at the end of calendar '15. Is that the right way to sort of think about this whole thing?

Scott Anderson *Chairman, President and Chief Executive Officer*

Absolutely. Yes, Steve. You've got it nailed perfectly, Steve.

Steven Valiquette *UBS Securities – Analyst*

Okay. So the quick follow-up on that then is that Sirona, on their earnings cal, they mentioned that they were hearing from distributors that 2015 has started off better with the Section 179 incentive in place. So I'm not sure why that would be the case given their chronology and the incentive expiring back on December 31. So this may be a tough question, but do you know what they might've been referring to when they made that comment about, you know, from a viewpoint of distributors things getting better in early calendar '15?

Scott Anderson *Chairman, President and Chief Executive Officer*

Well, I think sales have gotten off to a nice start in 2015, but I don't think it's tax-related. It's just more of the normal course of business. So as I said, once we got into January, it wasn't like there was a spillover effect, but our January sales were right on the internal plan and we're off to a nice start in February. But the tax-related issue would really apply, I think, more to the latter half of the year.

Steven Valiquette *UBS Securities – Analyst*

Okay. The final quick one - I may have missed this earlier, but the Dental Consumables growth in fiscal 3Q, like we benefited from easy comps due to weather, given, you know, the problems last January. Is there any way to quantify that benefit maybe one percentage point or so lift that you might've got due to easy weather comps in fiscal 3Q; is that reasonable?

Scott Anderson *Chairman, President and Chief Executive Officer*

I would say that the tougher comps or the larger weather impact for us were really February/March last year and it was really driven around the severe weather in the Southeast and the Ohio Valley. Of course, it is a bit ironic to talk about that today when most of the country is below zero and they're having a tough sled year for a few days. But we would see a potential tailwind. We didn't quantify it last year, but we talked about the number of days our distribution centers were closed, which were a complete anomaly to prior years. I would say here in the Midwest we've had a very mild winter so we - there definitely is some weather tailwind potential. We probably saw the (inaudible) of it in January and we're off to a nice start in February in terms of our Consumable growth as well.

Steven Valiquette *UBS Securities – Analyst*

Okay. Got it. Okay. All right. Thanks.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Steve.

Operator

And we go to our next question from Jon Block with Stifel.

Ethan Roth *Stifel Nicolaus – Analyst*

Hi. Thanks. This is Ethan Roth on for Jon. A couple of questions here; just the first, a follow-up on the guidance being unchanged which implies a very wide range for 4Q. If the underlying Consumables markets are stable and maybe even improving slightly, can you just give us any direction on what could cause you to finish the year at the high-end or the low-end?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes. I'll start. I would say that the high-end would be driven by strong Dental Equipment performance and potentially some outperformance on the Consumables side, particularly Dental Consumables. That being said, I think as we said last quarter, we are fairly comfortable that we can mitigate some underperformance to meet the midpoint of our range. Ann, you want to add any additional color to that?

Ann Gugino *Vice President, Chief Financial Officer and Treasurer*

No. I think you nailed it.

Ethan Roth *Stifel Nicolaus – Analyst*

Okay. Great. And then just a question on Vet Equipment; year-to-date it looks to be down modestly. The division, you know, had been a big - put up pretty big growth numbers in the past and has been an area of focus for Patterson. Could you give us any, you know, color on your expectations for Vet Equipment to return to kind of that double-digit growth rate? Like, when can we expect to see that occur? Thanks.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes. Great question. We anticipate a strong end to the year and feel good about our pipeline. We are going through the learning process too with our sales force on how to sell and prospect and build pipeline and capital equipment, and also sell higher-end equipment like the cone beam machine we sell, which is well over $100,000. So I would say our progress is very good and we would definitely see - look for strong growth in the fourth quarter and have high expectations into our new fiscal year for Vet Equipment sales.

Ethan Roth *Stifel Nicolaus – Analyst*

Okay. Thanks very much.

Operator

This concludes today's question-and-answer session. I'd like to turn the conference back to Scott Anderson for additional remarks.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Doug. We're pleased with our progress that we made during the third quarter across our strategic initiatives. We took meaningful steps towards further solidifying and broadening our partnerships in ways that allow us to deliver more value to our customers. We think we're well-positioned as we enter our last quarter to deliver a strong quarter for fiscal year 2015. We continue to focus on capitalizing on the growth opportunities that lie ahead and enhancing our products and services.

Thanks to everyone for being on the call today. We look forward to seeing many of you next week in Chicago.

Operator

This concludes today's conference. Thank you for your participation.