PATTERSON COMPANIES

EDITED TRANSCRIPT

PATTERSON COMPANIES 2nd QUARTER
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PRESENTATION

Operator

Good day, everyone, and welcome to the Patterson Companies' Second Quarter Fiscal 2015 Earnings Announcement Conference Call. Today's conference is being recorded. At this time, I'd like to turn the conference to Leslie Nagel. Please go ahead, ma'am.

Leslie Nagel *Investor Relations*

Thank you, Augusta. Good morning, everyone, and thank you for participating in Patterson Companies' Fiscal 2015 Second 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 be referencing our adjusted results for fiscal 2014, which exclude the impact of the restructuring charge for the medical divestiture. A reconciliation of our reported and adjusted results 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, and welcome, everyone, to this morning's conference call. As you saw in today's earnings release, Patterson Companies' consolidated revenues rose 10.5% in the fiscal 2015 second quarter. Organic sales, which exclude the impact of the NVS acquisition and last fiscal year's medical restructuring, were up more than 7% over the prior year. Earnings per diluted share totaled $0.54 and were up 12.5% from adjusted earnings per share of $0.48 in the prior year period. Patterson Companies performed well across all three business units. Our continued focus on customer success resulted in our business model benefiting from scale and creating financial leverage. We are confident that our businesses will continue to execute successfully and sustain solid gains through the remainder of the fiscal year.

So with that as a backdrop, let's take a look at our operational performance in the second quarter, starting with Dental. This business, which accounts for a little more than half of our total sales, experienced growth in all categories. Sales for Patterson Dental rose 7.5% from a year ago on a constant currency basis to $601.7 million. We gained additional share in all of our markets across North America. We were pleased to see continued positive trends in sales of dental consumables, which increased 3.1% on a constant currency basis from the prior year. Accelerated consumables stem from increased patient traffic in dentists offices and solid execution by our industry-leading sales force.

Basic equipment growth, which includes dental chairs, units, cabinetry and ancillary products, were also very strong, posting double-digit gains in the fiscal second quarter. Notably, this marked our fourth consecutive quarter of core equipment growth. We are encouraged to see renewed activity in dental office remodeling and new construction, as this has long been an area of competitive strength for Patterson Dental. Contributing to our success is Patterson's strong partnerships with equipment manufacturers. Sales with our long-term partner, A-dec, were particularly strong, as dentists continue to look for the highest quality and value when investing in their practices. While we are encouraged to see ongoing growth in our basic equipment lines, let me remind you that the basic equipment category industry-wide has not yet recovered to its pre-2008 levels. This speaks to the ongoing opportunity.

Moving on to our technology products, we had a strong quarter of CEREC CAD/CAM sales. New unit sales of the CEREC Omnicam grew very nicely, posting double-digit year-over-year gains. Patterson continues to win in competitive sales situations, with Sirona's Omnicam leading the way. We also saw increased interest in customers moving to the Omnicam from their CEREC Bluecam system. This interesting further validates the benefits and functionality of the 4.3 CEREC software improvements that I referenced on our last call. Our confidence in Sirona as a partner and industry leader in innovation could not be stronger. We see the advent of competitive products as further validation that chairside CAD/CAM will be the long-term standard of care technology in the dental office. We at Patterson look forward to being a major catalyst for this exciting and positive change for our customers.

Our industry-leading sales, training and technical support infrastructure gives customers confidence that we are committed to their ultimate success when they make this investment in their practice for their patients. Again this quarter, we saw nice sales gains, with our Schick digital intraoral products as customers continue to seek the benefits that digital X-ray brings to their practice. The growth prospects for our technology offerings, combined with the fact that there is considerable opportunity for dentists to investment in their practices, position us well going forward.

In the quarter, we also entered into two new strategic partnerships in the dental space. First, while not immediately material to sales levels and earnings, is our partnership with Straumann, a world leader in tooth replacement solutions. Straumann's implant systems are among the best in the world in terms of innovative design, precision and quality. This partnership allows us to further assist the increase in standard of patient care for dental implants in the general dental practice in a very methodical and thoughtful way. The Straumann One system, which, used with the latest cone beam technologies, enables our customers to provide a comprehensive digital implant workflow to maximize quality, efficiency and safety for their patients. We see the long-term success of this program as additive to the specialist market, where Straumann has a successful direct sales model. We have a very structured training protocol for both our salespeople and our customers as this program rolls out nationwide over the balance of our fiscal year. We are excited to work with Straumann to provide education support and a superior product to benefit dentists and their patients.

Second, in late October, we announced a partnership with Quality Systems Inc., or QSIDental, which offers powerful and flexible software solutions that allow larger and more complex dental practices to operate more efficiently and cost effectively. We are excited by the potential of this partnership to add incremental revenue and further penetrate the large dental practice market.

Moving next to Patterson Veterinary, which comprises just over one third of total sales, second quarter sales for this unit increased over 22% from the prior year period to $376.5 million. The business performed well, both in the United States and the United Kingdom in the fiscal second quarter. In the US, sales rose 6.4% to $202.5 million. The US experienced an increase in consumable sales of medications and supplies of 7.4%. Sales of equipment were down from prior year levels to $8.2 million. We continue to see equipment and technology as a growth opportunity and differentiator as we execute against our strategy to be a national provider of veterinary equipment and services.

Earlier last month, we announced a new strategic partnership with Abaxis, a leading manufacturer of point-of-care blood, instrumentation and consumables to the medical, research and veterinary markets. Patterson will sell the full line of Abaxis veterinary diagnostic products, including external reference lab services and in-clinic testing. We are excited by the access our veterinarians will now have to the Abaxis state-of-the-art diagnostic technology as we work towards our core mission of providing quality veterinary care to our customers and peace of mind for their pet owners.

Turning to NVS, we had another quarter of strong contributions from our UK-based veterinary business, as the unit executed well during the period and captured additional market share in region. NVS has been a great addition to Patterson Companies, and we remain pleased with the integration process and the talented group of personnel that we have in place there.

As we've stated, our go-forward strategy for the Veterinary business is to focus on increasing the diversification of both our equipment and technical service offerings in order to take advantage of favorable marketplace dynamics as pet ownership and the dollar amount people invest in veterinary care for their pets continues to grow. We believe that Patterson brings unique capabilities to the veterinary market, both in terms of our technical service and support and what we feel is the premier sales force in the industry.

Moving now to Patterson Medical, our rehabilitation, supply and equipment unit, which now represents approximately 11% of total Company revenues. We were encouraged to see sales growth for this unit's ongoing operations in the fiscal second quarter, reversing the trends of the past several quarters. Sales in the fiscal second quarter were up nearly 2% from prior levels after accounting for the planned divestitures of non-core product lines that began in the fiscal first quarter of 2014. With the divestitures now behind us, we have aligned our business around those areas that have the highest strategic value. Our renewed focus and strategic execution is having the desired effect on the segment and the unit is poised to capture additional share as the underlying market conditions continue to stabilize.

Our team has done a great job of managing and streamlining this business in the past year. They are now focused on organic growth and taking advantage of the competitive position we hold as the global market leader in the physical therapy, occupational therapy and sports medicine markets. Overall, we are pleased with the progress of Patterson Medical and know there is much opportunity ahead for this business.

Next, I'd like to cover our corporate-wide information technology initiative. As stated previously, we've undertaken this effort in order to support the Company's future growth, further enhance the customer experience and secure productivity gains going forward. We see this as a multi-year effort to overhaul our primary systems and review all of our internal business processes. The project thus far is on schedule and in scope. As we outlined in our Investor Day presentations last month, we are taking a phased approach to this project. We have completed the blueprinting stage of our IT investment. Now we are in the build-in and realization phase. We will update you in the coming quarters as we begin piloting and stabilization before heading into the final stages of implementation and deployment. Our information technology investments are critical to improve scale in our business platform, and we believe you saw that play out in our improved fiscal second quarter performance. Our customers will continue to benefit from improvements and we will enhance the customer experience and shareholder returns as we further execute on the strategy.

On a final note, in today's press release, we reaffirmed our EPS guidance range of $2.20 to $2.30 per diluted share for fiscal 2015. We remain focused on execution, first, on capitalizing on the growth opportunities available through the investments we are making; and second, through our strategies to further enhance our product and service offerings. In summary, we are well positioned as we enter the second half of the fiscal year, when we experience our heaver sales volumes.

Before I turn the call over to review our financial results, I'd like to take a moment to welcome Ann Gugino to her first earnings conference call as Patterson's Chief Financial Officer. Ann has been a key leader in both financial, management and strategic planning for Patterson for more than a decade. Many of you have already had the opportunity to interact with her and, no doubt, recognize her deep understanding of Patterson's operations and her superior business and financial acumen. We look forward to visiting with those of you who we have not had a chance to meet yet with Ann, and I'd like to take this opportunity to again thank Steve Armstrong, who helped facilitate a seamless transition of our finance function.

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

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

Thank you, Scott. Before I begin the financial review, I'd also like to thank Steve for creating a smooth transition and for his guidance and support over the years. I also want to thank all of you, who have welcomed me into this position, and I look forward to working with you in the future. With that, let me review our financial results.

Please note that this quarter is the last quarter that the NVS acquisition will have any impact on the year-over-year comparison. Additionally, the NVS acquisition had only a three-week effect on the fiscal second quarter comparison. It impacted year-over-year diluted EPS by less than $0.01 in the quarter. To demonstrate and focus on the underlying performance of our core business, all of my comments this morning will exclude the impact of last year's NVS acquisition, as well as the medical divestitures.

First, I want to highlight that this quarter's results, driven by accelerated growth, demonstrate the scale and leverage enabled by our business model. Further, our results show the benefits of the continued investments we are making to create efficiencies across our organization. These points are supported by our improved operating margins in all three business segments.

Gross margin was 31.8%, down 40 basis points from the fiscal 2014 second quarter, which reflects a higher percentage of equipment sales in the Dental business and a higher sales contribution from our Veterinary business. On a consolidated basis, the operating expense ratio in the fiscal second quarter improved approximately 70 basis points from prior year levels. In summary, this means our consolidated operating margin for the fiscal 2015 second quarter was 9.3%, up 30 basis points from the prior year period. Again, as a reminder, these numbers exclude the impacts from the NVS acquisition and our Medical's business prior year divestitures. The improvement in margins was seen in all three of our businesses, and by segment, our adjusted operating margins for the quarter were 9.8% for Dental, 4.9% for Veterinary and 14.3% for Medical.

Looking ahead, 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 2014, after excluding the unfavorable impact of the restructuring costs. Not including NVS, our DSO held steady at 44 days for the second quarter, while inventory turns were 6.4 compared to 6.5 last fiscal year. Also, please keep in mind a couple of additional items on the balance sheet. A reduction in the accounts receivable category generally reflects seasonal variances. Also, inventory increases since year end are due primarily to a higher buildup of equipment inventory as we enter our largest equipment sales quarter.

In the second quarter, our cash flow from operations totaled $29.6 million compared to $72 million in the year ago period. The primary difference between the first fiscal and second quarters was the impact of the timing of tax payments and cash disbursements on accounts payable. On a year-to-date basis, cash flow from operations totaled approximately $98 million, up from $93 million for the first half of the fiscal 2014.

We also continued to execute on our capital allocation strategy by returning cash to our shareholders. During the quarter, we returned $20.2 million to our shareholders in dividends, bringing the year-to-date total to $40.2 million. This demonstrates our confidence in Patterson's continued ability to generate growing cash returns on our business investments and growth opportunities. During the quarter, we repurchased approximately 90,000 shares of our common stock, with a value of $3.6 million, leaving approximately 21 million shares available under our current authorization.

Our capex in the quarter totaled $13.5 million and included payments for normal replacements, as well as the ERP project. For the full year, we're currently estimating capex of approximately $45 million to $55 million. Over half of this amount is directly related to the ERP investments.

Finally, as Scott reviewed earlier in the call, we are maintaining our fiscal 2015 outlook for earnings per diluted share. At this point, we're maintaining guidance as we enter the back half of the year, which typically includes heavier sales volumes. While we do not provide quarterly guidance, I want to take this opportunity to remind you about a couple of items to keep in mind for our fiscal third and fourth quarter year-over-year comparisons. Several of the expense reduction initiatives we took last year, in fiscal 2014, more heavily impacted the latter half of the year. Specifically, we adjusted the ESOP expense estimate in the third quarter. Also, please keep in mind that we took a non-recurring severance charge in the fourth quarter.

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

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Ann. As we progress through fiscal 2015, we believe with our focus on customer success that we can continue to capture market share, drive profitability and create long-term shareholder value. Our strategic partnerships continue to grow and strengthen across all of our businesses, and supported by Patterson's unparalleled service and support platform, we continue to receive very positive feedback from our customers and maintain a leadership position in our markets.

We entered the year with the conservative view of our markets due to the relatively soft performances in the global economies. To recap the base assumptions we use to build our earnings outlook range, are stable North American and international markets, with conditions similar to fiscal 2014; no impact from additional share repurchases that may incur during the year; the long-term extension of $250 million of debt that is due in March; no material acquisitions during the year; and no material impact from the distribution change announced by IDEXX Laboratories. While we are seeing stability in certain areas, we continue to take a guarded approach to the economic outlook. That said, we are confident in our ability to execute in any economic environment. With a focused and efficient organization, we believe we have positioned Patterson for the future, and we continue to be bullish on the long-term prospects for our customers and our Company.

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

Operator

Thank you, sir. The question and answer session will be conducted electronically. To ask a question, please press star, one on your phone at this time. If you are on a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that's star, one to ask a question.

We'll go first to Bob Jones of Goldman Sachs.

Bob Jones *Goldman Sachs – Analyst*

Hey, guys. Can you hear me okay?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes.

Bob Jones *Goldman Sachs – Analyst*

Great. Thanks for the question. Scott, I guess the one thing that jumped out obviously on the Dental side would be equipment growth in the quarter. I believe last quarter you talked about cycling a strong trade-up program. Just curious if you could maybe give a little bit more on what drove the equipment growth in the quarter. You know, relative to trade-ups, you are seeing better traction? Anything more specific you can give us just within that nice gross number would be helpful.

Scott Anderson *Chairman, President and Chief Executive Officer*

Sure, Bob. I'll break it into two parts. You know, so first, CEREC in technology and then core, you know, it was just a strong quarter across the board in CEREC, really driven by new units, and we talked about that in the last quarter that our focus would be on new units, but we did also see some trade-up activity, which really speaks, I think, to what a nice job Sirona has done with the latest software update, and now there is, I would say, a high level of interest amongst loyal Bluecam users about moving into the new technology. But really, the CEREC number was driven by new users, which is great to see and, you know, we take a long-term view on CEREC and CAD/CAM and really believe that chairside CAD/CAM will be the heart of the dental practice in the future. So we're very encouraged obviously by the CEREC performance.

The core equipment business, you know, this is fourth consecutive quarter where we've seen growth. I think we are encouraged by the fact that we're starting to see some life in the dental furniture and cabinetry business, which speaks to office remodels and the beginning of some new construction. I think, if I go back to my comments a quarter ago, we still are sort of cautious to call it a turnaround, but I will tell you all signs point to increased activity out in the field. When you look at our consumable numbers, I think it is beginning to firm up in the dental market that there is a bit of higher utilization, and that will speak, I think, well long-term to dentists' confidence and them investing in their practices.

Bob Jones *Goldman Sachs – Analyst*

Well, I guess that's actually my follow-up, Scott, would just be around the consumable number. You know, 3.1% growth, up nicely from 2.5% last quarter. Your peers have all kind of started to report some improvement sequentially. I guess, what more would you need to see to kind of feel more confident in maybe addressing or changing some of those market assumptions that you highlighted are behind the guidance for this year?

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

Yes, I think we really need to get through the third quarter, which is the largest volume quarter of the year. As we've talked about many times, we have a good sense of where we sit going into the quarter, but at the same time, a lot of our customers will sit down with their financial advisors right around this time and make decisions, so the decision window is always shorter in the calendar November-December time period. So, you know, I would we feel very comfortable and are very pleased with the performance of the business through the first six months but probably need to get through this important calendar year end selling season to make maybe a more bullish call going forward, so we're just - I would say we're being prudently cautious.

Bob Jones *Goldman Sachs – Analyst*

Fair enough. Thanks for the questions.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Bob.

Operator

Our next question comes from Glen Santangelo of Credit Suisse.

Glen Santangelo *Credit Suisse – Analyst*

Yes, Scott, maybe if I can just follow up on Bob's second question, I'm kind of curious about your assessment of the overall market growth, because if I listen to your commentary, you seem to suggest that the better consumable number was really you guys kind of gaining share, but when I look at your obvious closest competitor, they put up a pretty big number too, suggesting that they're gaining share, but I think some of the other dental players all were making the - operating under the assumption that they saw some improving strength in the underlying market, and so maybe if I could just get your take on where you think the underlying market growth is and how you think about that versus your comments, you know, that you gained share within the dental segment?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, great question, Glen. I think it's clear, if you look at the major consumable company results that we're growing faster than the market and taking share, I think you have to be careful, I think, comparing us to our largest competitor. I would tell you that they're probably growing in some areas where we don't compete head-to-head in terms of some specialist markets where they own manufacturing and compete against many of their partners, as well as the larger DSO space where they have a large share. I think we are very confident when we look at market data across all of our manufacturers that where we compete head-to-head with multiple people, we are more than holding our own and gaining share.

I think, when you look at the consumable business, we've seen nice sequential steady growth going back to mid-summer. It's been very consistent across geography, and I would say the areas of strength, which are I think good for the entire industry, our product's (inaudible) dentistry, so composites and pressure material, adhesive materials, so really bread-andbutter dentistry, and I think this is a good sign that our customers are seeing increased patient flow in their clinical laboratories. Obviously on the equipment side, I think the numbers speak for themselves.

Glen Santangelo *Credit Suisse – Analyst*

Scott, maybe if I just ask one follow-up, now with almost a year under your belt for NVS, maybe can you give us some of your take on maybe what some of the surprises were, both positive and negative? I'm kind of curious; at this point, do you feel that the organization is ready to maybe take on another integration challenge, so are you comfortable at this point maybe taking on another opportunity, should it come along, and where might you be looking at this time?

Scott Anderson *Chairman, President and Chief Executive Officer*

I would say that there are very few negatives around NVS, and the positives really have been around the people and their execution and the ability for us to take ideas, both from our US dental business and the UK dental business and leverage across both sides of the pond. We've got a great group of people at NVS, so you know, definitely they outperformed our expectations in the first year and are very focused going forward.

I would say, in terms of next potential steps, we continue to follow our strategic plan, and one of those strategic intents is to take a broader view of the markets we play in, and part of that was geographic expansion, but we're also very disciplined and patient and we'll look for the right opportunities. But could not be more pleased with the first year results from NVS and where they're headed going forward.

Glen Santangelo *Credit Suisse – Analyst*

Okay. Thank you.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Glen.

Operator

Our next question comes from Kevin Ellich of Piper Jaffray.

Kevin Ellich *Piper Jaffray – Analyst*

Good morning. Thanks for taking the questions. I guess, first on the Vet business, just wondering if you could provide an update how Abaxis sales are going, why you chose to do an exclusive with them versus opening up to some other diagnostic manufacturers? Then also, how much kind of the lost revenues from IDEXX do you expect to make up with this new relationship?

Scott Anderson *Chairman, President and Chief Executive Officer*

I think it's too early to give hard data, Kevin, but I would speak to the relationship with Abaxis. It's one of, I would say, Patterson's core tenets that we take partnering with manufacturers very seriously, and we really feel comfortable with both the people at Abaxis and the products they have and really want to focus our organization to make sure we're successful and live up to our end of the bargain with Abaxis out of the gate. So it became a pretty easy business decision and very consistent with how we partner with manufacturers to go exclusive at the beginning with Abaxis. I think - you know, we'll obviously be able to give you more color probably in the third and fourth quarter as things progress and business migrates back and forth.

Kevin Ellich *Piper Jaffray – Analyst*

Okay, that's fair. Then just turning to margins, we've seen a nice improvement here on Medical side. You guys have done a good job with the restructuring that's going on there. I guess, long term, where do you think those Medical margins can go, and on top of that, with the Vet margins kind of depressed off of NVS, just wondering how long it'll take to get back to kind of the mid to upper single digits on the Vet side, if you think you can get back there?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, I'll start and maybe have Ann give some additional color. Really nice progress on Medical businesses in the quarter. I would say that margin improvement of, I believe it was 110 basis points in the quarter, is probably not sustainable into the third and fourth quarter, because it'll run up a bit against a bit of a tougher comparison. But the business is positioned very well and they are focused on growing the business organically and doing it in the right way, so we are confident over time with both a stronger focus and execution and also some stabilization of the market, that they continue to drive margins.

I would say on the Vet business, and they made some nice progress in the quarter as well, it really is a revenue and scale story, and I'll have Ann give some additional color.

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

Yes, I would just say longer term, Kevin, I think the right ballpark for the Medical margins is back to that kind of mid-teens, which is where you're kind of seeing them land year-to-date. Then as far as the Vet business, it will take some time to get it back to north of 5%, just because NVS is pretty significant in terms of total revenue contribution. But we are in the process, as Scott mentioned, of bringing those value-added services across the pond (ph). Those have higher margins, so I think you'll see a slow and steady increase in margin expansion in Vet.

Kevin Ellich *Piper Jaffray – Analyst*

Got it, that's helpful. Thanks so much.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Kevin.

Operator

We'll go next to Steven Valiquette of UBS.

Steven Valiquette *UBS – Analyst*

Thanks. Just curious, in the - for the vet space, we obviously have seen some other distributors talk about some larger than average lumpiness in their vendor rebates for the back half '14 versus the back half of calendar '13. Just curious if you guys are seeing anything in your book that's worth calling out in relation to that, or do you expect maybe some smoother results quarter by quarter? Thanks.

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

Yes, Steve, this is Ann. So I would tell you that we have seen some lumpiness just in the first and second quarter and some shifting back and forth, just because we have some shifting of products within the buy/sell category between manufacturers as new products have come in and out of the market - or into the market and are cannibalizing other vendors. But what I would tell you in the back half of the year, I don't think we have anything significant to call out as it relates to rebates. (Cross talking).

Steven Valiquette *UBS – Analyst*

Okay. Just one other quick one. I'm sorry, okay. Just one other quick one that I had was just to sort of confirm the - so the Vet equipment growth in the quarter, obviously with minus 11, 12%, somewhere in there, so was there some impact already on the negative side from the IDEXX situation in terms of either destocking or just de-emphasizing some products versus others, or was this - is it too early for that to be impacting the numbers? Just wanted to get confirmation of how much that might have impacted this particular quarter.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, good question, Steve. I think there definitely was some channel disruption with the business model change by IDEXX. I'd say one of the positives on the equipment side, even though revenues were down slightly, was gross margins improved. So in terms of driving value and bringing technology to the customer and also having us be a part of the value chain, that was probably the positive development, but the full expectation of our Dental team is that they will show equipment growth in the back half of the year.

Steven Valiquette *UBS – Analyst*

Okay, got it. Okay. Thanks.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Steve.

Operator

We'll go next to Bob Willoughby of Bank of America.

Bob Willoughby *Bank of America – Analyst*

Thanks. Ann - I think it was Scott, you mentioned your cash is building here but you're going to term out the $250 million in debt. I guess that suggests maybe some other uses of cash are coming. Is it realistic to assume you can get a decent size acquisition done by the end of the fiscal year?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, I wouldn't speak to timing. I would say we continue to evaluate a lot of M&A opportunities inside our core businesses, and we feel we're in a strong position to really execute on our capital allocation strategy, which I'll have Ann review just to make sure everyone's very clear on it, but I really like the position we have right now in terms of driving shareholder value and opportunity for the business, and I'll turn it over to Ann.

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

Yes, thanks, Scott. So just as a reminder, our first priority is always to reinvest in the business and, of course, that would include making acquisitions. Our second priority is to sustain and growth the dividend, and if we can't deploy the cash meaningfully in either of these priorities and the stock market gives us an opportunity to so, we could be much more active on our share repurchases going forward. So I would just say in summary, you know, we're planning to maintain a flexible balance sheet, and we continue to evaluate the market conditions and our cash needs going forward as we get closer to March when that $250 million comes due, so more to come.

Bob Willoughby *Bank of America – Analyst*

Okay. I guess to push a little harder, the share buyback wasn't so meaningful. We haven't seen the dividend bump in a while. It just sounds like that transaction opportunity is close.

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

Well, we can't comment on reasons why we're in and out of the market.

Bob Willoughby *Bank of America – Analyst*

Okay, and there was nothing that precluded you in the latest period from buying back stock, correct?

Scott Anderson *Chairman, President and Chief Executive Officer*

Well, we don't comment to those things, Bob. All I would tell you is we're in a strong strategic position, and I would say (cross talking).

Bob Willoughby *Bank of America – Analyst*

Okay.

Scott Anderson *Chairman, President and Chief Executive Officer*

In term of strategy, with Ann and I now working together, one of the things we're doing with the Board is taking a fresh look at our strategy in terms of the capital allocation and finance strategy as well, as terms as obviously our operational strategy.

Bob Willoughby *Bank of America – Analyst*

Okay. Thank you.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Bob.

Operator

Our next question comes from Lisa Gill with JP Morgan.

Lisa Gill *JP Morgan – Analyst*

Thanks very much. I was just wondering, obviously with the strong results in the quarter doing better than the street, was the quarter roughly in line with your expectations, and I'm just curious as to why not narrow or raise the guidance at this point?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, Lisa, the quarter was stronger than our internal expectations. It was just strong execution across the board, but I go back to sort of the cautionary statement; as we're halfway through the year, our heaviest sales volume are in the second half and we really want to get through the third quarter before we would make that type of decision.

Lisa Gill *JP Morgan – Analyst*

Is there something, Scott, that, you know, outside of what you called out today that concerns you going into the third quarter?

Scott Anderson *Chairman, President and Chief Executive Officer*

No. I would say I'm optimistic about the third quarter, but at the same time, we know probably more than anyone since we sell over 50% of the capital equipment in the North American market that the calendar year end period, the November-December can be lumpy with both upside and downside surprises, and I would not read anything into it more than us just taking a very cautious outlook as we get into the next 90 days, but we - you know, as I said, we are very pleased with where we're positioned six months through the year.

Lisa Gill *JP Morgan – Analyst*

Then my second question just would be around that - I mean, obviously we talked a little bit about consumables being very strong today, but if I look at NVS specifically, it looks like it was up double digits on a comparable basis. One, is that correct; and two, can you maybe just give us a little more color as to what's driving that?

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

Lisa, this is Ann. So that was not up double digits on a comparable basis. I think what you're looking at is a full quarter of results last year versus we had three weeks of incremental impact this year. So I would characterize the growth in NVS as being similar to what you saw in the US.

Lisa Gill *JP Morgan – Analyst*

Okay, great. Thank you.

Scott Anderson *Chairman, President and Chief Executive Officer*

In terms of organic growth, yes.

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

Yes.

Lisa Gill *JP Morgan – Analyst*

Okay, great. Thank you.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Lisa.

Operator

We'll go next to Jeff Johnson with Robert W. Baird.

Jeff Johnson *Robert W. Baird – Analyst*

Thank you. Good morning, guys. Just few clean-up questions here on my part, I guess. So, Scott, I wondered if you can maybe address gating throughout the quarter? You know, as you exited kind of September into October and so far in November, anything changing dramatically one direction or the other on trend line? Then just on some of your equipment comments, or kind of your wanting to get through the third quarter, I guess, anything you would highlight with Section 179 and 168 coming down quite a bit? Is that is that a reason for a little caution, or just kind of wanting to see how third quarter plays out, or do you think that'll have any impact?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, good questions. First, in terms of gating, I think I mentioned before we're encouraged by really sort of sequential strength in the business around the consumables side, so we continue to see that momentum. The Section 179 issue, as many of you know, Section 179 every year has to be renewed, and it is stuck in the lame-duck session of Congress right now. I have been in correspondence with some of our local Congress people and the House has passed - or has put forward resolution to make the step-ups to 500,000 permanent so they don't have to be renewed every year.

I would say we believe strongly that Congress will act in favor of small business owners, because this is - as many of you know, it's not just dentists; it's farmers, it's all small business owners who are making capital decisions right now. So it is a little bit frustrating that our government has sort of cast some uncertainty in the minds of small business owners, so I believe it'll all be taken care of here in the next couple of weeks, but it does, I guess, give us a little bit of caution that they haven't renewed that to $500,000 yet. I believe it'll happen but, unfortunately, we're dealing with a bit of a dysfunctional House and Senate right now.

Jeff Johnson *Robert W. Baird – Analyst*

Yes, understood on that point, for sure. But from a gating standpoint, I guess just to clarify, Scott, when you say kind of - so you're happy with the sequential improvements, do you feel like throughout the fiscal second quarter you were seeing sequential improvements as well, or are you just talking kind of your second quarter improvements versus first quarter versus last year's fourth quarter?

Scott Anderson *Chairman, President and Chief Executive Officer*

I think we've seen it throughout the year, Jeff.

Jeff Johnson *Robert W. Baird – Analyst*

Yes, fair enough. Then, Ann, I think several times, I know at our conference at the Analyst Day, you've kind of positioned guidance as having maybe more of a conservative bias this year than in years past, or you know, having more upside potential than downside risk in that. Is - we're all trying to feel out how conservative guidance is here. Would you still kind of reiterate those words? Do you still feel comfortable with that?

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

Yes, that's exactly how I would characterize it, Jeff, and I think that's why you're seeing us not raise it at this time. So if I look at just the guidance for the back half of the year, not considering the overperformance in the current quarter, absolutely, you know, if you think about where you guys are, I would characterize it as more conservative than historically how we've set the ranges, with more upside potential than downside risk, absolutely.

Jeff Johnson *Robert W. Baird – Analyst*

Yes, very helpful. Thank you, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Jeff.

Operator

We'll go next to Michael Cherny of Evercore ISI.

Elizabeth Anderson *Evercore ISI – Analyst*

Hi. This is Elizabeth Anderson in for Michael Cherny. I just wanted to ask about your guidance. In terms of the puts and takes for achieving the high end versus the low end of the guidance, what do you think the biggest swing factors could be?

Scott Anderson *Chairman, President and Chief Executive Officer*

Hey, Elizabeth, this is Scott. I would say the biggest swing factors come around revenue growth. It really will be the performance of the underlying consumable business and potential strength in the equipment business that would push us towards the higher end. I think we've managed the business very well, so we could anticipate and mitigate any revenue softness. So, you know, as I've said before, and I think Ann just mentioned on the last call, we feel very comfortable and we have a high level of accountability in the organization to not only deliver the year, but really have a strong second half and exceed the year, but we're taking a cautious tone right here since we're only six months through the year.

Elizabeth Anderson *Evercore ISI – Analyst*

Sure. No, that makes sense, and if I could just get one more question in. In terms of the CAD/CAM market, I notice you obviously mentioned the strong sales in the quarter, but I was just wondering, has there been any change in sort of the competitive level or pricing in the CAD/CAM market, or would you say that it's been fairly consistent quarter-to-quarter for this year?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, I think the basic competitive landscape in terms of pricing - and I believe I mentioned it in the last quarter as well - dentistry is a relatively small market. I think the technologies are priced appropriately to ensure that there are viable sustainable businesses long term, so not only can you sell this technology, but you can support, service, have spare parts and really make sure the customer has a viable product five, 10 years down the road. So you always see competitive promotional pricing and we will participate that in as well, but I think it's a very stable pricing environment, and at the end of the day, there is no product that we sell that has a higher return on investment and a bigger impact on the practice than a chairside CAD/CAM CEREC machine.

Elizabeth Anderson *Evercore ISI – Analyst*

Perfect. Thank you very much.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thank you.

Operator

We'll go next to John Kreger of William Blair.

John Kreger *William Blair – Analyst*

Hey, Scott. Can you maybe talk a little bit more about your views of the implant opportunity given your Straumann partnership that you announced? What do you guys perceive as the underlying growth rates at this point in the implant market, and if you have a sense about how penetrated that technology is and how much of the volume is flowing through the GP offices at this point?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, John, we've talked about this in the past. We see that the implant market as being very well served right now in the specialists, the oral surgeons, the periodontists, by the current players, and we didn't think strategically for us to private label or buy a second-tier brand was a good strategic move for Patterson. We knew that, over time, as technologies improve, there would be a market for general dentists to place simple implants, and that market will grow just with the aging population. Once that happens, our distribution model makes a lot of sense to a manufacturer when you're dealing with more than just 8,000 customers but now potentially 50,000, 60,000, 70,000, 80,000 customers over time.

It's very early in the game, but I would say it's analogous to what you see in the endodontic market, where general dentists will do simple endodontic procedures but overwhelmingly will refer out most of their cases to the endodontists. We see that as being a responsible partner with Straumann to make sure that if general dentists are placing simple implants, that they're done correctly and that it becomes really, as I said in my comments, additive to the specialist market over time. So to me, I look at this as not material financially in short term but potentially very material strategically to Patterson's position in the marketplace long term.

John Kreger *William Blair – Analyst*

Great, thank you. That's helpful. Then a question on CEREC. Are you seeing any momentum at all in scanner-only sales, or are they pretty much all full chairside systems? I think you said at Analyst Day that you have about a - an installed base of about 15,000. Can you give us a sense about how much of that at this point is Blue versus Omnicam?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes. Number one is the majority of sales still continue to be chairside CAD/CAM. I think when dentists really take a hard look at the technology and then understand the return and really the patient benefits, it's - it becomes - it's interesting; people will start looking at digital impressioning but almost always will end up at the chairside. We're now almost up to 16,000 users in North America with CEREC, and we don't, for competitive reasons, give the specific breakout of Blue and Omni. But as I said in my previous comments, the latest software update that happened this summer really has been a positive boost for dentists with Bluecam systems looking at Omni going forward, and our new users sales are predominantly Omni.

John Kreger *William Blair – Analyst*

That's great. Thank you.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, John.

Operator

As a reminder, if you would like to ask a question, please press star, one on your phone at this time. We'll go next to Jon Block of Stifel Nicolaus.

Jon Block *Stifel Nicolaus – Analyst*

Great, thanks, guys, and good morning. I'm probably going to ask just a couple of questions, just in a different manner, in a different light. So just on CEREC, if you can talk to the mix; in other words, this was the second straight quarter where I think you talked about double-digit growth in new users, would that equate into sort of double-digit new user revenue growth, or - you know, you've had sort of CAD/CAM for everyone out there now for some time. Is there an increasing percentage of people coming on at the lower end ASP options?

Scott Anderson *Chairman, President and Chief Executive Officer*

No, it's revenue growth and I would say the majority of new users, a high majority are at the higher end. So we feel like we have a great portfolio of products to bring to the customer with a lot of options on when they can come in price point-wise and functionality-wise, but the majority of customers are opting for the latest technology, and because they really understand the return on investment and I think they also have great peace of mind when they partner with Patterson because of our commitment to their success and the satisfaction we guarantee our customers when they move into this technology.

Jon Block *Stifel Nicolaus – Analyst*

Okay, great. Then I'll also shift over to the Straumann deal. I know you laid that out, sort of that deal with Straumann being additive for the overall market, but I'm guessing there's going to be situations where the implant at the GP is sort of going to be displacing what would have been a referral to the specialist, and two of your biggest consumable partners have what I'd call formidable premium implant businesses. In the past, you've always stayed away from sort of stepping on their toes, so can you talk to your thoughts on how you successfully balance that, and also, could we see Patterson find other innovative ways to make a bigger splash in the specialist market? Thanks, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, I think Patterson will be a key partner for multiple manufacturers in different areas going forward. We have a great history of helping build markets and focusing on launching new products. It's just one of our core strategies that we don't see buying manufacturers and competing against our partners as really the way we go to market. So, you know, my predecessor, Jim Wiltz, had a great line; if we're going to get into the cold wars, we're not going to buy Shasta Light, and I think that speaks to the fact that we're patiently here and available to partner and drive business with our great manufacturers, and there are many of our manufacturers that sell direct into the specialist markets, but if there was ever a time where we could help them expand their business, I think St. Paul would be the first place they'd come to talk.

Jon Block *Stifel Nicolaus – Analyst*

All right, fair enough. Thanks.

Operator

We'll go next to Kevin Ellich of Piper Jaffray.

Kevin Ellich *Piper Jaffray – Analyst*

Hey, Scott, just wanted to go back to your comments on the strategic partnerships. With QSIDental, you mentioned incremental revenue opportunity; just wondering if you could size that for us? Then Straumann, did you say they previously had a direct sales model, or that they currently do?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, I'll take the Straumann one first. Straumann has and will continue to sell direct to the specialist market, and they serve that market very well. They have partnered with us in the GP market on a product called Straumann One, and it will be a very methodical rollout as we help general dentists learn how to place simple implants. But when you look at just pure demographics, the specialist market is going to have, I think, really strong demand for their services for the next 20 years, just with an aging population.

Kevin, what was the second piece of your question again?

Kevin Ellich *Piper Jaffray – Analyst*

With Quality Systems (cross talking).

Scott Anderson *Chairman, President and Chief Executive Officer*

Oh, QSI, yes. Yes, QSI (cross talking).

Kevin Ellich *Piper Jaffray – Analyst*

I guess, yes. Just wondering what that opportunity is?

Scott Anderson *Chairman, President and Chief Executive Officer*

Right. That gives us the ability to have a referral relationship with the leading software product in the large group practice space on the dental office, so the revenue opportunities we would have would be from gaining more share inside of those customers, and at this point, we wouldn't quantify that. But I just think that it's - once again, it's short term, not material to sales, but long-term strategic to how we're growing out that business the right way.

Kevin Ellich *Piper Jaffray – Analyst*

Got it. I guess it would be tough to find Shasta Light at this point in time, so thanks.

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

Yes.

Operator

We have no other questions in the queue at this time. I'd like to turn it back to Scott Anderson for any additional or closing remarks.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Augusta. Thank you for joining us today. During the fiscal second quarter, we made progress on our strategic initiatives to offer best-in-class product innovation and services in order to fuel our customers customers' growth. As a result, we were able to strengthen our market leadership position. We are focused on capitalizing on the growth opportunities that lie ahead as we continue to enhance our products and services.

I'd like to personally thank the great employees of Patterson Companies for their hard work through the first half of our fiscal year, and know that we are all committed to helping our customers grow and continuing to capitalize on the momentum we see in all of our businesses. We look forward to seeing many of you next week at the Greater New York Dental show and updating you in February on our fiscal third quarter results. On behalf of Ann and myself, a Happy Thanksgiving to all. Thanks for being on the call.

Operator

That does conclude today's conference. Thank you all for your participation. Have a great day.