PATTERSON COMPANIES

EDITED TRANSCRIPT

PATTERSON COMPANIES 3rd QUARTER
2014 EARNINGS CONFERENCE CALL

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Patterson Companies' Third Quarter Fiscal 2014 Earnings Announcement Conference Call. During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference will be open for questions. If you have a question, please press the star, followed by the one, on your touchtone phone. If you'd like to withdraw your question, please press the star, followed by the two. Also, if you're using speaker equipment, please lift the handset before making your selection. This conference is being recorded today, February 20th, 2014.

I would now like to turn the conference over to Ann Gugino. Please go ahead.

Ann Gugino *Vice President, Strategy and Planning*

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

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

Also, please note that in this morning's conference call, we will be referencing our adjusted results for the quarter in Steve's detailed financial discussion. Adjusted results 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.

Since Regulation FD prohibits us from providing investors with earnings guidance, unless we release that information simultaneously, we've provided financial guidance for fiscal 2014 in our press release, as well as in the financial slide presentation supplementing this conference call that can be found in the Investor Relations section of our website at pattersoncompanies.com.

Be advised that this call is being recorded and will be available for replay starting at 11:00 a.m. Central Time for a period of one week.

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

Scott Anderson *Chairman, President and Chief Executive Officer*

Thank you, Ann, and welcome, everyone, to this morning's conference call. As you saw in today's earnings release, Patterson Companies reported a solid third quarter, with double digit sales growth and increased adjusted earnings compared to the prior year quarter. We continue to be pleased with the progress we made in many aspects of our business. Notably, on the revenue side, we exceeded $1 billion in quarterly sales for the first time in the Company's history. We achieved this sales growth despite being impacted in January by adverse weather conditions across all of our US-based businesses. Bad weather is a short-term nuisance, but it doesn't reflect the health of the business. Revenue grow—grew in both our Dental and Veterinary business, and due to our strong cost controls, we were able to deliver increased adjusted earnings in the third quarter.

Let's take a deeper look at our operational performance in the third quarter, starting with Dental. This business, which accounts for just under 60% of our total sales, reported fiscal 2014 third quarter sales of $642 million, which, on a constant currency basis, was a 3.2% increase versus the prior year period. This was our third consecutive year of reporting growth in this quarterly period, which is generally the most important time for our Dental customers when they are deciding on capital investments for their practices. Again, this year, our Dental team executed well, with equipment and software sales increasing 5.6% from the year earlier level and all major categories posting gains. We are particularly encouraged by this sales level because our performance came on top of growth in the prior year period—strong growth, making it a very tough comparison.

In the 2014 third quarter, we saw good growth for CEREC equipment sales, generating double digit growth in that category. We had a more balanced mix in the quarter between new unit sales and trade-ups for the CEREC Bluecam to Omnicam system, and we still have some upgrade opportunities remaining from the introductory promotion for the Omnicam, but we are selling more of the new CEREC systems and we have worked through the customer training and installation issues on CEREC system upgrades that we encountered in the 2014 second quarter. Patterson also experienced growth in basic equipment sales. As we have noted for some time, this category has been the most sluggish and slowest to recover from the recession. While it is definitely too early to declare a long-term recovery in the basic equipment category, it was nice to see stronger results in the quarter.

Another bright side in the quarter was our A-dec partnership. A-dec is the US market leader for quality dental equipment such as chairs, units and cabinets. Also contributing to revenue in the Dental segment was a nearly 1.5% increase, again on a constant currency basis, in sales of consumable dental supplies versus a year ago. While dental consumable sales were up year-over-year, we believe consumable growth was constrained by adverse weather impact in January, and we are seeing some weather issues in February as well. Looking ahead, as the dental market returns to historic growth levels, we expect to benefit. We believe that there is considerable pent-up demand for dentists to invest in their practices. This fact, plus the growth opportunities from our technology offerings, position us well as dentistry migrates to a digital platform. Patterson Dental is poised to capitalize on the growing digital trend as we continue to implement new radiography and CAD/CAM technologies that we—that enhances—that are enhanced with Patterson's unmatched service and support offering.

Let's now turn to Patterson Veterinary, which is responsible for nearly one third of total sales. The Veterinary unit increased sales more than 90% in the quarter, including $145.5 million contribution from our NVS acquisition and a 7.1% increase in US sales. As a reminder, the third quarter is the seasonally slow time of the year for our Veterinary business. As you know, NVS is the largest veterinary distributor in the United Kingdom and it offers us an exceptional platform to extend Patterson's strategy into new geographic markets. This acquisition has been a win-win for NVS and Patterson, as we gain a talented team of associates in the UK which affords us the opportunity to move our strategies into new markets and they have access to additional resources to solidify their market leading position.

Looking at our US veterinary business, third quarter sales gains stemmed chiefly from a 5.6% increase in consumable sales, such as medications and supplies, and a 26% increase in equipment. In the quarter, we continued to execute against our strategy to be a national provider of veterinary equipment and services. We see significant opportunities to grow Patterson Veterinary. Our priority remains to increase both our equipment and technical service offerings so we can take advantage of the favorable marketplace dynamics as pet ownership grows and we see increases in the dollar amount people spend on veterinary care for their pets.

Turning now to Patterson Medical, our rehabilitation, supply and equipment unit, which now represents approximately 10% of total Company revenues. Sales declined to 107.3 million but were essentially flat after adjusting for the previously announced decision to divest certain non-core assets. This was in line with our expectations for the period. The remainder of the steps necessary to complete our restructuring plan are expected to occur in the fourth quarter of fiscal 2014. By existing—by exiting non-core product lines, we can lower the operating expense levels of our European medical distribution operations and concentrate on more strategic businesses for Patterson. We believe that these actions will benefit our growth in those markets over the long term.

Although US markets continue to stabilize, overall performance of our Medical unit has been affected by the continued uncertainty surrounding the nation's healthcare system, and in international markets, from the ongoing austerity measures that have dampened demand for the past few years. While these factors are likely to persist in the short term, our new Medical leadership team brings renewed focus and vision. We continue to be encouraged by this business' potential given our industry leading product and services and offerings, as well as the underlying favorable demographics in the rehabilitation market that indicate future growth. Patterson Medical is poised to capture additional market share as conditions improved.

Next, I'd like to update you on our information technology initiative which crosses all three businesses. As previously stated, we've undertaken this effort in order to support the Company's future growth, further enhance the customer experience and secure future productivity gains. Patterson's incremental information technology investment is estimated at 55 to $65 million. We are taking a phased approach to this initiative. We have completed the process analysis and vendor selection phases. We are now in the design and blueprinting stage, and we'll update you in the coming quarters as we begin testing and implementation. Our customers will continue to see various improvements as we execute on this strategy. In addition to accommodating future growth, we believe our information technology investment is critical to providing Patterson with the flexibility to adjust our platform as opportunities warrant.

Patterson Companies continues to have strong cash generation capabilities and a flexible balance sheet so we can take advantage of opportunistic acquisitions to augment our organic growth initiatives. Going forward, we remain focused on pursuing our growth initiatives, while maintaining strong cost controls to create long-term shareholder value.

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

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

Thank you, Scott. As Ann mentioned earlier in the call, my comments will be based on our adjusted results, which exclude the impact of the restructuring charge for the medical divestiture. A reconciliation of the reported and adjusted results can be found in this morning's press release, as well as the slide presentation we have posted to our website in conjunction with this conference call.

During this year's fiscal third quarter, as noted, we saw strong equipment sales in both our Dental and Veterinary units, with all our major product categories posting year-over-year gains and double digit growth in several categories. Earlier, Scott had provided certain growth amount on a constant currency basis as the impact from foreign exchange was higher this period than recent experience. This negatively impacted our consolidated sales growth by 50 basis points in the quarter, and operations absorbed an unfavorable $1.3 million swing in transactional currency expense, predominantly from the—our Canadian operations.

Consistent with prior quarters, fiscal third quarter 2014 operating expenses included approximately $3 million pre-tax, or $0.02 per diluted share, for our planned information technology investments. Our consolidated adjusted gross margins reflect both impact from the acquisition of NVS and the change in mix within the historic businesses during the quarter. Excluding the results of NVS, adjusted gross margins were 32.4%, down 40 basis points from the prior year. This decrease is a result of the faster relative growth of the US veterinary unit, the higher percentage of equipment sales in the Dental segment and pricing pressures in the international portion of the Medical business. On a comparative basis, our adjusted operating margin in the third quarter was 10.4% when you exclude the operations of NVS and the impact of the planned information technology investment.

By segment, our third quarter adjusted operating margins were 11.5% for Dental, 4.8% for Veterinary, and 11.5% for Medical. Note that operating margins for the Dental business include the information technology investment. Excluding IT and NVS, we still expect to gain 20 basis points of consolidated operating margin for the fiscal year.

Our adjusted effective tax rate in the third quarter was 35.2%, an 80 basis point increase from the prior year, due primarily to the favorable tax items in the year ago period. Our anticipated annual tax rate of 35.5% excludes the medical divestitures, not including NVS, our DSOs increased one day to 43 days for the third quarter, while the inventory turns were 6.3 compared to 7.1 last fiscal year.

The majority of our balance sheet changes result from the NVS acquisition. In addition, there are two other changes to point out. First, we extended the maturities on a portion of our invested cash balances in Canada from our traditional 90-day period to one and two-year tenures. While the one-year amounts are classified as part of cash and short-term investments, the 65 million that was invested for two years has been reclassified to non-current investment. Second, inventory has increased from the beginning of the fiscal year, as well as compared to the prior year, due to capitalizing on favorable buying opportunities from dental consumable vendors offered around the end of the calendar year. In addition, our equipment inventories reflect the backlog of customer orders that could not be installed by the end of the quarter, and the rebuilding of our CEREC inventory that we discussed previously. We would expect these inventory increases to be worked off by the end of the fiscal year.

In the fiscal 2014 third quarter, our cash flow from operations totaled $57 million compared to $46 million in the year ago period. During the quarter, we returned approximately $17 million to our shareholders in dividends. We also repurchased approximately 630,000 shares of our common stock with a value of $26 million, leaving approximately 23 million shares available under our current authorization. Our capex in the third quarter included the payment for the new ERP software.

Before I turn the call back to Scott for some closing comments, I will review our guidance for the remainder of fiscal 2014. With the majority of the fiscal year completed and based on our expectations for the fourth quarter, we are tightening our EPS range from $2.13 to $2.20. As we announced earlier in the fiscal year, Patterson anticipates incurring a pre-tax restructuring charge in fiscal 2014 in the range of 15 to $17 million, or $0.12 per diluted share for divesting non-core assets in our Medical unit. We recorded $0.01 per share of these costs in the third quarter and anticipate the rest to be taken by the end of the fiscal year. These charges will be primarily non-cash in nature. Divesting these product lines is expected to generate annual savings of approximately $22 million, or $0.01 per diluted share, beginning in fiscal 2015.

Scott Anderson *Chairman, President and Chief Executive Officer*

Two million.

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

Is it 22 million? I'm sorry, 2 million, thank you. Again, our fiscal 2014 guidance is predicated on several assumptions. That includes stable economic conditions in North America; modest operating margin expansion, excluding our planned investments; a $0.06 impact to deleted—I'm sorry, to diluted EPS from the information technology investments, and no impact from the share repurchases that may occur during the remainder of the year.

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

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Steve. As we complete this year and provide a springboard for fiscal 2015, we believe we will continue to capture market share as we exceed our customers' expectation. Our very strong strategic partnerships continue to grow and strengthen. Wrapped with Patterson's unparalleled service and support platform, we continue to receive very positive feedback from our customers.

We are speaking with you today from the 149th Chicago Dental Society Midwinter Meeting, featuring three days of the best dental lectures, demonstrations and continuing education courses. We also enjoy this opportunity to interact with our customers as they look for ways to improve their practices. We are proud to have kicked off our visit here last night at the Oral Health America Gala, where Patterson was recognized for our significant contributions as a lifetime partner of this organization and for achieving the milestone of $1 million in cumulative donations. Through Patterson's support, OHA gains a large audience for its key initiatives and campaigns, such as the annual Fall for Smiles program that educate communities about the importance of healthy food choices, regular dental visits, brushing, flossing and avoiding tobacco.

So let me reiterate what gives us confidence as we conclude the year and enter fiscal 2015. We continue to be encouraged as all of our markets will benefit from favorable demographics and the shift as our customers invest in increased productivity for their practices. Patterson is focused on efficiency, and we are executing focused strategies to position the Company for future growth. We are committed to generating long-term shareholder value through targeted investments, diligent expense management, dividend growth and strategic share repurchases.

Now we'd like to take any questions, so I'll turn the call back to Douglas, and Douglas, you can start the Q&A.

Operator

Thank you, sir. Ladies and gentlemen, as a reminder, if you have a question, please press the star, followed by the one, on your touchtone phone. If you would like to withdraw your question, please press the star, followed by the two, and if you're using speaker equipment, you will need to lift the handset before making your selection.

Our first question is from the line of Robert Jones with Goldman Sachs. Please go ahead.

Adam Noble *Goldman Sachs – Analyst*

Hi, thanks for the question. This is actually Adam Noble calling in for Bob. I was just hoping you could give us a little bit more color on dental consumables, definitely a little bit below our expectations. I know you mentioned the January weather and that's kind of continued into February. Just wondering if you could let us know how consumables and patient traffic was in the November and December months relative to January?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, Adam, our consumable growth was very consistent through December and we did see a slowdown in January, and you know, we hate to talk about weather but there's no getting around the fact that many geographic parts of the United States were slowed down, and we could tie that when we looked at the non-affected weather areas and how that grew. So, I think it's more of a short-term issue and there's no fundamental change in the market. Patient flow continues to be steady and growing slightly in the dental offices and we expect that to fully rebound once we get through these winter months.

Adam Noble *Goldman Sachs – Analyst*

That definitely makes a lot of sense, and just to go to NVS for a second; you know, I know revenue was very strong in the quarter. Just wondering if the third quarter is typically the strongest quarter of the year, and how we should think about revenue cadence for the business going forward? I'm just wondering, you guys had mentioned 500 million as a revenue run rate on an annual basis for the business. Should we still think of it that way, or has the business been outperforming your expectations?

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

Adam, this is Steve. The business has definitely been outperforming our expectations, but I wouldn't translate that into a significant change in the revenue forecast that we've given you. Like the United States, the United Kingdom is impacted by a bit of a slowdown. They see it less dramatically, according to the management team over there, but they do see some slower activity in the winter months with increased activity as we get into the warmer months. So, you should see some pickup, but by the time you annualize in the next couple of quarters and the second quarter when we purchased the business, revenue should accumulate to around that $500 million mark.

Adam Noble *Goldman Sachs – Analyst*

Okay. Thanks for the questions.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Adam.

Operator

Our next question is from the line of Glen Santangelo with Credit Suisse. Please go ahead.

Glen Santangelo *Credit Suisse – Analyst*

Yes, thanks. Just two quick questions, if I could. You know, Steve, back in—and Scott, when we talked about the original guidance a couple of quarters ago, you know, you laid out a pretty wide range and now we've kind of tweaked that range down a little bit. I'm kind of curious, could you maybe give us, you know, a look back over the past kind of couple of quarters, maybe what played out a little bit differently than what you would have expected? Is there a certain area of your business that maybe didn't perform as well as you expected, or was it more across the board?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, good question, Glen. You know, I think when we went into the fiscal year, we made some assumptions around growth, particularly on the equipment and consumable side. As you know, our second quarter came in a little light to what we had expected, and then, you know, I would say the impact and how we sort of look at the January/February months on the consumable side gave us a little bit of caution. But at the same time, we had plans in place to deleverage the expense structure of the business to deliver a solid year, which we are very confident we will at the end of the day. I'd say I'm, you know, really encouraged by how the Dental equipment business came through in the equipment side in the quarter, you know, we're coming off two really strong prior years, up 20% in 2012 and up 10% last year and I think we have some decent momentum going into the fourth quarter. So, you know, obviously, some market dynamic changes but all in all, not seismic material shifts and we adjusted our business as we saw fit to be able to deliver a good year.

Glen Santangelo *Credit Suisse – Analyst*

Well, thanks, Scott. I appreciate that detail because that kind of leads into my follow-up question on the gross margins. You know, Steve, if I heard you correctly, I think you kind of suggested that maybe, you know, the—faster growth in the US vet, maybe NVS and dental equipment, maybe all, you know, weighed on the mix and the gross margin, and so as we kind of look out to the next fiscal year – and I know you don't want to give guidance on this – is it fair to say that there's something that you can do with respect to NVS pretty quickly that should start to impact the margin more positively? Then, as a secondary question, you know, could you discuss the impact of maybe faster dental equipment sales on that gross margin, because it kind of feels like, you know, you said that the high-tech dental equipment did really well, but it also sounds like basic equipment was in positive territory as well?

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

Yes, that's a lot of questions there, Glen.

Glen Santangelo *Credit Suisse – Analyst*

Sorry, Steve.

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

We'll try to attack it a little bit. Scott will jump in here, as well. I'll give you some of the mechanics. As we pointed out when we bought NVS, that's a fairly low-margin business, we wouldn't expect that the gross margins are going to change a lot from what you've seen to date. Over time, we would expect those gross margins to come up as we strategically take some of the things we do here in the States and try to move those into the UK market. That will help build those margins but that is much more of a logistics play over there compared to what it is here in the United States. So it's fairly low margin at the gross margin line, low expense structure and a fairly low relative margin, but the business will generate – for what we paid for it – it'll generate a very nice return for the shareholders over time.

So with that, I'd turn it back to Scott and let him add any color that he may have.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, you know, our Dental margins actually were pretty stable and we would see a stable environment going forward and, you know, continued growth opportunities around our market-leading technology offering, and we saw some life in the basic equipment business, which was good to see and we still have a great conviction that that's going to be a very good business going forward as dentists begin to refurbish their offices and expand their offices to meet which we know is going to be strong demand over the next decade in the dental space. You know, on the vet side, you've had some margin movement in the flea and tick category; a lot of things going on there, as you know, with Sentinel coming back in the market and NexGard being launched at the NAVC meeting, but all in all, I think we feel very confident about where margins are headed and how we can leverage the business to drive the bottom line in that type of environment.

Glen Santangelo *Credit Suisse – Analyst*

Okay, thanks for all the detail.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Glen.

Operator

Our next question's from the line of Michael Cherny with ISI Group. Please go ahead.

Michael Cherny *ISI Group – Analyst*

Good morning, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Hi, Michael.

Michael Cherny *ISI Group – Analyst*

So I wanted to just ask a couple—dig in a little bit on the OpEx line. You know, you saw obviously a very nice improvement there. Attribute some of that to divestitures of non-core businesses in Medical. As you think about the long-term run rate of that business, and obviously, you had mentioned, you know, both talking about the IT investment as one but other opportunities, how do you think about that true trade-off and what should be, do you think, is a sustainable level of OpEx spend relative to the need to invest in the business?

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

Well, I think—we've given you enough detail that I would tell you that OpEx probably should run in the low 20s on a fairly consistent basis. We obviously try to leverage that, Michael, every year for the next couple with some of the investments that we're making, plus the impact of NVS coming in and some of the early amortization comes out of that purchase accounting, there'll be some pressure on that operating line. But NVS, as I mentioned earlier, has a lower operating expense structure than the other businesses, so as it continues to grow and move into the numbers, it's going to be—there'll be some downward pressure on that rate. So I would sort of target you at this point, without giving any guidance for '15, is it's going to be somewhere in the low 20s. That's historically where we've run.

Michael Cherny *ISI Group – Analyst*

Yes, no, directionally, that helps. Then maybe another way to ask the NVS question, you know, given that you now have few months in, you have the first full quarter under your belt, as you think so far about this specific acquisition as part of a broader capital deployment strategy given it's the first—or it's the largest deal you've done in some time, how do you think this positions you on a go-forward basis for other M&A? Are you looking for more large deals, or is it going to be closer to some of the more smaller bolt-on stuff that you've done previous to this?

Scott Anderson *Chairman, President and Chief Executive Officer*

Great question, Michael. You know, I think when we look at long-term opportunities, we still feel there potentially could be some larger geographic expansion opportunities with some great companies and great management teams that are out there. But as historic Patterson fashion, we've been very patient but very opportunistic and would continue to move on the bolt-on strategy, as well as looking at deals like NVS and just to echo what Steve said, you know, we couldn't be more pleased with that property and the great quality of the people over there and see that as a opportunity to not only grow that business but make it a more valuable business over time.

Michael Cherny *ISI Group – Analyst*

Thanks. That's helpful.

Operator

Our next question's from the line of Kevin Ellich with Piper Jaffray. Please go ahead.

Kevin Ellich *Piper Jaffray – Analyst*

Good morning. Just a couple of questions. Scott, wondering if you could help us out a little bit more on the weather impact. Did you guys actually experience delays in shipping and products not getting to customers, and the—I assume you saw the impact across all business segments, not just Dental, is that right?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, it was across all business segments. I would say we really didn't have any supply chain issues from vendors. You know, obviously, particularly in the southeast and northeast, there were days where UPS trucks literally could not get to customers, but probably the bigger impact is just the slowdown in patient traffic that the weather has created. You know, we're experts on weather in Minnesota because we live through this every year and our schools have been shut down four days in January due to how cold it is, and I can't remember the last time that's happened. So as I said in the opening remarks, we hate talking about weather but there is no doubt that it has had an incremental impact but I don't think it has any material long-term impact on the health of our businesses.

Kevin Ellich *Piper Jaffray – Analyst*

Well, it looks like they're shutting down school again, I think, at least in the southern part of the state. As for basic dental, good to see some growth there. Could you say how much basic dental was up this quarter?

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

Low single digits.

Kevin Ellich *Piper Jaffray – Analyst*

Low single digits? Okay, great. And then, you know—and, again, going back to 2015, we know you're not going to give guidance, but just thinking about the organic growth in the business and what you guys have done, which is a nice job, do you think it's possible to see double digit growth, and what would take to get us there?

Scott Anderson *Chairman, President and Chief Executive Officer*

On the equipment side?

Kevin Ellich *Piper Jaffray – Analyst*

Well, overall, just double digit EPS growth.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes. Well, I think double digit EPS growth is, you know, a combination of 3 to 5% revenue growth with solid margins and good expense control and capital allocation decisions. Absolutely, over time, that's the model we see for this Company.

Kevin Ellich *Piper Jaffray – Analyst*

Got it. Excellent. Thanks, guys.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Kevin.

Operator

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

Steven Valiquette *UBS – Analyst*

Yes, thanks. Good morning.

Scott Anderson *Chairman, President and Chief Executive Officer*

Morning.

Steven Valiquette *UBS – Analyst*

So, yes, a couple of questions here. You know, I guess, first, as we listen to Sirona's earnings calls, there seems to be more and more attention in recent quarters on potential competition to their, you know, what has been a virtual monopoly for CEREC chairside, CAD/CAM crown restoration, so just curious if you want to share your own thoughts in that particular subject as it's become more topical recently? Then separately, any general observations that you want to share from Chicago Midwinter Dental Meeting so far, besides the fact that the 51-degree high here today probably feels like Florida to you right about now.

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

We got our shorts on today.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, on the CEREC question, I think that's a great one because, you know, the way I look at it, and I think we look at it at Patterson, is the competitive entrants truly have validated chairside CAD/CAM with the profession, so I think it's a very exciting time as we look for that tipping point to increase adoption, and we feel very comfortable that we've got an amazing partner in Sirona to garner a large share of that future adoption and I think that validation of chairside is a really big deal. So, you know, when I was at the Yankee meeting in Boston and just walking the floor and seeing the other products were there and dentists looking at products and then coming to our booth to look at CEREC, you know competition, as we've always said, is a really good thing, and we still firmly believe that we're in the early innings of this digital revolution and this evolution of chairside CAD/CAM and couldn't be more pleased with the portfolio of products we represent from Sirona.

Second part of the question?

Steven Valiquette *UBS – Analyst*

It's—just any observations from Midwinter Dental so far, if anything?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, too early to tell. We've—you know, I spoke with a lot of customers last night at the Oral Health Gala, and I do sense professionally, other than everyone wanted to talk about the weather, there is a stability in the dental practices. There is sort of a, I think, quiet optimism about the future and, in general, I think the dental community truly understands that the next 10 to 15 years will create incredible opportunity for the dental profession. So I would say the mood so far – you know, we'll be down in the convention floor here in about an hour – the mood so far, I think, is very positive across the profession and the industry.

Steven Valiquette *UBS – Analyst*

Okay, that's great. Thanks.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks, Steve.

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

Thanks, Steve-o

Operator

Once again, ladies and gentlemen, if you would like to ask a question, please press star, one, at this time; and as a reminder, if you're using speaker equipment, you will need to lift the handset before making your selection. Our next question is from the line of Jeff Johnson with Robert W. Baird. Please go ahead.

Jeff Johnson *Robert W. Baird – Analyst*

Thank you. Good morning, guys. Hey, Scott, was wondering if I could start on the Vet business. That NVS number, I think as a couple of people have asked, you know, bigger than a lot of us were looking for in this quarter. Was there any pickup of new business in the UK vet market late last quarter, early this quarter, anything at all like that?

Then, Steve, maybe you could help us on the infrastructure side there. If you're taking, you know, maybe some of the US model there longer term, what does that mean maybe for margins in that business over the next year or two, good, bad, indifferent; and what does that maybe mean for the top line in that business as well?

Scott Anderson *Chairman, President and Chief Executive Officer*

Sure. I'll start—you know, we have gained some customers in the UK as the team really has hit the ground running since acquisition, so you know, they're moving at a very quick pace and are performing ahead of plan out of the gate, so we couldn't be more pleased with that. I would say from – I'll turn it over to Steve in a second on infrastructure – but I think it's also important that, you know, what is exciting is the team at NVS and our team at Patterson Vet in the US, led by our President, George Henriques, you know, we see that there is opportunity to grow that business on the technology side over time and bring some of the customer attributes and value-added services we deliver in the States, our NVS team is excited to bring some of those to their customers in the UK. So, we look for that to be margin accretive over time.

I'll have Steve just give some color on infrastructure investments.

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

Yes, I think at this point, Jeff, I wouldn't anticipate too much in the way of impact from infrastructure investments on that business. As Scott said, the new business opportunities will generate some revenue for us theoretically and, hopefully, at bigger—or larger margins than the historic logistics business. But it is a good size business with over $500 million in annual revenue and so your margin rate, I guess—the margin dollars will be accretive, obviously, but the margin rate is probably not going to be impacted very much. As far as what we can do from an infrastructure perspective, they will be pretty much standalone for the next two or three years as we go through the ERP implementation throughout the rest of the system and then they'll be brought on board. So, there'd be some opportunities at—near the end of that time period but the rest of it, combining with the medical operations and that sort of thing, I would not anticipate you're going to see much in the way of change there until at least deep into our fiscal 2016.

Jeff Johnson *Robert W. Baird – Analyst*

Okay, that's very helpful. Then the last question for me, just—I want to make sure maybe we're all on the same page on your Dental businesses as to what you're saying. So, if weather continued into February, it sounds to me like maybe you're saying, you know, fourth quarter similar to third quarter and then see kind of that return to normalization beyond that and also on the equipment side, I think—I don't remember, Steve, if it was you or Scott who mentioned the backlog of equipment. I'm assuming that backlog hasn't been booked to revenue yet. So, what kind of backlog are we talking about, and what could that may be support for fourth quarter equipment numbers?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, first of all, the backlog, the majority of that is in the basic equipment category, so that's why we feel pretty good about what's going on, on basic, and we would anticipate, you know, the majority of that backlog turning into revenue in the fourth quarter. I would say on the consumable side, you know, February is the—generally the lightest month of the quarter, so I don't feel like we're ready to make a call that it's going to have a material impact. Historically, when you've gone through big weather events, generally, the business just moves out; it doesn't incrementally come back but because there has been such a large impact, I think we're a little bit in uncharted waters and I wouldn't want to step away from the fact that we may see a nice spring-back in March and April as people get back into the vet offices and the dental offices and the rehab clinics.

Jeff Johnson *Robert W. Baird – Analyst*

Yes, that's helpful. I guess, just following up, Scott, on your equipment comments, is that basic—I'm assuming the answer to this is yes, but that basic backlog's bigger than it's been in the last few years. Does that give you what kind of confidence, I guess, on that fourth quarter equipment number?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, it's bigger than in the prior years. You know, the fourth quarter, which is always another large quarter for us, is also a really strong technology quarter, and as we've talked about previously, a lot of those decisions are on shorter timetables. So I would say we have, you know, decent visibility into the pipeline on the core equipment business and feel good about that, and we're still confident on the technology business that we can deliver another really strong quarter here in the fourth quarter. Still, a lot of interest in our digital offering, you know, Schick, GALILEOS, our Planmeca products, and then Omnicam continues to generate a lot of interest and I think increased competition, as I said in a question from Steve, you know, really has increased the visibility of chairside CAD/CAM across the entire profession.

Jeff Johnson *Robert W. Baird – Analyst*

Is that changing the selling cycle at all? Are you seeing any change, lengthening of the selling cycle on the CAD/CAM side? Then I'll drop, thanks.

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, I think sometimes it can extend the selling cycle, but I also think it brings more people into the funnel. So, you know, it's a net positive overall for the space.

Operator

Thank you. Ladies and gentlemen, if there are any additional questions at this time, please press star, one. Again, as a reminder, if you're using speaker equipment, you'll need to lift the handset before making your selection. Next question is a follow-up from the line of Kevin Ellich with Piper Jaffray. Please go ahead.

Kevin Ellich *Piper Jaffray – Analyst*

Yes. Hey, guys, I just forgot one question. Scott, you mentioned, in the Vet business, you know, the new products that are coming out and came back, like Sentinel, but with NexGard, do you think there's any chance Merial might consider moving that product to buy/sell from agency?

Scott Anderson *Chairman, President and Chief Executive Officer*

Yes, you know, I think they'll consider it. I wouldn't want to publicly comment on their decision-making process, but it's something to watch. I think it's a very exciting product, you know, a chewable flea and tick, and we're really excited to partner with Merial on that product going forward.

Kevin Ellich *Piper Jaffray – Analyst*

Yes. I mean—and given all the new products that have come out at NAVC and (inaudible) in the last couple of months, do you think, you know, high single-digit growth is kind of where you see the Vet business shaking out this year?

Scott Anderson *Chairman, President and Chief Executive Officer*

Well, I think the innovation is good for the market overall. So, you know, we're excited to see a new, I think, pace of innovation in the vet side, and we continue to prefer to take longer-term views of markets and see the companion animal space as having really solid fundamentals in terms of pet ownership and how pet owners take care of their pets for the next five to 10 years. So, real expectations of nice growth in that space for some time to come, and as we said, one of our big initiatives have been the equipment service side of that business, and we're continuing to see really strong double digit gains and as that business grows more substantial, that will help the overall look of our margin portfolio on the Vet side.

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

Yes, Kevin, this is Steve. Just to clarify; when you have new products within a category, it doesn't have the same effect as new products or starting a new category, so you're going to have shift moving back and forth between the vendors. So, I think you're going to see more of that going on with these new products and necessarily grow. Growth is going to be determined more by the seasonal aspects of summer as you go into flea, tick and heartworm and, as Scott said, by the number of pets, so not to get overly zealous or overly ambitious as far as these new products.

Kevin Ellich *Piper Jaffray – Analyst*

Got it. That's helpful. Thank you.

Operator

Next question is from the line of Ross Taylor with CL King & Associates. Please go ahead.

Ross Taylor *CL King & Associates – Analyst*

Hi, I just have one question. If I look at the vet consumable numbers, just in the US, I mean it looks like you had very good acceleration in the quarter despite the challenges of the weather, and I just wondered, you know, what might be driving some of that acceleration and just how sustainable it might be over the next several quarters?

Scott Anderson *Chairman, President and Chief Executive Officer*

I think it's good execution on the side of our Vet team, and I would say, you know, back to my previous comments, we feel good about the underlying growth characteristics of that space going forward. So, you'll always have some quarter-to-quarter variance but the long-term trend will definitely be one, I think, of solid growth in the vet space.

Ross Taylor *CL King & Associates – Analyst*

Okay and I'm assuming, you know, none of the new products really had any impact at all in the quarter given that they just launched?

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

At this point, not overly strong, Ross. We can't say that they didn't have some impact, but nothing of any substance in the quarter.

Ross Taylor *CL King & Associates – Analyst*

Okay, great. Thanks very much.

Operator

At this time, I'd like to turn the call back over to management for closing remarks.

Scott Anderson *Chairman, President and Chief Executive Officer*

Thanks Douglas, and thanks, everyone, for joining us today. In case you heard any sirens in the background, you know, we are doing this call from our hotel room in Chicago and are excited to be here in the Midwinter Meeting.

During the third quarter, we made progress on our strategic initiatives to offer best-in-class product innovation and services in order to fuel growth. As a result, we posted solid gains in equipment sales in both our Dental and Veterinary businesses. Further, our NVS acquisition performed well, helping us expand our veterinary footprint into the UK. We're focused on capitalizing on the growth opportunities that lie ahead as we continue to enhance our products and services.

We look forward to updating you in May on our full year results for fiscal year 2014 and our expectations for fiscal 2015.

Thank you for your time today.

Operator

Ladies and gentlemen, this does conclude our conference today. If you'd like to listen to a replay of today's conference, please dial 303-590-3030 or 800-406-7325 and enter the access code 4669120.

We'd like to thank you for your participation and you may now disconnect.