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Moderator: John Wright
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9:00 am CT

Operator: Please stand by, we're about to begin. Good day and welcome to the Patterson Companies Third Quarter Fiscal 2016 Earnings Announcement conference call. Today's conference is being recorded.

At this time, it's my pleasure to turn the conference over to your host for today's call, Mr. John Wright. Please go ahead.

John Wright: Thank you, Jason. Good morning everyone and thank you for participating in Patterson Companies' fiscal 2016 third quarter earnings conference call. Joining me today are Scott Anderson, our Chairman, President and Chief Executive Officer; and Ann Gugino, our Executive Vice President and 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, which could cause actual results to materially differ from those indicated in such forward-looking statements, are discussed in detail in our Form 10-K and our other filings with the Securities and Exchange Commission. We encourage you to review this material.

Also, a financial slide presentation can be found in the Investor Relations section of our Web site at pattersoncompanies.com. Please note that in this morning's conference call, we will reference our adjusted results for both the fiscal 2015 and 2016 third quarters, which exclude the impact of one time transaction related costs, deal amortization and foreign currency.

Additionally, our discussion of results is adjusted to reflect the reclassification of Patterson Medical as a discontinued operation. A reconciliation of our reported and adjusted results can be found in this morning's press release.

Today's earnings announcement and our discussion also reflect the realignment of our reportable segments. In additional to our dental segment, our companion animal business and our new production animal distribution business are now reported as the Patterson Animal Health segment.

Our other and more centralized shared functions that were previously embedded within the dental segment are now being reported in a separate corporate segment. This call is being recorded and will be available for replay starting today at noon Central Time for a period of one week.

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

Scott Anderson: Thank you John and welcome everyone to today's conference call. During the third quarter, we focused intently on making the most of the fundamental strengths in both of our businesses, and capitalize on the generally favorable market conditions affecting our dental and animal health segments.

We are pleased with our third quarter results, with our broad sales momentum and our execution. Since we closed the acquisition of Animal Health International last June, we have made it a high priority to preserve our focus on customer service and sales effectiveness as we moved through this critical period of integration.

Across our entire organization, I am pleased to say that we have done this and it is paying off. We achieved several additional integration milestones in the fiscal 2016 third quarter. We made additional progress on the headquarters relocations to our new animal health segment and consolidating functions to Greeley, Colorado.

We further strengthened what we believe to be the deepest leadership team in the animal health industry, and we unified our marketing and operations team. Today, we are truly operating as one business with our vendor partners, nearly all of whom have products across the entire animal health segment. Certainly, this is an important early integration win.

Also of note, at the end of the quarter, we moved forward with our first pilot implementations for our Next Generation Systems Initiative. This multi-year initiative will, over time, significantly enhance our efficiency and help drive bottom line performance.

To date, we have six branches, two fulfillment centers and several corporate functions directly involving more than 1000 employees on the new system. Overall, these early pilots are going well and I want to acknowledge the invaluable contribution of all Patterson employees involved.

I personally visited a branch office and fulfillment center as we went live and was very encouraged to see the commitment and determination of our employees firsthand. Let me also thank our new colleagues from Animal Health International, who bring valuable experience, having made this system's journey.

They have been incredibly helpful to our launch, and we believe their guidance and input will continue to be very valuable as we learn from these early pilots and ultimately extend the implementation across our entire organization.

Looking now at our markets, the stable to steadily improving conditions we have experienced in the past several quarters largely continued in quarter three. Both segments of our business saw sound, underlying dynamics, which served as tailwinds for our dental and companion animal businesses.

Improving employment levels and consumer spending continue to benefit both dental service utilization and spending on pets. On the production animal side, the end market conditions we witnessed in the second quarter largely continued in quarter three.

By combining our new production animal strength with our companion animal leadership, we have clearly created the market's most formidable animal health platform. Moreover, we've positioned Patterson to benefit from a new growth catalyst, the ever increasing global demand for animal protein.

Now looking at our results for the quarter, we turned in a strong performance. Consolidated sales from continuing operations rose 48% on a constant currency basis to $1.4 billion, reflecting the Animal Health International acquisition. Our adjusted earnings per diluted share from continuing operations rose 39% to 68 cents per diluted share.

Let's examine our two segments starting with dental. US dental market fundamentals were healthy during the quarter and we executed well. Sales from consumables expanded significantly during the period of more than 5% on a constant currency basis.

This is also a nice sequential improvement to our increase in the first half of the year, and we remain encouraged by the momentum here. Sales in our dental equipment category, which can be more variable quarter to quarter, posted solid gains. Equipment sales rose 6.8% in constant currency.

Technology remains a high priority area for investments of dentists. During the quarter, sales of digital radiography and traditional core equipment were particularly strong, although CEREC sales were below our internal expectations for the period.

However, just this morning, Sirona announced their new CEREC Zirconia workflow, which combines CAD/CAM technologies support with full contour zirconia material. This exciting new product offering will allow for single-visit restorations, using this high strength material. And we are very enthusiastic about this enhancement to the CEREC platform.

We feel confident in saying that the interesting CAD/CAM offerings is building across dental offices of all sizes. Today's product announcement once again expands the potential for CEREC chairside single visit dentistry.

Our leadership in digital dental technology as well as traditional equipment is driven by a particular philosophy: an approach to serving the customer that we believe has growing appeal. In addition to the many advantages this technology can provide dentists helping patients, dental offices of all sizes are increasingly seeking a worry-free approach to leveraging technology into their business.

We are speaking to you today from the Chicago Dental Society Midwinter Meeting, and this technology and equipment partnership is a common and compelling desire among our dental customers. The importance of superior technical support and service infrastructure needed to support this technology cannot be overestimated.

Patterson has invested significantly in these resources over the past 15 years, but we believe our service and support infrastructure give us a distinct competitive advantage to serve an ever evolving customer.

Looking now at traditional equipment, our quarter three performance was particularly strong. For several quarters, we have been describing our goal to build on the important strategic relationship we have with A-dec and improve our ability to address a wider range of customer needs with expanded offerings.

Those offerings include new partnerships with Pelton & Crane and the Belmont Company, as well as the new Sirona line of treatment centers and traditional equipment. Our results this quarter show that our execution in this area is clearly starting to pay off.

Sales of core equipment on a constant currency basis improved double digits year-over-year. We began training on the Sirona treatment centers last quarter. Customer reaction so far has been enthusiastic. We are confident that these lines will be welcomed additions to what we believe to be the most compelling portfolio of traditional equipment products in the dental community.

Now, let me provide some perspective on this year's extension of Section 179 tax benefits. Naturally, we're pleased to see the extension of these tax benefits for capital purchases made permanent, and we believe this certainly helps our customers with capital purchase planning in the years to come.

The extension of Section 179 benefits this year came at roughly the same time as last year. So we view our growth in equipment sales in quarter three as largely a function of market demand and sales execution rather than tax-incentivized purchases.

Now, turning to our Animal Health segment. During the quarter, sales in this segment more than doubled year-over-year on a constant currency basis. As I mentioned earlier, our sales team in this segment has focused on a thorough and timely integration, and these critical efforts are paying off across the entire animal health platform.

Companion animal continues to benefit from stable to improving market conditions and favorable pet ownership trends. Sales in the legacy companion animal business, excluding revenue from the acquisition and the impact of the shift in veterinary diagnostic vendor relationships, improved 6.2% in constant currency during the quarter.

US companion animal is particularly strong, expanding by more than 11%. I need to emphasize that this growth is the direct result of our efforts to rapidly integrate our companion animal management and sales teams and strong execution.

As you have seen in the press release, sales from Animal Health International added nearly $407 million to our animal health segment in the quarter. Similar to last quarter, end market pricing and customer profitability across the beef, dairy and swine species remain somewhat soft.

These factors are part of production animal market cyclicality, and they impacted growth in our production animal business. However, it's important to remember that regardless of market conditions, producers must continue to manage the health of their animals. And we play a critical role in helping them achieve this important objective.

And key to long-term growth, we now possess the foremost production animal business in North America. And we are especially pleased at how well we executed in the market while advancing all the integration activities involved with the acquisition.

All in all, we continue to make substantial progress in this all-important first year of integration in our animal health segment and are optimistic about the prospects ahead. With that, I'll ask Ann to review the financials.

Ann Gugino: Thank you, Scott. As Scott mentioned, we are pleased with the broad sales momentum and execution during our third quarter. Again on this call, I will discuss sales and adjusted results from continuing operations focus on the transformed Patterson Companies.

Also, bear in mind that today's results reflect the second full quarter of contribution from Animal Health International. So where appropriate, I will refer to organic sales, which strip out the impact of the acquisition to provide a more normalized view of operations.

Looking at the top line, we reported consolidated sales of $1.4 billion, up 48% on a constant currency basis. Organic revenue growth on a constant currency basis rose 6.2 %, excluding the impact from the change in diagnostic manufacturers in our companion animal business. Also, this is up sequentially from 3.3% organic growth in Q2.

The effects of foreign currency translation moderated slightly during the quarter. On a consolidated basis, currency translation sales reduced sales by approximately 1.7%. We continue to anticipate that 15% to 20% of our total revenue will come from international sources.

Now, let's look at margins. As a reminder, when we announced the acquisition of Animal Health International and the sale of Patterson Medical last year. The central rationale was to gain a broader platform for growth and improve our return on invested capital profile in exchange for some margin dilution.

Consolidated operating margins during the third quarter reflected that impact, declining 70 basis points. However, with the additional earnings power from Animal Health International, our operating income rose by $28 million to $108 million, up 35% over third quarter last year.

Organic consolidated operating margin in the third quarter averaged 8. 9%. We had another good quarter of operating margin expansion within both our dental and animal health businesses. On the bottom line, adjusted EPS from continuing operations totaled 68 cents.

Now, let's move on to our segments. In our dental segment, sales rose 5.9% on a constant currency basis. On the same basis, consumables grew more than 5%, as we saw solid gains in utilization. Equipment sales were up 6.8% in constant currency, reflecting strength in both core equipment and technology sales.

While we certainly believe the appetite for technology among practitioners is healthy and expanding, CEREC sales fell short of our internal expectations, as Scott noted. However, with the new product innovation and focused promotional offerings, we anticipate a stronger CEREC performance in Q4.

Operating margins increased 15 basis points over the prior year in Dental, driven by gross margins; specifically, earning additional manufacturer rebates, which resulted from our effort to broaden our core equipment portfolio as well as mix. We are on track to deliver operating margin expansion of between 20 and 30 basis points in dental for the full year.

Now, turning to our animal health segment. In this discussion, organic sales metrics exclude both the contribution from Animal Health International and the impact of the change in veterinary diagnostic manufacturers. Note that this is the last time that we will adjust for this change, since it has now been annualized.

On a constant currency basis, organic sales in the segment rose more than 6% for the quarter, driven by strength in the US sales from the legacy US companion animal business expanded 11.3%. This was partially offset by growth of less than 1% in constant currency sales in the UK.

The sales contribution from Animal Health International during the period totaled $407 million. With that contribution, sales for the consolidated Patterson Animal Health segment more than doubled from the prior year.

As Scott mentioned, the production animal market is currently impacted by some softness across beef and dairy cattle as well as the swine species. Currently expect these conditions to continue into fiscal 2017, with expected revenue growth rates in the 2% to 3% range for this business.

Operating margin within the animal health segment increased by 80 basis points, led by improvements in our legacy companion animal business and synergies capture. And we expect operating margins here to continue to expand going forward.

For the full year, we continue to anticipate operating margins on an adjusted basis of 4% to 5% in the animal health segment, as we've said previously. We are pleased with our progress in capturing synergies during the quarter.

Specifically, we have made strides in several areas, including the integration of our companion animal sales force, lowering facility expenses and reducing logistics costs, among others. Our efforts so far this year demonstrate that we on track to achieve our stated goal of realizing between 20 and 30 million in synergies over a three year period.

Now, a look at a few balance sheet and cash flow items. We used $47.5 million of operating cash flow from continuing operations in the quarter versus generating $119.4 million in the prior period. The increase in working capital is due to a few factors. Investment in inventories at our pilot locations and preparation for the new ERP system; inventory build with CEREC units; and purchasing opportunities from our consumable vendors at their year-end.

Working capital levels should come down over the next few quarters as we work through consolidation activities from the acquisition, stabilize business processes connected to our ERP initiative and work down the safety stock we used to ensure we would properly serve our customers during our pilot phase. As a result, we expect our net income to free cash flow conversion to still be positive for fiscal 2016 but lower than our historical performance.

We remain confident in our ability to generate growing cash returns on our business investments and growth opportunities. CAPEX in the third quarter totaled $15 million and included investments for normal replacements as well as our corporate-wide information technology initiative.

For the 2016 fiscal year, we are currently estimating CAPEX to be approximately $65 million to $75 million. In terms of shareholder return, year-to-date we have returned a total of $267 million to our shareholders through a combination of $67 million in dividends and $200 million of share buybacks.

I'll wrap up this discussion with a few comments on fiscal 2016 guidance. Based on our performance in the first nine months of fiscal 2016, we are narrowing our adjusted earnings guidance range to $2.42 to $2.48 per diluted share. I'll remind you that this range assumes stable North American and international markets.

It includes the impact of an extra week in fiscal 2016 and excludes any impact of additional share repurchases for the balance of the year. Our guidance excludes one time transaction-related costs, integration expense and deal amortization, nonrecurring IT training costs and tax costs related to cash repatriation.

Before I turn it back to Scott, a note about our Next Generation Systems Initiative and expense levels going forward. Today, we are actively shipping product on the new system. We are using it across a representative section of Patterson; and ultimately, this will lead to new efficiencies and cost savings.

However, this investment will begin depreciating in fiscal 2017, as we move further into implementation. We are currently in the stabilization phase with our pilot activity and are totally committed to ensuring a smooth transition to the new system.

This pilot phase will continue through the end of the fiscal year; then move into broader implementation during the late summer or early fall. We have significantly reduced our implementation risk by deploying the new technology gradually throughout our system rather than flipping the switch all at once.

But this comes with a cost in FY '17, as we are essentially running on two technology platforms. Additionally, some efficiencies cannot be fully realized until the ERP platform is totally implemented. As a result, we expect approximately a $25 million step up in operating expense pre-tax associated with the ERP implementation in 2017.

Although we are not providing specific guidance for fiscal 2017 today, we expect that momentum in the underlying business combined with efficiency initiatives should enable us to partially offset this step-up in expense. We will provide additional detail around this when we provide fiscal 2017 guidance during our year-end conference call in May.

All in all, we are on track for a sold fiscal 2016. And with that, I'll turn it back to Scott for some further comments.

Scott Anderson: Thanks, Ann. We are proud of our many accomplishments thus far in 2016, especially when I consider the range of initiatives we have before us. Specifically, we are forging ahead with the integration of Animal Health International into Patterson Companies.

We are moving forward with the pilot phase of our new ERP system. We are heavily concentrating on the sales front to make the most of the stable-to-strengthening market environment in front of us and doing all of this while maintaining the high levels of customer support and service we are known for.

Not only are we succeeding; we are accelerating through these challenges and opportunities and focusing on what we do best, which will be critical to achieving our growth goals. As we close out the year and look forward towards fiscal 2017, it's ultimately the people of Patterson that make us successful. And we continue to demonstrate the ability to attract top-tier talent.

Recently, we made some key additions to our already-strong management team. Doug Jones joined us as president of our Companion Animal Group. Doug comes to us from Merial North America, where he served as head of Merial's US Pet Sales and National Accounts team and most recently as President of Merial North America.

Doug's exceptional track record speaks for itself, and he will play a central role in enhancing our product and service offerings to our companion animal veterinarians. And Kelly Baker came on board as chief human resources officer.

Kelly joined Patterson from General Mills, where she most recently served as Vice President of Human Resources for General Mills US Retail operating segment. Her depth of experience in talent acquisition and development and workforce planning will be invaluable as we continue to grow.

Looking at our markets. In dental, we believe we are bringing to customers the right combination of product and technical support that will allow us to be the partner of choice for dental operations of all sizes. In animal health, I'm excited about the unity we have achieved within our team and at the synergies we are capturing and how we are positioned within both the companion animal and production animal markets.

The diversity of end markets and combinations of long-term growth opportunities and catalysts will be critical to us in the years ahead. Finally, we remain committed to our three-pronged capital allocation strategy and believe that our ability to propel the dividend and share repurchases while continuing to invest in the business reflects the strong financial platform we have built.

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

Operator: Thank you. At this time, if you do which to queue up for a question you could do so by pressing the star key followed by the digit 1 on your telephone keypad. If you are using s speakerphone, please make sure that your mute function is turned off to allow your signal to reach our equipment.

Once again, that is star 1 to signal for a question. And we'll pause for a moment to allow everyone the opportunity to signal. And we'll take our first question from Michael Cherny at Evercore ISI.

Michael Cherny: Good morning, guys, and thank you for the color so far.

Ann Gugino: Good morning.

Michael Cherny: So I just want to dive in a little bit on the consumables growth. It seems to be from a reported basis that this is the strongest number you've put up in two years. You talked about improving macro trends. Can you just give a sense maybe of some of the buying habits you're seeing that are driving that better number?

Is it more on a new customer basis? Is it more on a increasing the basket size each customer's getting? I just wanted to get a little more color on how much - what the various different pieces are that are getting you to that better consumables number.

Scott Anderson: Sure, Michael. I think it was a combination of a few things. One is we saw a pretty even growth in terms of geographies. I feel the dental community in general benefited in the November, December time period, which generally is one of a larger number of dentistry is done for insurance purposes. So some of that pent-up demand we've talked about.

Going back a few quarters, I think we began to see as we poll our customers, particular strength we're in, in sort of the chairside operatory products, which lends to the fact of more people are accepting open treatment plans. And then I think it was a strong execution.

So we absolutely feel comfortable that we're growing faster than the market and are pleased with the performance of the dental business.

Michael Cherny: Thanks. And then just, Ann, one question on the ERP Next Gen roll-out. Can you just level set us again what the total incremental cost is throughout 2016? And then as you think about in 2017, I know you don't want to give specific guidance, so just maybe qualitatively, some of the actions you need to pursue to try and offset some of that cost headwind.

Ann Gugino: Sure. The incremental cost in 2016 is very little, just because we have been heavily capitalizing the project up to this point. So the bulk of the incremental expense really hits in 2017, when we start the deployment across the system. And that's really two areas.

It's depreciation and then the people cost that you've been capitalized now start to kind of flow through the expense. So as I mentioned, it's about for 2017, we're anticipating it's about a $25 million step-up in expense pre-tax. So I think that would be the color I'd be able to provide at this point.

We can give you some more details as we get into giving guidance at the end of next quarter.

Michael Cherny: Okay. Thanks.

Operator: And we'll take our next question from Kevin Ellich at Piper Jaffray.

Kevin Ellich: Hey, guys. My phone kind of cut out, but - so if I missed it, I can go back and listen to the transcript. Scott, I wondered if you could provide a little bit more color as to what's going on with the equipment sales. I heard the comment about CEREC came in below expectations; and of course Sirona launched the new Zirconia workflow. Wondering how you think that's going to play out throughout the year.

And then second question in the animal health business. Clearly, the dairy and the beef cattle markets have been a little soft. Wondering what your outlook for 2016 is and expectations on the production animal side, especially with the swine business as well. Thanks.

Scott Anderson: Great. Yes, without going back over the transcript in total, I'll sort of hit the high points. You know, strong performance in a number of areas in North American dental equipment; very strong performance across our whole digital portfolio in terms of cone beam panoramics and intra-oral digital products as well as really nice growth on the traditional chair unit, light, cabinet, core equipment growth with multiple partners.

So a really nice quarter with A-dec as well as some of our new partners. Did mention that we began training on the Sirona treatment centers. But I would say that, that didn't have a material impact in our results in this quarter, but we look at that as a real catalyst to growing that top end of the market going forward.

On the CEREC front, I'd say sort of three things as we look at the quarter. One, we did have a, I would say, maybe a small drag coming out of second quarter. Second quarter was our second largest CEREC quarter in the history of the company and very, very strong on the new user demand.

We felt Section 179 passing late, if it impacted any area of it, it may have had a small impact on the CEREC area. And then as we got into January and we began to send out notices to our CEREC sales force about coming to Minneapolis for some training, that may have slowed down the pipeline a little bit towards the end of January.

So we have a challenge out to our CEREC salespeople and our salespeople in general because we know there's robust demand for CEREC and really feel like the Zirconia workflow is a game changer. We've talked for years about the CEREC system just becomes easier and easier to use with the improvements in software.

Great material partners have helped on the clinical side, but what Zirconia does is it really opens up a whole other customer base in terms of just really meat and potatoes dentistry. So it's very exciting. And I think this is just another part of this ongoing CEREC story that we've been such a big part of for 15 years.

And we're excited to drive demand with even, as I've said many times, CEREC is sort of the Swiss Army Knife of dentistry, and now we just have one more tool in the kit. Moving on to animal health, you know, as I said, we experienced similar conditions on the production side.

The one thing I would point out is we have a great management team in our Animal Health business in this team, and it was part of due diligence. They know how to manage cycles very well, so they're managing the business very well through the current cycle.

We feel like we're taking share. We're all over the integration plan. We'll probably see the conditions - Ann mentioned in her comments, you know, potentially 2% to 3% growth on the production side going into fiscal 2017.

But a common point that we've talked about in our Investor Day and many other times, and I apologize for the long answer, but we're a key part of keeping the animals healthy. And the producers are intent on keeping the animals healthy, regardless of their profitability swings.

So our cyclicality is much less than what our end consumers, producers experience. And we're managing the business very well through this period.

Kevin Ellich: Great. And then with the strong companion animal growth that you saw, the 11%, do you think much of that's - how much of that's due to the new products that came to market and then the very mild winter that we saw in Q4, or in the December quarter?

Scott Anderson: I think we'll see potentially more weather effect going into the fourth. But I think it was just strong execution. Just like the demo question I answered the last time, very even in terms of the geographic dispersion of where the growth was.

One of the things we talked about is we very quickly integrated that companion animal team and the management team and got our people very focused on taking care of customers and helping customers win in the marketplace. So just strong execution by that group.

Kevin Ellich: Okay. Last one for Ann. Capital allocation, you guys have done a lot of share repurchase this year so far. Wondering what your outlook is on the front between share buyback and acquisitions.

Ann Gugino: Sure. So I would say here in the shorter term, depending on the market conditions, we could choose to opportunistically get back into the market and continue to buy back our shares over the next few months. With that said, we are at the stated goal of $200 million for the quarter.

And of course, we need to balance that with the increased working capital needs in the short term that I discussed resulting from the ERP implementation and the AHI integration activities. But over the long term, we continue to believe that a capital allocation strategy that balances deployment of free cash flow back into the business could drive strategic growth either for M&A or just internal growth.

And then returning cash to shareholders through our dividend and share repurchases is the right strategy to drive increased shareholder value.

Kevin Ellich: Sounds good. Thank you.

Scott Anderson: Thanks, Kevin.

Operator: And we'll take our next question from Jeff Johnson at Robert Baird.

Jeff Johnson: Hey, guys. Good afternoon or good morning. Thanks for taking the questions. So couple questions here. Scott, I heard the 2% to 3% number on the animal health business on kind of a go-forward basis or the production animal side. You did 6% on the companion side this quarter.

As we think forward over the next few quarters and investors are starting to turn towards the 2017 model is that what we should think about for the companion side?

Scott Anderson: Yes. I'd say the companion side is sort of a mix of our NVS business in the UK and the U S business. I think we would see the NVS business strengthening a tad, getting over some tougher comps they've run into. But really, the driver of the companion business is the US.

And in the US, I think they're pretty healthy market dynamics across the board. So similar market conditions on the companion side, but most importantly in the US companion side.

Jeff Johnson: All right. That's helpful. And then, Ann, on the $25 million incremental next year on the IT side. How would you think about leveraging those costs then at you go into 2018? Is this just a step-up in the depreciation and the go-forward costs, and we kind of level set those into our 2018 and beyond numbers?

Ann Gugino: So the step-up in 2017 is the incremental costs of the depreciation of people costs. But with that said, to your point, when we get out of - either to the tail end of 2017 or well into 2018, we would expect to be able to take costs out of the organization because what we have currently in our underlying numbers are the costs to run the existing system.

So for 2017, we're actually going to be - we're going to be running two systems. So I would expect in 2018, there's two things. One, we're going to be able to shut down the legacy system. And, two, we'll begin harvesting the operating efficiencies because we'll have the entire company on the new platform.

Jeff Johnson: Well, maybe we'll offline kind of talk about some of that could come down. But last question I had, just on the consumable side, the number was obviously strong on the Dental consumables number this quarter. I've heard very good things on January, not just November, December.

And I think, Scott, you mentioned November, December for insurance purposes but I've heard good things on January as well and even continuing into February. So any comments just on the general trend?

Scott Anderson: Yes. Sure. And good question, Jeff. I can clarify a little bit what I said. In terms of - there's always a lag on when you resupplying the dentist. So the fact that the dentists were very busy in November and December definitely helped in January.

So obviously, our quarter is through January, so we saw that strength. The other thing I think we're all experiencing now as we get into February, March is it was a pretty rough winter last year, particularly in the Northeast and the Southeast.

So you're getting - I think the whole industry's getting a little weather benefit right now. But overall, pretty stable environment.

Jeff Johnson: Thank you.

Scott Anderson: Thanks.

Operator: And we'll go next to Steven Valiquette at UBS.

Steven Valiquette: Thanks. Good morning, Scott and Ann. So I guess for dental equipment - and I guess it's encouraging that we're characterizing the just-reported quarter as driven by normal equipment demand and not driven by Section 179. I think I asked the same question on your dental distributor peer, on their call as well.

If we fast forward to about a year from now, should we assume maybe preliminarily that you'll have some easier comps year-over-year in your upcoming fiscal 2017 for dental equipment because of the fact that the Section 179 tax break is already locked in to the upcoming year and would hopefully drive some extra purchases in your fiscal 2017? Thanks.

Scott Anderson: Yes. Steve, this is Scott. And I would absolutely anticipate that we would be in a very healthy environment for dental equipment as we go into the second half of calendar 2016. I think the fact that this was a permanent extension really resonates not only with our dental customers, but I've spoken to a number of sort of leading accountants who deal with dental practices across the county.

And just having the rules of the road in front of them, I think really opens up now discussions that have been tougher to have over the last 24 to 36 months. Particularly around potential major expansion of dental offices, major remodels.

And when you look at a produce like CEREC in particular, the Section 179 benefits are a major economic driver that helps a dentist make that day a great investment for their practice. So not to get too far ahead of ourselves; if we have a good macroeconomic backdrop with these incentives, absolutely, we would look to get back to a more traditional type volume that we had in years - two, three years ago.

So we're pretty excited about it, but we're concentrating right now on the fourth quarter.

Steven Valiquette: Okay. Great. And then one other quick one. I'm not sure if you hit on this or not, but did your employee medical expenses normalize this quarter? Just want to check the box on that as well.

Ann Gugino: Yes, they did. They came back to normal levels. So we're running about $15 million a quarter.

Steven Valiquette: Okay. Great. All right. Thanks.

Scott Anderson: Thanks, Steve.

Operator: And we'll go next to Robert Willoughby at Credit Suisse.

Robert Willoughby: Scott, a question. You mentioned on the weaker CEREC placements a couple reasons. Do you think there was anything involving the new product line coming out or I think you mentioned a promotion there. Does that result in any softness in the CEREC or no effect?

Scott Anderson: I don't want to let our dental team off the hook, but obviously - and I mentioned it a little bit - when we told our CEREC specialists they were coming to Minneapolis for training, they definitely knew that something was coming, particularly how we invited them and the confidentiality around the meeting.

So we may have had a delay there, but there'll be a full expectation that we get up and running real quickly here on the CEREC front. But the Zirconia workflow's a big deal, and we're really excited about the potential of it.

Robert Willoughby: And what is the promo that you mentioned?

Scott Anderson: Just, I would say nothing incremental in terms of promotions. Just - or I think a pretty solid promotional roadmap that we've laid out with Sirona not only for our fourth quarter but throughout the summer. So nothing incremental in expense.

Robert Willoughby: Okay. Nothing like buy one, pay us in a year?

Scott Anderson: No. No. No. I tried, but Gugino wouldn't let me do it.

Robert Willoughby: Right. Right. And Ann, do you have a balance sheet share base for the quarter? I have the income statement; I don't see the balance sheet one.

Ann Gugino: The balance sheet what, share? I don't have that with me.

Robert Willoughby: Okay. I will get that from you.

Scott Anderson: We'll follow up.

Ann Gugino: Yes.

Robert Willoughby: All right. Thank you.

Scott Anderson: Thanks, Bob.

Operator: We will go next to Jon Block at Stifel.

Jon Block: Great. Thanks, guys, and good morning.

Scott Anderson: Good morning.

Jon Block: Maybe two or three quick ones. Ann, the first one, the free cash flow as a percent of net income, you said expected to be positive. But it is a big revision. I think previously, you talked about 100% conversion. So what's that mostly a function of? Is that just largely the inventory build ahead of the ERP transition?

Ann Gugino: Yes. So you're right. We were coming into the year thinking it was going to be coming in line with historical levels, which is usually between 85% and 100% conversion. And you're right. It's inventory in a couple areas, so a portion of it is the ERP system and ramping up for that. And we think we'll be able to moderate those levels as we get near to year end.

Part of it is the CEREC build. Just due to the sales performance in the current year, we had built higher inventory levels up at the end of the second quarter and into the third quarter expecting a better performance. And then the third area is just as we consolidate warehouses in the animal health space.

We just had a little bit of a build in inventory there to maintain service levels as we're bringing one facility up and another down. You'll also see a little bit of a build in our long-term receivables, and that's really some unsold finance contracts.

That's really a timing issue but does have to do with the business process transition to shared services for accounts receivable, collections and processing. And that is a part of the SAP implementation as well. So we'll be able to bring those levels down over time, but it's going to take us a couple quarters.

So I think we'll be positive in Q4 but not to the same extent as last year.

Jon Block: Got it. Got it. Very helpful. And then shifting to the UK CAG business, the overall CAG growth was great; it was really robust. But the UK CAG was sort of flattish for that second or third straight quarter. I heard some of my other guys talking about some international weakness in prior quarters but seems to have gotten better.

So Scott, do you think UK CAG is still market, or do you think there's any market share going on with your NVS business over there?

Scott Anderson: I would say, Jon, we're very confident it's a market issue and we're performing against the market. As we've stated before, we are a market leader with over 40% share. And we would look for those conditions to improve as we get into the springtime.

Jon Block: Okay. And last one. Scott, I hope this is a fair question, but you're tracking towards the midpoint of your original fiscal 2016 guidance. But arguably, that's with what I compute as roughly 5 cents aid from the share repo. And I believe the end markets have certainly strengthened throughout your fiscal year.

So can you just talk to us on arguably, why you're tracking towards a little bit the lower end of your original guidance ex-share repo, despite end markets that have been strengthening over the past nine-plus months? Thanks, guys.

Ann Gugino: Sure. So I think you're right that the share repo is about 5 cents. And I think there's a couple reasons that I would point to tracking more towards the midpoint of the range versus the upper.

You might recall last quarter, we said we think we can get to the upper end of the range but that would be getting some tailwind from Section 179 which, as Scott noted, we really had no effect. It passed at about the same time this year versus last. And then part of the other thing is we had some one-time expenses in the first two quarters of the year.

We had the health insurance expense with the higher claims experience in Q2 of about $5 million, and then you might recall we had a bad debt write-off in Q1. So I kind of look at the share repurchases kind of offsetting a couple of unusual items in Q1 and Q2.

Scott Anderson: Yes. I would say from underlying business performance outside of those items, the businesses are performing well and we will look to them to improve going forward.

Jon Block: Perfect. Very helpful. Thanks for your time, guys.

Operator: And we'll go next to Lisa Gill at JPMorgan.

(Mike Minchak): Thanks. It's actually (Mike Minchak) in for Lisa. Just a couple questions. So first, I think it was about a year ago that you'd discussed a five-year goal of doubling the CEREC installed base. Can you talk about maybe where you're tracking with respect to that goal?

And has anything changed in terms of your confidence of being able to achieve that target or maybe the cadence around how you expect to build to that number?

Scott Anderson: Well, I'm absolutely confident in the target, and I think all who know me knows that I'm a real believer in the impact of what chairside CAD/CAM dentistry can do for the dental profession and for dental patients. So obviously, I would say sitting here right now, we need more lift out of the sales force.

We are spending a lot of time around training. We have the national sales meeting where we spent a lot of time talking about CEREC. But also another piece of this is innovation, and that's where my confidence in Sirona could not be higher.

And I also believe the combination of Sirona and DENTSPLY can be a catalyst towards driving our stated goals further. And something like the Zirconia workflow launch really opens up CEREC to pretty much every dentist in North America, regardless of their clinical preference, which is a big deal.

So I would not couch that goal at all. But it is an aspirational goal, but we feel like this is a product on the verge of a major tipping point.

(Mike Minchak): Got it. And then with regards to the Next Gen System, can you remind us if you talked about in the past maybe when you initially announced the initiative, you know, about what do you expect it to drive in terms of savings and efficiencies over the longer term and what that time horizon is?

And going along with that, do you expect to be at that full run rate of savings in your fiscal 2018?

Scott Anderson: Yes. I'll start on just some operational strategy questions and then maybe have Ann finish off. One of the things we stated about is we feel this is a big investment to really create a modern digital platform for the company; to be able to take care of not only the customer of today but the customer of the future.

But also make us a much more nimble, flexible company to be able to drive investment in the right place but also drive returns to owners, regardless of what end markets look like. Could not be more pleased with the initial launch. We have, I would say, three things.

One is we have a very stable system; two, the fact that we're fully operational in two fulfillment centers. And personally visiting our South Bend facility and seeing that work going on and picking some orders myself, I'm excited about the efficiencies there; and then the third good sign is all of our pilot sales branches are seeing sales growth.

It's not without a lot of effort by our employees, anytime you make a major organizational change like this. But we are off to a good start. Maybe I'll have Ann put a little more color on the end of that.

Ann Gugino: Sure. So the total investment in the technology is around $85 million. If we look out in terms of the return on that investment and what we talked about initially, I think Scott talked a lot about that already in his comments.

What I would add to that is we do have a very detailed plan, specifically by business function, by person, in terms of what we're expecting in terms of efficiency gains or operating margin expansion opportunities or working capital improvements. We have not quantified those publicly.

What I would say in terms of can - will we be at a full run rate in 2018? I hate to say, it depends, but it depends. So it will depend on, as we get into full scale roll-out later this summer, how well that goes, right? So if it's going as well as the pilot, we think we could accelerate that and be in a really good position to begin harvesting at the very beginning of 2018.

If we hit any bumps in the road, it might be a little later into 2018 until we start harvesting some of those synergies. And I think as we get closer, we can provide a little bit more color on how much of that $25 million we think we can mitigate through other operational efficiencies next year and then how much we think we can take out into 2018.

But I think we need a little more time. We're just in our strategic planning cycle right now.

(Mike Minchak): Great. Thanks for the comments.

Scott Anderson: Thanks, Mike.

Operator: And we'll go next to Robert Jones with Goldman Sachs.

Robert Jones: Great. Thanks, guys. I just had one question, actually, on the animal health side. If I heard you right, I think you were calling for 2% to 3% growth on the production side. So I guess, A, is that right? Did I hear you correctly?

And then relative to the synergies that you guys have out around AHI, does that growth range affect or impact the synergies that you guys have targeted or do you need it to kind of return back to that four to six normalized range that I think you guys had shared back at Analyst Day?

Scott Anderson: Yes, Bob. I'll take that. I was specifically, and in Ann's script was, it was 2% to 3% in the production side only. And the synergy plan was not tied to revenue growth, so we are on track regardless of end market conditions in the coming year to continue to accelerate our synergy roadmap.

Robert Jones: Great. That's all I had. Thanks.

Scott Anderson: Thanks, Bob.

Operator: And at this time, we have no further questions in the queue, so I'd like to turn the call back over to Mr. Anderson for any additional or closing remarks.

Scott Anderson: Thank you, Jason, and thanks, everyone, for joining us today. We're encouraged by our progress and look forward to updating you soon on our fiscal 2016 conclusion as well as seeing many of you this afternoon at the Chicago Midwinter Dental Meeting. Thanks for your time today.

Operator: This does conclude today's conference. Thank you for your participation.

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