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Operator: Please stand by. Good day ladies and gentlemen and welcome to the Patterson Companies Second- Quarter Fiscal 2017 Earnings Announcement. Today's presentation is being recorded. At this time, I'd like to turn the floor over to Mr John Wright – please go ahead sir.

John Wright: Thank you Catherine. Good morning everyone and thank you for participating in Patterson Companies Fiscal 2017 Second-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 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.

In addition, comments about the markets we serve, including growth rate and markets shares, are based upon the company's internal analysis and estimates. The content of this conference call contains time-sensitive information that is accurate only as of the date of the live broadcast, 22 November 2016. Patterson undertakes no obligation to revise or update any forward-looking statements to reflect events or circumstances after the date of this call. Also, a financial slide presentation can be found in the investor relations section of our website at pattersoncompanies.com.

Please note that in this morning's conference call, we will reference our adjusted results for both the fiscal 2016 and 2017 second quarters, which exclude the impact of transaction-related costs, deal amortization expense, integration and business restructuring expenses, accelerated debt issuance costs, and the tax impact of cash repatriation. We will also discuss free cash flow, which is a non-GAAP measure and the impact of foreign currency and extra selling days.

A reconciliation of our reported and adjusted results can be found in this morning's press release. This call is being recorded and will be available for replay, starting today at noon central time for a period of one week. Now, I'd like to hand the call over to Scott Anderson.

Scott Anderson: Thank you John, and welcome everyone to today's conference call. I'd like to begin by first discussing how some of the market dynamics we are currently seeing and the strategic shifts we are making are influencing our fiscal 2017 outlook and forecast. Our end markets are currently presenting us with some unique near-term challenges on both sides of our business.

First, in our dental business. The soft but stable market conditions we experienced in our fiscal first quarter extended into our second quarter. And on the animal health side, we were experiencing the effects of consolidation among the branded pharmaceutical manufacturers. While we believe this consolidation dynamic is short-term in nature, it has resulted in a softer manufacture pricing environment, which has impacted our margins in the animal health segment. Importantly, our current outlook also needs to factor in our recent strategic decision-making.

Today, we announced that we will change the nature of our relationship with Sirona for the goal of opening up new opportunities for Patterson and our customers. As we transition toward a new working relationship with Sirona, we can expect some near-term headwinds in exchange for longer-term growth opportunities. To reflect these dynamics, we have modified our fiscal 2017 adjusted non-GAAP earnings guidance from continuing operations to a range of $2.25 to $2.35 per diluted share this year.

As we work through these factors, we are committed to taking the steps necessary to improve our earnings performance and we remain confident in Patterson's long-term prospects. We operate in compelling markets and are building a business model that will be increasingly relevant to our customers. I remind everyone that there are important long-term demographic trends that underpin our business and in our view, remain very attractive.

In the dental market, the long-term fundamentals and trend lines are unchanged. Several factors, including a generally stable employment market, an ageing population and dentists seeking new ways to improve both the patient experience and how their practices operate, form the basis for our optimism in dental.

We have different but equally compelling factors on the animal health side of our business. One is the global expansion of the middle-class that will result in an increase in animal protein demand. We expect the US production animal market to have a global leadership role in satisfying that demand. We believe our entry into this market just over a year ago and into the position as the leading animal health distribution company in North America, is a compelling long-term growth catalyst.

Relatedly, we continue to have a lot of optimism in the long-term growth trends in the companion animal market. We believe stable market conditions and a persistent rise in both pet ownership and spending per pet, will continue to generate long-term opportunities for us. This component of our growth plan remains unchanged.

For the next few minutes, however, I would like to provide some additional perspective on the dental market: how it's changing and how we are responding. The various ways that practitioners of all sizes need to address the requirements of dental consumers are evolving. These are changes we have been anticipating. We have been adjusting our approach to the market and our business, to better position our dental operations for long-term success. These efforts have been methodical, multi-year and expansive.

They have included: changes in our basic equipment portfolio with the intent to bring a wider range of product offerings to the entire market of customers within the market; our commitment to our new ERP platform to ensure that we are building maximum efficiency into our operations and providing the backbone and toolset for a more expansive and effective e-commerce platform, that will accommodate modern buying habits. And the investment we have made in our technical service and support capabilities, which we believe represent untapped value and will play an increasingly important role in the years ahead. Our adaptation continues today.

Three other factors in dental are impacting how we view opportunities and how we are changing to capture them. The first two are trends: evolving practice models in the North American dental market and the continued evolution of digital dentistry. The third is the voice of our current and potential customers. We are listening very closely to our customers, and in many ways their feedback is directly influencing our change.

This has led to several important decisions and exciting developments over the past several months. First, in June we took steps to optimize our sales force in Dental with the goal of building a team that is better aligned with where we believe customer needs are moving.

We have gone to great lengths to build a value proposition around outstanding sales support with an emphasis on technical and operational needs of our customers. We believe these needs will become more pronounced in the future as practitioner environments of all sizes become increasingly digital. Our sales force needs to reflect this change. We have always been a destination for the best sales professionals in the business, and these efforts are putting more opportunity in front of our best people.

Second, regarding digital dentistry, we believe we have a unique perspective. Today, we are having conversations about technological need and preference and digital workflow with a much wider range of customers. Our leading position as a distributor and enabler of dental technology, gives us insights into the aspirations and decision-making considerations of practices of all sizes and more importantly how this is changing.

The reality is the dental market is – the definition of digital workflow - is evolving. It means something different across the practitioner spectrum. Being the distributor of choice across the full spectrum, means Patterson needs to evolve and leverage our superior support platform to customers. Therefore, to better address the needs of the full dental market, we have made the decision not to extend the exclusivity of our relationship with Sirona beyond September of 2017.

This decision is consistent with our strategy of serving the evolving needs of all of our customers and will allow us to better serve the full range of practice models. We believe the modern customer wants a partner like Patterson who can combine both the superior technology support platform with the full range of product options. Our global ‘best in class’ support structure for technology is a critical asset. It has been of great interest to many other product manufacturers who recognize the importance of this back-end support to the adoption of their technology.

Patterson’s technical service and support has been a major differentiator in the adoption of chairside technology. We believe that with the wider portfolio of product offerings, this asset will become even more valuable and an even stronger differentiator. We are confident that this deliberate shift away from manufacture exclusives will unlock opportunities for everyone involved in the dental supply chain. I want to be very clear: we are immensely proud of our 20-year relationship with Sirona and have great admiration for their technology and history of innovation.

Through this relationship, Patterson Dental effectively built the North American market for chairside technology. The combination of Sirona's CAD-CAM technology and Patterson's sales, service and support has set a very high standard. Sirona's chairside solutions, like the rest of their product portfolio, will remain a very important part of our offerings. For practitioners that seek single-visit solutions, I believe we will remain the clear supplier of choice.

We are fully committed to driving sales performance through the completion of our exclusivity period and then selling their products on a non-exclusive basis with the same commitment to driving mutual success. For practitioners and operations that need more flexibility and a wider range of technology options, they will now find that in Patterson and we will eventually carry the necessary products that will allow us to meet the digital workflow needs for the entire range of customers in the market.

Lastly, we believe our expanded product and support offering will enhance our ability to enhance the full spectrum of customers. That of course includes the DSO community. We are very excited by our new relationship with Heartland Dental, the largest dental support organization in the United States. The hallmarks of Patterson Dental – superior sales, service and support with technical applications – played a large role in this win.

In our conversations with Heartland, it was clear they were seeking a business partner that shared the same philosophy of bringing 'best in class' products and solutions to their network. With a strong focus and commitment to helping them improve in the operational areas they outline for us. Our respective teams immediately began working together to begin delivering the solutions that form the basis of our partnership, and the collaboration and cultural fit have been outstanding.

This is just the beginning of what we expect to be a broader and more fruitful period of engagement with dental support organizations and one that dovetails with our efforts to adapt to a changing market. In terms of capital deployment, many DSOs choose to deploy their resources to expand their reach with additional offices and would like to outsource some of their capabilities to their lab partners. Some of our DSO customers already have, or will embrace, full chairside restoration capability. Our superior service and technical support in that arena will be of critical importance to these DSOs and the local success of their practices.

A value-added distributor such as Patterson needs to be able to address the entire market with whatever the individual customer needs to make their professional offers most successful. Undoubtedly, this is the start of a very exciting time for our customers, our sales force and the product manufacturing community. We expect this shift within Patterson Dental to create new opportunities for us and for our customers, and to highlight the competitive advantage we demonstrate in the market every day.

As I mentioned earlier, we continue to see relatively stable but soft end markets in dental in the second quarter. As with our first quarter, this was generally aligned with what has been more widely reported within the North American dental market and the effects were most evident in consumable sales levels. However, we still believe a portion of this impact resulted from disruption caused by our sales force realignment initiative. As we work through the transition caused by this realignment, we expect this impact to moderate.

On the equipment side, we are pleased with our performance during the quarter, especially considering the difficult year-over-year comparable we faced with CEREC. From our point of view, we are encouraged that practitioners remain willing to invest for the future success of their businesses. Within the category, volumes on basic equipment and digital X-ray were solid during the second quarter.

In particular, we are pleased with how our broader basic equipment product portfolio is performing. You will recall that our basic equipment product category also experienced a change in manufacturer relationships. Adding more product manufacture options has benefited our customers and has strengthened this category for Patterson Dental.

Now, we'll look at our Animal Health segment. We continue to see stable to strengthening conditions across this segment during the quarter. In production animal, we saw overall recovery in end markets, with the swine market leading the way. We also saw strength in the beef cattle market, however recovery in dairy end markets is proving to be more protracted than anticipated. Companion health markets continued to perform well during the quarter.

As we mentioned last quarter, sales execution has been a significant priority for us, and we are pleased to see substantial sales growth and share gains across the segment. This is certainly a reflection of our efforts to unify our sales teams and present one Patterson Animal Health segment to the market. However, we currently face a challenging pricing environment with branded pharmaceutical companies, which is the result of market consolidation. This has impacted our ability to translate the significant sales momentum into profit contributions we want to see.

I will remind you that Patterson Animal Health is the North American leader in this space. We believe that our scale and scope are important assets, and as we work through this period of consolidation, we will emerge as the partner of choice for pharmaceutical manufacturers. As we do so, we continue to be intently focused on our customers and operational excellence. With that, I'll ask Ann to review the financials.

Ann Gugino: Thank you Scott, and thank you all for joining us today. During the fiscal 2017 second quarter, our growth agenda and sales execution were key focal points for Patterson. Overall, we remain competitive in our markets during the quarter. We broadened our markets in the Dental business, and saw substantial sales growth and gained market share in Animal Health. However, certain strategic initiatives combined with challenging marketplace dynamics, in both Dental and Animal Health, adversely affected our year-over-year quarterly financial results and our outlook for the balance of the year.

As I've done in the past, I will discuss sales and adjust the results from continuing operations to focus on our current portfolio of businesses. Where appropriate, I will make note of our adjusted results, which as John explained, excludes the impact of certain non-recurring and non-cash items. Also, our sales discussions for each business segment will exclude foreign currency impact, to provide a more normalized view of our results.

Taking a look at our top-line performance, consolidated sales for the fiscal 2017 second quarter increased 2.1% to 1.4 billion on a reported basis. Excluding the foreign currency translation impact, revenue grew 4.1%. Turning to margins, our second-quarter consolidated operating margin was 6.5%, which was 50 basis points lower compared to the prior-year quarter. The operating margin decline was chiefly due to decreased profitability in our Animal Health business, which accounted for the largest percentage of our consolidated net sales. I'll expand on this more in a moment.

On the bottom line, reported net income from continuing operations was 45.8 million, up 12% to $0.48 per diluted share, compared to 42.6 million or $0.43 per diluted share a year ago. Adjusted net income from continuing operations declined 3.2% to 53.5 million in the second quarter of fiscal 2017. Adjusted EPS from continuing operations was flat versus the prior-year quarter at $0.56 per diluted share.

Now, let's move to our segments. As Scott explained, in Dental we saw a softer but relatively stable market in the 2017 second quarter, which led to essentially flat sales on a GAAP and constant currency basis. On the consumables side, the dental market continued to reflect somewhat slower than historic growth. Patterson sales of consumable dental supplies decreased 2.5% in the second quarter.

We believe, however, that the sales force realignment that we implemented in the first quarter, primarily contributed to the consumables decline. While this initiative is important to better address the needs of the dental customer, it is causing some disruption in the channel.

Turning to equipment, Patterson has a long tradition as an industry leader and our equipment category was a bright spot in the quarter. We were pleased with our sales in this category, which grew 4.2% in the second quarter. Sales were led by double-digit increases in core equipment and digital X-ray products, which offset lower CEREC[?] sales. Looking at segment margins, operating margin improved 30 basis points, led by our sales force realignment initiative and lower incremental expense. Overall, we believe that the performance of our dental business in the second quarter was competitive relative to the industry.

As Scott mentioned, at the end of the second quarter we elected not to extend exclusivity with Sirona beyond September 2017. As a result, we expect to record a pre-tax non-cash impairment charge in the third quarter of approximately 36 million, or $0.24 per diluted share, related to the distribution fee associated with the CEREC product component of this arrangement. While this non-cash accounting charge will not affect Patterson's liquidities, cash flows or compliance with debt covenants, we expect this decision could negatively affect near-term operations. This impact is reflected in our updated fiscal 2017 earnings guidance.

Now, turning to our Animal Health segment: we saw sales expansion and share gains in our animal health business in the 2017 second quarter. Our Animal Health sales grew 4.2% over the prior quarter on a reported basis. After adjusting for the impact of foreign currency, Animal Health segment sales increased 7.8%.

Second quarter reported sales in our Companion Animal business rose 3.6%. Adjusting for currency, Companion Animal sales increased 10.8% over last year. Looking more specifically at the US Companion Animal sales, reported growth was up 15.8% and 9.8% when adjusted for agency buy/sell[?].

Growth in Production Animal sales in the 2017 second quarter improved 4.9% versus a year ago. Our overall performance in Production Animal reflects a stronger swine market, an improved geese market and continued softness within the dairy portion of the business. Looking at segment margins, while we generated solid sales volume increases, that growth did not translate to the bottom line improvement. We are capturing market share, although it’s not at the profit margin we’d like.

A reason for this is a more challenging environment related to branded pharmaceutical manufacturers’ pricing trends, which contributed to an 80-basis-point decline in operating margins during the quarter. We are implementing programs to respond to these challenges and remain focused on our customers, along with disciplined execution and integration synergy capture. Our ongoing Animal Health integration and progress to our planned synergies remain on track.

We are focused this fiscal year on more effectively leveraging logistics across both of our businesses and further consolidating our back office functions. We still expect to deliver between 18 and 20 million in run-rate savings by the end of this fiscal year, which will enable us to meet the 20–30 million run-rate of synergies in year three that we announced at the time of the acquisition.

Now, we’ll look at a few balance sheet and cash flow items. Net cash generated from continuing operations was 17.5 million compared to using 21.7 million in the prior-year quarter. We believe that cash flow will continue to improve for the balance of the year. We remain confident in our ability to generate cash returns in our business, and expect a return to converting between 85% and 100% of net income into free cash flow in fiscal 2017.

CAPEX totalled 14 million in the fiscal 2017 second quarter and included investments in our corporate-wide information technology initiative. Inventories were up by 40 million year-over-year. Dental equipment inventories came down in the quarter, but higher inventories remain in our Animal Health business and to maintain service levels through our integration and ERP implementation.

Regarding our ERP initiative, during this period we are essentially running redundant systems to help facilitate the transition to our new platform. We believe that our new ERP platform will lead to new efficiencies, however, some of them cannot be fully realized until the platform is totally implemented. That said, we believe we have a sound process in place to migrate to our new system in a way that ensures business continuity and high levels of customer support, and leads to significant future efficiencies once the transition is complete.

We continue to make good progress on the implementation. Our investments enabled nine additional locations to go live in the second quarter. Three Fulfilment Centers, one Vet Call Center, two Animal Health branches and three Dental branches. Together, this resulted in a $3 million expense increase for the quarter. As previously disclosed, we continue to expect a pre-tax 25 million step-up in the operating expense for the full year. This expense will accelerate in the back half of the year as we begin to depreciate the investment and scale of deployment.

We continue to execute on our capital allocation strategy by continuing – or by returning cash to our shareholders. Demonstrating our commitment to enhancing shareholder value, we returned approximately 48.5 million to our shareholders in dividends and share repurchases during the quarter, and nearly 100 million on a year-to-date basis. We remain fully committed to our dividend. Our strong cash flow generation is an asset and allows us to fully support our capital allocation strategy, which includes returning capital to our shareholders.

Given our continued position of financial strength, we have the ability to step up our share repurchases to deliver additional value to our shareholders. We have approximately 15 million shares under our current board authorization. Our strong balance sheet gives us the flexibility to repurchase shares opportunistically when we believe it makes sense to do so.

Now, turning to taxes. Our adjusted effective tax rate for the quarter was 35.7%. The adjusted annual tax rate is expected to be in the range of 34.5–35.5%.

Now, I will review our revised fiscal 2017 guidance. As mentioned in our earnings release, in light of both external factors and our strategic decisions, we have re-examined our financial outlook for the year. When we entered fiscal 2017, our guidance was predicated on end markets similar to those experienced in fiscal 2017. However, Patterson and others in our industry have seen a softness in the US dental market and challenges with branded pharmaceutical companies in our animal health business.

Just as important as these external factors are the strategic decisions we made in the first half of fiscal 2017: first, to realign our dental sales force, to enhance our effectiveness; and more recently to move away from exclusive manufacture relationship to leverage our support infrastructure across a broader range of products and customers. While both of these decisions are key to evolving the customer-centric approach for which we are known and realizing our growth conditions in moderate terms, we recognize they will affect near-term financial performance. Therefore we are updating our guidance as follows.

As Scott noted, we now anticipate adjusted earnings from continuing operations in the range of $2.25 to $2.35 per diluted share. Our adjusted guidance excludes the impact of one-time transaction-related costs, integration and business-restructuring expenses, deal amortization and non-cash impairment charges, totalling $0.60 per diluted share. On a GAAP basis, we expect fiscal 2017 earnings from continuing operations in the range of $1.65 to $1.75 per diluted share.

While we are only off a few cents from our internal plan to the first half, we are reducing our guidance to this new range based on what we see in the back half of fiscal ’17: specifically in Dental the softness in the market coupled with the transition of our exclusive relationship of Sirona; and in Animal Health, the impact of the margin decline experienced in the current quarter will continue in the near term as we diligently work to improve margins.

Our guidance range assumes North American and international market conditions similar to those experienced in the first half of fiscal 2017, and includes a 25 million pre-tax step-up in operating expense associated with the ERP system implementation. With that, I’ll turn it back to Scott for some further comments.

Scott Anderson: Thanks Ann. I’ll wrap up with a few additional comments. As I mentioned recently, Patterson is in the middle of an important period of change. Our portfolio moves, technology investments and shifts in how we address the needs of our customers are all part of an important evolution.

But I’d like to emphasize that just as we have demonstrated our committed to positioning Patterson in the future, we are equally committed to restoring Patterson to a more profitable growth in the near term, and have multiple levers to pull to do so. Fortunately, we are able to do this from a position of operational and financial strength. Keys to our operational strength are our enterprise resource planning initiative and our sales and support infrastructure.

We expect our ERP initiatives to significantly improve our ability to help Patterson stay in front of our customers' needs and pace of change. I have visited various locations where the cutovers to our new system are taking place, and I am pleased with our progress and operational continuity.

I commend all of our hard-working employees who have dedicated themselves to pursuing a smooth implementation of this system. We have built a very robust sales, service and technical support structure that customers truly value as they increase their dependence on technology to run their operations. Our financial strengths give us the ability to support each aspect of our capital allocation strategy, and this will continue.

While we face some short-term market challenges to navigate the change we have strategically elected, I am confident in the actions we are taking to position Patterson for the future and optimistic for the prospects of our customers, employees and shareholders. Now, we would like to take any questions you may have, so I'll turn the call back over to Catherine.

Operator: Thank you. Ladies and gentlemen, if you'd like to ask a question, please press *1 on your telephone keypad. If you're on a speaker phone, please pick up your handset and make sure your mute function has been turned off to allow your signal to reach our equipment. Again, that's *1 for questions. We'll hear first from John Kreger with William Blair.

John Kreger: Hi, thanks very much. Scott, can you just elaborate a bit on your decision to alter the Sirona relationship and how should we think about the sort of puts and takes to your business over the next 12 months? Thanks.

Scott Anderson: Sure, thanks John. I'll talk first about strategies because I think that's very important, and then I'll turn it over to Ann to maybe talk some of the economics. But I think it's critical that, as I talk about our decision, we also talk about the history and partnership, because we do have people who are newer to the story and I think it gives a very important context.

If you go back to the 1990s, it really was a vision towards the future that the Patterson management team had as they approached Siemens Dental with the offer that we would sell and service the CEREC 2 exclusively. At the time, Siemens had a game-changing idea with single-visit chairside dentistry but really had very limited commercial success to sell the product. We like to say that agreement was the beginning of what we call a 20-year overnight success story as we partnered with the eventual spinout of Siemens dental, which became Sirona, to really do true pioneer work to change dentistry.

I would say we could not be more proud – and I speak for all the employees of Patterson – about the work we've done together, no more excited – or more excited about what we are going to accomplish together in the future. I think it's important that everyone knows our executive teams, both at Patterson and Sirona, for years had been very consistent in our approach that there would be a day where Patterson will need to expand the portfolio of products. We sell to meet the needs of our customers and also Sirona will want to access more of the market through potential expanded distribution.

This is the critical point. I think we both as partners feel now is the perfect time at the end of our contract to move our relationship to the next level. And really this is predicated on our mutual confidence and I would say strong confidence in our ability to compete in the marketplace. As a reminder, we've seen the scenario: we've – it's playing out right now in our chair business, and our great partner A-dec, we remain their largest partner and yet we have the ability to sell more products, which has helped us access more customers.

The other piece is really unlocking growth for both companies, and the commitment of both companies of helping the profession accelerate the adoption of digital dentistry. So a key part of this strategic decision is we both feel an increased interest in activity that will come from expanded distribution and will lead to a potential acceleration of sales.

Bottom line is more people are going to be talking about digital dentistry, and more people will be talking about CEREC, and we think we can sell seven out of ten instead of five out of five, and overtime net[?] tested, net net this will be a real positive for Patterson and Sirona.

Ann Gugino: John, as it relates to your question around guidance, so as we think about our updated guidance for 2017, it does anticipate some headwinds regarding Sirona. Specifically, we anticipate there could be some near-term distraction with our field sales force around the Sirona announcement. And then in addition to that, we anticipate we'll incur some incremental costs to protect the technology assets we've built over the last 20 years.

When you think longer-term, out to 2018, at this point there's still a lot of moving pieces. In addition to Sirona, we plan to add additional technology products to the portfolio. We're on-boarding large new customers and then of course we should start to benefit from our ERP investments in the back half of 2018. So we'll continue to work through the challenges that we're facing over the next 90 days and our plan is to update you on our longer-term outlook next quarter.

But I would just emphasize that longer term, we do believe that the underlying business organically will be able to grow and continue generating significant amounts of cash.

John Kreger: Great, thank you. And maybe just one more quick one to clarify: your comments on Animal Health around the pharma manufacture pricing environment, were you referring to just maybe a more muted kind of inflationary trend on their part, or is this more a change in the terms that you can buy those products from them?

Scott Anderson: Yeah, great question, John. And yeah I think we really want to look at it from three points, so I'll start and talk about the current business challenges to give you a full context, and have Ann get into the financial impact and then talk about our mitigation go forward plan.

Really what we're experiencing right now is: I would classify as a sort of a near-term disruption as a result of some manufacturer consolidation in the space that, as we've talked about, is putting pressure on our margins. I don't want to call out specific manufacturers but it's clear that we're in the midst of a significant realignment of some of our key partners.

With that said, we really think long term and I think the important thing is that we have repeatedly demonstrated our ability to move share in the market and that, with our scale reaching both companion and production animal customers, really gives us confidence that we'll be the partner of choice among manufacturers as consolidation settles in. So I'll turn it over to Ann to walk you through the financial impact, and then I want to talk about mitigation.

Ann Gugino: Sure. So while we saw our ninth top-line growth in the second quarter about 10% in the US, our operating profit decreased double digits, about 18% on an adjusted basis. I would just say that the 80-basis-point decline that you saw, the challenges that we're seeing with the branded pharmaceutical manufacturers account for 100% of that decline. It's a variety of factors, John, whether it's rebates, mix and just kind of overall the changes that we're seeing in the terms of the agreements.

We are implementing programs immediately to respond to these challenges but it will take some time to work through and as a result we're taking down guidance for the back half of the year to more closely align with our current quarter performance. So while we're we initially targeting operating margins for the segment to be flat for the year, after absorbing an allocation for the step-up in expense associated with the ERP implementation, we now expect margins for the full year to decline. between 40 and 60 basis points for the year in Animal Health.

Scott Anderson: Yeah, and I'll just finish by saying our Animal Health management team is obviously actively engaged with our key partners as well as myself, and it's clear that our growing sales momentum across the platform, that Patterson Animal Health is the growing partner of choice for many end customers. We will continue to drive that value, and look forward to deepening manufacturer partnerships to serve the market and this is an issue that we intend to get resolved over the next six months.

John Kreger: Great, thank you.

Operator: Our next question comes from Ross Muken with Evercore ISI.

Ross Muken: Good morning guys. In terms of the Sirona relationship, obviously over a long period it's been very successful but there's also pressures on the sales force when you have minimum levels and you need to hit certain targets relevant to a certain product. Can you talk a bit about it and maybe use the chair example of what you learned, but talk a bit about sort of post the exploration of this exclusivity, what do you think it'll do to kind of, the sales force and how you expect them to react and whether or not this could actually be sort of a rallying event for folks versus maybe something that leads to, I don't know, departures or more transitionary[?] challenges.

Scott Anderson: Hey Ross, great question. I would say we've had a very thorough communication plan, and we had over 100 of our general managers in Minneapolis last week walking through the strategy of what we're doing and why now is the right time, and I would tell you there is a sense of a rallying cry both for – and I think I want to be very clear – both for support of Sirona and our long-term prospects but also we talk about 'one Patterson' and we have some tenets around 'one Patterson' and one of those is 'customer first'.

Really the feedback I've gotten - and we've done some focus groups as well with some of our top salespeople - is the ability to at every point put the customer first in the decision-making process is incredibly powerful. I think the exclusivity, particular on CEREC served Patterson and Sirona so well historically, because you need focus and commitment to make a market, and we made a market together. But we feel now there's momentum and actually a real chance for acceleration in the space that's going to let both Patterson and Sirona win.

So we learned this through the A-dec decision, which has been very powerful. I've talked to our salespeople all over the country, and I can't tell you how often our best salespeople say, ''Let me compete. Just give me all the products and we'll do what's best for the customer." And that also puts, I think, a really exciting and competitive spirit back on the manufacturer that the best product wins: the most effective, most efficient product wins.

In my previous answer, I talked about the confidence that Sirona and Patterson share, and I have been in this relationship for 20 years. We make this decision together as partners because of our confidence to compete and our confidence that this is right for customers.

Ross Muken: And is it possible that that is helpful to you in sort of gaining share on the DSO side, because I think their choice and best price etcetera would probably be a preference versus having just one product to push in on the CAD-CAM side?

Scott Anderson: Yeah, obviously, and I think it played into our discussions with Heartland. When you look at those large customers, they want access to all products and then they really truly want a logistics partner, a service partner, to take care of everything. So while we have opened a very large door in Heartland, I think - and I've had multiple conversations with many customers and am very actively helping our demo group as we expand and expect to win sales over the time - that this absolutely plays to the strategy. I think it also creates plenty of opportunity for Sirona over time to strengthen their story in the DSO community as well.

Ross Muken: Great, thanks.

Scott Anderson: Thanks Ross.

Operator: Thank you. Our next question comes from Michael Cherny with UBS.

Michael Cherny: Good morning guys, and thanks for all the details so far. Just using maybe Heartland as another example, obviously I know that was a nice win for your guys: can you maybe just go through a few more details specifically about what you can learn in terms of the Heartland sale process, and how you can apply that to the DSO market? I know it's an area that you're trying hard to go into – can you talk maybe about, from a DSO perspective, how much they care about service versus product breadth versus price?

Scott Anderson: Yeah, great, thanks Michael. Well, sort of a tenet[?] in the table stakes is that you have to be – have competitive economics and that's the same for all of our customers. But I think what was interesting in the evolution of the Heartland relationship – and I'm going to have Ann give some color as well because she was very involved as we built the partnership together as well. But really the value position centered around – and we did a lot of time listening to the customer: how can we help Heartland meet their growth expectations?

They wanted areas where they can improve their operations, they wanted to maximize their practice investments in the most efficient way, so we really looked at it from a joint partnership and how do we optimize the supply chain and really position Heartland and meet their growth expectations. I'll have Ann give some color because, as I said, she was very involved in the process as well.

Ann Gugino: Yes, certainly Heartland is a very exciting win for Patterson and I would just reiterate what Scott said I think. As I met with that team and had the opportunity to work on the RSP – I think it's all about unmet needs, so I think that one of the things that was super-exciting for me at Patterson is, while we were potentially a little late to the space, what I can tell you is there's absolutely still a lot of unmet need in this space that fits well with what Patterson does well in terms of our competitive advantage around service, around software, around technology.

As Scott said, Heartland is all about the customer. It was great; I think it's going to be a 'win win' partnership. And I think the other thing that's super exciting for me is that the investments that we'll partner with Heartland on, will help us really build a platform that we'll be able to leverage as we bring additional DSOs online, so definitely the work we're doing together will benefit the entire DSO space.

Scott Anderson: Yeah, and I would say there's going to be follow-on benefits in terms of the e-commerce initiatives that are going to benefit all of our customers.

Michael Cherny: Thanks. And then just one quick financial question: Ann, you mentioned how you have flexibility on the buy-back given the outstanding authorization. Are there any limitations you have related to leverage, or I guess any getting[?] factors in terms of being able to act on the buy-back?

Ann Gugino: No. So I think just to kind of walk through what we've said so far, and then I'll get kind of specifically to your leverage question, but we spent 50 million on share repurchases to the first half of the year, which is a little over a million shares. And, as you know, we're committed to driving shareholder value and cash generation is a real asset, so we'll continue to increase the dividend and do our value-enhancing share repurchases.

We've previously communicated as part of our overall capital allocation strategy, that we'll allocate between 100 to 150 million of free cash flow annually to share repurchases, but depending on market conditions, we may choose to accelerate the buy-back further. And given our financial strength, we certainly have the ability to step up our share repurchases if we chose to do so. Our current leverage is at about 2.5 times or 2.6 times EBITDA, so we definitely have room there if we chose to do so.

Michael Cherny: Okay, thanks.

Operator: And we'll now hear from Jeff Johnson with Robert Baird.

Jeff Johnson: Thank you. Good morning guys. So Ann, maybe a couple of follow-ups, to start with you if I could? You mentioned in one of your answers that some of the disruption here may be protecting the technology assets you've built around the CEREC platform and the Sirona platform. I just, I'm not quite sure I understand what you mean there; if you can maybe clarify that?

And then also wondering on the sales disruption side for CEREC, if that is indeed an issue you're kind of computing in guidance? Why would there be a sales disruption in the near term? I would think reps would want to be out there selling this, especially before more competition comes in and I've heard you've put a quota in now this morning for the next nine months or so before the change happens, so why the top-line impact? I'm a little unclear on that as well. Thank you.

Ann Gugino: Sure, thanks Jeff. I'll start and then I think Scott will probably follow up with a few comments. But I think as it relates to protecting the assets that we built, this is really around a couple of areas, and one is our people. We've been selling this product for 20+ years; we have deep expertise: so just making sure that we're doing the right thing for our people in terms of as we transition to a competitive environment.

And then it's really the intellectual property around the processes that we've built around training and after-sales support: we have quite the asset at the Patterson Technology Center in terms of providing first-class support and we just want to make sure that we're doing the right things and so there'll be some additional investment there just to make sure that we protect that IT.

As it relates to the sales disruption, I think when we put the guidance together we wanted to make sure that we were conservative and as we've gone through other transitions in the past historically, whether that's the A-dec change, or the change when we changed how we filled other technology products back with the Eaglesoft software days, sometimes when you're going through a transition there is some near-term disruption in the field so from a conservative standpoint, we did use the top line in our outlook just to account for that. But with that said, we fully intend to execute on the contract for the balance of our exclusivity and leave no rock unturned in terms of sales leads. But I'll turn it over to Scott to add to that.

Scott Anderson: Yeah, thanks Ann and thanks Jeff because I think that's a great question and I just want to reiterate what Ann said. Number one, it's taking a conservative approach, which we have as we've put together guidance for back after the year – half of the year. Two, it's an absolute commitment to defend what we've built and we will do that at every turn because we feel it's an absolute competitive advantage today but it's only going to grow with time.

Now three, to the sales force, and I would say I have great confidence in our managers and our salespeople to absolutely, as you said, use this as a rallying cry. We have incredibly deep relationships with Sirona: Sirona is family to Patterson and Patterson is family to Sirona. It is our intent that we use this as an opportunity to finish off the chapter of the 20-year exclusive, but also use this as a launching pad for what we think is going to be a very exciting time of competition.

When I had our people in Minneapolis last week, what got me the most energized is the confidence of our managers and how excited they are to compete and leverage what we've put blood, sweat and tears into over the last 20 years. So I think you're right on in terms of the conservatism in the guidance, but it is our absolute intent that we exceed those conservative targets.

Jeff Johnson: Yes, that's helpful. And then I guess my last question would just be: Scott, is there any way, or Ann, to kind of bucket[?] if guidance was being cut at $0.35 on the year. Obviously, some is soft end markets; it doesn't sound like the ERP spending is changing, so maybe how do we bucket the $0.35 between sales force disruption with the cuts this past June, the Sirona stuff, maybe currency and some other factors – can you help us out there at all?

Ann Gugino: Yeah, absolutely. So if we think what's changed in the marketplace and how those recent events are impacting our second-quarter results and then the implications to 2017, you touched on two factors. With unexpected changes in the marketplace, that negatively impacts the balance of the year: so there's the softness in the US dental market and then challenges with branded pharmaceutical pricing in our animal health business.

Then in addition to those factors, it's the strategic decisions we made in the first half of the year: most recently the move toward non-exclusive manufacture relationships within our technology portfolio. So when I think about breaking that down, what I can tell you is about half of the reduction in guidance is due to Animal Health and the other half is due to Dental.

When I think about Dental, Jeff, I would say probably half to two-thirds is really more on the consumer market softening and some disruption from the sales force restructuring, and then the other third is probably around the Sirona piece, as a rough bucket.

Jeff Johnson: Yeah, that's helpful thank you.

Scott Anderson: Thanks Jeff.

Operator: And Jon Block with Stifel, please go ahead.

Jonathan Block: Great, thanks. Good morning. Maybe just to start, I'll keep it to two. North American consumable growth was – I think the weakest is around the recession, and you mentioned market and sales force and I believe mostly sales force. So, Scott, maybe I'm just curious and with all due respect, why you didn't see this as a potential outcome from the sales pruning. I mean, obviously one of your main assets is the rep relationship with the practice so now several months later, post some of the changes: what took you by surprise on the rep approach[?]?

Scott Anderson: Yeah, I'll talk about the general market, John, and then I'll talk about the rep piece because I think they're two important parts. I would say on the general market commentary that the softness we experienced and the entire industry experienced during the summer continued through the fall and as we looked at the back half of the year we decided to take the conservative approach, saying there wouldn't be any market improvement.

I would say the market is stable and if I had to look at a growth rate I would say it's probably you know, zero to 100 basis points so a lethargic market. So while we're disappointed that it didn't swing back post-summer, I think we have really strong potential fundamentals for the market that give us optimism going forward. You've heard this before: it's stable to improving consumer confidence; it's low on employment levels; it's a continued trend of customers investing in technology and then it's the demand-driven for favorable North American demographics.

So on the sales force side – and I think this is an important part of the strategy, because we absolutely are committed to it and feel like we made the right move to move the business towards where the market is going – the sales erosion is contained to a certain number of customers, but when you look at the upside opportunity of almost 19,000 new customers that we've assigned some of our best salespeople to, we look at the long-term growth opportunity as being substantial and material. What we did not anticipate in the front end – and maybe I'll turn it over to Ann to talk about - just what a consumable softening does to our operating model.

Ann Gugino: Yeah, so great question Jonathan. So certainly when we put together our guidance for the year, knowing that we were going to do the rep realignment, we absolutely factored in some distraction in the field. I think what we didn't account for is the continued and softening of the markets, or in-market softening, and if we look across the industry, by my estimate we were off by about 200 basis points from the trailing 12 months.

It's really that factor that's causing the reduction in guidance. When you go back to my script, what we were trying to say there, when we were talking about the rep restructuring accounting for most of the decline, is that if you added the rep restructuring back and didn't factor that in, we'd be growing with the market.

Scott Anderson: Yeah, and I would just add one last piece. If you look at the strength of our equipment business in the quarter and that is with the realigned sales force, I think that shows that the productivity of our salespeople and the sales we're making across the platform: we haven't missed a beat on that side. Maybe Ann has one other comment she can throw in?

Ann Gugino: Yeah, I think the other thing when you look at the rep realignment, just to make the very salient point that the upside from these actions is much greater than the current business loss, so when we look longer term, we absolutely believe this is the right move in terms of unlocking market potentials for our best reps.

Jonathan Block: Okay, great. That's very helpful, thank you. And just one other one on the other side of the business, with – on the Vet side, can you just give some more clarity on the issue with the branded manufacturers? I apologize if I missed the details but the industry has been consolidating for some time now, so I guess what is incremental or new with the marketplace that's resulting in this pressure? And then just from a margin perspective, is there anything you can do to alleviate the margin pressures from the manufacturers, or is it just trying to find other sources of savings to help you guys with profitability? Thank you.

Scott Anderson: Well, I'll start. It's two things, John. As I said in my prior comment, I don't want to get into the specifics of key manufacturers and negotiate in public, but there are some significant realignments going on right now. We're working through that. The market is already also working through the consolidation that's happening in distribution. And that's why we are very confident that we will move through this and capture the value that we create for the customers. I can maybe have Ann add some color to that?

Ann Gugino: Yes, I think, to answer your question on is there opportunity with the manufacturers and then internally, I think the answer to that is both. So when I think about the size and scale of our organization, with the combination of Production Animal and Companion Animal and really serving both those markets and the value that we bring to the manufacturer community, I really think that as the consolidation settles down we will be the partner of choice.

But I think that's a little bit longer term and when I think about what we can do in the shorter term, while we're lowering guidance we are promptly taking steps to address the headwinds that we've identified. There are many levers we can pull to offset some of the profit pressure, for example, we've identified additional and we have ongoing cost management initiatives under way to bring savings to the company.

But of course it's a balance, right, because we also have the incremental step-ups in expense from our IT investment, and of course we're just ramping up that implementation, so it's definitely a balance. We also are continuing to work on integration activities and pushing hard to drive incremental synergies. So we are all over this but it will take some time to work through.

Jonathan Block: Thanks for the color guys.

Scott Anderson: Thank you.

Operator: Ladies and gentlemen, we have time for one more question. We'll go to Robert Jones with Goldman Sachs.

Nathan Rich: Hi, this is Nathan Rich on for Bob this morning. Ann, I just wanted to go back to your comments on the consumables market, and if you could clarify how consumables trended during the quarter? I think the comments that you guys had made on your last call about August, seemed to be that consumables were moving more in the right direction, so just curious how trends played out in September and October. And then in another – some other, to call out whether there's a potential headwind in October, so I'm just curious if you saw that as well?

Scott Anderson: Hey Nathan, this is Scott. Let me take that first and Ann can give some color at the end. I think it's very important when we're talking about volatility in consumables, we're talking about a very small band. This is a stable market that's moving between 2% underlying market growth and maybe flattish underlying market growth, so we don't want to overreact to the trends.

I would say we saw a little pick-up coming into the fall but then it settled back down, so what we see is just a stable market. We have a lot of confidence that the market is not receding from where it's at right now. Obviously, a lot happened here this fall politically, and it'll be interesting to see how small businesses potentially could see some positive influence from Washington going forward, which would benefit the dental market. But I think I just want to caution everyone that these are very small bands of quote, unquote 'volatility' and maybe turn it over to Ann.

Ann Gugino: Yeah, so when I think back to first quarter, we didn't want to overreact to the consumable results, and then of course we had a lot of noise going on with our internal restructuring activities. You're right, we did see some rebound in October, but unfortunately the softness has continued with similar results in Q2. I think as we look at our Q2, our Q2 actually improved throughout the quarter and I think that really speaks more to the sales rep realignment activities as we settled down and began to claw back our customers, that we lost and win back that share. So I think for us we saw - and again, as Scott said - it's a narrow band but we did see some improvement in October.

Scott Anderson: Yeah, and I would just finish, Nathan, by saying I don't think weather had a material effect. You had the hurricane in the South East but most of that was over the weekend and Friday generally can be a bit of a slower day in dental practices, so obviously some impact but nothing I would specifically call out.

Nathan Rich: Okay, great. I appreciate the comments, thank you.

Scott Anderson: Thanks.

Operator: Thank you. I would like to go ahead and turn the conference back over to our speakers for any additional closing remarks.

Scott Anderson: Thanks for joining us today. Ann and I look forward to seeing many of you next week at the Greater New York Dental Meeting and in the meantime, I wish each of you a happy thanksgiving and we look forward to updating you to our progress in the next quarter.

Operator: Thank you. Ladies and gentlemen, again that does conclude today's conference. Thank you all again for your participation.