Company: **Patterson Companies**

Conference Title: **Third Quarter Fiscal 2017 Earnings Conference Call**

Moderator: **John Wright**

Date: **Thursday 23rd February 2017**

Operator: Good day everyone, and welcome to the Patterson Companies Third Quarter Fiscal 2017 Earnings Conference Call. Today's call is being recorded. At this time I'd like to turn the Conference to your host Mr John Wright. Please go ahead sir.

John Wright: Thank you, Augusta[?], and good morning everyone, and thank you for participating in Patterson Companies Fiscal 2017 Third Quarter Earning 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 for 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 risk 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 market shares are based on the company's internal analysis and estimates.

The contents of this conference call contains time sensitive information that is accurate only as of the date of the live broadcast, 23rd February 2017. 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 presentations 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 third quarters, which excludes the impact of [inaudible] expenses, non-cash impairment charges, immigration and business restructuring expenses, transactional related 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.

Reconciliation of our reported and adjusted result can be found in this morning's press release. As a reminder todays earnings announcements and our discussion also reflects the re-alignment of our reportable segment. In addition to reporting our dental segment, our convenient animal distribution business, and our production animals distribution businesses are reported as our Patterson animal health segment.

This call is being recorded, and will be available for a 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. Today I want to begin by outlining how Patterson continues to evolve both in relations to the needs of our customers, and in our ability to strengthen our operating model. This is not only important to understanding key aspect of our third quarter performance, but also establishing the context of where we are heading, and our approach to get there. Patterson has a long history of leading change in our chosen markets, and this is at the centre of our current strategy. Our markets today face a combination of shifting customer needs, opportunities and challenges that demand will continually evolve in further enhance our ability to execute. I will break this down starting with our dental segment.

As I discussed last quarter we've had extensive conversations with customers over the past year representing all clinical environments about how their needs are evolving. We are speaking to you today from the Chicago Dental Society's Mid-Winter Meeting, where we continue to collect these observations, and use them to inform our product and service strategy. These conversation help solidify our decisions to make some strategic changes in our dental business over the next past couple of quarters. These changes have the potential to disrupt our business in the near term, but are designed to enhance our long-term competitiveness, and move Paterson even closer to being the partner of choice for the widest range of customers.

We began with our sales force re-alignment last June. We undertook this initiative not just to enhance productivity, but to nurture those sales professionals who are better able to accommodate our dental customer's needs, whose needs are becoming more sophisticated.

These changes continue with our decision to alter the nature of our relationship with our long-time and valued partners Sirona. As you know, we announced last quarter that Patterson has chosen not to extend the exclusive portion of its relationship with Sirona beyond its expiration in September of this year. We made these moves fully understanding their potential to impact our sales performance in the next term. However, we believe Patterson knows how to re-engineer for growth, and we have a history of making well calculated yet disruptive changes in our business to create new opportunities.

For example, just over two years ago we announced our intent to broaden the range of products we sell on the core equipment side of our dental business. This meant expanding beyond our relationship with our long time strategic partner RADAC[?]. While this move certainly created near term disruption in the channel, we have since added several other manufacturer relationships, and further clients to this offering. While further deepening our relationship with our highly-valued partner RADAC.

Our performance in the core equipment category during the third quarter was a bright spot, in fact it was the strongest quarter we've had in this product category since calendar 2009. We believe our success with navigating these kinds of business model adjustments provides a preview for what we intend to accomplish on the technology side of the dental business.

That decision two years ago to broaden our offering core equipment led to our desire to expand into other categories, while simultaneously enhancing our relationship with dental supply Sirona. When announced our decision last quarter to transition to a new working relationship with them we understood this had a potential to disrupt our technology portfolio in the near term. We made significant progress in the last 90 days to secure our key assets and focus our sales team, but the possibilities for disruption still exists. However, we remain committed to the [inaudible] platform for those practise environments where [inaudible] restoration can be an important differentiator. We were pleased to achieve modest [inaudible] growth in the quarter. In line with our expectations for [inaudible] sales during that period, our performance supports our committed to this important technology.

Looking at our dental equipment category more broadly, there are two aspect which were disappointing this quarter. The first was our performance the digital x-ray category. As we stated before, our efforts over the years have led to a substantial market share penetration for Patterson in this category. At a certain point, incremental growth in this area becomes even harder to achieve. The second release to the effects of section 179 which is now a permanent tax benefit for purchases of capital equipment per buy practitioners. While we typically see spikes in equipment purchases in late December, this did not materialise during the quarter as it has in previous years. We believe however, that the permanence of this tax benefit will create a better capital planning structure for our customers, and lead to an evening out of sales over the course of the year rather than concentrating at the calendar year-end.

Lastly, a word about dental consumable sales in the quarter. The consumable sales environment was mixed during the quarter, and our sales in this category continue to reflect temporal, but stable conditions compared to last year. We also believe that there remains certain softness in our performance that is unique to Patterson as a result to the disruption from our sales re-alignment initiative. That said, we remain optimistic that this period of transition to our dental business is a positive and necessary one to make us even more relevant, and valuable partner to all our customers, from the small dental practitioner up to the dental service organisations.

The new customer relationships we are creating through expanded equipment offerings we believe will lead to new consumable relationships. Regarding dental service organisations, we are pleased with the progress we have made new customers, Heartline[?] Dental. We devoted the month of January to implementation, and are now getting close to being fully operational with all of their offices. Based on the feedback from Heartlines this relationship is off to an outstanding start, and we are excited about the potential it holds.

Moving on to our animal health segment. We are at roughly the halfway mark of our three-year integration time frame in our animal health business. In only a relative short amount of time we have accomplished a tremendous amount. We've unified two cultures, consolidated the animal health business headquarters Greeley, Colorado, integrated numerous locations and we've accomplished all of this while piloting and preparing to roll out a new enterprise resource planning system.

However, along with these many critical successes we – have come challenges, and new learnings of how we can better execute. Last quarter, I mentioned that we will experience a softer price environment, which was leading to margin compression, in the animal health segment. Indeed, we have more manufacturer contract changes during this period of integration than we've previously ever experienced. And this is clearly was one factor affecting the margin. However, we are fully committed to thoroughly examining all factors and approaches to restore the margin profile of this business.

During the third quarter we looked very closely at a wide range of potential factors, and gained clarity and deeper understanding of various executions that we need to target for improvement. While some of manufacturer pricing pressures remained, we have identified several ways all within our control to improve margins. These includes partnering more closely with our manufacturers, adjusting and aligning our marketing approaches, and better managing our product mix. We begin to implement some of these initiatives late in the third quarter, and while we have more work to do on this front we are already starting to see improvement. It's certainly encouraging to see our team respond swiftly to these execution challenges. We have a long history of collaborating with our manufacturer partners to best serve our customers in a mutually productive way. I'll remind you that Patterson animal health is a distributor of choice in the animal health industry, and as consolidations take place at a manufacture level we believe that our skill will become increasingly critical to the supply chain.

Looking at our performance in the segment during the quarter, in production animal, we continued to see general overall, recovery in end markets with particular strength I swine, where we continued to gain market share.

In beef cattle, which is our largest production animal market we did see some sale softening in the quarter due to lower utilisation among the independent producers. We also experienced solid growth in the companion animal category during the period, a reminder that the fiscal third quarter is the seasonably lowest period in this segment.

Before I turn it over to Ann, it's worth re-iterating that both of our businesses are tied to compelling long term and market trends. In dental that includes a generally stable employment market, an ageing population that will drive demand for dental care, and practice environments that are becoming increasingly sophisticated, and therefore ever more reliant on us to support this dimension of change.

In animal health it means the central role the US agriculture industry will play in satisfying the protein demands of a growing middle class. It also means the persistent rise in both companion animal ownership, and spending per pet. These are opportunities we are engineering for.

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

Ann Gugino: Thank you Scott, and thank you all for joining us today. As Scott touched on, we experienced the combination of some challenging conditions and self-imposed head winds during the fiscal 2017 third quarter, and our performance would [inaudible]. We are focusing on the factors we can control while adapting our approaches in both of our segments to improve growth and operating performance. As I've done in the past, I will discuss sales and adjust the results from continuing operation.

Well there are some minor final tax adjustments related to the sale of Patterson Medical reflected in our GAAP result, the results from discontinued operation has essentially cycled. Looking at the top line performance, consolidated sales for the fiscal 2017 third quarter were virtually flat at 1.4 billion on a reported basis. When adjusting for foreign currency translation, sales grew 1.4%.

On to margins, our third quarter consolidated adjusted operating margin was 6.7%; this is down 100 basis point versus the prior year quarter. The decline primarily stemmed from reduced growth margins across the business, and a planned incremental cost from our [inaudible] implementation.

On the bottom line, GAAP net income from continuing operation with 27.8 million, or 29 cents per deluded share compared to 57.2 million, or 60 cent per deluded share a year ago. As we outlined last quarter, [inaudible] did not extend[?] sales exclusively for the full portfolio of beyond September 2017. This move, we recorded a non-tax impairment charge in the current quarter of approximately 36 million pre-tax, or 24 cent per deluded share, and our GAAP result reflect the impact. This non-cash charge related to the distribution seat associated with a [inaudible] product compliant of this arrangement. It will not affect Patterson's liquidity, cash flow, or compliance with debt covenants.

Adjusted net income has continued operation which excludes certain non-recurring and deal amortisation costs declined 14.9% to 55.4 million in the fiscal 2017 third quarter. It is important to point out that on a pre-tax basis the step up at [inaudible] expenses represents approximately 11 million of the decrease in adjusted net income for the quarter, as anticipated. Adjusted EPS from continuing operations decreased 14.7% to 58 cent per deluded share compared to the year ago quarter.

Now a look at our segments. In dental we saw market conditions in the quarter that were similar to the first half of the fiscal year. On a GAAP basis sales were down 1.8%, and that decrease was essentially the same on a constant currency basis.

Patterson's sales of dental supplies decreased 2.8% constant currency during the third quarter. The decline here reflects the combination of end market softness as well as disruption from our sales force re-alignment that we implemented in the first quarter of the fiscal year. We expect this effect to moderate over time.

While not a significant contributor [inaudible] third quarter, the kick off to our relationship with Heartland Dental was another highlight. In January, we completed the role out of our ordering system to Heartland Dental location on schedule. This included getting Heartland 750 office location trained on the new web portal. This is an important accomplishment and Heartland is very pleased with its sales rate thus far. We look forward to further growing our partnership with Heartland

On to dental equipment, our results here were also mixed. The 1% constant currency decline in dental equipment sales reflected a combination of factors. Lower contributions from the digital x-ray category, modest growth in [inaudible], and a double digit increase in core equipment. As Scott mentioned earlier from a volume perspective, this is our strongest performance in core equipment in the better part of the last decade.

Looking at our dental segment margin, adjusted operating margin was down 80 basis points year over year. However, when you back out a step up [inaudible] in the third quarter [inaudible] segment, operating margin improved 20 basis points, reflecting good execution on our [inaudible] efforts.

Now turning to our animal health segment. As in dental, results in this segment were mixed. Overall, we have increased sales across our animal health business in the 2017 third quarter. On a reported basis, consolidated animal health sales grew 1.7% year over year. After adjusting for the impact of currency, animal health segment sales grew 4.9%.

Our animal health business continued to face a more challenging environment related to [inaudible] pharmaceutical trends. In response, we began adapting our go to market approaches to increase profitability, and are pleased with the early progress.

It’s worth noting, excluding the expense step-up related to enterprise resource planning systems implementation allocated to the animal health business, operating profits for this segment was up slightly throughout the year. We also maintained our focus on integration synergy capture, which remains on track.

Taking a look at our companion animal business, our third quarter reported companion animal sales rose 1.9%. Adjusting for currency, companion animal sales increased 8.5% over last year.

Looking at our US companion animal sales, reported growth was up 12.8%, and 6.2% when adjusted for agency [inaudible].

As a reminder, our fiscal third quarter is the seasonally lowest sales volume quarter for the companion animal segment. Growth and production animal sales from the 2017 third quarter grew 1.3% constant currency versus the year ago period. Overall performance in the production animal segment reflects strong sales in the [inaudible] market, offset by lower sales in [inaudible].

A word about these category sales. We continue to see some recovery at these end markets during the quarter. However, sales were impacted during the period by lower utilisation by [inaudible].

Our ongoing animal health integration initiative and progress towards planned synergies remain on track. This fiscal year we are focused on more effectively leveraging logistics across both of our business, further consolidating our back-office function. We still expected to deliver between 18 and 20 million in runway saving between the end of this fiscal year, which will enable us to meet the 20 to 30 million runway of synergies in year three that we announced at the time of the acquisition.

Now a look at a few balance sheet and cash flow items. Our net cash generated from continuing operations improved in the quarter to 45.9 million compared to a [inaudible] of 33.6 million in the prior year quarter. We believe that cash flow will continue to improve for the balance of the year as we continue to work on reducing our [inaudible] inventory. I'll remind you that we are maintaining a higher inventory in our animal health business and [inaudible] a service level throughout the year of implementation. We remain confident in our ability to generate [inaudible] in our business, and continue to expect to converge between 85% and 100% of negative [inaudible] free cash flow fiscal 2017. Over the next five years we expect to generate more than 1.3 billion of free cash flow

CapEx totalled 8.1 million in the fiscal 2017 third quarter. As you are aware, the implementation of our new Enterprise Resource Planning Initiative has been an area of intense focus for our team for the last three years. [Inaudible] efficiencies across the enterprise and provide the foundation for a more ambitious and effective e-commerce platform. These efforts are now moving much further into the roll–out phase and we want to share some perspective on our progress.

For many companies, the past enhanced efficiencies and new capabilities these systems can provide, is rarely straight or smooth. However, as we have moved through the piloting and rollout phases of this initiative, we have gone to great lengths to ensure that the learnings at every step can be quickly leveraged and rolled forward into subsequent stages. Our production animal colleagues who had recently completed such implementation have been a tremendous asset in our recent progress. We continue to make progress rolling out the system and scaled up our deployment in our third quarter.

During the period, we brought another 17 locations on to the new platform across the threshold and across implementation of the new system. It's impressive to see how the system is already starting to transform our business, especially in the speed of order picking. As previously disclosed, we expect a 25 million pre–tax step up [inaudible] for the full year related to this system. In the third quarter, we began depreciating our investment with the new system which, along with training, contributed to the rise in related expense. As we noted below, these expense step ups are largely loaded to the back half of the year, as we scale up deployment. And we expect this to continue for 2018.

Turning to our capital allocation strategy. We continue to execute on our strategy by returning cash to our shareholders. We returned approximately 60 million to our shareholders in dividends and share repurchases during the quarter and nearly 160 million year to date. We remain fully committed to our dividends and we have increased it every year since it was instituted. We have approximately 14.5 million shares remaining under our current board authorization.

Our strong balance sheet along with our [inaudible] expanded debt capacity, gives us the flexibility to repurchase shares opportunistically. During the quarter, we extended and increased the company's [inaudible] credit line for 500 million to 750 million and also amended Patterson's [inaudible] loan. These new capabilities give us greater financial flexibility and more favourable terms and enhance our ability to execute all components of our [inaudible] allocation strategy.

Looking at tax rate, our adjusted effective tax rate for the quarter was 33.4%. Our third quarter tax rate is historically lower due to [inaudible] of estimated taxes as actual [inaudible]. By comparison, our tax rates for the quarter are in line with the same period last year. We still expect an adjusted annual tax rate in the range of 34.5-35.5%.

Now I will review updated fiscal 2017 guidance. We have narrowed our adjusted earnings from continuing operations to the range of $2.27-$2.33 per diluted share. Our adjustments exclude the impact of transaction–related costs, [inaudible] amortization, integration and business restructuring expenses, non–tax [inaudible] charges and benefit from [inaudible] cash repatriation, totalling 56 cents per diluted share. [Inaudible] fiscal 2017 earnings [inaudible] operation in a range of $1.71 to $1.77 per diluted share.

Our guidance range assumes North American and international market conditions are similar to those experienced in the first nine months of fiscal 2017. I will also note that it does not include the impact of future share repurchases. Our guidance assumes we will continue to have EPS headwinds related to our ERP implementation, our Sirona relationship change and margin pressures in animal health, much of which will extend into the next fiscal year.

We are committed to delivering on key elements within our control in these areas. Realizing efficiencies as we implement our ERP system, focusing on procurement savings across all areas of our business, improving working capital, particularly in the area of inventory[?] and receivables and closely managing expenses. In addition, we will work to capture even more synergies in our animal health segment.

With that, I will turn it back to Scott for further comments.

Scott Anderson: Thanks, Ann, I will wrap up with just a few additional comments. We have mentioned this before, but it is worth repeating. We are guiding Patterson through an important period of change that we believe will lead to an even tighter alignment for our customers and partners in both segments and [inaudible] growth.

As we have gone down this path, we received positive feedback from many of you regarding our ability and willingness to make the difficult decision to move Patterson to a new plateau. With our desire for portfolio expansion efforts in dental, our margin improvement efforts and ongoing integration efforts in animal health and our Enterprise Resource Planning Initiative, we believe will combine to do just that.

And I'm greatly encouraged by the confidence and enthusiasm of our teams. Whether it is our efforts to refocus in dental, stepping up our execution and animal health, or pushing through each stage of our Enterprise Resource Planning Initiative, I believe that our level of engagement and commitment has never been higher. This will drive our future success. And so will the support of our customers and manufacturing partners. We are encouraged by this engagement, at dental and vet industry events thus far in 2017.

We have substantial traffic at our booths at our North American veterinary meeting earlier this month. We are again looking forward to a positive engagement here in Chicago at the mid–Winter

Meeting and we are certainly eager to again participate in the international dental show in Germany next month. This is the world's leading dental trade show and we are looking forward to the introduction of multiple new innovations at this event.

Finally, we are in the process of putting together our tactical business plan for fiscal 2018. We look forward to giving you insights into this when we report our fourth quarter and full fiscal year earnings in May.

Now I'd like to take any questions you may have, I will turn the call back over to Augusta.

Operator: Thank you, the question and answer session will be conducted electronically. To ask a question, please press *1 on your phone at this time. If you're on a speakerphone, please make sure your mute function is turned off to allow the signal to reach our equipment. Again, that is *2, if you like to ask a question, we will go first to Ross Muken with Evercore ISI.

Elizabeth Anderson: Good morning, this is Elizabeth Anderson in for Ross. How are you thinking about the dental consumable trends coming out of the quarter, given the industry trends we have been seeing over the last six months or so?

Scott Anderson: Yeah, sure, thanks, Elizabeth. With regards to North American consumables, while we are seeing some encouraging signs around the consumable market, we do think it is too early to call any short-term trends permanent. I think it is safe to say we are taking a prudent approach to the remainder of our fiscal year with regards to consumables. But we are still quite confident in the long–term fundamentals for the market in North America. And just as a reminder, we look at stable to improving consumer confidence, unemployment levels that are below 5%, I think the key thing is continued customer interest in investing in equipment and technology, which we believe enhances their clinical outcomes and productivity. And then sort of the big macro factor that is the favourable demographics that are going to drive demand. So, we still look at a stable market, some encouraging signs, but I want to be cautious not to call a breakout just yet.

Elizabeth Anderson: Got it, thanks. Can you also talk about any early feedback you've received from the sales force and customers regarding the Sirona transition and perhaps anything you have heard from Sirona competitors as well?

Scott Anderson: Yeah, I would say on the Sirona front, when you look at the quarter, I think, from an operational perspective, it was very successful, we worked through a number of tactical issues. I feel very good about the messaging that has been communicated throughout our organization and throughout by Sirona, with regards to the decision being in the best interest of our customers and our partnership. And also, I think the traction we are getting from our prior strategy about expanding the portfolio, I think gives our people and our customers great confidence in the future.

I think it's important to state, once again, as I did last quarter, that [inaudible] Sirona is, and always will be, a great and strategic partner. Currently, we are working very close with them on managing through the next phase of the partnership and are absolutely committed to each other's mutual long–term success. I would say the initial noise of the announcement, and I don't want to underestimate that, is mostly behind us and we are focused on sales execution through the balance of our exclusive relationship with Sirona.

Elizabeth Anderson: Great. Thank you.

Augusta: Our next question comes from John Kreger with William Blair.

John Kreger: Hi, thanks very much. Scott, can you just expand a bit more in your comments around the profitability for animal health? Some of the contract issues that you talked about last quarter, how has that played out as just one manufacturer, or is it of a broader trend? It seemed like margins had a nice little rebound, at least sequentially, can you just kind of talk about where you see that going on a normalized basis? Thanks.

Scott Anderson: Sure, thanks, John, I will have Ann sort of cover the shorter–term tactics that we've tackled and then let me talk a little bit about the longer–term strategy around margins in the segment.

Ann Gugino: Sure, so over the last 90 days, we have done a deep dive on the margin compression in the contract term and we have confirmed that our contract terms across the big Pharma companies did deteriorate relative to prior year. A little bit higher [inaudible] we have seen in the past. We do believe our contract terms are similar to others in the industry. With that said, clearly it appears [inaudible] short–term impact than others in the industry.

However, if you look at the current quarter, our actions have resulted in some [inaudible] margins improvement, our consolidated growth margins in the segment are actually up ten basis points in the current quarter and if you compare that to the first–half of the year, where we saw margin compression, that is [inaudible]. You asked kind of long–term where we think the market will go, I would expect that we can get back the 5% operating margin rate in the next two years.

Scott Anderson: Great, and let me get a couple of items to give some context to where we are at, and more importantly, where we are driving the business. It is a fact that we have more changes, and I mentioned that in my script, to our vendor contracts with our largest partners than probably any other time in our 15 years in the companion space. And at the very same time, we were integrating two businesses and combining our corporate and marketing function to one location in Greeley. I would say the integration timing magnified some of these short–term issues with regards to the contract changes.

That being said, we have identified our issues and really spent the last 90 days implementing our go–forward strategy, which includes strengthening our marketing and promotional strategy, as well as better management of our product mix. We have had substantial communication with our top partners, which we really appreciate, and are working on driving mutual success, because we see Patterson as a partner that future suppliers are going to want to leverage, in terms of our sales coverage scale and logistics expertise. So, we feel like we're tackling the issue and making progress.

John Kreger: Thanks, Scott, that is helpful. Maybe just to go back to, I think, the very last thing you said in the prepared remarks about still working on the plan for '18. Broadly speaking, should we be able to view '18 as a return to more normalized earnings growth for Patterson, or should we be thinking about it still as a transitional phase for the company? Thanks.

Scott Anderson: John, I would say it is still going to be a transitional year. You know, clearly, if you look at the current year there is a lot of moving pieces here. And some of those factors will take time to work through and carry into fiscal 2018, so namely working through the profitability challenge that we just talked about, animal health associated with the brand of pharmaceuticals. We've got the changes within the dental technology products in addition to Sirona; we are planning to add new technology products to the portfolio next year.

We have new customers that we are onboarding, but, of course, we will continue the ERP rollout, so as you look at the [inaudible] heading into fiscal 2018, we do expect our ability to grow EPS will be a bit constrained and below our stated five–year average target of 8–10%. So, we are continuing to refine our outlook as we continue to work through the challenges we're facing, and will continue to do that over the next 90 days, and provide a more definitive outlook on 2018 next quarter. I would emphasise though that longer term, passed 2018, when we get through the ERP implementation and some of these transitions, we do believe the underlying businesses organically will grow in the 8–10% range or better and will be able to continue to generate [inaudible] cash.

Scott Anderson: Very helpful, thanks, Ann.

Operator: Our next question will come from Robert Willoughby with Credit Suisse.

Robert Willoughby: Scott and Ann, can you evaluate the sales force realignment? Is it safe to say sales trended below where you thought they would be? But what can you say about profitability, did that meet your expectations, what the remaining sales force was able to accomplish?

Scott Anderson: Great, thanks Bob. Good question. I will have Ann start with some breakdown and growth by customer segment and then I would like to come back and sort of revisit the strategy, which I think is important.

Ann Gugino: Sure, I will start with the profitability, so I would say yes, if you look at the dental business, we saw an 80–basis point margin decline. When you back out of the impact of the ERP implementation we were actually up an improvement 20 basis points. So, we're definitely getting the profitability that we expected. If you look at the top line, and you look at the accounts that were not impacted by the sales force changes, we are definitely growing at market or better in those accounts.

And then if you look at the accounts that were impacted by the changes, I would characterize it as stable and similar to what we saw in Q2 as it relates to consumables, but definitely equipment sales are up nicely and [inaudible] which was part of the strategy. And then just as a reminder before I return it back to Scott, you know, the upside opportunity from these actions is much greater than the current business lost. There is between 200–300 million of market potential tied up in these underperforming accounts.

Scott Anderson: Yes, and just going back to the strategy, you know, many people who have followed our story know, we have a history of evaluating our go–to–market strategy. You know, we did a similar action about eight years ago and we really retooled the way we went to market around technology and that really led to a big acceleration for [inaudible] and our digital products.

So, the move strategically was about putting our best people in front of more opportunity, as well as knowing that we are going to leverage more and more technology to make our sales force more productive. So, it really does tie in strategically to this foundation we are building through ERP, in terms of really being able to drive data and then the digital strategy we are building out. So, I would say we anticipated there would be some short–term share loss, but are incredibly committed not only to the strategy, but I think it is very important, committed to the sort of market–leading strategy that the Patterson sales force is the best sales force in the dental industry and we are now just giving ourselves more opportunity going forward to interact with customers.

Robert Willoughby: Maybe a follow–up: while you're below your 8–10% GPS growth guidance for this year, next year, are there no opportunities to accelerate your ERP implementation and why not step up the share repurchase? At this point, it doesn't make as much sense, you know, if you're growing north of 8–10% in 2019 and beyond.

Ann Gugino: I think it relates to the ERP. I would agree, it is kind of a common theme amongst the team where we're saying, 'Okay, let's pull it forward, let's go faster.' So, this was the first quarter where we're really in that raw implementation phase and we brought up 2017 sites. And so we just need to watch that closely, but certainly, if there is an opportunity to accelerate that and go faster, we are in 100% alignment that we want to make that happen.

As it relates to the share repurposes, you know, clearly it is a balance. We are carrying higher than normal investment and working capital, as it relates to the ERP. So, we have to balance the share repurchases against the cash needed to operate against the business and then, of course, the debt leverage. So, we will take a very disciplined approach, but I do agree there is more opportunity to invest in the future there, Bob.

Robert Willoughby: Thank you.

Operator: Our next question comes from Brandon Couillard with Jefferies.

Brandon Couillard: Thanks, good morning. Scott, back on the core equipment experience in dental, can you parse out how much of the improvement is the new portfolio, and some of the internal things you are doing versus the market? And, you know, is it fair to look at that growth experience as a positive leading indicator, potentially, for consumables?

Scott Anderson: Yeah, Brandon, I think you're onto something here. I think where we're very encouraged is the strength of the sales in traditional equipment is broad across our partners. And leading the way with our largest partner. I think there is some benefit, as I mentioned, from section 179 being permanent and [inaudible] being able to plan their capital spend more strategically. So, with volume numbers like we had here in the quarter, and I would say we feel very confident as well in our backlog, we are starting to see new office build and remodel projects begin again. And that absolutely is a very positive indicator for the future.

So, when I look at what is going on in the marketplace, you know, I am a believer that the consumable market has very strong, long–term fundamentals in it, and we are still going through, I think, a bit of a patchy period in the industry where, you know, any green shoots, people are saying that is a trend. But longer–term, I think the market is in a very solid place and, you know, our customers are small business people with the right tax incentives and economic environment. Our ability to get back to normal market rates for the whole industry I think is very realistic going forward.

Brandon Couillard: Thanks. And then one for Anne; on the inventory line stepped up quite a bit sequentially. You know, can you talk about, you know, where you see that level of safety[?] stock plateauing given the RP roll-outs, you know, will continue over the next few quarters? And, you know, the free cash flow for the year – another year, you know, back-end loaded; is this, sort of, the new normal in terms of the seasonality for free cash flow generation?

Anne: You know, it's definitely always been a bit seasonal, but I would agree it's been a little bit more volatile over the last couple of years and I think part of that is just the integration with the animal health business and just learning how their inventories flow and then of course, as you mentioned, we're working through the ERP implementation.

We did have improved cash flow from operations in the quarter. We actually generated $45.9 million this year versus a year ago on the quarter we used $33.6 million, so we are getting better each quarter, and we believe the cash flow will continue to improve in the balance of the year. We estimated about $200 million. And to your point, this will be driven by a strong finish in working capital. But it's also historically strong just due to the sales volumes and operating [inaudible] that happens just naturally in our business in Q4.

You know, we're probably somewhere between $100 million and $150 million higher than we'd like to be. A year ago between Q3 and Q4 we were able to take out about $140 million, we'll probably take out $100 million. But to your point, the real value is reducing it over the longer term, and that's something that we're really working on with the ERP team. You know, it's a balance because you want to make sure you hit those [inaudible] rates and take care of the customer, and so we're really just refining that, it's something we talk about every day, but I would expect us to get to more normal working capital levels next year in 2018.

Brandon Couillard: Super, thank you.

Operator: Our next question comes from John Block of Steifle[?].

Ethan: Hi, this is Ethan[?] on for John Block. A couple of questions here. Wondering if you could just circle back on the North American Dental Market. You indicated that consumables, conditions and fiscal for the third quarter were similar to what you experienced in the first half of the year. Two of the other larger dental players specifically called out improved market conditions in January and also December. I just want to be clear, are you not seeing that same level of improvement that the other players alluded to, or is it just you're choosing to take a more conservative view at this point?

Scott Anderson: Yeah, I think – good question, I think we're just taking a more conservative view. If you look at the raw numbers that people are reporting, they're very similar to the prior quarter on absolute terms. So we're in no way seeing the markets degrading at all. It's stable, there are signs of improvement, but I just think as the entire industry struggled for explanation as to the slowness over the last six months, I think you have to be careful as well to bullishly call a rebound.

Ethan: Got it. And then just shifting to animal health, you provided a decent amount of commentary on the beef cattle market. I was hoping you could just discuss how dairy performed in the quarter. I believe last quarter you called out a more protracted recovery than expected, but prices have seemed to rebound over the past couple of months. So any thoughts on how dairy performed in 3Q? Thanks.

Scott Anderson: Yeah, dairy was similar to prior quarter but I would say we're encouraged by a few things on the dairy front when we think longer term. Particularly the largest dairy market is California, and obviously the impact that the derogatives had on input costs for our producer customers has been a strain. And obviously I think everyone knows it looks like the drought has been broken, and longer term that will benefit our customers and the health of that sector. So our team, you know, one of the things we really love about our animal health team is the deep experience they have managing through cycles. And I would say the leader of that business feels good about the longer-term prospects around dairy and the strategies we'll implement to gain share there.

Ethan: Great, thank you.

Operator: Jeff Johnson with Robert Baird has our next question. Mr Johnson, your line is open.

Jeff Johnson: Sorry, can you guys hear me okay now?

Scott Anderson: Yeah.

Jeff Johnson: Okay, good morning. So Scott, I guess one question just on the sales force realignment I want to come back to is just, you know, I think at one point last June when you talked about these cuts, you talked about, kind of, backfilling with some of your higher performing reps and all that. Is it still the plan to backfill with current reps? Are you hiring new reps for those territories? And if you're backfilling, are you starting to see some, you know – I don't know, pick up of business, I guess would be the word I'm looking for or something there in those territories or is it going a little slower than you thought?

Scott Anderson: Yeah, great question, Jeff. You know, it's a mix of putting the right talent. Sometimes it's a, you know, a two or three year rep who's really hitting their stride on giving them more opportunities, other times it's our more established reps who have more capacity. I would say some early positive signs, as Ann mentioned, is the equipment sales we had into that segment. And as we've said, there was a lot of white space, almost $200 million to $300 million of what we felt was trapped opportunity.

That being said, it's, you know, when you do something like this, it's never a straight line. But we're very committed to it I would say. We continue to add a high level of sales talent, but it's not like we're filling back the same number of sales reps as we go forward.

Ann Gugino: And I think the interesting part to note when you look at just the overall strategy and the number of accounts impacted, if you look at about 85% of accounts, we're actually retaining the majority of the business and growing very nicely at market or better. There's about 15% of the account where we're just struggling a little bit more, where maybe the rest was a little bit stickier. And we're starting to see, you know, that stabilize, but that will take some time, but it's in a very small group of accounts.

Jeff Johnson: All right, that's helpful, thank you. And then Ann, just my other question would be on the gating of the RP and I ask this quite a bit, but I just want to make sure again this quarter, I think you said $11 million in incremental ERP this quarter, so it feels like we're, kind of, at now the peak level we should be expecting in the near term. Is that fair? Are we up here now at $10-11 million a quarter? We see that for another, what, three quarters? And then maybe we start to see some leverage off that in the back half of 2018 or how should we think about the gating of those ERP expenses from here?

Ann Gugino: So that's correct, right, so it's $25 million for the year. So we had $1 million in Q1, about $3 million in Q2, $11 million in Q3, so we're expecting, you know, somewhere in the neighbourhood of $10 million in Q4 and then that step up in expense will continue to annualize in. So it's not that it will be increasing beyond the $25 million necessarily, but it will continue to annualize in to the first half of 2018. And then to your point, we'll start reducing the expenses as we get the rollout completed in the back half of the year.

Jeff Johnson: And any early views on how quickly that maybe $25 million run rate could come down as 1/3 of that comes out over a year, or just how to conceptually think about that?

Ann Gugino: Well, so if we go back to the $25 million step up, 20-25% is depreciation and doesn't go away, right?

Jeff Johnson: Right.

Ann Gugino: And then 25% is roughly implementation cost, so that goes away right away. So as soon as we're done implementing and we're not doing any more, so I would say, you know, 25% comes out right away, and then the remaining 50% is really the infrastructure required to support the ongoing system and, as Scott alluded to, you know, the next step is to continue to improve our web platform. So I would say about 25% comes out right away, and then the real magic is now how do you get the return on investment in terms of efficiencies across the portfolio. Once you're up and running now you're able to truly shut down legacy systems, so there will be some other expenses that come out now as well that we're working right now on plans to implement.

Jeff Johnson: Fair enough, thank you.

Operator: Our next question comes from Robert Jones with Goldman Sachs.

Jason Jacoby: Hey, this is Jason Jacoby[?] in for Bob. Can you talk about your [inaudible] inventory levels as we get closer to the end of your exclusivity agreement with Sirona? I guess what are you seeing in terms of sell through in dental equipment? Thanks.

Scott Anderson: Yeah, thanks, Jason. This is Scott. I'll take that and – actually, why don't I have Ann talk about working capital strategy. She talked a little bit about it previously but I think that's important. And then let me get into the specificity around Sirona.

Ann Gugino: Right. So we're still carrying, as we talked about, a higher level of investment in working capital. It's in accounts receivable but, as Scott mentioned, it's inventory as well. And it is primarily related to the ERP implementation. We expect to reduce our investment and working capital by about $100 million over the next 90 days, as I talked about before. And this is very similar to prior years, so we tend to run inventories down at the end of the year to minimize the impact to lipo[?]. And then Q4, and this ties in a bit to your Sirona question, is usually a bit equipment quarter which helps working capital utilizations, because we don't generally carry receivables on equipment sales. So there's still an opportunity to improve and we fully expect to do that through the balance of the year.

Scott Anderson: Yeah, and I would say with regards to Sirona, obviously, you know, as we move from an exclusive to a non-exclusive relationship we are working with them on working our inventory levels down on certain product lines, [inaudible] in particular. You know, we have had a 20-year relationship with Sirona and have worked through many supply chain ebbs and flows with them, so this is not new to either company. But we are committed as partners and I think you saw that already in some public messaging from our great partner Dentsply Sirona. So in the quarter we did make some progress on the [inaudible] front and on some digital infernal products. I would say we were a little bit heavier on the external x-ray front, particularly because that is an area that traditionally in the late half of December, those are the fastest moving products because if customers can make a late tax-based decision. And in the last two or three years we got into situations where we were actually short on inventory towards the end of the year. So we always want to be very cognizant of not being able to fill all orders. So net-net, we ended the year or the calendar year with a little bit more external inventory than we had hoped, but we're starting to make progress on the other side in, sort of, moving our [inaudible] and some other inventories down and we'll continue to work on that over the next six months.

Jason Jacoby: Got it, thanks. And then on the DSO segment, thanks for the update on Heartland, good to hear that that's almost fully operational. Could you just provide us any more detail there? And then just broadly speaking about the DSO segment, how focused are you on this market and is further DSO penetration embedded in your long-term growth outlook?

Scott Anderson: Yeah, thanks, Jason. You know, obviously, we're very excited about this new partnership with Heartland. As I said, we're off to a really good start, and I think both our management team and Heartland's are very encouraged by how our teams are working so closely together. They're pleased with the transition and when the customer is happy, those are good things.

I would say it was – I had the honour to speak to over 1,000 over Heartland's dentists at their winter conference in December and that was an incredibly impressive event. And it was also exciting, I spoke to a lot of customers who were former Patterson customers who were excited about the new relationship. I would say we've seen this space as a strategic imperative and one that will drive future growth. I would couch it right now as very active and dynamic and we're excited about the number of conversations we've been brought into. And also, I think it's a proof point of our ability to serve this space and also be a partner of choice with more customers. So as we work through our strategic plan and tactical plan for FY18, obviously this will be a part of our growth story that we talked about 90 days from now.

Jason Jacoby: All right, thanks guys.

Scott Anderson: Thanks.

Operator: We'll go next to Kevin Kedra with Gabelli.

Kevin Kedra: Hi, thanks for taking the questions. First on the dental market, I know it's been tough to pinpoint what's been driving the softness there, but just any additional intelligence on that and maybe anything that might be driving the easing of that softness that we seem to be seeing? And then secondly, just on the UK vet business, the old MVS. Any update on how that business is doing in the quarter and any opportunities to maybe improve the cross structure there?

Ann Gugino: I can handle – I can handle the –

Scott Anderson: Ann, just go back to the first question.

Ann Gugino: So the first question was the US market. I can handle – I'll knock the UK one out, and then –

Scott Anderson: Yeah, and then – yeah.

Ann Gugino: Hi, Kevin. So the update on the UK business is it was, you know, a pretty average quarter growing at market, so they were up about 4% in local currencies. They've been turning around that 4-5% all year long. They are having some good customer wins. We just won a large corporate account over there. So clearly when you look at leveraging your fixed and semi-variable costs, that definitely helps. You know, we're always looking at ways to become more efficient and more profitable. One of the other things that we're working on there is bringing some of our value-added equipment offerings and service offerings to that market. And so we've been at that for about 12 months of so, we're starting to get some traction there. So we do believe we can bring those markets up over time and I would say the business is stable and performing well.

Scott Anderson: Yeah, and then Kevin, I'm sorry about that. Back to the US market. I think it's just a case of mixed signals in terms of where the market was headed over the summer. But I think we're in complete agreement with many of our industry partners in the long-term prospects as well as the stability of the market. And as I said before, you know, our dental footprint is North America. And as we look to improving North American economic conditions and also potentially US pro-business friendly tax policies, we think that can drive the business to more historical market trends. So in no way do I want to be pessimistic, because I'm not, but I think just given the facts out of the last six months, you need to be careful about calling the breakout just yet.

Operator: We'll go next to Michael Turney[?] with UBS.

Alan: Hey, this is Alan[?] in for Mike. On animal health, you spoke about the contract changes upstream. So looking downstream, are there any opportunities to partner with other pharmaceutical purchasers or other things to improve your leverage for procurement?

Ann Gugino: Yeah. So that's definitely part of the strategy, right? So one piece of it is the big pharma companies and the contract terms there. But then to your point, you know, there's always the private label strategy. About 60% of the total revenues are pharmaceuticals, but there's another 40% where, you know, getting after a private label strategy, potentially doing some bundling is an opportunity.

I will say on the pharmaceuticals, and this is a point that I think is important, is that as it relates to the big pharma branded products, the manufacturers actually set the price with the customer. So that one's a little bit more to manage, or a little bit more difficult to manage with the customer. You really have to manage that more back with the manufacturer. But certainly there are other areas, private label, certainly the value added services, as we continue to build up the equipment platform. Equipment has margins in the 30-percentile. So there are a number of things that we can do to improve margins in that segment. And then of course there's cost reductions, right?

How do you become more efficient, the ERP implementation is a piece of that but – and so are the synergy captures, so we're looking at where are more creative ways that we can get after the expenses.

Alan: Got it, thank you.

Operator: Our next question comes from Lisa Gill with JP Morgan.

Mike Minchak: Thanks for taking the question, it's actually Mike Minchak in for Lisa. Maybe just taking a step back on the dental equipment side, you know, you obviously have some near-term headwinds related to the decision around the Sirona portfolio and you've talked about the slowing growth in digital x-ray. Can you maybe talk about what you see as, sort of, the longer term top-line growth in, sort of, the broader dental equipment category on a more normalized basis and do you think that growth opportunity has slowed relative to prior years?

Scott Anderson: Yeah, Mike, I would say absolutely not. I think when we look at the future and you look at the best in class infrastructure we've built in terms of technology support and probably the mostly highly trained sales force, that we see we will be the most relevant player in, sort of, the digital transformation of dentistry. And that I think you'll see a lot of investment in the space going forward. So I think we're working through just some short-term issue. As I said, very encouraged by the volume levels we saw in the traditional chair unit, light cabinetry business. You know, back to really pre-recession levels which we haven't seen for eight years. So, you know, when I look at growth rates I see technology and equipment being a big part of the future growth story for the entire industry. And it's going to lead to productivity gains and better clinical outcomes, which is good for everyone.

Mike Minchak: Got it. And you talked about increasing capacity on the revolver. Just wondering if you could talk about, sort of, the longer-term target for leverage and can you remind us if, you know, how you, sort of, rank your priorities for capital deployment?

Ann Gugino: Sure. So if we look at our leverage, we're currently at 2.5 times EBITDA and we can comfortably take that up to 3.5 times for a short period of time, but we would target, you know, somewhere between 2.5 to 3 times as, kind of, an optimal leverage scenario. Our capital allocation priorities really haven't changed. Our first is to, you know, reinvest in the business for strategic growth. We remain committed to the dividend, which is at 96 cents per share; that uses about $100 million annually. And then the third lever is the share of purchases, we tend to allocate between $100-150 million there, but we can get more aggressive if we choose to, depending on market conditions and working capital levels, etc.

Mike Minchak: Got it, thanks for the comments.

Operator: We have no other questions at this time. I'd like to turn it back to our presenters for any additional or closing remarks.

Scott Anderson: Thanks, Augusta. I'd like to close by sharing some sad news from the Patterson family. Yesterday we learned that our long-time former chairman and CEO Pete Frechette passed away unexpectedly. We trace our roots of the company back to 1877, but as many of you know, Pete was our modern founder. He shaped the industry in the 1980s and early 1990s and built the company with an amazing customer-first and employee culture. Please keep Pete's family in your thoughts and prayers, and we thank you all.

Operator: That does conclude our conference for today. Thank you for your participation, you may now disconnect.