PATTERSON COMPANIES

EDITED TRANSCRIPT

PATTERSON COMPANIES 3RD QUARTER
2013 EARNINGS CONFERENCE CALL

EVENT/DATE/TIME: February 21, 2013/9:00 AM CT

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Patterson Companies Third Quarter 2013 Earnings Conference Call. During today's presentation, all participants will be in a listen-only mode. Following the presentation, the conference will be open for your questions. If you have a question at that time, please press the star, followed by the one, on your touch-tone phone. If you need to withdraw your question, press the star, followed by the two, and if you are using speaker equipment today, you may need to lift your handset before making your selection. Today's conference is being recorded, February 21st, 2013.

I would now like to turn the conference over to Jeff Lichner with Patterson Companies. Please go ahead.

Jeff Lichner *Senior Financial Reporting Analyst*

Thank you, Alisha. Good morning, everyone, and thank you for participating in Patterson Companies' fiscal third quarter earnings conference call. With me in the room today are Scott Anderson, our President and Chief Executive Officer, and Steve Armstrong, our Chief Financial Officer. After a brief review of the quarter by management, we will open up the call to your questions.

But 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 are discussed in detail in our Form 10-K and our other filings with the Securities and Exchange Commission. We urge you to review this material. Also, since Regulation FD prohibits us from providing investors with earnings guidance unless we release that information simultaneously, we've provided financial guidance for fiscal 2013 in our press release earlier this morning.

Be advised that this call is being taped and will be available for replay starting today at 11:00 a.m. Central Time until one week from today. To access a replay, please dial 303-590-3030 and provide the conference ID number 4594665 when prompted.

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

Scott Anderson *President and Chief Executive Officer*

Thank you, Jeff, and welcome, everyone, to our third quarter conference call. Steve and I are in Chicago, where we will be attending the Chicago mid-winter meeting over the next couple of days.

Overall, we were pleased with Patterson's performance in the third quarter as our markets continue to stabilize. Financial results were in line with our expectations. Not only did we see more than a 2% year-over-year growth in sales despite what continues to be a challenging worldwide economic environment, but that growth lapped a particularly strong performance in the third quarter of last year. Yet we are confident we will do even better and take full advantage of our growth opportunities as we see further economic recovery.

As I will review in the next few minutes, we saw improvement across all of our businesses, especially in Patterson Dental and Patterson Veterinary. We continue to make internal investments to position the Company for long-term competitive advantage. These investments are critical to reinforce our leadership position in Patterson's chosen markets as we respond to shifting demographics and market dynamics.

Patterson Dental, our largest business, reported sales of $626.5 million, which was up 3.5% from the prior year on a reported basis. Within this unit, the key driver was double digit growth in our digital equipment categories. Within our technology categories which are benefiting from the ongoing trend to the digitization of dentistry, sales of CEREC systems and digital radiography products were strong during the quarter. As you remember, sale of Sirona's industry-leading CEREC Omnicam system, an innovative 3D CAD/CAM camera for dentists, had been constrained in the second quarter due to product availability issues we outlined in our last conference call. In short, demand for this next generation system outstripped product availability last quarter; however, third quarter sales for this product were robust as Sirona fulfilled their delivery commitments.

Consumable sales, which consist primarily of disposable dental items and office supplies, were up modestly from prior year levels. When you take into account the two fewer selling days in this year's fiscal third quarter, as we have stated in the past, the consumable market is stable; but until we see an improvement in employment and a boost in consumer confidence, sales levels lack the catalyst to return to historic industry growth rates. Sales of basic dental equipment, including chairs, units, cabinetry and lighting, were down slightly from the prior year. Dentists remain cautious about expanding or remodeling their practice in this uncertain economic environment. While we continue to work with our customers on investments in their basic operations' infrastructure, sales growth in this category faces the same economic headwinds as consumables. As the market for basic infrastructure stabilizes and begins to grow, we will be there with our industry-leading offerings to assist dentists in achieving greater efficiencies for their practices. We believe that we are well positioned with our complete sales and service offering to support the modern dentist's office.

We were very pleased with the third quarter performance of our Veterinary unit, which currently constitutes approximately 20% of Patterson Companies. The Veterinary division grew over 9% in the period. This is adjusted for two factors – two fewer selling days in the quarter and the continued affect from the change in the nutritional products distribution agreement that we made in the fourth quarter of fiscal 2012. They also expanded their operating margin by over 100 basis points during the third quarter, which is typically the slowest selling season for this market.

Most noteworthy during the quarter is that we rebranded Webster Veterinary Supply to Patterson Veterinary Supply effective January 1st of this year. With this name change, we are now able to leverage the Patterson brand across all three of our businesses. By doing so, we are enhancing our visibility and position in the U.S. companion pet veterinary market. We believe closer public identification with Patterson will also facilitate our marketing initiatives in this growing sector. We are already seeing the benefits.

At the recent North American Veterinary conference in Orlando, we had a very strong showing, with increased booth traffic and interest. This show is a great opportunity to interact with our customers in a way that demonstrates our commitment to technology and innovation.

Earlier this quarter, Patterson Veterinary acquired the assets of Universal Vaporizer Support based in Foster City, California. UVS provides cleaning and calibration services for a variety of anesthetic vaporizers used in veterinary medicine. In combining our operations, we plan to expand our current vaporizer service to include more models and additional factory-trained expertise in the area of vaporizer maintenance. We are now able to address this very important aspect of modern veterinary clinic management. This is another extension of the value-added service offerings that we provide to our customers.

Patterson Veterinary has been one of our growth engines in recent years and we are confident its positive trajectory will continue well into the future. We look forward to the growth opportunities that will come from our industry-leading sales and service model in the veterinary business. We are committed to building our equipment and technical service strategy to capture market share as veterinarians expand their practice capabilities to meet increased pet owner expectations. We believe we can continue to reshape the market as Patterson redefines the industry sales model.

Turning to Patterson Medical, our rehabilitation, supply and equipment unit constituted approximately 15% of Patterson Companies' sales and was down slightly from prior year levels. Sales were essentially in line with our internal forecast for the third quarter and performance continues to be hampered by health care reform uncertainty and global economic malaise. Although this situation is likely to persist in the short term, we believe Patterson Medical is well positioned to leverage its technology and portfolio of value-added products to capture future growth. Long-term demographic trends make rehabilitation services and products an attractive market to be in.

Earlier this month, we announced the resignation of Dave Sproat as President of Patterson Medical. As we outlined in the announcement, I will assume the leadership of the Medical business on an interim basis until a successor is named. The process to identify the new President of Patterson Medical has already begun and we look to fill the position in the first half of the upcoming fiscal year. I want to personally thank Dave for his 16 years of service to Patterson but, most importantly, for building a very capable team at Patterson Medical and as a business with a reputation as the world's leading distributor of rehabilitation and sports medicine products. We look forward to continuing to work with Dave as he joins Young Innovations, one of our dental suppliers.

Finally, as we stated in this morning's release, we are maintaining our fiscal 2013 earnings guidance range of $2.00 to $2.06 per diluted share. I said at the outset of this call that while we were pleased with this quarter's performance, especially in light of the comparison with last year's strong results, we are not satisfied. We believe we can do better. We will continue to make internal investments designed to further strengthen both our competitive position and long-term performance.

With that, I'd like to turn the call over to Steve Armstrong to review the financial highlights from our third quarter results. Steve?

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

Thank you, Scott. Good morning, everyone. As a backdrop to our performance and as Scott noted, all Patterson Companies' business lines in the fiscal 2013 third quarter were affected by two fewer days in the selling period due to our fiscal calendar and the timing of holidays. This was most notable in the consumable categories, with an approximate 2 percentage point negative impact on a comparable basis to the year ago results. We also were affected by the disruption of Hurricane Sandy.

In addition, the change in the distribution agreement for a line of nutritional products in our Veterinary unit reduced consolidated sales by 130 basis points in the quarter. This change, which will continue to affect our sales volumes through mid-March, has had minimal impact on our operating profit since we now sell this product under a national agency commission arrangement. Even with these factors, reported sales rose 2.3% on a consolidated basis. This includes a combined benefit of slightly less than 1% from foreign currency and acquisitions.

We were pleased to see a 50 basis point year-over-year improvement in our consolidated gross margin for the third quarter due to a better mix of product sales. In the Dental division, the mix of CEREC revenue shifted to a much higher proportion of new user sales of the Omnicam product. Additionally, Veterinary margins were up approximately 160 basis points due primarily to product mix and vendor rebates.

Operating expenses rose 70 basis points as a percentage of revenue from last year. The increase reflects continued investments to support our growth initiatives. By segment, our third quarter operating margins were 10.5% for Dental, 5.7% for Veterinary and 11.9% for Medical.

As I have mentioned in previous quarters, our effective tax rate has been favorably impacted by the dividends paid on the Patterson shares owned by our ESOP. As the dividend increases, our tax rate has declined further. Our effective tax rate in the third quarter was 34.4%, down by approximately one half percentage point on a year-over-year basis.

A review of our balance sheet shows that inventory levels increased by approximately 33 million from the start of the fiscal year. The growth in inventories resulted from normal seasonal fluctuations during the quarter. Our DOS stands at 42 days in the current period, down from 44 days in the prior year period, while inventory turns are 7.1 compared to 6.6 one year ago.

Our cash flow from operations in the quarter was impacted by the increase in inventory, as well as the timing of tax payments. We generated $46 million from operations in the period compared to 110 million last year. I would expect a good portion of this working capital swing to turn by the end of the fiscal year.

Our capex in the third quarter principally included regular, ongoing expenditures in addition to investments in our IT infrastructure. We are still anticipating fiscal 2013 capex of approximately $25 million.

Also in the third quarter, we repurchased approximately 1.4 million Patterson shares under our 25 million share buyback authorization that expires in 2016. Approximately 7 million shares remain available for purchase under this authorization. We will continue to make open market purchases as part of the capital allocation strategy that we have outlined. Unless the markets change dramatically, I would expect future purchases of shares to remain consistent with our past few quarters.

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

Scott Anderson *President and Chief Executive Officer*

Thanks, Steve. As we move towards wrapping up fiscal 2013, entering a new fiscal year and looking beyond, I want to emphasize why we are confident about our future. I believe we are well positioned to capture market share as the economy rebounds and starts to recover and reach pre-2008 levels. The economic headwinds of the past five years have constrained consumer spending, as well as capital investments by our customers, leading to pent-up demand. Coupled with this pent-up demand is the demographic shift that we continue to see, as well as the emergence of new technologies. Combined, these factors present growth opportunities for Patterson Companies as we have built the size and scale to serve customers across our three markets.

Our competitive strength is buoyed by a market-leading product and service offering, as exemplified by our strong partnerships and supported by our state-of-the-art technology center. Patterson's complete end-to-end solution uniquely positions us to extend our leadership position, and importantly, it enables our customers to provide outstanding service to their patients and pet owners. We also maintain a strong financial position, and we are committed to enhancing long-term shareholder value through targeted investments, dividend growth and strategic share repurchases. In short, there are many reasons to be excited about Patterson Companies and our future success.

With that, I'd like to open up the call to questions. Alisha, please open up the call.

Operator

Thank you. Ladies and gentlemen, we will now begin the question and answer session. As a reminder, if you have a question, please press the star, followed by the one, on your touch-tone phone. If you need to withdraw your question, press the star, followed by the two, and if you are using speaker equipment today, you may need to lift your handset before making your selection.

And our first question comes from the line of Kevin Ellich with Piper Jaffray. Please go ahead.

Kevin Ellich *Piper Jaffray – Analyst*

Good morning. Thanks for taking the question. First off on the Dental side, Scott, could you give us a general outlook for Omnicam demand? Obviously, it's been pretty good and as (inaudible) indicated, the supply has now caught up to the demand. Are you expecting, you know, strong growth in that segment for the next couple of quarters, or what should we expect?

Scott Anderson *President and Chief Executive Officer*

Yes, Kevin, thanks for the question. Obviously, we're very excited about Omnicam, but I would also maybe reframe it as we are very excited about the entire CAD/CAM opportunity and the portfolio of choices we have for our customers, and we believe with our partner, Sirona, we offer more entry points and different modalities for customers to implement CAD/CAM. Obviously, this last quarter was very strong. We had strong demand and Sirona absolutely met their commitments to us, but at the same time, I think it's worth noting that in terms of our sales infrastructure and our training infrastructure, that became really fully in place in late January. So we look at this space, both CAD/CAM and digital, as having a very long runway for growth.

Kevin Ellich *Piper Jaffray – Analyst*

Got it, that's helpful. And then also, you mentioned in your prepared remarks that basic dental equipment was slightly down. I think that's kind of what the trend's been like. Do we have any more visibility or (inaudible) light at the end of the tunnel in terms of seeing an inflection point when you can see, you know, the consumable and the basic equipment sales come back?

Scott Anderson *President and Chief Executive Officer*

Yes. I think one thing that's important to note is we came off a pretty strong quarter last year, so while we were slightly down, it was a pretty significant volume. You know, we don't want to call a turnaround, but we are encouraged by our pipeline on the basic equipment side going into the fourth quarter. And we really think we have a unique story, coupled with the leading-edge technologies we present and really strong partnerships with industry leaders like A-dec that will continue to take share and are excited to really tap into that opportunity in the years to come.

Kevin Ellich *Piper Jaffray – Analyst*

Got it. And then just switching over to Vet really quick, Steve, I think you made the comment on the nutritional product change. Did you say that that annualizes in March?

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

Yes, it should be about mid-March of this year is when that arrangement changed over.

Kevin Ellich *Piper Jaffray – Analyst*

Got it, got it. And then of the, you know, margin improvement that you saw in the Vet business, how much of that was attributed to mix versus I guess vendor rebates?

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

It was a combination, Kevin; round numbers in relative terms, probably 50/50 rebates and then product mix (cross talking).

Kevin Ellich *Piper Jaffray – Analyst*

Okay, and…

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

Equal (cross talking).

Kevin Ellich *Piper Jaffray – Analyst*

Great. And then the last kind of big picture, more for Scott, you know, in the Vet space given the diagnostic distribution agreement changes that we've seen in the business, just curious if you've given any more thought to kind of expanding your offerings and the ability of your sales people to sell other products as well?

Scott Anderson *President and Chief Executive Officer*

I'd say, Kevin, you know, we are very excited about our relationship with Idex (ph). At this point, we think they've got cutting-edge products that really help our customers build their practices and help the pet owners, so at this time, I would just reiterate our excitement about our partnership with Idex.

Kevin Ellich *Piper Jaffray – Analyst*

Do you think it puts you at a disadvantage by not being able to sell the other products?

Scott Anderson *President and Chief Executive Officer*

I don't think so.

Kevin Ellich *Piper Jaffray – Analyst*

Okay. Thank you.

Scott Anderson *President and Chief Executive Officer*

Thanks, Kevin.

Operator

Thank you. Our next question comes from the line of Lisa Gill with JP Morgan. Please go ahead.

Lisa Gill *JPMorgan – Analyst*

Thanks very much. Good morning.

Scott Anderson *President and Chief Executive Officer*

Hi, Lisa.

Lisa Gill *JPMorgan – Analyst*

Scott, you talked about the pent-up demand and I was wondering if you've looked historically around consumer confidence and the—what consumer confidence impact has on a practice's willingness to think about it by equipment, et cetera, and so if I look at consumer confidence, it continues to fall. As you're talking to these dentists, does that have a big impact on how they think about buying equipment, would be my first question? And then secondly, in the quarter, did you see any pull forward due to, you know, tax incentives in 2012 or with the device tax coming in '13 around sales that you saw in the quarter?

Scott Anderson *President and Chief Executive Officer*

I'll answer the last part first, Lisa, and then we'll talk about consumer confidence. Obviously, we were very pleased with the demand on the equipment side at the end of the calendar year. As we've talked about in the second quarter, a lot of decisions are made post sitting down with financial advisors and we saw robust sales, as we talked about, particularly around our digital category, so strong chic (ph) sales, strong 3D sales, obviously coupled with CEREC. I would say the med device tax probably had less impact than the uncertainty around Section 179 at the end of the year. Obviously, we were very pleased that Section 179 was extended for two years after the 1st of the year, but based on what we've seen in January and starting off into our quarter, we would not say that business was pulled forward and would create a backwash in the coming quarter.

And then secondly around consumer confidence, the dental industry is very stable right now. Our customers, for the most part, their practices are in strong financial position. But as we said in the past, part of the cautious outlook really has been around major expansions and remodels of their dental practices. As we've proven, the strong return on investment of technology products has resonated with our customers, so we see, as the market continues to grow again, the ability for the basic equipment market to return to pre-2008 levels is complementary to growing technology sales.

Lisa Gill *JPMorgan – Analyst*

And are you seeing that demand? I mean, obviously, you're out at the mid-winter meeting right now. Are you seeing—you know, when you talk about that pipeline, can you give us any kind of idea of over what period of time that you think you can return to those pre-2008 levels? Is that in the next 12 to 24 months, or do you think it's a longer period of time just given the economic uncertainty?

Scott Anderson *President and Chief Executive Officer*

Yes, I wish I was that good a prognosticator. You know, I think we'll continue to see stability and, you know, obviously, different things are going to need to happen in the economy for it to return back to 2008 levels. But, you know, I would just reiterate how excited we are, both about the technology story we'd have when we sit down with customers, but also when you look at the demand for dentistry and for the veterinarian's practice and for rehab over the coming decade, as this demographic shift happens, we will be there to help our customers meet that demand for their services.

Lisa Gill *JPMorgan – Analyst*

Okay, great. Thank you.

Scott Anderson *President and Chief Executive Officer*

Thanks, Lisa.

Operator

Thank you. Our next question comes from the line of John Kreger with William Blair. Please go ahead.

John Kreger *William Blair – Analyst*

Hi, thanks very much. Scott, I'm sure you don't want to give guidance yet for fiscal '14, but maybe broadly, can you tell us some of the key things you're thinking about? What are the puts and takes and do you think, without kind of a stable macro environment, you'll be able to deliver improved earnings growth versus what you're seeing in fiscal '13?

Scott Anderson *President and Chief Executive Officer*

Yes, we've talked about before, you know, part of our story comes down to revenue and really to see operating leverage expansion, we need growth, you know, north of 3%. But at the same time, you know, as we've talked about, we are making investments to position this Company for the future and it's something I'm strongly committed to. So, you know, obviously we won't give guidance today but as we, you know, look at the stability of our markets, you know, we probably go into next fiscal year for the first time in a while with slightly more headwinds and tailwinds out there. But as we've seen over the last three years, particularly in the summer months, there's been a lot of unpredictability in the economy and the underlying markets.

John Kreger *William Blair – Analyst*
That's helpful, thanks. A question now about calendar '13 and the impact that the med tech tax is having, particularly on your revenue growth. You know, now that we're moving through '13, what percentage of your revenues are being impacted, and is that having any bottom line impact as far as you can see?

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

John, this is Steve. At this point, it's really hard to say what the med tax is going to do to overall revenues. We did some early studies. We only saw it for basically three and a half/four weeks of January, so it's a little difficult to say what its impact is going to be over the calendar year. But Dental is obviously the division that's going to be most impacted by it and we're estimating somewhere around 75, 80% of revenues will be impacted by the med device tax. It won't have really any effect on the bottom line as expected today. It could. It really just depends on how the total cost of operations goes and what kind of costs the manufacturers are passing on and how the markets are receptive to those costs.

John Kreger *William Blair – Analyst*

Great, thanks. And then lastly within the rehab business, do you have a timeline yet for getting a permanent replacement for Dave?

Scott Anderson *President and Chief Executive Officer*

Yes, as I said, we'll probably look to the first half of our fiscal year. We're fortunate to have strong internal candidates in our organization, as well as some nice interest from the outside. We have a very capable team in place in terms of the vice presidents who run that business and I feel confident that we can deliver in the short term while we look for a replacement for David. So I would anticipate probably early summer.

John Kreger *William Blair – Analyst*

Great. Thanks very much.

Scott Anderson *President and Chief Executive Officer*

Thanks, John.

Operator

Thank you. Our next question comes from the line of Robert Willoughby with Bank of America Merrill Lynch. Please go ahead.

Robert Willoughby *Bank of America Merrill Lynch – Analyst*

Scott or Steve, you had something of a CAD/CAM backlog at the end of the second quarter. How much of that did you get through? Is there much of that sitting out there, or did you move through all that in terms of delivering the orders?

Scott Anderson *President and Chief Executive Officer*

Bob, I think we—probably the best way to put it, Bob, was Sirona met the commitments, so we definitely had plenty of demand for the product and look at, really, demand for that product being at a fairly high level for the foreseeable future, so I don't want to, you know, make the statement that we emptied out the demand just in one quarter. That's not even close to being true.

Robert Willoughby *Bank of America Merrill Lynch – Analyst*
Okay. And you did mention, Scott, some targeting—targeted marketing. That was just a comment, I think, that you through into the discussion. Is there any promotion going on at the moment, or is that selling at full list price, the Omnicam?

Scott Anderson *President and Chief Executive Officer*

Yes, full list price, Bob, so definite excitement in the product. And I think the other thing to note that I said in a previous question was the fact that we really met the demand, the early demand of the product launch, but we are just starting really in the last three weeks of actively getting out and showing the product to dentists in North America. So we really are at, in essence, the executional beginning of the launch of Omnicam in terms of, you know, face-to-face demos with customers.

Robert Willoughby *Bank of America Merrill Lynch – Analyst*

Okay. And maybe a bigger picture, just on the Vet business, I've attempted to redefine the equity research effort here quite a few times with no great return, unfortunately, but what does redefining the Vet sales effort mean to your, you know, sales and profit outlook here near term? In what inning do you really think you're in on that with this effort?

Scott Anderson *President and Chief Executive Officer*

Yes, a good question, Bob. You know, one of the things we are doing at Patterson Veterinary is we're really trying to refocus our sales force in a very similar fashion that happened in the Dental business 20 years, to be more than just consumable sales people and to really look at being a partner in helping the veterinarian grow their practice, and obviously, equipment and technology is a big piece of that. We saw a need two years ago for our veterinarian customers to look to us as a service provider in terms of technical service, so in this last year, we set off on that initiative. By the end of the fiscal year, we will have national coverage. And part of this is retraining our sales force to be more than just gatherers in terms of equipment sales, to really go out and proactively make markets.

So to me, we're in probably the first or second inning of that, but I'm excited at the progress I see. As I said in the comments at the NAVC meeting, I think if you walked up to our booth and saw the way we present technology and talk to our customers, it's very different than what you would have saw if you went into the Webster booth two years ago.

Robert Willoughby *Bank of America Merrill Lynch – Analyst*

And what does that ultimately mean for margins of the business then? Does this…

Scott Anderson *President and Chief Executive Officer*

Well…

Robert Willoughby *Bank of America Merrill Lynch – Analyst*

How quickly do they move up?

Scott Anderson *President and Chief Executive Officer*

Yes, it's definitely part of the strategy to create a more margin-rich portfolio in terms of our products because of the higher margins we will get on the equipment side, as well as on the technical service side. So as we talk about our long-term goals of getting operating margins and our Veterinary unit up into the high single digits, this is an important part of that strategy.

Robert Willoughby *Bank of America Merrill Lynch – Analyst*

And lastly, just a timeframe for that, Scott, potentially?

Scott Anderson *President and Chief Executive Officer*

We're making great progress. You know, Patterson Vet is exceeding our internal forecast this year, and I think you'll continue to see momentum over the next two to three years.

Robert Willoughby *Bank of America Merrill Lynch – Analyst*

Okay. Thank you.

Scott Anderson *President and Chief Executive Officer*

Thanks, Bob.

Operator

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

Glen Santangelo *Credit Suisse – Analyst*

Yes, thanks for taking my questions. You know, first on the Medical business, you know, in the press release, you seem to cite uncertainty of health care reform and continued austerity measures. You know, can you give us a sense for, you know, maybe what could turn those sales around? I mean, in the Dental business, you clearly think it's consumer sentiment, maybe it's unemployment. How should we think about that Medical business returning to growth? And if you could give us the split between international and domestic, that'd be helpful.

Scott Anderson *President and Chief Executive Officer*

Yes, a great question, Glen. I think the bright spot in our rehab business is if you look at our core business, which really is the North American rehab business, that business is growing low single digits in a market that we think maybe is down 2 to 3% right now, so about 50% of the revenues is that core rehab space. Then we have sports medicine in the U.S. Our international business is roughly 20%-plus of revenues, and as we've talked about, that's been a challenge market, particularly in the UK as austerity measures have been implemented. So the two drags on that business in the last 12 months have been international operations, primarily around the UK, and then a pretty soft equipment market in the U.S. But if you look at just core rehab supplies, we actually feel pretty confident about where we're at.

So the catalysts for turning this around are adjusting our market approach internationally, which we are doing right now, to take advantage of what still will be strong demand for those services and then really getting the equipment pipeline built up again here in the U.S. as our customers, now that, you know, the Affordable Health Care Act is law, the rules of the road are being more well understood, they'll start moving ahead on making capital purchases.

Glen Santangelo *Credit Suisse – Analyst*

Hey, Scott, maybe if I could just follow up on Bob's question on margins, I mean, you know, for those of us that have followed the Company for a while, I mean the Company has always had a historical goal of expanding margins consistently year-over-year and you've kind of defined that differently throughout the years. But as I look over the last kind of five or six, you know, margins have consistently trended down and maybe obviously slower utilization has played a part in that, you know, obviously mix probably has played a part in that, but could you maybe opine on, you know, maybe what's led to some of the margin contraction over the past couple of years, and then maybe your plan, you know, over the next kind of two or three to return to some consolidated margin expansion?

Scott Anderson *President and Chief Executive Officer*

Yes, good question, Glen, and I think you sort of hit two of the big points. One has been mix. Obviously, the Veterinary business with the lowest operating margin has been our fastest grower, but also part of our story is a revenue story. We are very proud that we have industry-leading profitability and have made the strategic decision to really not cut into our value-added proposition here in the short term because we do believe our markets will recover and when revenue growth returns, you know, above that 3 to 4% level, our ability to expand margins is quite significant.

So we have not stopped in terms of investments. You know, we're putting money right now into IT infrastructure and other things that we feel will position us in a very strong way going forward. We always are looking for ways to become more efficient so we can get more profitability out of each sales dollar or we can help our sales rep become more productive. I will tell you that we are, as a management team, absolutely aligned with our shareholders in terms of our incentives, that profitable revenue growth is—and return on invested capital is the goal of Patterson Companies.

Glen Santangelo *Credit Suisse – Analyst*

Okay. Thank you.

Scott Anderson *President and Chief Executive Officer*

Thanks, Glen.

Operator

Thank you. Our next question comes from the line of Jon Block with Stifel Nicolaus. Please go ahead.

Jon Block *Stifel Nicolaus – Analyst*

Great, thanks and good morning.

Scott Anderson *President and Chief Executive Officer*

Hi, Jon.

Jon Block *Stifel Nicolaus – Analyst*

Good morning. Maybe just the first one on Vet. You know, the adjusted numbers were solid and I think once you adjust for nutritional, you approached about 10% internal, but you know, it still lagged some of the other—your two other main competitors in North America. Maybe can you speak—do you think you're holding share? I know there's a lot of noise in the numbers, but do you think you're holding share in Vet? And then the second part of the question would be, again, the numbers are strong so can you talk to how the market growth looks for Vet currently and going forward? Thanks.

Scott Anderson *President and Chief Executive Officer*

Sure. You know, on the first part, I think from a comparable basis, you know, we're a November/December/January quarter, which affects comparability, I think, on the Vet side a little bit more just because, you know, the flea and tick business is probably the weakest in that January month. You know, we were up 12% in our last quarter and when we look on an apples-to-apples basis, we are absolutely confident we are holding our own and putting plans in place to take market into the future. We feel really good about the vet industry, about the underlying growth characteristics. I would say, anecdotally, the mood of our customers at the last two large shows, in Las Vegas this week and in Orlando at NAVC, was exciting to talk to customers and have them talk about the future of their practices, and we think the way the population takes care of their pets will be a tailwind for the entire industry for the decade to come. So we see continued nice underlying growth dynamics for the vet industry.

Jon Block *Stifel Nicolaus – Analyst*

Okay, great. And then maybe one on rehab and one on Dental. On the rehab side, to the previous question, you did a very helpful job of sort of breaking out what was, you know, austerity, if you would, versus some uncertainty, but can you talk to when you would sort of lap some of the issues in the UK; in other words, when the specific UK comps ease and would that mean that it's possible you restore growth in Medical when we get out to fiscal '14?

Scott Anderson *President and Chief Executive Officer*

Yes, I think the UK and international markets are still going to be challenged here for the foreseeable future, just because it was such a massive (ph) change is terms of rehab delivery that has happened. On the other side, I think we'll start to see a rebound on the equipment side in the U.S. business and, you know, we are absolutely committed to this business and we get very excited about the demand characteristics and the market is being reshaped a little bit right now. But, you know, we're four to five times larger than our nearest competitor, and we think we're nimble enough to position Patterson Medical in a way where we can be big winners in the future in this space.

Jon Block *Stifel Nicolaus – Analyst*

Okay. Thanks. And the last one, just quickly on Dental consumables. You know, consumer confidence remains choppy but if you isolate private job growth, it's actually been decent, if you would, especially over the past, you know, four to six months and arguably, arguably that would be some sort of a leading indicator for consumable growth which had lagged (ph). So can you talk to, you know, what maybe the disconnect is? Maybe if you isolate the past, you know, month, have you seen a pickup, or do you just think that maybe consumer confidence is the more important variable when you sort of stack it up versus that of private job growth? Thanks, guys.

Scott Anderson *President and Chief Executive Officer*

Yes, you still have a lot of moving parts and you—I think we're still dealing with an under-employment problem as well, which is going to affect. I would say we're cautiously optimistic about the consumable market and are—absolutely can state that it is a stable market and will continue to grow in the year ahead. But, as I said, there really isn't—I don't think we will see a catalyst that will create a sharp turn in the trajectory in the industry here in the next 12 months, but it definitely, we believe, will be a market that grows, albeit slow growth, in the coming year.

Jon Block *Stifel Nicolaus – Analyst*

Thank you.

Operator

Thank you. Our next question comes from the line of Robert Jones with Goldman Sachs. Please go ahead.

Stefan *Goldman Sachs – Analyst*

Thanks. A question but it's actually Stefan (ph) calling for Bob. Just to stay on consumer, could you, I guess, expand a little bit on the trajectory you saw throughout the quarter, so January versus, you know, December, November? And also on the guidance range for fourth quarter, it seems a bit wide. Anything we should be thinking about there, some of the pushes and pulls? Thanks.

Scott Anderson *President and Chief Executive Officer*

Stefan, was the question about the consumable trajectory?

Stefan *Goldman Sachs – Analyst*

Yes, just…

Scott Anderson *President and Chief Executive Officer*

Yes.

Stefan *Goldman Sachs – Analyst*

You know, how December/January looked versus the other two months.

Scott Anderson *President and Chief Executive Officer*

Yes, we did have an interesting quarter and I think it's fair to say the entire industry did, with the fact that we had Hurricane Sandy shut down the East Coast for some time and then we sort of had a unique holiday situation this year. So I would say the—taking those two factors out, the trajectory of sales was pretty stable throughout the quarter.

I'll turn it over to Steve on the guidance question.

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

Yes, I'd just add maybe one comment to Scott's. There may have been some elevated activity in December, just as people were thinking about the medical device tax on consumables and whether they were buying ahead, but it was a bit of an unusual December but nothing, as Scott said, that really laid any patterns as far as we were concerned.

As far as the guidance, we probably could have tightened the range, Stefan. We left it where it was. We typically ratchet it down as we get later in the year, but since we'd done that at the end of the second quarter, we really didn't see any need to do it further at this point. We're very comfortable with the range as it exists today.

Stefan *Goldman Sachs – Analyst*

Great, thanks.

Operator

Thank you. Our next question comes from the line of Michael Cherny with ISI Group. Please go ahead.

Michael Cherny *ISI Group – Analyst*

Good morning, guys. So, Steve, maybe just one quick housekeeping question. You talked about the—a little less than 1% from M&A and FX. Would it be possible to break it down between the two?

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

Yes, I think they were both about 30 basis points, Michael.

Michael Cherny *ISI Group – Analyst*

Okay, thanks. That's helpful. And then thinking big picture, I know you had mentioned the fact that you view kind of more headwinds and tailwinds for next year, you know, going into 2014 with the advent of the exchanges and the implementation of ASA (ph), it seems like there should be some incremental benefit related to the Dental from increased coverage. Have you guys thought about what that impact could be on your business yet and what the drivers could be in terms of the potential for upside of growth, or is it still too early to understand that?

Scott Anderson *President and Chief Executive Officer*

Probably too early to understand that, but I—maybe I need to clarify my comments, you know, that we believe there are potentially more tailwinds than headwinds going into next year, so that's an important clarification there.

Michael Cherny *ISI Group – Analyst*

Oh no, that is, thank you.

Operator

Thank you. Ladies and gentlemen, for additional questions at this time, please press the star, followed by the one, on your touch-tone phone. As a reminder, if you are using speaker equipment today, you may need to lift your handset before making your selection.

And our next question comes from the line of Jeff Johnson with Robert W. Baird. Please go ahead.

Jeff Johnson *Robert W. Baird – Analyst*

Thank you. Good morning. Can you hear me, guys?

Scott Anderson *President and Chief Executive Officer*

Absolutely.

Jeff Johnson *Robert W. Baird – Analyst*

Yes, great. So, Steve, and one question on consumables, and I think we're all picking around here trying to just make sure things are stable, and Scott, you know, I appreciate your comments that the market is very stable here. And, you know, I'm sure I can be put in kind of that bucket of being one of the bigger bulls on dental in general out there, but even as I look at these numbers, for you and for some of your competitors and some of the manufacturers this quarter, it's hard not to feel like maybe the consumables market slowed again this quarter, you know, maybe very slightly but slightly this quarter, slightly last quarter and we're definitely not at that 2 to 3% range we were late '10 through early '12 or so. So what really gives you that confidence? I mean, Steve, can you break it down even kind of a day's selling rate? Has that stayed pretty stable for you? Or just looking for anything to kind of help here.

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

Jeff, it's—I think there's a—some moving parts underneath that that make it difficult on a comparable basis. I think I would tend to agree with you that from where it was maybe late '11, early '12 to where we are today, the market seems to have slowed, but as Scott jotted a note here reminding me that last year's winter probably was very unusual across the entire country and there might have been a bit of a false positive that maybe the market was moving higher than it was just because you had two fairly different periods as far as traffic in and out of the dental office. But if you kind of adjust for Hurricane Sandy and some of the other noise in the last few quarters, I think it's probably fairly stable right now and it's probably in that 1 to 2% range as far as underlying market is concerned. Really hasn't changed a lot for the last 15, 18 months.

Jeff Johnson *Robert W. Baird – Analyst*

All right, that's helpful. Thanks, Steve. And then, Scott, I guess just a bigger picture question on the Dental equipment business, especially as it pertains to CAD/CAM and CEREC and what have you. I—if you—as new products roll out here over the coming month or two and, you know, maybe we see kind of a multi-tiered pricing structure for CEREC and for CAD/CAM in general, how many price points do you think are going to settle out here? I mean, are we going to span all the way up from 136.9 (ph) for Omnicam? Are there going to be five or six different and—you know, kind of iterations of things you can put together with different milling chambers versus different acquisition units, all the way down to a 10 or $12,000 standalone digital impression system?

Scott Anderson *President and Chief Executive Officer*

Yes, Jeff, actually a great question. You know, we think with our partner, Sirona, we'll be able to offer multiple entry points in terms of price but also with price comes functionality and, you know, what we're excited about – and we've been a leader in this CAD/CAM space for a decade now – is there's still such a strong return for the chair side CAD/CAM product, particularly very—at the top end of the Omnicam, and we've had multiple other products to offer here in the last few years at lower price points. But, generally, the return on the investment has always come out the highest when you put the top product with a one-visit dentistry chair side application together with it. I think from a competitive standpoint, you know, one of the things we love about Sirona is their commitment to research and development, and we're very excited about how deep the pipeline is. And as I've said many times, we're in the early innings of this digitization CAD/CAM game, and we're excited to go to the market with multiple options for our customers.

Jeff Johnson *Robert W. Baird – Analyst*

Any thoughts—this is my last question, I promise. Any thoughts, Scott, if four or five different price points on even a Sirona-branded system so you could, you know, tout their name, obviously their reputation, but have four or five or six different price points there? Any thoughts on how to think about, you know, where penetration—or where demand for the highest of high end goes versus what percent may fall into some of the hundred thousands of 100,000-type price categories?

Scott Anderson *President and Chief Executive Officer*

Yes, I think it's too early to make a prediction on where the market settles out, but just to remind everyone, you know, we have roughly 14,000 CEREC users in North America so the runway is extremely long for this technology. And as I said, I think you have to focus more on the patient benefit and the return to the practitioner in terms—both clinically and economically as to who the big winners will be at the end of the day. But the ability to offer multiple modalities, I think, is a great strategic advantage for Patterson and Sirona.

Jeff Johnson *Robert W. Baird – Analyst*

That's great. Thanks, guys.

Scott Anderson *President and Chief Executive Officer*

Thanks, Jeff.

Operator

Thank you. I would now like to turn the conference back to Mr. Anderson for any final remarks.

Scott Anderson *President and Chief Executive Officer*

Thanks for joining us on today's conference call. Again, let me remind you of the factors which give us confidence in our future. Our complete product and service offering is supported by a focus on innovation, a solid financial base and a commitment to generating long-term shareholder value through targeted strategic capital allocation. We look forward to updating you as we move forward. Thanks very much for your interest and we'll see quite a few of you, I'm sure, later today at the Chicago mid-winter meeting. Thank you.

Operator

Ladies and gentlemen, this concludes our conference for today. Thank you for your participation. You may now disconnect.
