

Patterson Companies (PDCO)

\$23.01 (As of 02/14/20)

Price Target (6-12 Months): **\$24.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/04/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:A

Value: A

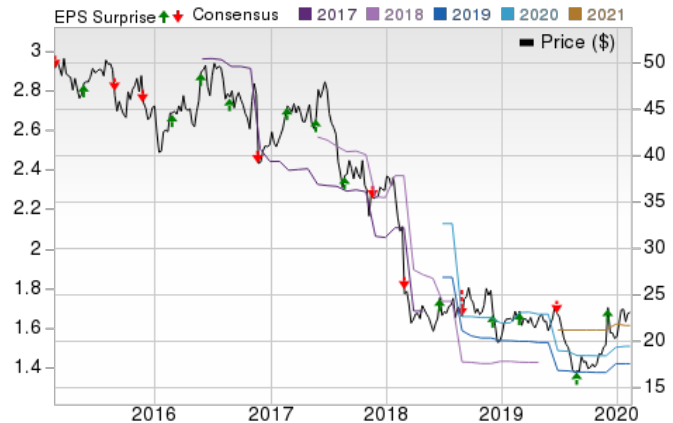
Growth: B

Momentum: D

Summary

Patterson Companies' consistent efforts to drive profitability in core business were evident from its performance is praiseworthy. A broad spectrum of products cushions it against economic downturns in the MedTech space. We believe that a diverse product portfolio, strong veterinary business prospects, accretive acquisitions and strategic partnerships are the key catalysts. Expansion in gross margin remains a positive. Moreover, raised outlook for fiscal 2020 instills optimism in the stock. However, declining Dental Consumable revenues have been plaguing Patterson Companies for quite some time. Patterson Companies has underperformed the industry in a year's time.

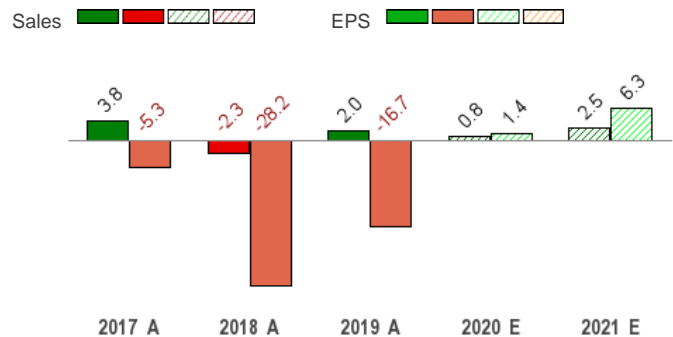
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$25.25 - \$15.73
20 Day Average Volume (sh)	795,875
Market Cap	\$2.2 B
YTD Price Change	12.4%
Beta	1.42
Dividend / Div Yld	\$1.04 / 4.5%
Industry	Medical - Dental Supplies
Zacks Industry Rank	Top 43% (109 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	11.4%
Last Sales Surprise	0.2%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	02/27/2020
Earnings ESP	0.0%
P/E TTM	16.3
P/E F1	16.2
PEG F1	2.9
P/S TTM	0.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,361 E	1,458 E	1,455 E	1,495 E	5,760 E
2020	1,329 A	1,419 A	1,417 E	1,459 E	5,622 E
2019	1,336 A	1,405 A	1,397 A	1,437 A	5,575 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.32 E	\$0.38 E	\$0.39 E	\$0.41 E	\$1.51 E
2020	\$0.27 A	\$0.39 A	\$0.37 E	\$0.39 E	\$1.42 E
2019	\$0.26 A	\$0.39 A	\$0.38 A	\$0.37 A	\$1.40 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/14/2020. The reports text is as of 02/17/2020.

Overview

Headquartered in St. Paul, MN, Patterson Companies Inc. (PDCO) is one of the leading distributors of dental and animal health products.

The company completed the divestiture of medical business (Patterson Medical) to private equity firm Madison Dearborn Partners (MDP) for \$715 million in cash. Owing to this deal, Patterson Medical was reported as discontinued operations since the first quarter of fiscal 2016.

The company currently distributes its products through two subsidiaries — Patterson Dental and Patterson Animal Health.

Patterson Dental: The segment distributes consumable products (x-ray film, restorative materials, sterilization products and hand instruments); basic and advanced technology dental equipment; practice management and clinical software; patient education systems; and office forms and stationery in the U.S. and Canada.

The company's customers include dentists, dental laboratories, institutions, and other healthcare professionals. Patterson Dental is also the exclusive distributor for Sirona Dental Systems, a leading dental technologies company.

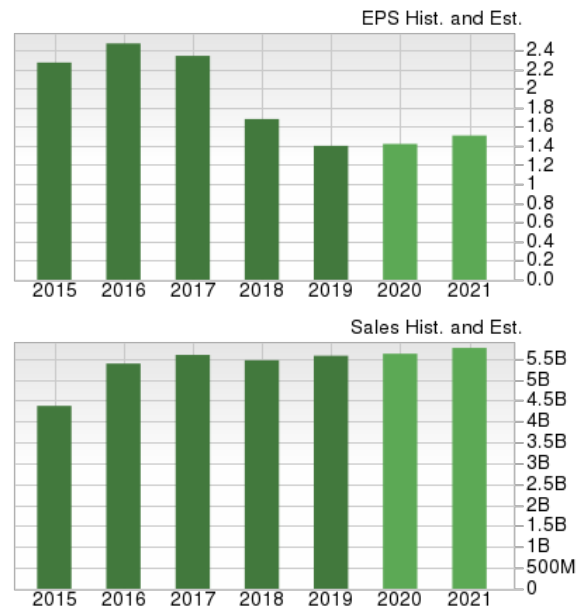
Patterson Animal: Notably, Patterson Animal Health is a leading distributor of veterinary supplies to companion-pet (dogs, cats and other common household pets) veterinary clinics, equine and large animal veterinary clinics, public and private institutions, and shelters across the U.S.

The acquisition of National Veterinary Services Limited (NVS) in 2013 expanded the company's footprint in the U.K. Following the acquisition of Animal Health International, this segment sells products for pets, horses, beef and dairy cattle, poultry and pigs.

FY19 at a Glance

Revenues were \$5.57 billion in FY19.

Patterson Dental registered revenues of \$2.2 billion in FY19, i.e. almost 39.3% of net revenues. Patterson Animal Health registered revenues of almost \$3.4 billion in FY19, i.e. 60.2% of net revenues.



Reasons To Buy:

▲ **Share Price Movement:** Over the past year, shares of Patterson Companies have slipped 0.6%, outperforming the industry's decline of 2.1%. The current level however fell short of the S&P 500 Index's rally of 20.9%. Macroeconomic issues and tough competition in the U.S. dental products space are headwinds at the moment.

▲ **Broad Product Spectrum:** Patterson Companies provide a wide range of consumable supplies, equipment and software, and value-added services to its customers. The company's wide range of products hedges it from any meaningful sales shortfall during an economic downturn. Further, Patterson offers world-class service to its customers by delivering frequent, small quantity orders rapidly and reliably from its strategically located distribution centers.

A growing diversified product portfolio, strong veterinary business prospects, accretive acquisitions and strategic partnerships are key growth catalysts, going forward

In fiscal 2019, Patterson Companies launched and integrated a new cloud-based veterinary practice management software – NaVetor – for its Animal Health segment. This software is designed to streamline and simplify workflows for veterinary practices and demonstrates Patterson Companies' commitment to providing innovative solutions to customers. In the fiscal second quarter, the company continued to boost the platform with new features and improvements that included the integration of a tool named Reputation Builder. This tool has been created to help veterinarians manage their online reputation and ratings and automate the distribution of customer surveys to strengthen their relationships and act quickly on feedback to improve their practices.

During the fiscal first quarter, the company introduced a new private label brand named Pivotal, while continuing to add SKUs to its broader private label portfolio. Patterson Companies stands to gain from private label brands as they enable the company to serve customers with brilliant products at a reasonable price and more attractive margin profile.

▲ **Patterson Technology Center:** Patterson Companies' solid technology support infrastructure – the Patterson Technology Center in Effingham Ill, helps it to strengthen its customer base. Per management, Patterson companies is the only company that boasts specially trained staff dedicated solely to the sale and support of technology.

The Patterson Technology Center supports over 80,000 customers nationwide and resolves hardware, software, computer networking or digital technology issues very fast. In fact, management at Patterson confirmed the receipt of the title of technology leader by continually researching, developing and upgrading technology and support to keep pace with growing demand for greater efficiency and profitability for healthcare practices.

▲ **Dental Market Holds Promise:** Patterson Companies is expected advantage from the gradual recovery in the dental market and the rebounding dental equipment business (especially in North America), assisted by increased technology marketing/promotional activities. A research report by the Grand View Research suggests that the global dental equipment market is projected to grow at a CAGR 4.9% by 2020.

Per management, the company remains optimistic about serving a strong and stable dental end market. In this fiscal second quarter, the company exhibited strong performance across all three categories of its Dental business – equipment, consumables and value-added services. Effective mix management in its Dental segment and continued focus on sales execution and customer experience drove the company in the quarter under review.

In fact, it is encouraging to note that Patterson Companies' dental sales in fiscal second-quarter 2020 improved 4.1% year over year to approximately \$564.6 million driven by strong growth in equipment sales, sustained improving trends in consumables and robust demand for value-added services.

▲ **Solid Prospects in Animal Health Unit:** Patterson Companies' growing Animal Health unit is a key long-term growth driver. Management at Patterson Companies expects solid margin improvement in the Animal Health Unit through stronger partnerships with product manufacturers and strong sales execution.

Patterson Companies is focused on the enterprise-wide productivity and efficiency initiatives that are essential for optimizing the company's operating model. Primarily on the back of high growth in companion pet population, the veterinary market seems to provide ample growth opportunity for the company. Moreover, the acquisition of Animal Health International is expected to double the size of Patterson Companies' existing veterinary business. It will help the company gain a strong foothold in the animal health market, complementing its existing presence in the companion pet market.

In the fiscal second-quarter earnings call, management announced that its Animal Health business continues to remain committed toward meeting the product and service needs of customers and driving sales execution. Per the company, Animal Health business remains well poised to drive the top line and thereby margins in fiscal 2020.

▲ **Acquisitions Driving Growth:** Patterson Companies has been expanding its business on the back of strategic acquisitions. In recent past, Patterson Dental Supply, Inc., a business unit of Patterson Companies announced that it acquired Fitzpatrick Dental Design, a dental office design and dental equipment dealer located in Moorpark, California.

Since 1987, the company has acquired over 30 dental products distributors in the United States and Canada, which improved its penetration in both the countries. The acquisition of Holt Dental Supply expands the company's local reach while also enhancing its Midwest domination. Patterson's past acquisition of NVS expanded its footprint in the UK veterinary market. Recently, Patterson acquired Animal Health International. We believe that the company will continue to pursue strategic acquisitions that will expand its product portfolio as well as improve its competitive position over the long term.

In fiscal fourth quarter of 2019, the company acquired VetIT – a leading cloud-based practice management software in the U.K. – in a bid to boost international veterinary business. The buyout will enable the company to enhance service offerings and technology capabilities to lend support to more vets and build presence in a key geography.

Reasons To Sell:

- ▼ **Cutthroat Competition in the Niche Space:** The U.S. dental products distribution industry is highly competitive and consists principally of national, regional and local full-service and mail-order distributors. Patterson faces competition from another national, full-service firm, Henry Schein Dental, a unit of Henry Schein. In addition, there are at least 15 full-service distributors that operate on a regional level and hundreds of small local distributors. Patterson needs to continue to introduce newer products in the market to withstand competitive pressures. Failure to do so will dilute the company's market share.
- ▼ **Supplier Concentration Issue:** Patterson has a significant key supplier concentration. The company's top 10 supply vendor's account for more than 40% of its cost of dental products sold in a fiscal year. Loss of relationship with these vendors will disrupt the supply of raw materials, which in turn will lead to lower sales of Patterson products.
- ▼ **Integration Risks:** Patterson had been on an acquisition spree which is improving its revenue opportunities on one hand and aggravating integration risks on the other. Regular acquisitions are also a distraction for management which is likely to impact organic growth. This may limit Patterson's future expansion and worsen the company's risk profile, going forward.
- ▼ **Challenging Macroeconomic Scenario:** Pricing pressure in the United States and Europe has been a staggering issue over the past few quarters. Healthcare reform in the United States has created a degree of uncertainty for the medical devices companies and has created a less flexible pricing environment. The company also anticipates these trends to persist in the coming quarters. In fact, the company's earnings declined year over year in the fiscal third quarter.

A rapidly changing healthcare environment in the U.S., unfavorable price movements, declining dental revenues and integration risks pose significant challenges.

Moreover, the overall macro-economic uncertainty across the globe affects physician office visits, thereby impacting the company's progress. Thus, the company is treading cautiously in the markets it serves, especially Europe and the Americas, as the results from these territories might hurt margins. With growing concerns over healthcare spending taking its toll on players in the medical device space, the stock might suffer due to a sluggish market.

Last Earnings Report

Patterson Companies Q2 Earnings Surpass Estimates

Patterson Companies, Inc. reported adjusted earnings per share of 39 cents in second-quarter fiscal 2020, which beat the Zacks Consensus Estimate by 11.4%. However, the bottom line remained flat year over year.

Net sales in the quarter were \$1.42 billion, outpacing the Zacks Consensus Estimate by 0.2%. However, the figure rose 1% year over year.

Quarter Ending **10/2019**

Report Date	Dec 05, 2019
Sales Surprise	0.19%
EPS Surprise	11.43%
Quarterly EPS	0.39
Annual EPS (TTM)	1.41

Segmental Analysis

The company currently distributes products through subsidiaries Patterson Dental and Patterson Animal Health.

Dental Segment

This segment provides a complete range of consumable dental products, equipment, software, turnkey digital solutions and value-added services to dentists, and laboratories throughout North America.

In the second quarter, dental sales improved 4.1% year over year to approximately \$564.6 million.

Dental Consumable

Sales in the sub-segment totaled \$303.1 million, down 0.2% year over year.

Dental Equipment & Software

Sales in the segment improved 12.2% on a year-over-year basis to \$188.2 million.

Other

This segment comprises technical service, parts and labor, software support services and office supplies. Sales at the segment improved 3.2% on a year-over-year basis to \$73.3 million.

Animal Health Segment

This segment is a leading distributor of veterinary supplies to clinics, public and private institutions and shelters across the United States.

In the second quarter, the segment sales declined 0.8% on a year-over-year basis to \$848.2 million.

Corporate

Sales at the segment were \$5.9 million, down 12.8% from the year-ago quarter's figure of \$6.8 million.

Gross Margin Analysis

Gross profit in the reported quarter was \$301.5 million, up 2.2% year over year. As a percentage of revenues, gross margin of 21.3%, improved 30 bps year over year.

Operating expenses in the reported quarter totaled \$319.6 million, up 25.9% on a year-over-year basis.

Operating loss came in at \$18.1 million, against the year-ago quarter's operating income of \$41.2 million.

Fiscal 2020 Guidance Raised

For fiscal 2020, Patterson Companies now expects adjusted earnings per share in the range of \$1.36 to \$1.46 (up from the prior range of \$1.33-\$1.43). The mid-point of the guidance of \$1.41 is above the Zacks Consensus Estimate of \$1.38 per share.

Valuation

Patterson Companies' shares are down 0.6 % in both the year-to-date period and the trailing 12-month periods, respectively. Stocks in both the Zacks sub-industry are up 6.6% and in the Zacks Medical Sector are also up 2.1% in the year-to-date period. Over the past year, the Zacks sub-industry and sector are down 2.1% and up 20.9%, respectively.

The S&P 500 index is up 5% in the year-to-date period and up 20.9% in the past year.

The stock is currently trading at 15.24X Forward 12-months earnings, which compares to 17.96X for the Zacks sub-industry, 21.44X for the Zacks sector and 19X for the S&P 500 index.

Over the past five years, the stock has traded as high as 21.32X and as low as 10.36X, with a 5-year median 16.48X.

Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$24 price target reflects 16X forward 12-months earnings.

The table below shows summary valuation data for PDCO.

Valuation Multiples - PDCO					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	15.44	18.43	21.38	19.36
	5-Year High	20.99	19.99	21.38	19.36
	5-Year Low	10.36	19.7	15.83	15.18
	5-Year Median	16.4	16.67	18.9	17.47
P/S F12M	Current	0.38	0.37	2.84	3.58
	5-Year High	1.15	0.37	3.83	3.58
	5-Year Low	0.27	0.23	2.45	2.54
	5-Year Median	0.65	0.28	2.96	3
P/B TTM	Current	0.38	0.37	2.84	3.58
	5-Year High	1.15	0.34	3.83	3.58
	5-Year Low	0.27	0.23	2.45	2.54
	5-Year Median	0.65	0.28	2.96	3

As of 02/14/2020

Industry Analysis Zacks Industry Rank: Top 43% (109 out of 255)



Top Peers

AmerisourceBergen Corporation (ABC)	Neutral
Align Technology, Inc. (ALGN)	Neutral
Danaher Corporation (DHR)	Neutral
Henry Schein, Inc. (HSIC)	Neutral
Integra LifeSciences Holdings Corporation (IART)	Neutral
IDEXX Laboratories, Inc. (IDXX)	Neutral
DENTSPLY SIRONA Inc. (XRAY)	Neutral
Zimmer Biomet Holdings, Inc. (ZBH)	Neutral

Industry Comparison Industry: Medical - Dental Supplies				Industry Peers		
	PDCO Neutral	X Industry	S&P 500	ABC Neutral	HSIC Neutral	IDXX Neutral
VGM Score	A	-	-	A	A	B
Market Cap	2.20 B	1.92 B	24.61 B	19.43 B	10.58 B	24.77 B
# of Analysts	8	5	13	8	9	4
Dividend Yield	4.52%	0.00%	1.78%	1.78%	0.00%	0.00%
Value Score	A	-	-	A	B	D
Cash/Price	0.06	0.06	0.04	0.17	0.01	0.00
EV/EBITDA	12.20	12.22	14.06	12.22	11.78	44.09
PEG Ratio	2.92	2.09	2.09	1.65	2.20	NA
Price/Book (P/B)	1.51	4.25	3.29	6.33	3.06	139.31
Price/Cash Flow (P/CF)	10.25	13.05	13.65	9.76	13.05	53.95
P/E (F1)	16.20	21.74	19.21	12.26	19.47	52.60
Price/Sales (P/S)	0.39	1.73	2.70	0.11	0.99	10.29
Earnings Yield	6.17%	3.62%	5.19%	8.15%	5.14%	1.90%
Debt/Equity	0.49	0.32	0.71	1.18	0.30	3.93
Cash Flow (\$/share)	2.24	1.80	6.92	9.67	5.53	5.35
Growth Score	B	-	-	A	B	A
Hist. EPS Growth (3-5 yrs)	-12.79%	8.88%	10.85%	8.88%	8.77%	23.57%
Proj. EPS Growth (F1/F0)	1.43%	11.78%	7.17%	8.52%	7.41%	12.27%
Curr. Cash Flow Growth	-11.19%	9.29%	8.56%	-0.05%	10.44%	-0.23%
Hist. Cash Flow Growth (3-5 yrs)	-3.58%	12.65%	8.36%	12.37%	8.23%	11.91%
Current Ratio	1.59	1.67	1.23	0.95	1.63	0.94
Debt/Capital	32.97%	26.85%	42.91%	54.23%	27.89%	79.72%
Net Margin	1.01%	4.08%	11.81%	0.36%	4.66%	17.77%
Return on Equity	8.97%	15.76%	16.86%	49.95%	15.93%	283.27%
Sales/Assets	1.67	1.02	0.54	4.65	1.43	1.38
Proj. Sales Growth (F1/F0)	0.86%	5.42%	3.85%	6.05%	3.48%	9.84%
Momentum Score	D	-	-	B	D	C
Daily Price Chg	-0.43%	0.00%	0.06%	-0.17%	0.87%	1.31%
1 Week Price Chg	4.04%	0.59%	2.47%	7.46%	1.49%	2.73%
4 Week Price Chg	-2.91%	1.19%	0.59%	3.17%	3.96%	-0.39%
12 Week Price Chg	20.79%	7.76%	6.98%	6.85%	5.39%	10.78%
52 Week Price Chg	-0.52%	7.42%	16.62%	9.15%	15.65%	39.55%
20 Day Average Volume	795,875	311,996	2,020,569	1,386,019	856,883	438,879
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	-0.05%	2.25%	0.00%	1.34%
(F1) EPS Est 12 week change	3.18%	0.00%	-0.17%	2.06%	-0.06%	1.34%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	-0.24%	-0.27%	0.00%	0.20%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	B
Momentum Score	D
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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